

St Antony's International Review

1

VOLUME 7, NUMBER 1, MAY 2011

NOTES ON CONTRIBUTORS	2
EDITORIAL INTRODUCTION	
International Financial Institutions in an Age of Crisis David Blagden, Julian Gruin, and Jiajun Xu	3
RESPONDING TO CRISES: THE PAST, PRESENT, AND FUTURE OF INTERNATIONAL FINANCIAL INSTITUTIONS	
Saving Capitalism from the Capitalists? Financial Regulation After the Crash Philip G. Cerny	11
The World Bank and Private Sector Development: Is "Doing Business" an Extension of the Structural Adjustment Programme or a Departure? Mallika Shakya	30
The Global Financial Crisis and the Reforms to IMF Lending Manuela Moschella	48
Emerging Powers and IMF Reform: Where Multipolarity in the World Economy is Leading the Fund Anton Malkin and Bessma Momani	61
Fuelling Ambition or Fending Off Risk? Revisiting the International Monetary Fund's Role in Sub-Saharan Africa Christian M. Brütisch	79
Social Values and the Future of Global Finance: An Interview with Harold James	97
Global Financial Governance in an Interdependent World: An Interview with Paul Martin	107
GENERAL SECTION	
Training Is Not Enough: Economic Development and Military Professionalism in Turkey Nathan W. Toronto	119
The Arctic: Avoiding a Polarized Pole Tom Karsten	144
Are Democracies Aggressive? Is the United States Aggressive? An Exchange Seth Johnston, Dan Reiter, John Schuessler, and Richard Ned Lebow	166
BOOK REVIEWS	189

NOTES ON CONTRIBUTORS

Christian M. Brütisch is Senior Lecturer in International Relations at the Institute of Political Science, University of Zurich.

Philip G. Cerny is Professor Emeritus of Politics and Global Affairs at the University of Manchester and Rutgers University.

Harold James is Professor of History at Princeton University and Professor of International Affairs at the Woodrow Wilson School for Public and International Affairs.

Seth Johnston is a doctoral candidate in International Relations at Trinity College, University of Oxford.

Richard Ned Lebow is James O. Freedman Presidential Professor of Government at Dartmouth College.

Tom Karsten is an officer in the Royal Navy and currently serves as Commander British Forces Gibraltar. In 2010, he was the Royal Navy Hudson Fellow at St Antony's College, University of Oxford.

Anton Malkin is a PhD candidate at the Balsillie School of International Affairs at Wilfrid Laurier University.

Paul Martin was the Prime Minister of Canada from 2003–06 and its Minister for Finance from 1993–2002.

Manuela Moschella is a Post-doctoral Fellow at the University of Trento.

Bessma Momani is an Associate Professor in the Department of Political Science at the University of Waterloo and a Senior Fellow at the Centre for International Governance and Innovation.

Dan Reiter is Chair of the Department of Political Science at Emory University.

John Schuessler is Assistant Professor of Strategy and International Security at the US Air War College.

Mallika Shakya is a Wolfson Research Fellow with the Contemporary South Asia Studies Programme at the University of Oxford and with the Human Economy Initiative at the University of Pretoria.

Nathan Toronto is an Assistant Professor at the US Army School of Advanced Military Studies.

International Financial Institutions in an Age of Crisis

DAVID BLAGDEN, JULIAN GRUIN, AND JIAJUN XU

"It was the age of wisdom, it was the age of foolishness,
it was the epoch of belief, it was the epoch of incredulity,
it was the season of Light, it was the season of Darkness."
(Charles Dickens, *A Tale of Two Cities*)

As was initiated in the February 2011 issue, this issue of the *St Antony's International Review* again contains both a general section on broader topics within international affairs and a section dedicated to a specific topic of current and pressing importance. Turning first to the special theme, few topics demonstrate such a level of contemporary relevance as the past, present, and future of the international financial institutions (IFIs). Economic crises can indeed be perceived as both "the season of Light" and "the season of Darkness," for despite their visceral impact upon employment and living standards, they also present opportunities for sober reflection upon the underpinnings of global society. Whilst perhaps not in true Schumpeterian fashion, the financial turmoil that began to roil economies and markets across the world in 2008 has prompted both far-reaching reflection and transformative action. Developments in the sophistication, interconnectedness, and depth of reach of the global capitalist system provoke ongoing reassessment of the extent to which it can secure material efficacy, environmental sustainability, and ethical legitimacy. Policymakers and scholars have been forced to recognize that the model of finance-led growth that came to dominate Western societies, which was increasingly exported across the globe during the 1980s and 1990s, and which came to shape the basic international financial architecture, has very real limits.

David Blagden, Julian Gruin, and Jiajun Xu, "Editorial Introduction: International Financial Institutions in an Age of Crisis," *St Antony's International Review* 7, no. 1 (2011): 3–10.

The current issue of the *St Antony's International Review* aims to shed light on the continuity and change emerging from this recognition. What were the causes of the crisis, and how should it affect our attitudes towards the role of finance in society? What role did IFIs play in the development of a neoliberal discourse of development? How have they responded to the crisis? What are the shifting configurations of power and interest that will determine the evolving structure of global financial governance and development? And perhaps most importantly, what institutional reforms and transformations in perspective are necessary to improve the effectiveness and legitimacy of the international financial system?

In seeking answers to these questions, attention inevitably focuses on the most enduring and significant components of the international financial architecture, the Bretton Woods Institutions (BWIs). Following the rise and decline of programmes of structural adjustment during the 1980s and 1990s, both the normative legitimacy and the practical relevance of the International Monetary Fund (IMF) and the World Bank increasingly came under question. The Washington Consensus came to be discredited not only due to the ineffectiveness of its reliance upon a neoliberal modernization theory, but also through the increasing economic power and confidence of emerging economies, such as Brazil, China, and India. Yet the doubt that was cast upon the stability and sustainability of the global financial system also catalyzed the reinvigoration of those same institutions that, ironically, had been most closely associated with the neoliberal paradigm, as policymakers have sought to restore confidence in the international financial system through concerted action at the level of global governance. The renewal of faith in the BWIs may be meaningfully sustained in the medium-term. However, whether this renewal of faith will retain the support of emerging countries already sceptical of the legitimacy of the BWIs remains unsettled. Their on-going vitality and ultimate survival will be secured not solely through their operational effectiveness, nor their representational legitimacy, but also, and perhaps most importantly, by virtue of their ability to adapt themselves to the changing configuration of power and interests in an effort to maintain global financial and monetary stability.

At the same time, the emergence of new institutions, arenas of action, and discourses has been a critical feature of a post-crisis financial world seeking to mitigate the macro-volatilities of contemporary capitalism as well as their felt impacts on welfare, development, and equality. Are informal institutions such as the G20 complementary to or competing with existing IFIs? To what extent can they offer a more legitimate institutional platform for global economic co-ordination of both the interests and the underlying economic features of emerging and estab-

lished economic powers? The dynamic evolution of these relationships in an era where economic expansion—and contraction—is more rapid and pronounced than ever before demands not only equally rapid responses from policymakers and global leaders, but also a willingness of scholars and analysts to tackle difficult questions that concern actors and structures in perpetual motion.

As states, institutions and transnational actors respond to the new dynamics of this post-crisis political economy, the inter-linkage of power, norms, and interests therefore remains critical. Transnational elites seek to command and retain both financial and regulatory power by securing discursive hegemony and promoting institutional path-dependency; emerging economies are competing to secure their various interests in an increasingly multipolar world; and those economies historically relegated to sub-altern positions are drawing upon the potential of both old and new discourses of development and legitimacy in order to argue for the reconfiguration of increasingly fluid, contestable, and perhaps also unstable structures of global governance. The ramifications of the interplay between these actors and the social forces at their disposal extend not just to the issue of who gets what, and when, but also to the question of whether the broader social values in a stable and sustainable financial system can be assured.

It is in this context that the first article of this issue addresses the broad question of the origins of the current crisis—an event that has triggered both debate about the legitimacy of core neoliberal tenets, as well as precipitated a rethinking of the role of financial institutions in providing the indispensable public good of an equitable and just global economic order. Phil Cerny rethinks the fundamental question of what we mean by the “efficiency” of financial markets, arguing that the financial system should be regarded as a “public good” in order to efficiently reallocate capital and economic resources from investors to producers for the purpose of stable, continued, and equitable economic growth. At the same time, he criticizes the “deregulation” paradigm prevalent since the 1970s, in which financial markets have been considered as “private goods” to maximize profits for shareholders. Based on this core argument, Cerny makes a strong case for financial regulation: the lack of government rules, restrictions, and support would result in inefficient financial markets fraught with monopolistic behaviour, excessive risk-taking, fraud, and periodic crises. He concludes with a review of the compelling challenges brought by the globalization of financial markets as well as the prospects for effective re-regulation.

Interrogating the entrenchment of contestable norms at the institutional level, rather than in the context of the financial regulatory system

more broadly, Mallika Shakya challenges the conventional wisdom and coherency of the World Bank's neoliberal agenda. On the basis of a case study of the Bank's enterprise development facilities in its client countries in Asia, Eastern Europe, and Africa, she argues that the potential for change in organizational direction hinges both on the emergence of new concepts and projects as well as their interaction with the organizational structure of the Bank. This presents the broader theoretical implication that organizational politics within IFIs are a key factor in understanding the origins and direction of their development policies and projects. In addition, Shakya makes the case that a holistic solution to the developmental problems requires internal institutional transformation, a view that she argues has been largely dismissed due to the epistemic hegemony of macroeconomists within the Bank.

The next three articles address questions of effectiveness and legitimacy in the context of how the IMF has responded and been affected by the crisis. Manuela Moschella examines changes to IMF lending facilities in the wake of global financial crisis. On the one hand, she commends the IMF for enhancing transparency to market actors and introducing innovative procedures for faster and larger disbursements. On the other hand, she expresses concern about the IMF's ability to mobilize adequate resources in the event of a systemic crisis. Apart from an evaluation of the Fund's latest lending facility reforms, Moschella highlights the renewed trust in the Fund from developing and emerging market countries, and urges the Fund to avail itself of the opportunity to regain broader support from amongst its diverse member states.

Anton Malkin and Bessma Momani investigate the rising influence of emerging markets on the reform of the structure of IMF governance, including quota share reallocations, the reshuffling of seats at the Executive Board, and the proposed reform of Special Drawing Rights. Malkin and Momani argue that the reforms reflect a multilateral consensus between emerging and established economic powers, which is essential to a legitimate and effective IMF. Notwithstanding this, as long as substantive internal reforms—including to lending policies, the Fund's mandate, and its day-to-day activities remain unfulfilled, such superficial reforms in governance will have only marginal effect. In particular, there is still a long way to go before reaching a consensus between emerging and established economic powers regarding the IMF's authority on macroeconomic policy co-ordination. This raises fundamental questions over the extent to which the legitimacy of the IMF, given the potentially different interests of its member states, can be derived from a consensus-seeking approach to the substantive aspects of the Fund's mandate and operations.

Finally, Christian Brütsch distinguishes between the “old” Fund’s efforts to entrench “sound” macroeconomic policies and the “new” Fund’s plans to insure its members against global volatility. Based on two case studies of Angola and Mozambique, he argues that co-operation with the Fund improves resilience but that such IMF-instilled resilience sacrifices a more ambitious developmental programme. He offers evidence to demonstrate that the IMF adheres to a norm of prioritizing macroeconomic prudence over developmental ambition. Brütsch concludes by recommending that the IMF should take the political cost of risk insurance seriously by targeting its advice and assistance to governments that are prepared to explain, make, and follow-up on difficult choices.

Rounding out the themed section are interviews with Harold James and Paul Martin. Emphasizing the role of social values, James provides a sense of how the weight of values may be shifting from West to East as the flaws and insecurities of the established financial system become more apparent. The reinvigoration of the Western financial architecture according to the same strategic logic that characterized the development of the neoliberal paradigm holds little promise for the future of international finance. In this light, the crisis appears as something of an opportunity to re-examine the normative values underpinning the global financial system, and provides space for new pragmatic approaches to governance to emerge from local practices and decentralized discourses.

Conversely, Martin maintains a faith in the ability of the established and emerging actors at the centre of the global economy to engage with each other and develop the institutions and practices necessary to improve the stability and sustainability of the system. In an interdependent world in which no economy can thrive in the absence of a stable and conflict-free system of economic and financial exchange, all actors have a vested interest in the development of a pluralistic yet coherent multi-lateral system of governance, and will accordingly be propelled into the co-operation necessary to achieve and maintain such a system. The creation of informal “steering committees,” support and provision for more effective technical analysis, and regulatory checks and balances are all necessary components of a global financial architecture, in which notions of “rule-takers” and “rule-makers” hold diminished relevance.

Looking beyond the IFIs theme, this issue also contains two general section articles, along with a scholarly exchange between four brief papers. The acceptance of articles not related to the specific theme of each issue was a new development for *STAIR* in 2011, beginning with our February issue, and we are pleased to build on the successful launch of that inaugural general section here.¹ While the two papers and the

exchange all consider different subjects, they are united by a focus on pressing issues of international security, broadly-defined. That our second general section has evolved its own security studies “quasi-theme” to sit alongside the political economy focus of the IFI section of this issue therefore makes for a pleasing complement.

First, Nathan Toronto considers the thorny issue of Western military assistance for building the professional capacity necessary to supply internal and external security in less developed partner countries. With American, British, and allied forces still embroiled in Iraq and Afghanistan, along with their other ongoing commitments around the world, this is a process on which enhanced understanding is sorely needed. Toronto challenges the prevailing policy wisdom that adequate home-country security capacity can be generated by domestic forces, providing they are well trained by a large team of their advanced-military alliance colleagues. Instead, he finds that economic development has an important causal impact on military professionalism—and crucially, that this impact owes to subsidiary mechanisms besides Western training. Toronto contends that national wealth levels, urbanization, and human capital—three intrinsic characteristics of economically developed states—are all important drivers of military professionalism. This professionalism is, in turn, a central component of developing states’ ability to provide for their own security. To be sure, he concedes that the relationship between economic modernity and military professionalism is neither one of necessity nor of sufficiency—but it is nonetheless important enough to merit consideration. Toronto supports his theoretical conjectures with an analysis of a broad tract of Turkish military history. The message arising from his study of intra-case variation seems to be that in important instances, training is indeed not enough: economic development can be a key driver of military professionalism. This is a message that analysts of contemporary Western disengagement strategy should take note of.

Next, Tom Karsten analyses recent developments in Arctic geopolitics. With the melting of the polar ice cap exposing maritime routes, natural resources, and other economic opportunities previously beyond systematic exploitation, the scope for commercial tension is already beginning to manifest itself in the High North. Add to that a globalized world in which many actors beyond the five Arctic rim states—including emerging great powers, such as China—consider themselves important Arctic stakeholders with legitimate interests in the region, and the stage is set for what Karsten characterizes as a re-polarization of the Pole. By this, he does not mean a simple re-division of the Arctic along the same East-versus-West lines as seen in the Cold War. In today’s world, the United States might have just as many Arctic disagreements with

Canada as it does with Russia, say, depending on the issue-area, and the Arctic five may well be unified in their opposition to further regional political and economic engagement from non-Arctic rim stakeholders. Nonetheless, the results could potentially be just as deleterious to regional environmental conservation and mutual economic gain as the days when NATO and Soviet maritime forces vied for control of the Greenland-Iceland-United Kingdom (GIUK) gap. Moreover, a world of tense commercial, environmental, and political relations makes the re-emergence of serious security competition all the more likely, as ongoing hints of renewed naval activism in the region suggest. Karsten concludes his article with an appraisal of how a further deterioration of Arctic geopolitical relationships can be avoided. In particular, he argues that the United Kingdom is well-placed—given its combination of geographical proximity, diplomatic and institutional leverage, regional economic interests, maritime capability, scientific expertise, and close relations with both North American and Continental European stakeholders—to play an important role in mediating debate over the Arctic's future. Others may disagree with his diagnosis or prescription, but given the environmental, economic, and strategic significance of the topic for the decades ahead, Karsten's article represents a valuable contribution to an important conversation.

Finally, we have produced, for the first time, a scholarly exchange on a provocative article that appeared in an earlier issue of *STAIR*. Specifically, we invited a cross-section of scholars—junior to senior, all with a special interest in some aspect of the topic—to respond to Richard Ned Lebow's "Aggressive Democracies," which we published in February this year.² Each of the three respondents submitted a short critical analysis of a dimension of Lebow's argument. Seth Johnston poses questions for Lebow's empirical evidence base, suggesting that the available data does not unambiguously support the contention that democracies—with the United States foremost amongst them—can be particularly aggressive as a consequence of domestic ideational variables. Dan Reiter endorses several aspects of the original argument, but proposes that many of the variables that Lebow codes as ideational are in fact compatible with a rationalist explanatory typology based around the expected costs and benefits of fighting. He is also more confident than Lebow that statistical analysis gives us a better chance of testing the relative merits of competing explanatory variables. John Schuessler, meanwhile, argues that although Lebow makes important points, most of what the original *Aggressive Democracies* thesis classes as explanatory variables are really enabling factors, with the true explanation of US aggressiveness lying closer to the structural level: most notably, in a cocktail of structural uni-

polarity and domestic liberalism that produces “imprudent vehemence” in US foreign relations. The three response pieces are followed in closing by Lebow’s rejoinder. He offers rebuttals to each of the three respondents before drawing some final conclusions on what the product of the exchange means for Democratic Peace theory and the wider field.

We believe that this exchange reflects the best *STAIR* traditions of dialogue between differing perspectives and between established and emerging scholars. Indeed, the hope of further promoting such conversations was one of the reasons that we opened the *Review* to general section submissions in the first place. Taking the IFIs special section and the general section together, we are confident that this issue of *STAIR* makes a noteworthy contribution to the study of contemporary international affairs—we hope that you enjoy it. ■

Notes

¹ David Blagden, Justin Hempson-Jones, and Linda van der Horst, “Editorial Introduction: China’s Rise and Adapting Global Structures,” *St Antony’s International Review* 6, no. 2 (2011): 3–9, 7.

² Richard Ned Lebow, “Aggressive Democracies,” *St Antony’s International Review* 6, no. 2 (2011): 120–33.

RESPONDING TO CRISES: THE PAST, PRESENT, AND FUTURE OF INTERNATIONAL FINANCIAL INSTITUTIONS

11

Saving Capitalism from the Capitalists? Financial Regulation After the Crash

PHILIP G. CERNY¹

ABSTRACT

The central question of financial regulation in developed capitalist economies is whether government regulation of financial markets and institutions enables the financial system to operate more efficiently or alternatively obstructs or even counteracts that goal. The latter state of affairs, labelled “moral hazard” by economists, is at the heart of current debates. This article argues that the financial system constitutes a public good essential to contemporary society, and that the recent global financial crisis has reopened political questions not seriously asked since the 1970s and the onset of the “deregulation” paradigm, which treated financial markets and institutions as private goods. Without government rules, restrictions, and support, financial markets tend to be beset by monopolistic behaviour, excessive risk-taking, fraud, and periodic crises, thus becoming even more inefficient. In this context, the concept of the “efficiency” of financial markets is contested too. Does it mean profit-making and “shareholder value” for market actors and institutions, as proposed by many economists, or does it mean the efficient reallocation of capital and economic resources from investors to producers in ways that promote stable, continued, and equitable economic growth? Furthermore, the globalization of financial markets has made effective regulation infinitely more complex. This article surveys a number of core issue areas that cut across diverse levels of governance, leading to some mixed and partially effective re-regulation but also much scope for interest group politicking, regulatory arbitrage, regulatory capture, and regulatory fatigue.

Introduction: Capitalism, Risk, and Crisis

The development of capitalism over the past three to four centuries has created rates of economic growth and levels of material wealth unparal-

Philip G. Cerny, “Saving Capitalism from the Capitalists? Financial Regulation After the Crash,” *St Antony’s International Review* 7, no. 1 (2011): 11–29

leled in human history, but this has not been a linear process. Capitalism has been reinvented at regular intervals. A key part of this process has been the occurrence of major economic and financial crises. These crises—along with state backing for the financial and economic system, purging of the worst excesses, bringing workers into cross-class alliances, compensating losers, and learning from experience—have enabled extensive restructurings to take place that have actually strengthened capitalism and led to new rounds of expansion.

This capacity of capitalism to grow and renew itself is rooted in risk-taking. In static societies, risk-taking is severely circumscribed—by religious prohibition, social inhibition and/or the hostility of the external environment. Capitalist economies, however, grow precisely because individuals and firms are encouraged to take risks and strike out for pastures new. Firstly, an appetite for risk-taking is needed to sustain and accelerate the innovation on which growth depends. Secondly, it is believed that the self-interest of the risk-takers benefits the system as a whole—as in “enlightened self-interest.” And thirdly, it is believed that well-designed capitalist systems will prove relatively stable over time, entrepreneurs will seek a balance of risk and return, and markets will at least partly regulate themselves.

Capitalism has thus come to depend on entrepreneurial investors and borrowers in vibrant financial markets to sustain economic growth. And as both Michel Foucault and Margaret Thatcher argued, growth is the core social policy under modern neo-liberal capitalism. Without wealth creation in the first place, there would be nothing to redistribute. There would be no newly created money to invest, lend, pay workers with, finance consumption, redistribute in taxes and government spending, or with which to reconcile the competing interests of different groups. Economic growth and the financial activity on which it depends are therefore the preconditions not only for the success of capitalism as such, but also for the political reconciliation of conflicts that underwrite its reproduction.

In the light of financial crises in general, and the recent global financial crisis in particular, therefore, I argue here that the financial system as a whole, traditionally conceived of as characterized by what economists and political scientists call “private goods,” needs to be redefined as a “public good”—a complex argument I will touch upon below. Rather than entailing risk as something individual actors or firms can best determine in a decentralized, spontaneous Hayekian market process, I will draw attention to cumulative risks affecting the financial system as a whole.² This phenomenon has come to be called “systemic risk,” and demands a more holistic understanding of how that system works, permitting an approach to regulation that maximizes not only the stabil-

ity of the system, but also its capacity to carry out its most fundamental task in a capitalist political economy—the reallocation of capital to its most “efficient” uses. This means subordinating the extraction of rents—profits over and above those that could be made in a well-functioning economy—to the provision of investment leading to economic growth and development in general. Nevertheless, reconceptualizing the financial system as a public good raises analytical issues that will be returned to at the end of this article.

Risk-taking, the Economic Cycle, and the Scale of Financial Activity

As risk-taking gathers speed in the upswing of the economic cycle and those risks are increasingly seen to pay off, two things happen: first, those risks become ever riskier; and second, the attraction of higher potential returns feeds into the risk/return calculus, causing those risks to become ever more dangerous while short-term profits become increasingly attractive. At the same time, props erected during previous crises often themselves encourage riskier behaviour. The concept of risk today implies a calculable quantity, a statistical probability that can be used to make more “rational” predictions of market outcomes; advances in the measurement of risk are seen in turn as crucial to the development of financial markets and thus to the ability of market actors more generally to make efficient and profitable investments.³

However, especially since the onset of the recent global financial crisis, critics have argued that there is a problematic threshold between risk in the calculable sense and broader uncertainty. Theoretical discussions increasingly focus on so-called “black swans” and “fat tails”—market trends and events that do not conform to the standard deviations found in the quantitative Gaussian models used for the calculation of risk. Such unpredictable events challenge the claim of financial markets to be efficient in the economic sense—i.e., to lead to relatively steady profitable investments that contribute to economic growth and stability. In such an uncertain world, vicious spirals leading to market crashes are not the result of irrational behaviour by market actors, but of normal events in systemic terms, even if their occurrence cannot be predicted from recent trends at any particular point in time.⁴

Indeed, market actors, as in the run-up to the recent global financial crisis, not only cannot predict such events, but may increasingly act in systemically counterproductive ways—not so much irrational in the broader linguistic sense of the term but ironically conforming

to an alternative or perverse rationality in the short- to medium-term context. These behaviours feed into vicious spirals that can significantly exacerbate the downside of a crisis. Everything looks rosier as the bubble is increasingly inflated. The causes are obvious with hindsight, but economists and financial analysts cannot effectively predict such “tail events.”⁵ Furthermore, financial “innovation” has taken place through the invention and proliferation of new complex financial instruments such as derivatives, seen originally as promoting efficiency and “risk diversification”—the widespread idea in recent decades that holding a set of financial securities containing products with apparently diverse and complex risk characteristics is inherently stabilizing. Such developments have led not only to increasing interconnectedness among markets and what has been labelled a “cascade effect” both within and across market sectors, but also to extensive opportunistic behaviour and fraud.⁶

Financial Market Governance in Interconnected Markets

In this context, there are two main challenges to financial market governance. The first is what role regulators and other bureaucratic and political actors and institutions—mainly in national governments, but increasingly in international and transnational institutions such as the International Monetary Fund (IMF), the Group of Seven (G7), the European Union (EU), or the more recently established Group of Twenty (G20)—can and/or should play in resolving or mitigating the crisis. The second is what sort of new or reformed regulatory approaches and processes might be adopted to prevent future “tail events” from becoming full-blown crises. I argue here that while an awareness of the necessary conditions for effective regulatory reform abounds at the height of a crisis, that awareness is rapidly overcome as the crisis recedes and is replaced by a dynamic political process characterized by political interest politicking, regulatory arbitrage, regulatory capture, and, as a result of the first three, growing regulatory fatigue.

Thus it would seem at first glance that the experience of the recent global financial crisis has led to useful political lessons. Despite continuing problems of an uneven and sluggish economic recovery in 2009–10, the adoption by most governments until recently of essentially Keynesian policy responses—government intervention to support and often subsidize markets and firms (and sometimes to weed out the worst offenders, such as Lehman Brothers), as well as various fiscal stimulus packages—has long been considered highly effective in preventing the wider economic crisis from worsening to the extent feared in the early stages. Neverthe-

less, with rising public awareness of the costs of these measures, political opposition to such approaches grew dramatically, as manifested in the guise of the Tea Party movement in the United States, the deficit-cutting approach of the Conservative-Liberal Democrat coalition government in the United Kingdom, or the reluctance of Germany (now partially overcome) to bail out governments in Greece and Ireland.

At the same time, however, much confusion remains over the role of financial market regulators and regulatory institutions in both the lead-up to the crisis and the short-term reaction to it. The failures of the United States Federal Reserve (the Fed) and, especially, the Commodities and Futures Exchange Commission (CFTC), and the Securities and Exchange Commission (SEC) to take even the most straightforward measures to prevent the crisis have been widely noted—what Gillian Tett has called “dancing around the regulators.”⁷ Three key issues are significant here. First, a number of regulatory and legislative measures and court decisions in the United States and elsewhere over the course of three decades elevated the concept of deregulation to an accepted paradigm and common sense in the philosophy of government regulation of financial and other markets. The lifting of regulations and/or their reform in order to embed pro-free-market behaviour in institutional and enforcement procedures and processes was accepted as both normal and theoretically valid, and was internalized in the behaviour of regulators themselves—so-called “intellectual capture.”

Second, both the reform and interpretation of detailed rules in the American tradition and “principles-based” or “light touch” regulation in the United Kingdom and elsewhere in the run-up to the crisis led to greater regulatory and political tolerance and support for complex forms of financial innovation and what has been termed “competition in laxity” among different regulators and between regulatory systems. This has given rise to regulatory arbitrage, as market actors seek to be covered by the least intrusive rules and regulatory bodies, whether within particular states or across borders. Third, the structure of regulatory systems themselves, whether centralized in relatively few bodies (usually some tripartite combination, as in the United Kingdom, of a central bank, a securities regulator like the Financial Services Authority (FSA), and the Treasury) or characterized by a number of competing regulators supervising particular institutions, as in the United States, often prevents, rather than enables, effective and coherent regulation.

In this context, probably the main development in approaches to financial market regulation has been the undermining of what I have called the deregulatory paradigm, but its only partial replacement by ad hoc policy and structural responses. In other words, coherent theory, however

mistaken, has been replaced by a certain *tous azimuts* or “pick and mix” approach.⁸ Part of the reason for this scattered reaction is politics, both domestic and international. For example, party politics in the United States, combined with extremely effective and well-financed lobbying by a powerful set of bank and non-bank interests in a divided political system with a separation of powers inherently conducive to gridlock in the policymaking process, has led to the passage of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010—a cumbersome set of compromises that requires the *ex post* negotiation of detailed rules and implementation over several years.⁹ In the United Kingdom, the Conservative Party ran for office in 2010 on a policy of abolishing or splitting up the FSA and is still finalizing the details. The EU is also setting up a range of new regulatory bodies. There has been a process of policy cross-fertilization in these reforms, but whether real convergence results, is still to be determined. The scope for diversity and therefore for regulatory arbitrage both within and across borders is still huge.

A central issue in all of these changes has been the intellectual and policy shift noted earlier towards focusing on systemic risk and so-called “macro-prudential regulation,” although the content of such regulation is still highly contested and fragmentary. Financial market regulation in the past has been focused overwhelmingly on the supervision of specific firms and markets, i.e., on micro-prudential regulation. However, the main lesson of the recent crisis has been one of the interconnectedness of different firms and markets. Market actors have reacted to incentives that have privileged firm-level profitability. Indeed, the main intellectual understanding of how financial markets work has depended on the assumption that what makes markets go awry is not an emphasis on firm level profitability, which is seen as rational and efficient behaviour, but on government intervention and the ensuing perverse reactions to it by market actors. Economists and financial analysts, especially in the discourse of the current crisis, have thus focused on what has been called “moral hazard,” a concept based on the assumption that what really distorts markets is behaviour caused by regulation itself, particularly in the form of government guarantees to troubled institutions and failing markets.

This returns us to the concepts of calculable risk and uncertainty. If market actors come to expect support from governments (or sometimes other non-market institutions, depending on whose definition of moral hazard is being employed), they will increasingly have a perverse incentive to take on more and more risk, building fragility into the system. Government guarantees make excessive risk-taking appear highly rational, until, of course, the obscure threshold from calculable risk to uncertainty and tail risks is crossed and the system itself is undermined.

This is particularly true of banks and non-bank financial institutions that are classed as “too big to fail” or “systemically important financial institutions” (SIFIs).¹⁰ In the discursive world of moral hazard, therefore, what is so surprising is not that bubbles grow and burst. Rather, it is that they do not bring the system down even when they are completely unanticipated. New rounds of bailouts and restructuring always seem to usher in a recovery, but then set the cycle in motion again, only on a greater scale.

Economic Theory in Crisis

In attempting to cope with twenty-first century conditions, one of the key factors is that Economics, as a discipline and practice, is really only suited to “normal” times. Financial crises are treated as exogenous shocks, not as failures of the financial system itself. This is one of the ways economic theory, which claims to be scientific and predictive, is essentially ideological. Mainstream economic theories, such as the Efficient Market Hypothesis—especially prominent in recent decades—usually assert that capitalist markets are self-regulating or self-correcting overall. If we assume that market participants have all the relevant information available to act according to their needs and preferences, then markets will “clear.” When a market clears, all available goods and assets that have been offered for sale will have been bought at a negotiated price acceptable to buyers and sellers, investors and borrowers. An equilibrium will have been reached that will be satisfactory to all.

There are many well-known problems with this theory. One is that some market participants have more or better information than others, and are thus able to manipulate that information to skew outcomes in their favour. Another is the assumption that supply and demand automatically adjust to each other, which in many cases is simply not true. A third is that where there are either too few sellers or too few buyers, they can corner the market and impose monopoly (or oligopoly) prices, extracting “rents”—i.e., profits over and above what would be available in a genuinely competitive market. A fourth problem, already mentioned, concerns the question of whether major changes in market conditions arise out of the markets themselves, or whether they are a result of “exogenous shocks.” And finally, there may be insufficient liquidity available for either side in a transaction to be able to bargain properly. When a market is liquid, it can ostensibly “clear;” when liquidity dries up, however, markets are liable to simply seize up, with no takers for particular goods or assets and thus depriving such goods or

assets of an “exchange value” in the marketplace. They can no longer be used as collateral for raising short-term capital and must be sold off at “fire sale” prices, undermining the ability of a firm to fund continuing obligations and future investing. This is sometimes referred to as an “illiquidity cascade.”¹¹

Where a range of troubled (or “toxic”) assets are inextricably intertwined, a general loss of confidence can lead to cascades of illiquidity across different markets, bringing the whole economy to a shuddering halt. Today there are not only too few loans available for financing major industrial investments, but also for day-to-day borrowing and lending—whether among banks themselves to keep their books straight; among businesses large and small for purchasing raw materials, paying production costs, maintaining inventories, sales and marketing, workers’ wages, etc.; or among ordinary people for paying the bills and getting by.¹² All of these elements are mutually interdependent and tightly linked, so that bankers, investors, businessmen and workers alike are increasingly dependent on credit for their day-to-day activities and basic living. We are all more and more highly “leveraged”—i.e., we use increasing amounts of debt to keep the economic cycle expanding, while banks used dramatic increases in leverage to double their return on equity from the late twentieth century to the boom years of the early twenty-first.¹³ The days of being able to live off retained earnings or careful savings are long gone. And in an era of heightened global financial mobility, this illiquidity has cascaded through the entire world economy.

“Money Makes the World Go Around”

The problem here is that money and finance have in effect become the “infrastructure of the infrastructure,” prone to transforming into means of gaming the economy rather than performing the fundamental function of underpinning the “real economy” and economic growth.¹⁴ Money is universal, insofar as anything can be exchanged for anything else if you have the money to do so. It is, as the traditional triptych goes, a means of exchange, a unit of account, and a store of value—all of which are necessary for complex systems of commodity exchange to develop. Money itself is therefore fungible or, in Selmier’s terms, “transmutable.”¹⁵ In addition to substituting for any other good, asset or commodity, it can also take on different and complex forms. And those forms can themselves change quite quickly in markets where different financial instruments are traded. Money is thus also immaterial, or abstract, and whereas it was once embodied in precious metals like gold and silver, money in

a modern capitalist economy consists of bits of data in a computer, manipulable in a myriad of ways in the space of mere nanoseconds.

But for our purposes, the most important characteristic of money is as *finance* itself. Money has always been used to invest in and to finance other economic activities. In the contemporary world, however, this does not mean merely moving money around from one use to another, as in the classical theories of money. It means the actual *creation* of money through the expansion of credit and debt—i.e. leveraging, as in the use of levers to multiply the strength of a power source, whether man, animal or machine. We live in an increasingly “leveraged” world. But despite the downside, which is obvious in the case of the current financial crisis, what we must seek is not to do away with credit and debt, but to develop safe forms of leverage needed to finance the panoply of activities necessary for continuing economic growth.

Governments can, of course, create money by printing more of it, but this causes direct inflationary pressures that cause prices to rise because there is too much money chasing too few goods. Critiques today of stimulus programmes like “quantitative easing,” the purchase by a central bank of a range of relatively safe securities from the banking system in order to inject cash into the wider economy, are based on the belief that such policies are inherently inflationary. The most important form of monetary creation is, however, carried out by banks and financial institutions themselves that issue loans and underwrite securities that go beyond their deposits or capital bases. This is tantamount to betting that their depositors, shareholders or primary dealers will not ask for all their money back at the same time. And of course, sometimes they do—which is exactly what happened in the recent global financial crisis.

The Roots of the Crisis

Over the course of the last three decades it has become common for loans—especially long-term loans—to be split and packaged up into tradable securities or derivatives (named after the “real” loans or traded securities, financial instruments, from which they and their prices were originally derived). Buyers’ appetites for these derivative securities ballooned during the 1990s and early 2000s because they were perceived to be especially safe and risk-free. There are two main reasons for this misperception. The first reason was that the loans were originally for purchases that were themselves thought to be safe. In particular, it was believed that house prices over time would always go up—something which is true in the long term but dangerous to use as a rule of thumb for

short-term transactions. During an upswing, there is always a tendency to assume the best and to expect continuing gains rather than losses. A variety of derivative securities were created using mortgages and loans for things like car purchases and credit card debt, and these in turn were bought and sold by huge numbers of financial market participants.

The second reason was the reigning financial ideology, mentioned earlier, of supposed risk diversification, which became especially influential in the booming 1990s and 2000s. Risk diversification developed from the long-held notion of “portfolio diversification.” Simply put, portfolio diversification counsels that it is best not to put all your eggs in one basket. An investor, in order to balance (supposedly calculable) risk and return, needs not only to speculate but also to hedge his or her bets with supposedly safe financial instruments. However, the “securitization” of assets with different risk characteristics into a single tradable unit with different “tranches” of risk designed to appeal to different kinds of investors was a direct result of this ideological commitment that inoculated the complex financial securities market from serious scrutiny.¹⁶

This is how mortgage-backed securities, especially (but not exclusively) those derived from subprime mortgages, became the trigger for the wider illiquidity cascade leading to the global financial crisis. Because these sorts of derivative securities were seen literally as “safe as houses,” they were in great demand for hedging purposes. Liquidity ran rampant, buyers were bidding up their prices, and suppliers across the financial sector—from top-tier investment banks to local brokers, often with the complicit support of newly obliging (and highly credulous) credit rating agencies—were more than happy to create more and more of these assets and inject them into the markets. In the minds of all involved, it was a win-win game.

Unlike the bank runs of the early 1930s, however, the complexity of contemporary derivative securities means that the exact details of their systemic implications are virtually incomprehensible to everyone except quantitative “rocket scientists”—and even they were largely fooled. As the crisis was gestating, ordinary people knew only that they could suddenly afford previously unattainable loans in order to maintain and expand their consumption patterns despite stagnating real wages, and that they could continue to do so as long as the economy in general kept expanding through increasing leverage. Nevertheless, former Senator Phil Gramm, one of the most ardent deregulators of the 1990s and adviser to 2008 Republican presidential candidate John McCain, continued to boast about how his mother, a poor nurse, could only afford to buy a house and send him to university because she had managed to secure a subprime mortgage. Indeed, his wife, Wendy Gramm, as Chairman of

the Commodity and Futures Trading Commission, was able to block virtually all government regulation of the derivatives markets themselves. To many, increased leverage has meant personal achievement and social mobility as well as economic progress.

Of course, some financial market actors realized that they could get money for nothing. This is starkly illustrated by the hugely corrupt pyramid (or “Ponzi”) scheme set up by the former NASDAQ head Bernard Madoff, which collapsed spectacularly in December 2008. In most cases, however, the pyramid was built up by quite sophisticated market believers who thought a new era had arrived. At last, they believed, you could take more and more risks without becoming less safe. In this atmosphere, it was entirely normal—even timid—for a bank to lend up to ten times its deposit or capital base. It even became common for banks to lend up to thirty or even forty times their capital base, because their capital was thought to be extra-safe if invested in derivatives. As we know now, these instruments were anything but safe.

The crash began because of an oversupply of “subprime mortgages”—long-term loans granted to house buyers with “no income, no job or assets” (so called “Ninja” loans)—which were repackaged into tradable derivatives with complex combinations of tranches, and sold on to other buyers. Such “collateralized mortgage obligations” were one of a range of subcategories of “collateralized debt obligations” (CDOs) that were sold all over the world to both sophisticates and suckers, high-end financial institutions and local governments, pension funds, and hedge funds. There were also increasingly complex derivatives of derivatives (CDOs of CDOs). All of these were, in the context of rapidly expanding financial markets and continually rising house prices, ostensibly said to be hedges, not highly speculative risks. According to one former derivatives banker, the risks were well known but ignored in the name of firm profitability, fee income, and personal bonuses.¹⁷ At the same time, however, the hegemonic ideology of the period seemed to justify the risks—until illiquidity cascaded through not only financial markets but also real economies the world over.

Preventing Future Crises?

Until recently, governments, financial institutions, major industrial sectors, small businesses, workers, and consumers alike were focused on fighting the fire rather than rebuilding the house: bailouts, restructurings, and stimulus packages were the order of the day. Financial regulatory reform was a major agenda item, but despite new legislation, the

restructuring of parts of the regulatory apparatus, and a certain amount of transnational convergence, especially on capital adequacy rules, it has been eclipsed by other policy issues. Today, fiscal policy—in particular, cutting government deficits—and currency exchange rates have come to the fore. The biggest question of all, however, is still whether and how illiquidity cascades can be prevented in the future. There are currently two pathways being discussed in the mainstream and industry press.

The first pathway involves the use of governmental regulation in order to limit the systematic expansion of debt and leverage in the upswing of the economic cycle. Various policy reforms in this vein have been discussed and put into practice. The following is a partial list, and both the range of proposals and their actual formulation and implementation are still contentious and incomplete.

- Leverage limits to keep debt under control, like the ones lifted by the United States Securities and Exchange Commission in 2004;
- Better, more counter-cyclical capital adequacy requirements to make institutions keep capital bases higher in boom periods and lower them in hard times to keep loans flowing;
- Taxing banks, whether directly or in the form of private insurance or bailout funds;
- Greater transparency and more rigorous statistical oversight;
- Consolidating or splitting up regulatory bodies and setting up new ones;
- Improving private sector oversight through, for example, strengthening the self-regulatory sanctions available to private trade associations—a process which can entrench those special interests and hinder as well as reinforce regulatory reform;
- Proposing new forms of consumer protection regulation;
- The establishment of formal clearing houses for derivatives transactions;
- Setting more rigorous rules for credit rating agencies in the light of their extremely over-optimistic endorsement of derivatives in the years leading up to the crisis;
- Banning the “short selling” of borrowed securities in order to force prices down;
- Regulating bankers’ pay and bonuses (the most politically charged of these issues); and
- Adopting more rigorous accounting standards.

In all of these policy debates and processes, effective global regulation seems increasingly far off while national states are caught up in quasi-corporatist bargaining processes that privilege the best resourced and entrenched private interests, especially those that can organize and coordinate their activities across borders.¹⁸

As noted earlier, capitalism depends on investors, entrepreneurs, and companies taking risks for the sake of profit, which in turn drives economic growth. Successful risk-taking, however, leads market actors to become complacent about the possibilities of further risk-taking, which, along with “herding” in markets—successful bets being copied and elaborated on by imitators—leads to over-leveraging and indebtedness, a vicious spiral which has been the cause of all major financial crises in the modern world. Markets, however, do not have the institutional capacity to counteract these vicious spirals by themselves, because they are composed of individual or group actors with a severe “collective action problem,” and are therefore dependent upon states, and, increasingly, upon transnational political structures and processes, in order to avoid and counteract market failure. States, however, also depend on economic growth and therefore support risk-taking while it is successful and often well into the run-up to a crisis. In fact, markets depend for their vitality not merely on their own endogenous dynamics, but also on the capacity of the state to underpin and guarantee the stability of the system as a whole, especially in times of crisis.

So-called “moral hazard,” while on the one hand decried by economic and financial theorists as leading to excessive risk-taking, is on the other hand a basic, fundamental necessity and requirement for the existence of capitalist systems in the first place, starting with the development of property rights regimes from the thirteenth century onward. Nevertheless, the capacity of states proactively to avoid serious market failures in advance has always been undermined by a combination of

- the capability of market actors to play the regulatory game, find loopholes, and avoid restrictions;
- the herding instinct, recently referred to by the former Citigroup Chairman and Chief Executive Officer Chuck Prince as a sense that “as long as the music plays, you’ve got to get up and dance;”
- the relatively static nature of regulatory structures and controls; and
- the changing endogenous character and exogenous scale of crises themselves, an increasingly critical problem in the era of capitalist globalization in general, and the globalization of financial markets and institutions in particular.

Thus state actors (bureaucrats and politicians) are not only like “generals fighting the last war,” but also intellectually co-opted into the dominant market paradigm of the era (as well as more directly captured by market-based interest groups), as well as increasingly prone to “regulatory fatigue” because of the complex political and bureaucratic processes required for effective regulatory reform.

Whilst the global financial crisis and recession of 2008–09 have dramatically shaken up the politics of financial regulation across the world, the superficiality of these transformations renders it doubtful that current (even quasi-reformed) political structures and bureaucratic processes will enable markets to avoid future (and ever-changing) crises. In the current situation, the politics of deregulation have been partly superseded by a politics of re-regulation. However, the new regulatory politics do not hark back to direct intervention in markets, but retain a neo-liberal focus on attempting to improve market performance and promote competition through arm’s length regulation while at the same time attempting to develop anti-cyclical regulatory policies to prevent further “bubbles.”

Whilst there is a strong consensus that extensive reforms are needed, both open debates and more opaque interest group bargaining and lobbying processes are nonetheless deep and contentious across all of the specific policy issues listed above. These debates are far from being resolved, and positions are often entrenched on all sides of each issue—not to mention the problems of bringing them together into coherent regulatory reform packages. States go down their own roads, depending on their vulnerability to crisis, their particular “variety of capitalism,” their internal political structures and processes, their interest group and political party constellations, their existing regulatory regimes, etc. Each of the issue-areas outlined above also has a critical transnational dimension that cannot be easily reconciled given the lack of any overarching international institutional authority or global financial architecture; the new G20, originally set up as a meeting of finance ministers in 1999, but extended to summits of heads of state in 2008, has been sidelined by a lack of consistent regulatory policy-making across borders. After the November 2010 summit in Seoul, attempts to forge concrete co-operative policies were replaced by the so-called “Seoul Consensus,” based on the notion that states would have to develop their own policies incrementally. Co-operation had proved ephemeral and convergence ad hoc.

Back to Business as Usual?

Finally, the more successful the quasi-Keynesian economic stimulus packages and monetary easing that governments have been prioritizing

prove to be, the more “business as usual” will be coming back (as it has been), and lobbies and political factions will be able to both obstruct reform and shape it to their own interests—what I have called “regulatory fatigue.” Therefore, although as the crisis was unfolding there seemed to be a “new politics” of financial regulation emerging rooted in a strong belief in its necessity for preventing future crashes and strengthening systemic and macro-prudential regulation, it lacks both domestic and international coherence and is in danger of being strangled at birth. With regard to capital adequacy regulation, the taxation of financial institutions, and rules for the compensation of bankers themselves, who have continued to earn extremely large salaries and bonuses, regulatory convergence is limited and regulatory arbitrage increasing. For example, although the Basel Committee on Banking Supervision has been working on a new system called Basel III for nearly two years, their recommendations in early 2011 are still not fully agreed upon. States are working on their own regulations, often increasing the amount of capital that banks—especially SIFIs—must hold against their loan assets, while at the same time bank lobbies are furiously advocating the relaxation of those standards. Furthermore, the G20 in 2009 placed at the centre of their proposals for regulatory reform the development of bank taxes and levies as part of insurance funding in order to make the banks themselves, rather than taxpayers, responsible for funding the rescue of failing institutions. However, such taxes were removed from the final version of the Dodd-Frank Act, and now different countries are toying with a range of different approaches (if any at all).¹⁹

This brings us to the second pathway, which involves waiting for markets to reform themselves. The question, of course, is whether the volatility of the crash—the supposed cure—is worse than the disease of the bubble. In keeping with this line of argument, however, *Financial Times* columnist Andrew Hill put forward ten reasons why hedge funds, sometimes seen to be at the heart of the crisis, may also be at the heart of the recovery, including the provision of liquidity, their role in actually bursting bubbles, their ability to spot new opportunities for investment, their capacity to innovate, and the very fact that they can fail without creating systemic risk.²⁰ In the same vein, an influential recent book by Council of Foreign Relations economist Sebastian Mallaby argues that hedge funds have been highly significant in terms of actually enabling market corrections. Indeed, it has been argued that, unlike banks, hedge funds have been remarkably flexible; many have failed without systemic fallout; and their size means that, unlike the original system-endangering hedge fund of 1998, Long Term Capital Management, they actually do channel investment into the real economy, instead of simply gaming the financial

system.²¹ Hedge funds were supposed to do these things before, but instead they have come to be regarded as significant factors in exacerbating the crisis, especially by European policymakers. How many hedge funds will survive the crash, and what sort of market clout they will have in the future, is very much in doubt. But the likelihood is extremely low that market actors such as hedge funds or other financial institutions themselves, freed from—or in spite of—moral hazard, will be able to play the market correction role that economic theory envisages.

As mentioned earlier, there is thus a fundamental collective action problem here. Financial markets are populated for the most part, especially in relatively neo-liberal states, by private actors. Their incentive structure is based on an assumption that the system itself is characterized by what theorists of political economy call “private goods.” Two properties can be seen to define private goods: first, they are “excludable”, i.e., consumers can be excluded from enjoying those goods if they are not willing or able to pay for them; and second, they are “rivalrous,” that is, zero-sum. Markets are seen as the most efficient ways to organize the production and consumption of such goods. “Public goods,” in contrast, are neither: consumers cannot be excluded from their use (standard examples are street lighting and national defence); and they are not zero-sum in that consumption by one individual does not prevent others from using them. Mainstream economic conceptions of financial markets see them as involving private goods, in which case relatively deregulated markets should eventually prove more efficient than regulated ones, and the moral hazard of government intervention will simply make them more inefficient.

However, increasing awareness of systemic risk and the requirements of macro-prudential regulation tell a different story. Because of the role financial markets play as “the infrastructure of the infrastructure,” the structure that enables and empowers all other economic transactions and production systems, a stable and liquid financial system *as a whole* is necessary for the rest of the economy to work. Therefore it is crucial to redefine the financial system as a public good, not one dominated by private goods.²² Individual firms, of course, will continue to pursue their own private profitability through the system. Nevertheless, it is regulation that enables the financial system to work in the first place, providing at the most general level property rights, contract law, fraud prevention, anti-trust regulation, etc., and at more specific levels, government promotion, support, specific guarantees that empower market actors to participate in the system in the first place, and regulations that ensure some essential level of genuine competition and not merely oligopolistic opportunism. “Moral hazard”—a most misleading term—is not something

that stops the system from working. On the contrary, it is a necessary precondition for the system to work in the first place, to prevent market failures, and to mop up after the crisis. History tells us that capitalism is too serious a business to be left to the capitalists alone. But the challenge for designing and implementing effective, enabling regulation is much greater in a world of globalizing financial markets, where international institutions are often rudimentary and ineffective, and states are increasingly constrained by political interest politicking, regulatory arbitrage, regulatory capture, and regulatory fatigue. ■

Notes

¹ The author would like to thank Christopher Clarke, Gita Subrahmanyam, Giselle Datz, and the anonymous reviewers for this journal for their comments on an earlier version of this article.

² For a discussion of these issues, see Philip G. Cerny, “Webs of Governance and the Privatization of Transnational Regulation,” in *Governing the World's Money*, David M. Andrews, C. Randall Henning and Louis W. Pauly, eds. (Ithaca, NY: Cornell University Press, 2002), 194–216.

³ Peter L. Bernstein, *Against the Gods: The Remarkable Story of Risk*, 2nd ed. (Hoboken, NJ: Wiley, 1998).

⁴ The tendency for financial markets to experience regular, serious crises is analyzed in Hyman P. Minsky, *Stabilizing an Unstable Economy* (New Haven, CT: Yale University Press, 1986), and Anastasia Nesvetailova, *Fragile Finance: Debt, Speculation and Crisis in the Age of Global Credit* (Houndmills, Basingstoke: Palgrave Macmillan, 2007); “fat tails” and “black swans” are most notably discussed in Nassim Nicholas Taleb, *The Black Swan: The Impact of the Highly Improbable*, 2nd ed. with new section “On Robustness and Fragility” (New York: Random House, 2010).

⁵ Economic and journalistic critiques of the notion of market rationality abound. A useful primer is Justin Fox, *The Myth of the Rational Market: A History of Risk, Reward and Delusion on Wall Street* (New York: Harper Business, 2009).

⁶ On the former point, the most prescient treatment I have read that was written prior to the crisis is Richard M. Bookstaber, *A Demon of Our Own Design: Markets, Hedge Funds, and the Perils of Financial Innovation* (Hoboken, NJ: Wiley, 2008). On the latter point, see Satyajit Das, *Traders, Guns and Money: Knowns and Unknowns in the Dazzling World of Derivatives*, revised ed. (Harlow, Essex: Prentice Hall/Financial Times, 2010).

⁷ Gillian Tett, *Fool's Gold: How Unrestrained Greed Corrupted a Dream, Shattered Global Markets and Unleashed a Catastrophe* (Boston: Little, Brown and Company 2009); Michael Hirsh, *Capital Offense: How Washington's Wise Men Turned America's Future Over to Wall Street* (Hoboken, NJ: Wiley, 2010).

⁸ The concept of “pick and mix” regulation is proposed by Susan Strange, *Casino Capitalism* (Oxford: Blackwell, 1986).

⁹ The definitive work on this subject is Viral V. Acharya et al., eds., *Regulating Wall Street: The Dodd-Frank Act and the New Architecture of Global Finance* (Hoboken, NJ: Wiley, 2010).

¹⁰ The debate on how to deal with institutions that are deemed “too big to fail” is at the forefront of the current regulatory debate. The perceived need to restrict the size of institutions is at the core of, in particular, Simon Johnson and James Kwak, *13 Bankers: The Wall Street Takeover and the Next Financial Meltdown* (New York: Pantheon Books, 2010).

¹¹ Bookstaber, *A Demon of Our Own Design*.

¹² Return on equity rose from about 10 per cent in the 1980s and 1990s to 20 per cent in the bubble years up to 2008 (*Financial Times*, 28 March 2011). Banks and many non-bank financial institutions raise short term money (for traditional commercial banks, in the form of deposits that can be withdrawn at any time; for investment banks and today’s market-imbricated commercial banks and non-bank firms, short term borrowings from overnight “repurchase” or “repo” markets, money markets, etc.) in order to fund supposedly long term investments, including, today, many derivatives as well as long term loans. This is called “maturity mismatch,” and is at the core of the potential instability of any financial system.

¹³ For the definitive study of over-indebtedness or “over-leveraging” in causing financial crises throughout modern history, see Carmen M. Reinhart and Kenneth S. Rogoff, *This Time is Different: Eight Centuries of Financial Folly* (Princeton, New Jersey: Princeton University Press, 2009).

¹⁴ Philip G. Cerny, “The Infrastructure of the Infrastructure? Toward ‘Embedded Financial Orthodoxy’ in the International Political Economy,” in Barry Gills and Ronen Palan, eds., *Transcending the State-Global Divide: The Neostructuralist Agenda in International Relations* (Boulder, CO: Lynne Reinner, 1994), 223–249.

¹⁵ W. Travis Selmier II, “The Complexity of Financial Goods and Governance”, paper presented to the Annual Convention of the International Studies Association, Montreal, Canada, March 16, 2011. See also Philip G. Cerny, “The Dynamics of Financial Globalization: Technology, Market Structure and Policy Response,” *Policy Sciences* 27, no. 4 (November 1994): 319–342.

¹⁶ One of the most detailed journalistic treatments of this process is Bethany McLean and Joe Nocera, *All the Devils Are Here: The Hidden History of the Financial Crisis* (New York: Portfolio/Penguin, 2010).

¹⁷ Gita Subrahmanyam, email correspondence, March 2011.

¹⁸ See Philip G. Cerny, *Rethinking World Politics: A Theory of Transnational Neopluralism* (New York: Oxford University Press, 2010), especially Chapter 12, “Financial Globalization, Crisis, and the Reorganization of Global Capital.”

¹⁹ Acharya et al., eds., *Regulating Wall Street*, focus at several levels on the potential role of bank levies and the weaknesses of the Dodd-Frank Act as the result of their exclusion from the final version.

²⁰ Andrew Hill, “Ten Reasons Why You Should Go and Hug a Hedgeie,” *Financial Times*, December 18, 2008.

²¹ Sebastian Mallaby, *More Money Than God: Hedge Funds and the Making of a New Elite* (London: Bloomsbury, 2010).

²² There are two complications to this argument that there is not space to consider here. On the one hand, there are good reasons to classify financial markets as “club (or ‘franchise’) goods,” i.e., excludable but non-rivalrous. This means that they involve the worst of both public goods and of private goods, in private hands but depending upon a state “grant” or (in Schwartz’s terms) “franchise” for their existence and operation – thereby leading to a parasitic dependence on the state that the state finds it difficult to control (cf. Selmier, *op. cit.*, and Herman Schwartz, “Uncertainty or Incommensurability? Ideas, Production Structures, and the Problems Securing a New and Stable Regime of Accumulation,” paper presented to the Annual Convention of the International Studies Association, Montreal, Canada, March 18, 2011). On the other hand, the very concept of “public goods” as conceived of and applied by economic theorists since Paul Samuelson is far too economistic. A more politically sophisticated version is needed, which I have tried to develop elsewhere (Philip G. Cerny, “Globalization, Governance, and Complexity,” in Aseem Prakash and Jeffrey A. Hart, eds., *Globalization and Governance* (London: Routledge, 1999), 184–208.

The World Bank and Private Sector Development: Is “Doing Business” an Extension of the Structural Adjustment Programme or a Departure?

MALLIKA SHAKYA¹

ABSTRACT

Private sector development lies at the heart of the World Bank’s Structural Adjustment Programme (SAP), but there is no consensus within the Bank on its own role in fostering competitiveness within the private sectors of their client countries. Should the Bank be a global referee of trade and competitiveness, acting as a conscientious watchdog of reform movements focusing on improving the business enabling environment? Or should it be a diligent practitioner working to develop public goods necessary for industrial development? What exactly is the dividing line between the market-distorting measures of “picking winners,” a residual from the early SAP era, and creating “public goods” now deemed necessary for sustainable private sector development? This paper situates this debate within the organizational transformation taking place in the private sector development wing of the World Bank. It argues that this institutional paradox can offer important insights into the way the World Bank has historically carved out its space within global economic governance. Its deliberations involving the enterprise development facilities set up in far-flung countries that experiment with new collaboration modalities with its donors and development stakeholders can tell us a lot more about what can be reformed within the Bank and what cannot. More importantly, it gives us important insights as to what must be transformed for the international financial institutions to offer any real hope to their clients in a new global economic order.

Introduction

The World Bank is of one voice: higher industrial productivity within a free market triggers economic growth and raises living standards. A contentious debate is going on within the Bank, however, on its own role in helping developing countries around the world to “take off” industrially.² Approximately three decades after the Washington Consensus endorsed

Mallika Shakya, “The World Bank and Private Sector Development: Is ‘Doing Business’ an Extension of the Structural Adjustment Program or a Departure?” *St Antony’s International Review* 7, no. 1 (2011): 30–47.

Structural Adjustment Programmes (SAPs), consisting of a set of market liberalization programmes to be implemented by its client governments, it is now a good time to examine its implications for the organization of the Bank.³ Discussions on the economic, social, and political implications of SAP have already generated a prolific literature both on the left and on the right, as well as among the academics of international studies and the practitioners of international development. I build on this conceptual debate but do not dwell on it. In this paper I intend to problematize the less-visited topic of the Bank's own organizational restructuring concerning its industrial development agenda within the broader SAP discourse.

This paper revisits the practice agenda behind the industrial policy debate involving SAPs, and investigates the Bank's changing role in shaping the fundamentals of economic governance in its client countries in Asia, Eastern Europe, and Africa. What are the implications of this debate for the World Bank as a development organization in terms of its role in helping client countries "take off" industrially? Should the Bank be a global referee, that is, a passive watchdog of movements toward an industry-enabling environment? Or should it be an active practitioner working with its client countries to remove industry-specific bottlenecks at national and subnational levels? The dividing line is relatively thin between the market distorting measures of "picking winners," a residual from the initial SAP era, and creating "public goods" now deemed necessary for private sector development. The Bank has so far experimented with a number of policy frameworks that may favour one approach over the other, at times switching between them. However, the organizational politics within the Bank have prevented it from paying sufficient attention to the inherent institutional differences across societies it is dealing with.

For international engagement on industrial development to be effective, industrial policy agendas should be allowed to emerge out of countries' unique domestic environment; this is far from happening. Currently, the Bank is little cognizant of the possibility that technical deficiency alone may not be the culprit of policy failure. The overall neo-liberal economic mindset of the World Bank has led to the downplaying of the social and political contexts of its client countries, which are bound to affect the way policies are interpreted and implemented on the ground. Further I argue that a serious analyst of the Bank cannot afford to ignore the complexity of organizational politics within the Bank, which directly affects its programmatic focus and engagement with its client countries. My analysis of the ongoing organizational restructuring of the private sector development wing of the World Bank sheds light on the theoretical debates and organizational battles it must resolve in applying itself to development.

My interest on this topic evolves from my own stint at the World Bank. I joined the World Bank in September 2004, and spent just over five years working on assignments related to international trade and competitiveness, after completing a ten-month “rotation” in an enterprise development facility based in South Asia. In writing this paper, my data consists of the public reports prepared by Bank analysts on its industrial development operations. My analysis also benefits from a number of academic and activist publications that have made the World Bank their focus.⁴ As Howard Stein has argued, an institutional theory rooted in the work of scholars such as Douglass North and Ronald Coase provides a useful set of tools for understanding not only the socio-political context that lies at the heart of the development work that the Bank is engaged in, but also the internal organization of the Bank.⁵ I agree with Stein that the Bank has traded the original institutional economics for its reductionist and economized version, the New Institutional Economics (NIE). My case study on the Bank’s industrial development work complements Stein’s analysis of finance, human development, and governance components. Analyzing the launch and retreat of the Bank’s enterprise development facilities in its client countries in Asia, Eastern Europe and Africa, I show that the Bank’s institutional paradox offers important insights into the space it has carved out for itself in global economic governance.

Situating Structural Adjustment Programmes within a Human Economy

Since 1980, a series of policy reforms towards economic liberalization have been promoted by the Bank under the broad umbrella of SAPs. According to neo-liberal economic theory, the dismantling of domestic barriers to the entry and exit of firms combined with international trade liberalization ensures that scarce resources move to the best industrial sectors, and within those sectors, to the best firms. The free market agenda romanticizes the idea that a human being is ultimately a *Homo economicus*, and goes on to argue that private profit is what drives an individual to deliver his best, both materially and morally.⁶ Accordingly, SAPs mandate that client governments remove both industrial protection and discrimination in their own countries. One side of this argument is that government protection for any particular set of industries will create a “rent”, encouraging firms to move to those industries even when the market rationale for doing so does not exist.⁷ The other side of the argument is that the government must not impose industrial regulations barring firms—both domestic and foreign—from entering or leaving a certain sector if there is a market-

based rationale for doing so. Both aspects of this argument have lately been critiqued within and outside the Bank by people who believe that industrial development will not happen in isolation, and that it requires some degree of proactive planning by the government.⁸

There are two primary arguments within the debate on industrial policy. The first is that the removal of production and trade barriers will spontaneously result in better economic rationality. Indeed, moral justice directs attention to how economic considerations cross paths with the broader social norms and political realities of developing countries. As early as 1944, Karl Polanyi critiqued *laissez faire* economics for naively discounting the reality that the market is just one among many parameters, and is often a function of broader social and political constructions. Other economic sociologists have problematized the inherent roles played by social, political, and spatial hierarchies in the economic modernisation process, and explored the relationship between the formal and the informal as well as between individuals and the collective.⁹ From these, there emerged a strong school calling for the regulation of market forces so to serve humankind as opposed to ruling it.¹⁰ The development economics of the twenty-first century should attend to such overlaps in the constitution of the market and the subjectivities of those who constitute it.

Secondly, even those industry scholars who are reluctant to question the supremacy of market-based economic system have lately come to recognize that the nature and structure of the market do evince features that vary distinctively across societies. For example, Clegg et al have made a case in their comparative studies of Asia and the West that divergent traditional institutions of trust, hierarchies, and collaborations have had a direct bearing on the architectures of entrepreneurship and the market.¹¹ Francis Fukuyama drew on the metaphor of the emblemized eagles to denote among Americans a unique combination of strong individualism with a tendency towards a high degree of spontaneous sociability, and a willingness to remain under the umbrellas of large organizations.¹² The result has been a society which places a strong emphasis on individualism, but which is also capable of instigating a rise of large-scale producers, distributors, and service-providers. Fukuyama contrasted this with the case of Asian societies, especially China and Japan, where people follow different norms of social organization which extend to the differences in the way businesses are organized in these societies. This is consistent with earlier assertions by Charles Sabel that the American adherence to Taylorist mass production might have been more of a historical accident than a destiny worthy of being prescribed globally as the natural path to economic success.¹³

Despite its wide circulation among academics and practitioners working on industrial organization, the socio-economic embeddedness

debate has not gained much ground within the Bank. One contentious attempt was its Social Capital Initiative launched in 1999 under Robert Putnam's leadership, which tried to equate the concept of embeddedness with behaviouralism under an economic banner.¹⁴ This has been widely criticized by anthropologists, sociologists, and economists alike, and the Bank has now distanced itself from the social capital theory.¹⁵ A somewhat rectified effort was its re-engagement with anthropologists and social scientists under another initiative entitled Culture and Public Action.¹⁶ The flagship Bank publication on culture did secure contributions from several leading thinkers, including the Nobel Laureate Amartya Sen, but remained peripheral in the Bank's discourse and operations. Social scientists were somewhat perturbed when a Bank review of culture referred to its contributors, which included such eminent anthropological figures as Arjun Appadurai and Mary Douglas, as "relatively unheard [of] scholars."¹⁷ Douglass North, who has long worked on the nuances of institutions—including their non-rational aspects—seems to have been relatively more effective in the Bank in employing history to argue that formal and informal institutions are equally important in shaping economies. However, his discourse remained confined within the Governance Department of the Bank, which advises its client governments on issues of corruption and ineffectiveness within public administration.¹⁸ In any case, the notion of economic rationality continues to shape the Bank's hegemony, and the dominance of quantitative expression over any other form of scholarly communication remains paramount. With this remains unchanged the fates of Bank social scientists who are confined to working on relatively peripheral sub-sectors within Bank operations, and have limited say on the Bank's core economic policy dialogues and country assistance strategies.

The internal Bank debate on proactive industrial policy revolves around mainstream economists. Among them are Paul Krugman and Anthony Venables, whose work demonstrates how the trajectories of economic competitiveness vary across diverse geographies along with the way economic agglomeration is achieved and trade is conducted.¹⁹ Indeed, the economic geography literature has been crucial for the rise of the infrastructure agenda within the Bank. Its Infrastructure Department has grown to be the largest since its recent reshuffling, and has been renamed the Sustainable Development Department after the consolidation of the social, rural, and environment wings. A recent World Development Report acknowledged that spatial concentration of industrial production has been a consistent economic development phenomenon over several decades, making it necessary for a set of redistributive efforts that aim to spread growth and equalize living standards for those on the peripheries.²⁰ A natural exten-

sion of the infrastructure argument, and one that is more relevant for the industrial policy debate, is the idea of industrial co-ordination, which calls for proactive government strategies that direct, regulate, and facilitate industrial activities on certain geographical locations. The conceptual work on industrial co-ordination has crystallized best in the theory and practice of industrial clusters. Michael Porter defined industrial clusters as “industrial ecosystems” and Charles Sabel considered them “search networks.”²¹ They both called on macro-economists to acknowledge that economics is underpinned by a complex interplay of geographic, socio-cultural and political forces, and that economists must acknowledge the variety of such interplay across societies. It is somewhat ironic that despite being accepted as leading scholars in their own fields, both Porter’s and Sabel’s engagements with the Bank have not gone beyond cursory brainstorming, and their call for interdisciplinary methods has been met with scepticism.

Perhaps most notable among the proponents of industrial policy argument is the renowned Harvard economist Dani Rodrik, who was invited by the Bank to advise its Growth Commission for a reassessment of SAPs. Rodrik built on Nobel Laureate Joseph Stiglitz’s earlier argument that the market supremacy theory abandons the blind alleys of market failures, often attributable to the problems of information asymmetry and the lack of public goods, where the market alone will not trigger firm responses until the minimum requirements of public institutional and physical infrastructure are met.²² The modelling performed by his team, later turned into an interactive database for use by Bank economists, made the case for a stronger public role, especially in achieving export diversification and technology upgrades in developing countries. Enthusiasm for this new discourse fizzled, however, as the Bank management declared at the launch of the Growth Commission report that the advisory committee had re-endorsed SAPs as the economically sound trajectory to growth.

The Bank, the International Finance Corporation, and their Joint Programme on Private Sector Development

The Bank’s early engagement with its client countries on private sector development made a clearer reference to its industrial policy debate than SAPs per se, and this discussion is incomplete without consideration of the role played by the International Finance Corporation (IFC). While the World Bank Group (WBG) in general works directly with its client governments on policymaking, infrastructure, and the institution-building necessary for development, the IFC works exclusively with private

firms to extend credit for necessary development work when the market fails to ensure its availability. The IFC's organizational culture and programmatic model varies from the rest of the WBG in wanting to avoid "bureaucracies," while functioning smoothly with an explicit business motive. Although the IFC manages its operations autonomously, including reporting to the Executive Board independently, it crosses paths with the World Bank to manage joint operations on Private Sector Development (PSD). The Bank's PSD Vice President is also the Chief Economist of the IFC, and the approximately two thousand people under his leadership form a complex apparatus that establishes a link between SAPs' macroeconomic agendas and the micro-issues relating to industrial development. At the outset, this apparatus was divided mainly between two groups: the "investment" practitioners who developed commercially competitive loans, and the "technical assistance" (TA) practitioners who worked with industry leaders and policymakers from developing countries to develop public goods necessary for the private sector to flourish. The two kept their distance as much as possible, although the rhetoric on collaboration and teamwork continued.

Up until the 1980s, the envisaged role of the IFC was to make finance available for sound commercial ventures necessary for development. For example, large firms investing in infrastructure and innovation received loans at commercial interest rates when local markets failed to extend credit. The Bank's operations, on the other hand, identified industry leaders who might be able to set good examples for others, and worked with them to develop infrastructure and institutions that might be necessary but lacking in these countries. They both faced challenges: as firms identified alternative sources of finance, the IFC surmised that the needier of its clients valued its technical assistance over its finance. As the Bank became more cognizant of the complexities involved in the industrialization process, it became increasingly critical of the idea of "picking winners." The result was PSD's closer collaboration with the economic policy wing of the Bank, or the Poverty Reduction and Economic Management Network (PREM). This resulted in a shift of focus from entrepreneurial engagement to working primarily with governments on economic policies.

This was the context in which the IFC launched a number of "enterprise development facilities," later to be known as project development facilities (PDFs), which would provide technical assistance and advisory services to small- and medium-scale enterprises (SMEs). Conceptually, it was agreed that market failures can provide a rationale for supplying subsidized resources to SMEs in developing countries. Programmatically, the IFC argued that SMEs account for the bulk of private sector employment

in frontier markets, and that proactive support for SMEs can help them develop the scale and sophistication necessary for independently seeking IFC investment support. Operationally, IFC's donors were more willing to fund facilities that were directly based in the field, especially if they were sufficiently accommodating of the programmatic priorities set by donors. The result was a cluster of field-based PDFs, which were relatively autonomous from the mainstream operations of the IFC. The PDFs were recognized as "multi-donor facilities managed by the IFC," and they marked a departure from the traditional model of donor-funded projects. Sometimes casually referred to among IFC staff as the "Intel-inside" model, PDFs took more detailed guidance from their donors than the earlier donor-funded projects did, welcomed donor interventions at all phases of project cycles, and were prepared to offer detailed progress reports in the formats required by donors, especially when the donors had field-based offices and were both familiar and interested in local details.²³ Under the PDF model, the donors would also receive greater publicity and readier acknowledgement of their support during the implementation of the project, not to mention the listing of their logos in workshop banners as well as invitations for direct participation in stakeholder consultations. Thus, the PDF model was seen as, among others, a closer collaboration with the donors as well as a more genuine drive on decentralization towards the "field" than earlier donor-funded projects run by the IFC.

The first PDF to be established was the Southeast Europe Enterprise Development Facility (SEED) that lasted between 1995 and 2001. The second was established in Mekong in 1997. The third was established in Africa in 1999 and the last in South Asia in 2002. An SME Department was created within the IFC in March 2000 to oversee these facilities. Under its guidance, newer facilities with revised models replaced old PDFs, giving continuity to the work.²⁴ By 2003 the number of facilities had reached twelve, into which the IFC and its donors had invested just under half a billion US dollars. In principle, the field-based nature of these PDFs allowed more opportunities for closer interactions with the governments and private sector actors in their host countries, but in practice, they remained a top-down bureaucracy—a point I will return to while discussing PDF restructuring.

While each facility was free to develop its own programmatic focus and take on a series of projects it felt necessary for enterprise development in their part of the world, they were guided by the overall focus of the IFC's SME Department and its donors. Although the work of each facility varied from others, the overall functions they took on can be grouped into four categories. The largest was the facilities' provision of firm-level services designed to help entrepreneurs develop business plans

for seeking external investment, undertake organizational restructuring for efficiency, and support technological upgrades. Second, they offered vocational training to local service providers and workers. Third, they helped build the capacities of business associations for any joint action in advocating for public goods necessary for business. Fourth, they worked with governments to develop a business-enabling environment through legal and regulatory reforms. In addition, some of the facilities pursued programmes such as industrial cluster development, business linkages to IFC's investment projects, and export promotion.

The Rise of Industrial Benchmarking

If the IFC's emerging work on SME development and the Bank's declining work on industry support can be traced to the industrial policy debate, then the rise of the joint Bank-IFC work on benchmarking industrial and regulatory indicators across developing countries can be seen as a renewal of the SAP agenda. The unfolding of the industry agenda inevitably renegotiated and reproduced the earlier organizational hierarchies within the Bank. The IFC remained in charge of SME development, while the PREM and PSD specialists in the Bank launched a new set of benchmark indicators on infrastructure and institutions deemed necessary for enterprise development. Initially called the Investment Climate Assessment (ICA) and later renamed the Enterprise Survey (ES), this initiative documented firms' perceptions of what their biggest public good hurdles in pursuing private business in their respective countries were. The initiative went on to compile a comprehensive database of more than 180 countries, spanning over a decade. In terms of developing the idea and legitimizing it, the ICAs (or ESs) took more or less the same trajectory as most other Bank knowledge products had earlier done. These were conceived by economic scholars housed in the Development Research Group (DEC), the knowledge centre of the Bank. Once their quantitative rigour in economic analytics was deemed adequate, the ideas were then passed on to the Bank task team leaders in the PSD and PREM for turning into operations. Even though some of their client countries were consulted throughout this process, and it is possible that some industry leaders may have participated in those consultations, the quality control was essentially performed by the Bank's DEC-based researchers.

The knowledge agenda, which deviated from this norm, and which still achieved significant prominence among the client country policy-makers and practitioners despite being criticized by the DEC scholars, was the “Doing Business” initiative. It was launched around the same time as the ICA, and was intended to be a complement to it. The idea behind Doing Business was that it would benchmark developing countries on the ease of their regulatory regimes. It argued that the regulatory hurdles placed on the various stages of a business’ life are what determine how vibrant a country’s entrepreneurial scene will be. It then argued that removing these hurdles at the grassroots level would trigger industry development without having to resort to the “market-distorting” initiatives impinging on publicly-driven, or donor-funded, enterprise development support. This initiative had little involvement from DEC scholars. Instead, it was nurtured by IFC officials working on technical assistance, who, based on their experiences of extending the Bank and IFC credits in the newly emerging markets of the former USSR countries, took the regulatory simplification of doing business procedures to be key to its industrial agenda.

Doing Business assesses economies on ten key indicators relating to the time and costs incurred by firms to start and end a business, pay taxes and get credits, enforce contracts, employ workers, trade across borders, and deal with business permits. It deliberately leaves out more complex issues of infrastructure and institutions, security, transparency or macroeconomic conditions, where the public sector retains a crucial and proactive role. Data is generated not through a representative sample survey but by interviewing a small number of limited liability companies, mostly law firms, operating in the largest city of a given nation. Methodologically, this was justified on the grounds that the research was primarily intended to measure *de jure* laws and regulations. In terms of its implementation, Doing Business was meant to match the smooth and sleek working style of the private sector, and to demonstrate that research could be produced and disseminated through a small and disciplined team of dedicated workers. The methodology of Doing Business remains contentious within the Bank, but this aside, its success is reflected in the fact that these reports have risen to become the most widely read Bank publication around the world, generating large business for the Bank on reforms related to promoting business-enabling environments. Doing Business was considered a significant departure from the earlier trend of the Bank’s knowledge agenda being led and dominated by the DEC.

Organizational Restructuring and a Return to the Status Quo

Following the new direction set by the rise of the benchmark indicators, the IFC's project development facilities (PDFs) on technical assistance to SMEs underwent a major reorganization in the mid-2000s. This was bound to have important implications for the overall structure of the Bank in the near future. Was this restructuring a departure for the Bank Group's industry agenda? What implications was this restructuring to have for the relationship between the Bank and the IFC? More importantly, what does this restructuring say about the future direction both institutions could take towards decentralization and deepening engagement with "the field"?

In 2004, it was decided that all twelve of the PDFs in the field would no longer be supervised by the IFC's SME Department in the headquarters, but integrated into its regional investment operations. This organizational restructuring was deemed necessary for the facilities to be mainstreamed into the IFC's core operations, and the merger was considered a step towards deepening the IFC's decentralization drive. However, talk about the difference in "culture" was increasingly circulated following this merger, and IFC managers acknowledged the need to bridge the gap between the two cultures for this merger to work. It was said of the "investment" practitioners, who developed commercial deals for the IFC's mainstream operations, that they were largely MBAs or finance specialists and had "corporate mind-sets." In contrast, those who worked on donor-subsidized programmes for SMEs within the "technical assistance" wing were development workers with public policy degrees and often came from NGO or activist backgrounds. Their respective client-side constituencies differed fundamentally too. While the former dealt with astute business people capable of negotiating business deals with the IFC as equal partners, the latter dealt with clients who owned small or medium-sized businesses and looked up to them for guidance and support. While the former invested from the core IFC funds, and were obliged to strictly follow the corporate standards on business ethics, the latter generated its funds from multiple donors who may have had varied business standards and different programmatic preferences.

Larger differences emerged on how investment and TA practitioners defined "effectiveness." Investment projects were deemed effective if they met investment targets and repayment schedules, whereas the TA projects were more concerned about the quality of the entrepreneurship generated through their engagement. The Development Effectiveness

team responsible for the monitoring of investment projects criticized PDF projects, much to the disappointment of both sides. Within the IFC, the PDFs were regarded as fringe operations with a smaller number of employees, and it was generally expected that they should adapt to the IFC core culture on investment. At a higher level, however, PDFs had been set up to further the industry debate in the context of SAPs, and hence an emphasis was put on the PDFs to take a broader view on effectiveness. What was agreed in the end was that the Investment-TA merger was not to be underestimated, and that it required concentrated efforts at all levels to bridge the inherent gap between the two. The PDFs were then put under an “independent evaluation” within the Bank.

The task of reducing cultural differences between the investment and TA groups was initially assigned to the SME Department of the IFC specially after releasing it from the role of a direct supervisor. Following what was called a “dotted line” relationship with the PDFs, the SME Department sought to implement some of the recommendations that came from its evaluation. One of the key recommendations was that the IFC should take advantage of the opportunities that may have emerged from the Investment-TA merger to improve the facilities’ systems and processes for project selection, planning, monitoring, and evaluation as well as for management of information, including internal control and reporting. Following this, the SME Department developed new management information software, called Technical Assistance and Analytical Services (TAAS). TAAS was fully compatible with the management software used for IFC investments but it added provisions to specifically capture TA-specific considerations. More so than developing the software, the larger challenge for the SME Department was to ensure that the facilities in the field used it appropriately. This required several rounds of staff training as well as setting up a dedicated help desk. Additionally, this required careful negotiations with the PDF donors who could no longer expect tailor-made progress reports to be sent directly to them, but now had to learn to read IFC’s monitoring reports. Further challenges lay in ensuring that PDFs now adhered to IFC corporate standards on business ethics, environment and gender, which had earlier been mainstreamed into its investment operations but not into TA activities. Again, the donors had to be brought on board so that they agreed to accept IFC standards in those rare cases that they conflicted with their own.

Another recommendation was for the SME Department to take a more active role in encouraging cross-facility collaboration and knowledge sharing with the wider World Bank Group. Earlier collaboration initiatives had come from the PDFs, but now the SME Department took an active interest in it. Furthermore, the SME Department launched a

knowledge initiative that disseminated successes and failures of the PDF operations to the wider IFC and Bank communities. In contrast to the Bank's Knowledge Events, which usually brought leading scholars and policymakers from around the world together to ponder a certain policy question, the IFC took a decidedly different approach that favoured precision, timeliness and style over analytical rigour or theoretical depth. For example, one of its early initiatives was called the "SME Idol," as part of which, staff from the facilities were invited to write short and crisp notes on the lessons learnt from their own projects. These notes were then circulated among peers for consumption and feedback, following the popular British and American television shows that select musical talents through popular votes. The second in the series was called "IFC Smart Lessons," which again saw long project narratives being condensed into briefs that highlighted relevant project lessons aimed at a business audience. Eventually, these began to form a different genre of knowledge within the Bank.

What the independent evaluation did not spell out clearly but had to be read between the lines, and which remained a point of contention within the World Bank Group, was the conflicting voices emerging from the field on policy and institutional reforms required in its client countries. I have already talked about the ongoing struggle between the macro-economic diagnostics undertaken by PREM economists, which called for structural economic reforms for overall growth, and the Doing Business studies undertaken by PSD specialists, which called for regulatory reforms for improving the business-enabling environment (BEE). The facilities added to the complexity by bringing in a third voice: business associations from client countries. Through its capacity-building programmes, the facilities had mobilized business associations to seek joint action on policy and regulatory reforms deemed necessary for their businesses. Although it was expected that business associations' demands would be consistent with the analytics of both PREM and Doing Business studies, in practice they often were not. The independent evaluation emphasized the need for consistency. It pointed out that "since the facilities cannot control the views expressed by business associations they support, the IFC should in each case ... consider whether it is willing to bear the reputational risk of a facility-supported association's calling for government actions that would run counter to WBG views on appropriate economic policies."²⁵ It may then be more than just a coincidence that the restructuring of the PDFs in the late 2000s especially targeted its work on both capacity-building and BEE.

In a massive restructuring of the South Asia Enterprise Development Facility (SEDF) undertaken between 2006 and 2008, for example, pro-

grammes on BEE dramatically changed hands and styles. As part of the reform, the team initially moved its focus away from regulatory reforms towards gender and the environment. Its new business strategy recommended the withdrawal of support to women's business associations and sought alternative ways of engaging with women entrepreneurs, primarily along the lines of corporate social responsibility—a new trend of the time. Similarly, its new environmental strategy brought all of SEDF's projects under core IFC environmental auditing. The most contentious part of the reforms was arguably the creation of a sub-facility, the Bangladesh Investment Climate Facility (BICF), which took over most of the BEE-related work earlier overseen by SEDF. Most of the staff and consultants from the SEDF's BEE department were retrenched, including the programme manager, while a new team was brought on board to implement the new strategy on regulatory reform. A number of SEDF's projects faced rushed conclusions and even withdrawal while others were abruptly revised, but very little resistance was registered from its local partners to a restructuring of this scale. Even though the SEDF was supposed to have been working closely with its local counterparts, they remained outsiders to the intensive discussions that eventually finalized the changes to the organization.

The withdrawal of the term “BEE” and the rise of a virtually synonymous term “investment climate” became the vehicle through which this institutional restructuring was completed. The major effect of this restructuring was that the new team began to take its directions from the Doing Business studies.²⁶ While distancing itself from “free-style” engagement with businessmen and their associations on the ground, BICF developed new platforms for public-private dialogue which sought to implement the recommendations of the Doing Business studies, and in so doing, sought closer collaborations with the Bank's PSD wing.

Conclusion

This case of internal Bank and IFC restructuring challenges simple notions about the coherence of the Bank's neo-liberal agenda, as well as the developmental claims made of it. It suggests a complex dynamic of a causal triangle between the neo-liberal agenda's conceptual foundation, an acknowledgement of—and resistance to—the need to change, and Bank internal politics that triggered renegotiation and reconstruction in charting organizational trajectories for its PSD operations. Only a positive interaction between all three dimensions is likely to make a firm directional change. In fact, the potential for change in organizational

direction depends not only on the rise of new concepts and projects, but also on their interaction with the overall organizational structure. Crozier pointed out as early as 1964 that crises are essential for organizational functioning, and that it is not the continuity but the disjuncture that defines the long-term course of an organization.²⁷ Putting on this lens, it is difficult to think of the Bank's trajectory on industrial development as either unique or as a calamity at any level.

Nevertheless, this was a major organizational restructuring involving its industry agenda, which is at the heart of what the Bank preaches. With a weak vision and limited institutional insights, PDFs within the Bank seemed orphaned, and came under attack both from DEC scholars, who were wary of any concepts critical of neo-liberal economics—let alone concepts that lacked rigorous analytical foundations—as well as from “investment” practitioners, who were not used to dealing with the messiness of development. With strong institutional mobilization—that is, with ideational contents backed by managerial blessings that availed implementing mechanisms—the Doing Business initiative was able to challenge the hegemony of macro-economists within the Bank. However, it still needed to demonstrate its alignment with SAPs. Any restructuring could lead to internal struggles within the World Bank Group, depending on the broader organizational direction within which the restructuring must fit. The outcomes of such struggles depend on the nature and strength of conceptual founding, the astuteness of organizational handling, and the opportunities available within limited timespans. They can lead to directional change, counter-hegemony, or a reversal.

Organizational restructurings need to negotiate trade-offs that are both necessary and inevitable for their completion and for acquiring meanings. To the extent that the World Bank Group considers itself a “knowledge bank,” it must problematize the changing landscapes and timescapes in the countries where they claim to help development and, if necessary, reassess the conceptual foundation they work under. Developmental designs are contingent upon the rigour of both markets and public institutions, but above all, the way people insert themselves into these systems and put them to work. The WBG's dismissal of socio-economic embeddedness in this regard is regrettable, while its chosen course for engagement with the proactive industrial policy debate seems virtually biased. A large problem remains its unquestioning submission to neo-classical economic doctrines and methodologies, which have muffled other sound theories and weakened the Bank's claim to be the “knowledge bank.” The result, as in the case I discuss, is the rise of conceptually weak PDFs set up in far-flung countries under donor support and direction but with little corporate ownership from the WBG itself. While

the facilities served the WBG well—both in scoping out client country appetites for proactive industrial support, as well as in functioning as the guinea pigs for the IFC’s decentralization drive that was to follow soon after—their real developmental contributions remained questionable both before and after their merger with the IFC’s mainstream investment operations. Although the SME Department sought to capture the lessons learnt from the PDF operations, this was patchy and agenda-driven.

The soundness of any technical support will depend on the social and political context, and a holistic solution to the developmental problems of countries involves institutional transformation from within. Local transformation depends upon an unbiased process of incremental restructuring of local power equations. Effective development support presupposes conditions most likely to be found in local institutions, and initiates local engagement in a democratic manner. The PDF’s decision to abruptly end its engagement with local stakeholders and create a new apparatus that resembled the old one, as opposed to revising the design of the engagement so that the perceived and stated shortcomings of the programme were overcome through open consultation and insightful retrospection, was operationally short sighted. Moreover, the notion that such a decision was undertaken because of the perceived conflict between the voices from the ground and the “findings” of the Doing Business studies that were in no way representational, makes it a conceptually thorny issue. Indeed, there seemed to be little resistance on the ground to such an abrupt change of direction. This gives us clues as to how engaging the PDFs’ capacity building programmes were in the first place. The relative ease with which the facilities were brought under IFC mainstream operations—virtually without any criticism from its field stakeholders—may hint at their developmental shortcomings.

This paper has been conceived as a reminder that the world of development, including industrial development, cannot be easily captured in the problematic concepts of neo-classical economics, nor can they be achieved through rigid bureaucratic functions. I believe that continuing to analyse the circumstances and motives behind the actions a developmental organization chooses at a given time and in a certain context is a worthwhile endeavour for institutionalists concerned with global economic governance. ■

Notes

¹ I am grateful to Keith Hart at University of Kwa-Zulu Natal for comments on an earlier draft. The public debate organized by Oxford Forum for International Development shaped ideas in this paper.

² Walt Whitman Rostow, *The Stages of Economic Growth: A Non-communist Manifesto* (Boston: Cambridge University Press, 1960).

³ John Williamson, "What Washington Means by Policy Reform," in *Latin American Readjustment: How Much Has Happened?* ed. John Williamson (Washington, DC: Institute for International Economics, 1989).

⁴ Yi-chong Xu and Patrick Weller, *Inside the World Bank: Exploding the Myth of the Monolithic Bank* (New York: Palgrave Macmillan, 2009); Diane L. Stone and Christopher Wright, *The World Bank and Governance: A Decade of Reform and Reaction* (London: Routledge, 2006); Graham Harrison, *The World Bank and Africa: The Construction of the Governance States* (London: Routledge, 2004).

⁵ Howard Stein, *Beyond the World Bank Agenda: An Institutional Approach to Development* (Chicago: University of Chicago Press, 2008).

⁶ Adam Smith's notion of the "invisible hand" maintains that individual profit maximization is ultimately beneficial for the society as a whole.

⁷ Anne O. Krueger, "The Political Economy of the Rent-seeking Society," *American Economic Review* 64, no. 3 (1974): 291–303.

⁸ Karl Polanyi famously said about Adam Smith's notion of unregulated free market, that "laissez faire was planned ... planning was not." See Karl Polanyi, *The Great Transformation* (Boston: Beacon Press, 1944), 141.

⁹ Mark Granovetter and Richard Swedberg, eds., *The Sociology of Economic Life* (Boulder: Westview Press, 1992); Keith Hart, *The Political Economy of West African Agriculture* (Cambridge: Cambridge University Press, 1982).

¹⁰ Keith Hart, Jean-Louis Laville, and Antonio D. Cattani, *Human Economy* (Cambridge: Polity Press, 2010).

¹¹ Stewart R. Clegg, Gordon S. Redding, and Monica Carte, eds., *Capitalism in Contrasting Cultures* (Berlin: Walter de Gruyter, 1990).

¹² Y. Francis Fukuyama, *Trust: The Social Virtues and the Creation of Prosperity* (London: Hamish Hamilton, 1995).

¹³ Charles F. Sabel, *Work and Politics: The Division of Labour in Industry* (Cambridge: Cambridge University Press, 1982).

¹⁴ Robert D. Putnam, Robert Leonardi, and Raffaella Y. Nanetti, *Making Democracy Work: Civic Traditions in Modern Italy* (Princeton, NJ: Princeton University Press, 1993); Partha Dasgupta and Ismail Serageldin, eds., *Social Capital: A Multifaceted Perspective* (Washington, DC: World Bank, 2000).

¹⁵ John Harriss, *Depoliticizing Development: The World Bank and Social Capital* (New Delhi: Leftword, 2001).

¹⁶ Vijayendra Rao and Michael Walton, eds., *Culture and Public Action* (Stanford, CA: Stanford University Press, 2004).

¹⁷ Author's personal communication.

¹⁸ Douglass C. North, John J. Wallis, John, Steven B. Webb, and Barry R. Weingast, *Limited Access Orders in the Developing World: A New Approach to the Problems of Development* (Washington, DC: World Bank Policy Research Working Paper Series 4359, 2007).

¹⁹ Masahisa Fujita, Paul Krugman, and Anthony J. Venables, *The Spatial Economy: Cities, Regions, and International Trade* (Cambridge, MA: MIT Press, 1999).

²⁰ World Bank, *World Development Report: Reshaping Economic Geography* (Washington, DC: World Bank Publications, 2009).

²¹ Michael E. Porter, Christian Ketels, and Mercedes Delgado, "The Microeconomic Foundations of Prosperity: Findings from the Business Competitiveness Index," in *Global Competitiveness Report 2007–2008*, ed. Klaus Schwab (Davos: World Economic Forum, 2007), 51–81; Charles F. Sabel, Eduardo Fernandez-Arias, Ricardo Hausmann, Andres Rodriguez-Clare, Ernesto Hugo Stein, eds., *Self-discovery as a Coordination Problem: Lessons from a Study of New Exports in Latin America* (Washington, DC: Inter-American Development Bank Working Papers, 2010).

²² World Bank, *The Growth Report: Strategies for Sustained Growth and Inclusive Development* (Washington, DC: World Bank Commission on Growth and Development, 2008).

²³ In the case of South Asia, for example, one of its donors—the UK Department for International Development (DFID)—shared the office building with the PDF, and was much more involved in the PDF's project selection and implementation compared to IFC headquarters back in Washington, DC.

²⁴ Private Enterprise Partnership (PEP) models, for example, developed larger in-house capacity to deliver technical assistance than the earlier PDF models, which often hired consultants for the technical tasks. Not only this, the PEPs sought prior agreements with donors for the overall programme duration, whereas the earlier PDFs had kept room open for renegotiations and periodic guidance throughout the life of the facility.

²⁵ World Bank. *Independent Evaluation Group's Comprehensive Review of IFC Project Development Facilities* (Washington, DC: World Bank, 2005).

²⁶ Measures were, however, taken in Washington, DC, to ensure that the team which undertook Doing Business analytics remained independent from the team that led policy dialogues with client countries on regulatory reforms as highlighted in the DB analytics.

²⁷ Michel Crozier, *The Bureaucratic Phenomenon: An Examination of Bureaucracy in Modern Organizations and its Cultural Setting in France* (Chicago: University of Chicago Press, 1964).

The Global Financial Crisis and the Reforms to IMF Lending

MANUELA MOSCHELLA

ABSTRACT

The global financial crisis of 2007–09 has spurred a number of reforms to the International Monetary Fund's (IMF) lending toolkit, including the use of *ex ante* conditionality to make crisis prevention instruments available to member countries. These reforms have led to the creation of new credit lines and the enhancement of High-Access Precautionary Arrangements (HAPAs) in Stand-By Arrangements (SBA). By analyzing the changes to IMF lending, the paper pursues a twofold objective. On the one hand, the analysis assesses the extent of change brought about by the most recent reforms. In other words, the paper attempts to assess what is truly new among the Fund's recent reforms. On the other hand, the paper speculates on the implications of these reforms to the IMF's role as a lender of last resort.

Introduction

There have been tremendous changes in the IMF's role as a financial intermediary as a result of the global financial crisis of 2007–09. After many years of declining loans to its members and serious cuts to its budget, IMF resources were tripled to meet the organization's growing lending commitments.¹ Furthermore, important changes were made to the Fund's lending facilities. In particular, the Fund streamlined the conditionality attached to its lending programmes and created new instruments through which to disburse its financial assistance for crisis prevention purposes. These new instruments include the Flexible Credit Line (FCL) and the Precautionary Credit Line (PCL) for countries with a good track record. The focus on crisis prevention also led to the enhancement of High-Access Precautionary Arrangements (HAPAs) in Stand-By Arrangements (SBAs). In short, the Fund has significantly reformed the way in which it provides financial assistance to its members by making its lending programmes more flexible and tailored to both crisis management and crisis prevention circumstances.

Manuela Moschella, "The Global Financial Crisis and the Reforms to IMF Lending," *St Antony's International Review* 7, no. 1 (2011): 48–60

But just how profound are these changes in IMF lending? Are we simply witnessing a period of relatively rapid evolution with adjustments only at the margins, or are we in fact witnessing a profound transformation in IMF lending? This paper answers this question by analyzing the changes to the Fund's lending facilities as adopted after the onset of the crisis. In particular, the paper reviews the transformations to HAPA, the traditional instrument through which the Fund provides financial assistance to its members, and the workings of the newly created credit lines, the FCL and the PCL. Based on such analysis, this paper argues that the changes to IMF lending do not constitute a revolutionary innovation in terms of the goals that the new instruments are meant to pursue. That is, similar to the Contingent Credit Line (CCL) created at the end of the 1990s, HAPAs, the FCL, and PCL pursue the goal of crisis prevention. Nevertheless, the recent transformations in IMF lending policies represent a significant transformation of past practices, if they are analyzed in terms of the modalities through which crisis prevention assistance is disbursed. Indeed, the changes to the IMF lending toolkit have introduced important innovations regarding the transparency through which member countries qualify for assistance and the procedures for quick disbursement.

Although it is too soon to judge how the new facilities will operate, the analysis of the changes to IMF lending as a response to the latest financial crisis will also provide insight into the implications for the Fund's role as a global lender of last resort.² Indeed, the reforms to the Fund's lending have been allegedly adopted in order to allow the IMF to tackle large and potential liquidity shortages that can be derived from market turbulence, thereby addressing many of the criticisms that had been levelled at the Fund's lending over the past decades.³ The analysis conducted in this paper, therefore, aims to reflect on the extent to which the recent reforms have achieved—or have the potential to achieve—the purported goals of rendering the Fund an efficient and legitimate provider of financial assistance to its members.

Before proceeding, three caveats are in order. First, the changes analyzed in this paper do not exhaust the list of changes adopted by the Fund in response to the 2007–09 global financial crisis. In particular, the crisis has spurred an intensive in-house reflection on the Fund's mandate and future role in the global monetary system.⁴ The IMF has also started reassessing some of the tenets of its macroeconomic doctrine, including its position on the use of capital controls.⁵ Although the overall process of transformation of the Fund's role deserves serious attention, this paper solely focuses on the changes to IMF lending. In other words, the paper reviews the main transformation in the instruments through which the

Fund provides financial assistance to its members.⁶ Second, the paper solely focuses on the reforms to the Fund's non-concessional assistance, bracketing the analysis of reforms to lending facilities for low-income countries that borrow from the Fund on concessional terms. Finally, the paper does not provide a critical assessment of the new IMF lending on the ground, and it does not deal with important questions regarding the relationship between the IMF and its borrowers. More narrowly, the objective of the paper is that of tracing current transformations and investigating their magnitude.

This paper develops the argument in three steps. Section one describes the key features of IMF lending and provides a brief historical overview of its evolution. Section two focuses on the response to the global financial crisis of 2007–09. In particular, I analyze the changes to the Fund's conditionality and the content of the newly created credit lines. Section three assesses the extent of the change in IMF lending and reflects on the political implications of the lending reforms.

IMF Lending

Amongst the activities the IMF performs, the provision of financial assistance to its members is probably what the IMF is most well-known for.⁷ Indeed, "about four out of five member countries have used IMF credit at least once."⁸ According to its Articles of Agreement, designed at the end of the Second World War, the Fund provides financial assistance upon request of a member that faces a severe disequilibrium in its balance of payments. Specifically, the Articles of Agreement read that one of the key purposes of the IMF is "to give confidence to members by making the Fund's resources temporarily available to them under adequate safeguards, thus providing them with opportunity to correct maladjustments in their balance of payments without resorting to measures destructive of national or international prosperity" (Article I [v]). In other words, IMF loans are meant to help member countries tackle balance of payments problems, thereby stabilizing their economies and restoring the prospects of economic growth at both the domestic and international levels. In order to address the problems arising from disequilibria in the balance of payments, the Articles of Agreement (specifically, Article v, Section 3(a)) charge the Fund with developing policies on the use of its general resources. In other words, the organization, through its decision-making process, defines the content of the rules that guide the provision of its financial assistance. Over the decades, the Fund has thereby developed

principles and policies on the use of Fund resources directed at meeting the needs of members with balance of payments problems.

Two features characterize IMF lending policy since its creation. First, IMF assistance is not automatic but is available upon request. Indeed, the cycle of a lending program starts with a Letter of Intent from the country that requests IMF financial assistance. Second, IMF assistance is conditional upon the recipient country's implementation of a number of agreed economic reforms.⁹ Indeed, the Fund is precluded from making its general resources available in the absence of conditionality, that is to say, the absence of assurances that the resources will be used to resolve the member's balance of payments problem, and that the member will be in a position to repay the Fund in accordance with the relevant maturity schedule. As a result, once a Letter of Intent has been received, a team of IMF staff members visit the country in order to consult with national authorities and to diagnose the causes of the balance of payment problems and estimate the amount of financial assistance required to address it. Following these consultations, IMF staff teams prepare a report wherein a number of corrective measures are proposed. This report becomes the basis of the adjustment programmes that the country commits to respect in order to receive the IMF's assistance.¹⁰ The program usually includes highly specified performance criteria that vary across countries because of the diversity of problems and institutional arrangements of members. For instance, although performance criteria have normally been confined to macroeconomic variables, including monetary and credit targets, over time conditionality has also been extended to structural variables.¹¹ For instance, the IMF has encouraged countries to adopt corrective measures in the area of labour and financial markets. Moreover, compliance with performance criteria is closely monitored during the life of a lending program. Resources are usually disbursed in tranches, once the IMF staff's assessment as to the degree of implementation approved by the Executive Board, which is the primary decision-making body of the Fund.

Over time, the Fund has developed various facilities through which to provide financial assistance to its members. In particular, as new challenges have emerged in the international economic system, the Fund has developed facilities with the aim of helping its members cope with new problems, which in turn helps to justify its existence. For instance, in the 1970s, the Fund created Oil Facilities in response to the rise in oil prices in order to help oil importers deal with anticipated current account deficits and inflation. The Extended Fund Facility, in turn, has been created for countries with structural problems requiring a lengthier

time of assistance than the one necessary for addressing short-term balance of payments problems.¹²

Along with these ad hoc facilities, the traditional instrument through which the Fund ‘gives confidence’ to its members is the SBA, created in June 1952. Under the SBA framework, all member countries that face external balancing needs are eligible for the Fund’s assistance, subject to conditionality. The length of an SBA typically spans a period of 12–24 months, but does not last more than 36 months. The limited duration of the SBA is meant to ensure that resources are used to address short-term balance of payments problems. Before the global financial crisis of 2007–09, normal access to the SBA was up to 100 per cent of quota for any 12-month period, and 300 per cent of total credit outstanding. In addition to normal access, however, the SBA framework also entails both exceptional access, under which the IMF can lend amounts above normal limits on a case-by-case basis, and rapid access, which enables rapid approval of IMF lending.

As this brief overview has revealed, experimentation with the instruments of IMF lending has been continuous over the decades and has continued to evolve in an interesting manner after the most recent global financial crisis.

IMF Lending in the Aftermath of the Global Financial Crisis of 2007–09

Even before the global financial crisis of 2007–09, the IMF’s role as a financial intermediary had been significantly challenged. Most of its borrowers had repaid their debt and new loans were not significantly large, putting the Fund’s operating budget under pressure.¹³ Expressed in Special Drawing Rights (SDRs, the IMF’s unit of account), the IMF’s income from loan interest and charges dropped significantly from an annual average of over SDR 2 billion between 1998 and 2005 to a mere SDR 484 million in 2007.¹⁴ In this atmosphere, the Fund even considered new modalities through which to finance its operations, including through the use of the Fund’s gold reserves.¹⁵

The eruption of the global financial crisis helped revitalize the Fund’s financial assistance role. IMF lending, which had decreased to about \$10 billion in September 2008, at the end of the first year of the financial crisis, subsequently expanded to more than \$200 billion.¹⁶ This was accompanied by a substantial increase in the IMF’s resources. In April 2009, the leaders of the Group of Twenty (G20) agreed to increase the resources available to the IMF in order to channel capital to

emerging market countries. In particular, leaders pledged to increase the Fund's resources from \$500 billion to \$750 billion, while supporting the issuance of \$250 billion with SDRs, to ease liquidity in emerging and developing economies.¹⁷ In July 2009, the Fund announced it would increase lending to low-income countries to help contend with the global economic crisis. In particular, the IMF is expected to provide up to \$17 billion to these countries through 2014.¹⁸ Along with the increase in the use of its resources, IMF lending has been transformed in a number of other respects. Since early 2009, the Board reformed the conditions for access to SBAs and created new credit facilities. In what follows, I analyze each of these changes to the IMF's lending toolkit in turn. First, one of the earlier reforms to the Fund's financial assistance adopted as a response to the latest crisis was the reform of the SBAs. In particular, access limits to Fund resources under the SBA were doubled to give countries access to up to 200 per cent of quota for any 12-month period, and 600 per cent of total credit outstanding. Still, the new SBA framework provided increased flexibility to front-load funds that were warranted by the strength of the country's policies and the nature of its financing needs.

In addition to revising access limits, the recent changes to the SBA framework also entailed a change in conditionality. In particular, conditionality has been simplified by scrapping structural performance criteria in favour of greater reliance on program reviews and *ex ante* policy measures. In particular, structural reforms will from now on be monitored in the context of programme reviews, rather than through the use of structural performance criteria. Finally, another important change to the SBA framework has been the addition of a precautionary credit line. That is to say, countries can count on High-Access Precautionary SBAs (HAPAs) when they do not intend to draw on approved amounts, but retain the option to do so should they need it. Three HAPAs, with Costa Rica, El Salvador, and Guatemala, were approved during the crisis.

Second, the Fund established two new credit lines: FCL to provide large and upfront financing to members with very strong fundamentals and policies and the PCL for countries with sound policies and good track records, but with some vulnerabilities. In order to understand how the new facilities work, in what follows, I review some of their design features including the qualification process, access limits, and conditionality.

The Fund engages in qualification assessment only upon request from a member. In other words, the Fund does not engage in pre-qualification, but the staff and the Board decide upon request of the member seeking the Fund's support. The Fund will decide on the eligibility of member countries' access to the FCL based on nine criteria, including

the presence of a sustainable external position, a capital account position dominated by private flows, a track record of access to international capital markets on favourable terms, a reserve position that is relatively comfortable when the FCL is requested on a precautionary basis, and low and stable inflation. Furthermore, qualifying for access to the FCL requires sound public finances, including a sustainable public debt position, sound banking systems, and effective financial sector supervision. Data integrity and transparency also figure in the criteria used for the qualification process.¹⁹ The qualification process for the PCL is based on an assessment of the actual balance of payments needed at the time of the arrangement's approval. In the qualification process, IMF staff members are expected to verify that the country has sound economic fundamentals and policy frameworks, a track record of implementing sound policies, and remains committed to maintaining such policies in the future.²⁰ Interestingly, the Fund has also established a criterion that excludes some members from qualification to the PCL. In particular, "countries suffering any of the following problems at approval cannot access the PCL: (i) sustained inability to access international capital markets; (ii) the need to undertake large macroeconomic or structural policy adjustment; (iii) a public debt position that is not sustainable in the medium term with a high probability; or (iv) widespread bank insolvencies."²¹

The original design of the FCL prescribed a duration of one year with a six-month interim review and an implicit cap on access to IMF resources of 1000 per cent of quota. Furthermore, the FCL provides for repayment terms that range from 3¼ to 5 years without renewal restrictions.²² As with other non-concessional IMF facilities, the cost of drawing under the FCL varies with the scale and duration of lending—i.e. large and prolonged use of IMF resources are subject to the highest surcharges. In the summer of 2010, the Fund revised the access limits to the FCL.²³ In particular, the duration of the credit line has been lengthened to two years with a review after twelve months. One-year arrangements remain available, but no longer require a six-month interim review to preserve access to the credit line. The implicit cap on access of the 1000 per cent of quota also has been removed. In short, the reforms to the FCL allowed for the doubling of the duration of the arrangements to two years and the removing of the implicit cap on access.

Conditionality also deserves special attention in the analyses of the FCL and PCL. Indeed, as already mentioned, the Fund is precluded from making its general resources available in the absence of assurances that the resources will be used to resolve the member's balance of payments problem, and that the member will be in a position to repay the Fund. Interestingly, however, a key feature of the FCL is the absence of condi-

tionality. On this point, the FCL differs significantly from the traditional IMF assistance because, once approved, assistance under the FCL can be fully disbursed when the need arises rather than being conditioned on compliance with policy targets as in traditional IMF-supported programs. The lack of conditionality can be explained in terms of the qualification process detailed above. As access to the FCL is restricted to those members that meet strict qualification criteria, drawings under it are not tied to policy goals agreed with the country. Hence, the necessary assurances that the Fund's resources will be used to resolve the member's problems and that the member will be able to repay the Fund are mainly obtained through an examination of the relevant member's policies implemented in the period preceding the approval of the arrangement, and through reliance on qualification criteria that give confidence in its future policies.

In contrast to the FCL, however, and similarly to the SBA, the use of funds under the PCL is subject to conditionality. In particular, conditions are focused on the vulnerabilities identified during the qualification process, including semi-annual reviews, possible prior actions, and performance criteria. Indeed, it is important to remember that "the PCL is a dedicated instrument for countries that have sound policies but, facing moderate vulnerabilities, may not meet the high bar set by the FCL's qualification criteria."²⁴ The PCL can be considered an instrument designed to fill the void that separates the SBA from the FCL. In this way, similarly to the FCL, the PCL relies on FCL-style qualification rooted in surveillance to send positive signals about the strength of policies. In contrast to the FCL, however, the PCL also relies on conditionality to guarantee an appropriate use of Fund's resources.

Assessing the Extent and Implications of the Reforms to IMF Lending

At a superficial level, the reforms adopted in response to the global financial crisis of 2007–09 entail a significant transformation in IMF lending. Specifically, the FCL, the PCL, and the HAPA seemed to have radically transformed IMF lending by shifting its goals from crisis management to crisis prevention.

While this transformation may appear revolutionary at first, a closer look reveals that efforts at creating insurance-type lending tools are not new to the Fund's history. For instance, in the aftermath of the 1997–98 Asian crisis, the Fund had already experimented with the creation of a contingent facility—the CCL. This facility, which was launched in 1999

and dismissed in 2003, was meant to “be a new instrument of crisis prevention” by providing “a precautionary line of defence readily available against future balance of payments problems that might arise from international financial contagion.” In common with the newly created credit facilities, the CCL would have been available for countries with “strong economic policies.”²⁵

Much significant change can be found if we focus not on the goals, but on the modalities through which the new crisis prevention lending tools operate. Indeed, the new credit facilities attempt to improve the original design of the CCL by responding to many of the criticisms that have been raised in the past, including the scarce transparency and lack of speed associated with the qualification process, as well as the duration of financial assistance.²⁶ First, by specifying the qualification criteria *ex ante*, the FCL and the PCL are meant to give private sector lenders a higher degree of clarity about the potential support of the IMF, therefore reducing volatility more effectively than in the past. Secondly, the approval of procedures to expedite the Executive Board’s decision-making process is meant to ensure that IMF financial assistance will be quickly disbursed and front-loaded.²⁷ Finally, the reforms to IMF lending also included lengthening the duration and the magnitude of crisis prevention financial assistance. In spite of these important improvements in the design of the new credit facilities, especially when compared with past contingent credit lines, the new IMF lending toolkit still suffers from two problems: lack of resources and stigma associated with the qualification process. These issues cast doubt on the efficiency of the Fund’s role as a lender of last resort—that is to say, its role as a lender against good collateral, regarded at the international level as sound macroeconomic policies. As far as concerns the first problem, the creation of the FCL and the PCL was animated by the willingness of addressing liquidity shortages derived from volatility and contagion that dramatically characterized the crises of the 1990s.²⁸ The problem is that today, as in the recent past, the IMF does not command sufficient resources to tackle systemic crises, that is, crises that hit many countries simultaneously. Many factors contribute to this shortcoming. To start with, given the extent of global financial integration, the magnitude of financial crises has intensified and has thereby multiplied the amount of financial assistance that is required to stem instability. This, in turn, makes it difficult to strike a compromise among member countries on support of IMF lending: if it is difficult to estimate how much funding will be needed in the future, how can member countries commit to indefinitely support the Fund? Moreover, many member countries are already committing their resources to regional bail-out funds—the European Financial Stability Facility (EFSF) is

the most obvious example. The Fund itself acknowledges the problem of limited resources for the effectiveness of its lending. For instance, before the opening of the 2010 Annual Meeting, the Managing Director noted that the IMF “must also explore enhanced *liquidity provision* in times of systemic stress and closer co-operation with regional financing arrangements. And we must make sure the Fund has the *resources it needs* to be credible in these tasks.”²⁹

The second problem with the new IMF lending procedures concerns the qualification process and the negative signals this process may send to the markets.³⁰ Again the history of the CCL is of some guidance here: at the end of the 1990s, countries that might have qualified for IMF assistance were concerned that markets would interpret their decision to apply as a sign of hidden weakness rather than strength. Moreover, the advantages of qualifying were not overwhelming. Several emerging market countries therefore drew the conclusion that they had to self-insure against future crises rather than relying on IMF assistance. Therefore, they accumulated large foreign exchange reserves to avoid the need to go to the Fund “cap in hand.” As a result, no country applied for the CCL and it was eliminated in 2003. The qualification process at the heart of the FCL and PCL therefore poses similar concerns to the one raised by the CCL. However, in contrast to the problem associated with the amount of resources available to the Fund, the problem associated with the qualification process seems much more tractable—at least so far. For example, a number of member countries, including Mexico, Colombia, and Poland, decided to accept a precautionary credit line from the IMF to withstand the effects of the latest financial crisis.

While it is difficult to state conclusively that these decisions to resort to the Fund indicate that members no longer perceive the stigma associated with IMF lending and qualification process, these developments are nonetheless important. Indeed, as compared to the political environment of the late 1990s, when the Fund was largely discredited among its members, recent events suggest the opening of a “window of opportunity” for the Fund to redress past problems and enhance its role as a reliable provider of financial stability.³¹

Conclusion

The global financial crisis of 2007–09 has spurred significant reforms to the Fund’s lending toolkit. In particular, one of the major changes has been the institutionalization of the principle of crisis prevention as one of the key goals of IMF financial assistance. Rather than solely focusing

on managing a crisis when it unfolds, the Fund's financial assistance should aim at preventing crises by providing the required liquidity in the face of external pressures. In this way, the FCL, the PCL, and the HAPA have all been designed with the aim of insuring member countries against the risks of financial crises.

After reviewing the characteristics of these new credit facilities, this paper has assessed their novelty and implications for the role of the Fund as a global financial intermediary. It has argued that while the changes to IMF lending facilities are not a radical innovation in terms of the goals—the 1999 CCL is the most direct predecessor to the FCL and the PCL as a precautionary tool—the new credit lines are innovative in terms of the modalities through which they operate. Indeed, they address most of the problems that plagued the CCL. In particular, the FCL and the PCL clarify the qualification criteria *ex ante*, thereby providing greater transparency to market actors, and introducing modalities for faster and larger disbursements.

In spite of these improvements, this paper has argued that the most significant problem for the new lending facilities is the amount of resources that the Fund can mobilize in the event of a systemic crisis. Finally, although it is too soon to speculate about the success of the recent reforms, it has also been noted that the global financial crisis of 2007–09 has provided the Fund with a 'window of opportunity' to address the problems associated with its lending and to regain its credibility among its members. Indeed, in contrast to the recent past, a number of developing and emerging market countries have signalled their trust in the Fund by seeking its financial assistance. It is now up to the Fund to take advantage of this renewed trust through its actions to regain support across its wide and diversified member states. ■

Notes

¹ See André Broome, "The International Monetary Fund, Crisis Management and the Credit Crunch," *Australian Journal of International Affairs* 64, no. 1 (2010): 37–54.

² Stanley Fischer, "On the Need for an International Lender of Last Resort," *Journal of Economic Perspectives* 13, no. 4 (1999): 85–104.

³ Among the most well-known criticisms see, for instance, Allan H. Meltzer, "Asian Problems and the IMF," *The Cato Journal* 17, no. 3 (1998): 267–74, and Jeffrey Sachs, "The Wrong Medicine for Asia," *New York Times*, November 3, 1997.

⁴ IMF, "The Fund's Mandate—An Overview," Report prepared by the Strategy, Policy, and Review Department, IMF, January 22, 2010; IMF, "The Fund's Mandate—The Legal Framework," Report prepared by the Strategy, Policy, and Review Department, IMF, February 22, 2010; IMF, "Financial Sector Surveillance and the Mandate of the Fund," Report prepared by the Strategy, Policy, and Review Depart-

ment, IMF, March 19, 2010; IMF, "The Fund's Mandate—The Future Financing Role: Reform Proposals," Report prepared by the Strategy, Policy, and Review Department, IMF, June 29, 2010.

⁵ IMF, "Global Financial Stability Report," Report prepared by the Monetary and Capital Markets Department, IMF, Washington, DC, April, 2010, 8; IMF, "Global Financial Stability Report," Report prepared by the Monetary and Capital Markets Department, IMF, Washington, DC, October, 2010, 29–32.

⁶ The Articles provide the Fund with three distinct areas of authority with respect to the provision of financial assistance: (a) the use of its general resources; (b) the allocation of SDRs; and (c) the use of resources held in the Special Disbursement Account, which are derived from the sale of gold held by the Fund at the time of the Second Amendment. This paper focuses primarily on issues arising from the use of the Fund's general resources.

⁷ Along with lending, the IMF carries out two major tasks: surveillance of member countries' economies and technical assistance.

⁸ IMF, "Lending by the IMF," <http://www.imf.org/external/about/lending.htm#changing> (accessed May 8, 2011).

⁹ Whether IMF assistance should be conditional or not had been a topic of debate at the time the Articles were framed. This feature was not originally clear at the time of creation. The first conditionality guidelines were introduced in 1979.

¹⁰ About the complex relationship between the IMF and borrowing countries see, for instance, the case studies in Ngairé Woods, *The Globalizers: The IMF, the World Bank, and Their Borrowers* (Ithaca, NY: Cornell University Press, 2006).

¹¹ The inclusion of structural conditions in IMF programs has been a matter of intense debate especially because structural adjustment does not explicitly fall within the purview of the IMF. See Graham Bird, "A Suitable Case for Treatment? Understanding the Ongoing Debate About the IMF," *Third World Quarterly* 22, no. 5 (2001): 823–848.

¹² For an historical overview of the creation of these facilities see, for instance, Margaret Garritsen de Vries, *The International Monetary Fund 1972–1978: Cooperation on Trial* (Washington, DC: IMF, 1985).

¹³ IMF income is primarily a function of interest and charges in loan repayments.

¹⁴ Broome, "The International Monetary Fund, Crisis Management and the Credit Crunch," 45.

¹⁵ Committee to Study Sustainable Long-term Financing of the IMF, "Final Report," January 31, 2007, <http://www.imf.org/external/np/oth/2007/013107.pdf> (accessed May 8, 2011).

¹⁶ Garry J. Schinasi and Edwin M. Truman, "Reform of the Global Financial Architecture," (working paper 10-14, Peterson Institute for International Economics, Washington, 2010).

¹⁷ G20, "Declaration on Delivering Resources Through the International Financial Institutions," April 2, 2009, <http://www.g20.org/Documents/Fin—Deps—IFI—Annex—Draft—02—04—09—1615—Clean.pdf> (accessed May 8, 2011). The G20 also expressed interest in exploring mechanisms of "market borrowing by the

IMF to be used if necessary in conjunction with other sources of financing, to raise resources to the level needed to meet demands.”

¹⁸ IMF, “The IMF and Low-Income Countries in the Global Crisis,” July 29, 2009, <http://www.imf.org/external/np/exr/faq/licfaqs.htm> (accessed November 2, 2010).

¹⁹ IMF, “The Flexible Credit Line: Guidance on Operational Issues,” Report prepared by the Strategy, Policy and Review Department, IMF, November 2, 2009.

²⁰ Of course, a question can be raised about what is “sound policy” from the IMF’s perspective. This is a crucial question that will need to be addressed in future research on the performance of the new lending instruments.

²¹ IMF, “Factsheet: The IMF’s Precautionary Credit Line (PCL),” <http://www.imf.org/external/np/exr/facts/pcl.htm> (accessed October 23, 2010).

²² IMF, “The Flexible Credit Line: Guidance on Operational Issues,” November 2, 2009, <http://www.imf.org/external/np/pp/eng/2009/110209.pdf> (accessed May 8, 2011), 3.

²³ IMF, “IMF Enhances Crisis Prevention Toolkit: Press Release No. 10/321,” August 30, 2010, <http://www.imf.org/external/np/sec/pr/2010/pr10321.htm> (accessed May 8, 2011).

²⁴ IMF, “Fund Facilities,” September 9, 2010, <http://www.imf.org/external/np/exr/faq/facilitiesfaqs.htm> (accessed October 11, 2010).

²⁵ IMF, “Press Release: IMF Tightens Defenses Against Financial Contagion by Establishing Contingent Credit Lines,” April 25, 1999, <http://www.imf.org/external/np/sec/pr/1999/pr9914.htm> (accessed May 8, 2011).

²⁶ See Michael Mussa, “Reflections on the Function and Facilities for IMF Lending,” in *Reforming the IMF for the 21st Century*, Edwin M. Truman, ed., (Washington, D.C.: Institute for International Economics, 2006); Edwin M. Truman, ed., *Reforming the IMF for the 21st Century* (Washington, DC: Institute for International Economics, 2006).

²⁷ IMF, “Decision 14283 (09/29),” March 24, 2009, paragraph 6(a)(v).

²⁸ For instance, David Vines and Christopher L. Gilbert, eds., *The IMF and its Critics: Reform of Global Financial Architecture* (Cambridge: Cambridge University Press, 2004), 25.

²⁹ Dominique Strauss-Khan, “Statement by the Managing Director to the International Monetary and Financial Committee on the Fund’s Policy Agenda,” October 6, 2010, <http://www.imf.org/external/np/pp/eng/2010/100110c.pdf> (accessed May 8, 2011).

³⁰ Mussa, “Reflections on the Function and Facilities for IMF Lending,” 441.

³¹ For instance, Leonard Seabrooke, “Legitimacy Gaps in the World Economy: Explaining the Sources of the IMF’s Legitimacy Crisis,” *International Politics* 44, no. 2/3 (2007): 250–268. See also Manuela Moschella, *Governing Risk: The IMF and Global Financial Crises* (Houndmills, Basingstoke: Palgrave Macmillan, 2010).

Emerging Powers and IMF Reform: Where Multipolarity in the World Economy is Leading the Fund

ANTON MALKIN AND BESSMA MOMANI

ABSTRACT

This paper examines the impact of increasing global economic multipolarity, reflected in the rising influence of emerging markets in global economic multilateralism, on International Monetary Fund (IMF) reform. We explore the extent to which the Fund's recent revival, as evident in commitments made at the Group of Twenty (G20) summits and in the governance reforms passed by the IMF's Executive Board in the autumn of 2010, is indicative of a multilateral consensus between emerging and established economic powers. Specifically, this consensus would imply a revival of a legitimate and effective IMF. We argue that recent reforms passed by the Fund are certainly a reflection of increasing multipolarity in the global economy, but conclude that the path to accommodating emerging powers is far from clear. In particular, recent changes to the Fund's governing structure provide only a superficial enhancement of the IMF's legitimacy and effectiveness as an international financial institution (IFI). Indeed, the foundations of IMF reform remain fragile and hinge on whether both the Fund's governance structure and its mandate, which are mutually constitutive, will ultimately be perceived as legitimate by emerging and status quo powers alike. Governance reforms are certainly an important part of this equation but internal reforms (those affecting its broader mandate and technical capacity), which affect the IMF's function as an independent and effective IFI, remain unsettled. To illustrate our case we evaluate the recent governance reforms and proposals, including quota share re-allocations, the consolidation and reshuffling of seats at the Executive Board, as well as the recent proposal to expand and institutionalize the use of Special Drawing Rights. Based on recent surveys by the IMF's Independent Evaluation Office, we provide an appraisal of the ways in which both emerging and advanced countries view the Fund and conclude by discussing some limitations in our analysis.

Introduction

This paper examines a recurring theme in the debate surrounding international financial institutions (IFIs): the ability of the International

Anton Malkin and Bessma Momani, "Emerging Powers and IMF Reform: Where Multipolarity in the World Economy is Leading the Fund," *St Antony's International Review* 7, no. 1 (2011): 61–78

Monetary Fund (IMF) to be perceived as a legitimate and effective institution by its members. We focus specifically on its powerful emerging market members, or emerging “powers” as they are increasingly being called. Since the global financial crisis, we have seen a revival of economic multilateralism at the global level. Today, it appears that a financial crisis of global proportions has provoked a truly global response. While regional monetary arrangements like the Chiang Mai Initiative in East Asia have failed to produce financial rescue packages in their respective domains, global multilateralism appears to have flourished. The IMF, in particular, has come out on top, with a renewed mandate and resources from the Group of Twenty (G20) club of advanced and emerging economies to provide financially stressed countries with balance of payments financing. Moreover, on November 5, 2010, the Fund agreed to a doubling of members’ quotas—including a large realignment of quota shares toward emerging powers. This ends a decade-long stalemate on the debate surrounding the IMF’s governance structure. Thus, it may be tempting to conclude that the crisis has effectively revived the once ailing IMF and restored its fading legitimacy. In this paper, we aim to explore the extent to which the Fund’s recent revival is indicative of a nascent multipolar bargain between emerging and established economic powers, and whether this bargain restores the IMF’s legitimacy and effectiveness as an IFI. To put it another way: do the recent IMF reforms and reform proposals satisfy the ascent of emerging powers in the global economy, and do these reforms thereby make the Fund a more legitimate and effective IFI? Notwithstanding the significance of other actors to the debate surrounding IMF reform (namely, the low-income developing countries), we limit our analysis to the interaction between emerging and advanced economies—those that have the most influence over how the Fund distributes loans and carries out its surveillance functions.

It was suggested shortly before the global financial crisis that the IMF had reached a milestone of insignificance or even obscurity.¹ We examine how that decline of IMF legitimacy in the previous decade has seen a reverse since 2008, via the G20 commitments of enhanced resources and (recently enacted) governance reforms—and whether these commitments reconstitute the Fund to the prideful place it once held in the international financial architecture. We then outline recent developments with respect to governance reform, including the recently implemented quota and voice reforms and discussions surrounding the IMF’s Board of Governors. A great volume of literature has been devoted to advocating governance reforms that would make for a more legitimate and representative IMF, including rebalancing Executive Board votes toward emerging powers, changing the operative logic and size of the executive

board, and shrinking European representation therein.² We show how recently implemented reforms fit with these proposals and discuss what this means for enhancing the IMF's legitimacy. Next, we explore the proposals for making the IMF a more responsive IFI through expanding the use of the IMF's Special Drawing Rights (SDRs). The proposed expansion is relatively novel but potentially the most far-reaching reform with the potential to affect the Fund's effectiveness in global monetary governance.³ Lastly, drawing on new survey data produced by the IMF's Independent Evaluation Office (IEO), this paper also explores how the Fund is perceived by the two country groups comprising its most powerful members: the advanced industrialized countries and the large emerging markets economies.⁴ It has already been suggested that effective IMF surveillance, along with other internal functions—such as the training, hiring, and professional predisposition of IMF staff members—are crucial components of the Fund's function as a legitimate and effective institution of global macroeconomic management, and thus must be reformed.⁵ This fourth section of the paper will illustrate why this is crucial from the perspective of IMF lenders.

We argue that recent IMF reforms and reform proposals are certainly a reflection of increasing multipolarity in the global economy, representing the culmination of efforts to give emerging powers a greater stake in how the Fund is governed. But we caution that it may be premature to infer from these reforms the restoration of IMF legitimacy. In particular, the recent changes to the Fund's governance structure provide only superficial enhancement of its legitimacy and effectiveness as an IFI. The foundations of IMF reform remain fragile. Its success hinges on whether the IMF's governance structure *and* its mandate, which are correlated and not exclusive, will ultimately be perceived as legitimate by its most powerful members. Governance reforms are certainly an important part of this equation, but the internal functions affecting the Fund's broader mandate and technical capacity—which, together with governance structure, also exert influence on the IMF's function as an independent and effective IFI—remain unsettled. Unless these reforms are addressed, the IMF's global macroeconomic management role—its function as a “ruthless truth-teller” and policy co-ordinator for weak and powerful members alike—will remain an ideal rather than reality.

What kind of IMF? The Legitimacy of an IFI

After the Argentine financial crisis and before the 2008 global financial crisis, the IMF had been declared all but completely irrelevant to managing the global financial order. This was manifested in the diminu-

tion of its operating budget (including significant staff down-sizing), the dwindling of its revenue from lending operations, a lack of legitimacy in the eyes of its key emerging economies in Asia and Latin America (traditionally its most significant pool of borrowers), and the lack of enthusiasm for the Fund's global economic governance role from key advanced country lenders such as the United States.⁶ Advanced economies (or countries) are typically referred to as the "rich" countries and include, among others, the Group of Seven (G7).⁷ The term "emerging economies" (or, emerging *markets*, and *countries* interchangeably) is more multifaceted. It refers to rapidly growing, economically and politically significant countries, commonly understood as being distinct from other developing economies in their per-capita income and GDP growth potential. They comprise the geopolitically and economically indispensable BRIC countries (Brazil, Russia, India, and China), but also include smaller but significant economies like Argentina, Indonesia, Turkey, and others. The term has significance for investors, who see above-average asset growth and large returns on investment, and for economists, who see them converging with advanced economies on per-capita income terms, as well as on other indicators. The emerging country label has also found its way into the parlance of political scientists. International relations scholarship often describes the ascent of "emerging powers," referring to those members of the emerging economy grouping that have the greatest potential to impact and change the international security, financial, and trade architecture. Not surprisingly, these actors have become indispensable to the debate surrounding the reform of the IMF.

Following the East Asian financial crisis in the late 1990s, the emerging economies of East Asia had decided that the IMF's policy advice was ill-conceived, reflecting the ideational and policy goals of American policymakers rather than their own. Hence it was unsuitable to their domestic economic contexts and development strategies. As the crisis subsided, East Asian governments opted to insure themselves against future financial crises by building up foreign currency reserves, promptly paying back their IMF loans and refusing to turn to the Fund again for balance of payments financing. Other emerging markets in Eastern Europe and Latin America, such as Russia and Brazil, also followed suit.

To be sure, the logic behind the self-insurance motive was not, at its core, a direct response to IMF advice (although this notion is a useful bargaining chip to push for more voting rights at the Fund). Past experience with financial crises, coupled with domestic political economy considerations, had led emerging markets to conclude that the level of their reserve ratios—that is, the international currency assets held by national central banks—did not meet their needs in responding to finan-

cial crisis and in mitigating the volatility of global capital markets more broadly. Indeed, the policy of accumulating large volumes of reserves was not unprecedented. Both Japan and Germany—formerly “emerging” (or perhaps re-emerging) economies during the post-war reconstruction era—employed similar tactics and continued to do so. Moreover, self-insurance cannot be the sole motivation for the accumulation of reserves. Changes in exchange rate regimes, as well as trade-motivated factors, have all been cited and debated as rationales behind the drive to accumulate reserves. For example, China is often accused in this regard of employing neo-mercantilist tactics in keeping its exchange rate low to gain export-oriented competitiveness. Some have pointed to a variety of other related economic and strategic motivations.⁸ However, the IMF’s role in the East Asian financial crisis *did* contribute to a marked reorientation of macroeconomic policy among large emerging markets. Contrary to IMF advice, emerging market policymakers concluded that crises were exacerbated not by inadequate convergence to “best practices” in domestic financial market and banking structures (that is, poor microeconomic policies), but by inadequate liquidity: the deficiency of available lines of credit to cover balance of payments needs or to defend the domestic currency without having to draw on external credit.

Another key turnaround in IMF fortunes was an increase in hostility toward the Fund from conservative voices in the US executive and legislature. Washington’s enthusiasm for the IMF’s role in helping to steer the global financial architecture waned under the administration of President George W. Bush. Long standing US conservative reservations about the “moral hazard” of financial rescue packages—those that proliferated both in East Asia and Latin America—asserted themselves in the White House and Congress alike. By 2006, a cottage industry of reform proposals was developed by think-tanks, independent evaluation offices, academics, central banks, world leaders, and the IMF itself to address the decline in its legitimacy. At that time, many emerging market economies developed their own macroeconomic indicators and policies, and were able to turn to private capital markets and commercial banks for their financing needs.

When tremors in global capital markets reached crisis proportions in the second half of 2008, the IMF’s role as an international lender of last resort was uncertain. The rise of the Goldman Sachs designated “BRIC” countries (Brazil, Russia, India, and China) had implied that the G7 advanced industrialized countries could no longer steer a global policy consensus, and that the IMF could hardly be seen as a vehicle for orchestrating a global rescue as such. But the Fund’s fortunes shifted as multilateral responses to the crisis did eventually materialize. The organ-

ization was seemingly restored to its former glory by both the established powers of the G7 and their emerging power counterparts in the crisis-prompted G20 summit of leaders. In their London leaders' statement on 2 April 2009, the G20 leaders promised:

...to treble resources available to the IMF to \$750 billion, to support a new SDR allocation of \$250 billion, [...] to ensure \$250 billion of support for trade finance, and to use the additional resources from agreed IMF gold sales for concessional finance for the poorest countries, constitute an additional \$1.1 trillion programme of support to restore credit, growth and jobs in the world economy.⁹

Indeed, this sudden cascade of support for IMF lending and its expanded operating budget came as unexpected to many (perhaps including the IMF's own staff). The most powerful economic actors displayed a sudden appreciation for economic multilateralism and for the IMF's role therein. Seemingly overnight, countries once again started to borrow from the IMF—not only developing countries, but the developed world as well.

Nevertheless, closer examination of the details surrounding this reinvigoration of the IMF does not reveal a return to business-as-usual for the organization, nor does it signal a broad-based consensus among the states that provide the Fund with implicit and explicit support. Unlike the IMF of the 1990s, whose policy prescriptions, technical assistance, and lending conditionality were backed up by a relatively close-knit group of advanced industrialized countries (that is, the G7), the IMF's mandate today rests on much shakier foundations. Beneath the surface of the appearance of solidarity among the G20 on the IMF's role in the global economy, the degree of support for the organization was relatively ambiguous. The new financing announced at the G20 Summit in Pittsburgh in September 2009 was not an expansion of the IMF's resources *per se*. Rather, it was largely a commitment to make available a collective stream of credit lines (more than \$600 billion) from various advanced and emerging economies, in the form of crisis-contingent loans to the Fund (see Appendix 1 for the breakdown of IMF credit lines as of March 2011). Moreover, this lending was largely funnelled through a facility known as the New Arrangements to Borrow (NAB). The NAB does not provide the IMF with new permanent resources and, unlike the more significant General Agreement to Borrow (GAB), does not require a reshuffling of IMF voting rights based on contributions. Not surprisingly, the BRIC countries, along with other emerging economies, did not agree to participate in the NAB directly and only took part in lending to the Fund by agreeing to purchase the newly created IMF bonds, which was later rolled into the NAB as part of a further promise to redistribute IMF quotas away from advanced economies.¹⁰

To be sure, the recent realignment of quotas and voting shares (discussed in the next section), are certainly legitimacy-enhancing in this respect. But it should not obscure the fact that while the IMF was certainly the vehicle for co-ordinating lending to small emerging and developed economies, the multilateral response to the crisis was carried out through the informal channel of the G20, not through the formal institutionalized channels of the Fund itself. As such, we are currently witnessing, through the lens of IMF reform proposals, an attempt by the G7 to bring the major emerging economies into existing global governance structures. The G20 commitments show that the IMF has become an important bargaining chip between emerging and advanced economies as they try to address the problem of global macroeconomic co-ordination, and as such, the legitimacy of the Fund remains an uncertain and ambiguous issue.

What kind of IMF is emerging from the crisis? Borrowing the framework developed by Ngaire Woods, a useful way to understand the IMF's evolving role is to distinguish between its three competing roles, which include a Fund responsible to its borrowers (that is, dependent on revenue from its lending operations); a Fund responsible to its lenders (wherein it is beholden to the wealthy members who lend it money); and an independent Fund (one that relies on its own resources and stands on its own mandate).¹¹ As Woods explains, the IMF that emerged from the crisis is a heavily lender-dependent institution, which reduces its ability to act as a genuinely autonomous, operationally-independent IFI. As we explain below, this lack of independence is very much reflected in the reform process—not least, in the latest enacted reforms, wherein most of the changes are set to increase the leverage of IMF lenders without any commitment to enhance the IMF's function as an institution independent of the immediate interests of global economic powers. In short, will the IMF assume a mandate independent of the G20's communiqués? Will it be able to provide effective surveillance functions and balance of payments lending without relying on informal bargain between emerging and advanced industrialized economies (which take place outside the Fund itself)? The answers remain unclear. As the following sections will show, while the latest round of reforms may be a step in the right direction, it certainly does not guarantee more legitimacy and effectiveness for the IMF.

Governance Reforms

The global financial crisis has certainly sparked a revival in the IMF reform process, and the speed with which governance reforms have been adopted has been a surprise to many. The G20 agreed to adjust IMF

quotas to better reflect members' contribution to the world economy in Pittsburgh in 2009—a commitment reiterated in Toronto in 2010, and detailed further in the finance ministers' meeting in Gyeongju, South Korea, that same year. The BRIC countries then proposed that the IMF should transfer seven per cent of the advanced economies' quota share to emerging economies.¹² As a compromise, the negotiations leading up to the Pittsburgh G20 meeting instead produced a proposal to shift five per cent of quota shares by January 2011. In this respect, the recent reforms adopted at the IMF Annual Meeting on November 5, 2010 are quite significant. The IMF Executive Board agreed to double its members' quota contribution and to realign the voting shares at the Board by six per cent—an even compromise between the two proposals. The IMF promised this realignment to take the form of a shift from “over-represented to under-represented members,” with “dynamic emerging market and developing countries,” such as Brazil, Russia, India, and China, making significant gains at the Board.¹³ This does appear to be a major acquiescence in the demand of rising economic actors, putting an end to an almost decade-long debate on a key aspect of IMF reform.

However, it is important to approach this achievement with an air of caution. First, over half of the realignment in voting shares to emerging markets will come from various developing countries, with the voting share of advanced economies falling by only 2.6 per cent. Some emerging market members, such as South Africa and Argentina, are actually losing rather than gaining shares.¹⁴ Moreover, the purported rebalancing of quota shares in order to better reflect members' position in the global economy (a legitimacy-based argument) remains fraught with caveats and contradictions. For instance, it remains a fact that on certain metrics of global economic significance, the United States is actually under-represented at the Board, as are most low-income countries. As such, the latest reshuffling of quota shares is more about balancing the interests of IMF lenders than about broad-based legitimacy per se. To be sure, the claim of large emerging market lenders to have better representation at the institution is an important component of IMF reform, but it remains an insufficient (albeit necessary) component of enhancing the Fund's legitimacy and effectiveness.

Further contributing to these outstanding issues is the size of the Executive Board itself. The original architects of the IMF always intended to keep the size of the Executive Board small in order for it to be effective. The IMF Executive Board is currently comprised of twenty-four seats. However, only twenty seats are actually mandated by the IMF articles of agreement. The top strata of IMF Board seats go to the five appointed members with the largest quota share. Currently, these seats are occupied

by the United States, France, Britain, Germany, and Japan. While the Articles of Agreement mandate that the top five quota holders appoint five Executive Board seats, these appointed seats are actually “on-loan,” as quota allocations are reviewed every five years. These quota reviews give members a chance to make their case for enhanced quotas and to potentially unseat other Executive Directors. Making the case, however, is a highly politicized process, regardless of the economic merits for change. Japan experienced this most clearly in 1970, when it finally unseated India and received a seat at the Board.

Since IMF reform discussions commenced in 2006 in Singapore, and through the 2010 G20 summits, the Executive Board debates have centred on shuffling Board seats among the Fund’s members. Most significantly, negotiations and discussions have centred on how to reallocate seats from European countries—which are in practice over-represented on the Board, with eight out of twenty-four seats—to the emerging economies. This remains a key, intractable issue of legitimacy in IMF reform. In recent years, the United States has joined the BRIC countries in pressuring Europe to decrease and consolidate its IMF representation. In August 2010, the United States publicly stated that its *de facto* veto power at the Board would be used to ensure that the twenty-four seats would be reverted to the mandated twenty seats. On current practice, this would have unseated Brazil, India, Argentina, and Rwanda, which hold the bottom four seats, with the lowest amount of pooled quotas. Instead, the United States hoped that the Europeans would succumb to peer pressure at the Board and forgo their seats; eyes were particularly set on Belgium, Netherlands, and Denmark, all of which represent a multi-constituency group at the Board.

The focus of reforming the Board as such has centred on consolidating quotas within the Eurozone. After all, the IMF is technically a monetary organization and European countries that share the euro currency should, on this logic, only have one seat at the table. This, however, would put pressure on France, Germany and many other European countries to consolidate their seats, leaving the United Kingdom’s (as a non-Eurozone member) seat untouched. To the benefit of the Europeans, this move would create one of the largest and most powerful single chairs. However, the European project of centralization and consolidation of political and constitutional authority has hit a number of obstacles, and national authorities therefore remain sceptical of combining their IMF representation. In other words, the IMF reform process hinges, in part, on whether the European integration project can be made acceptable to individual European domestic constituencies, which prefer to maintain national authority and representation at the Bretton Woods Institutionss.

The Europeans have proposed in G20 summits to contribute an additional permanent \$75 billion to the IMF lending facility in order to prevent a decrease in their influence and to augment their voting strength to thirty-five per cent of the total votes. Nevertheless, the system of weighted voting means that one country's gain in quota must correspond to another country's loss of quota. Because of this apparent zero-sum game, the Europeans are worried that the emerging markets' increased strength at the Board could result in a loss of their respective power. For example, if China were to increase its quota to reflect its GDP size, its rank as the world's second largest economy would then unseat the British or the French from the Board's top five. Recently, the G20 finance ministers agreed to keep Board composition at twenty-four, while increasing the emerging market economies' representation at the Executive Board by eliminating two European chairs—most likely Belgium and Denmark. But while the G20 members agreed to these reforms, the challenge will be to implement these changes and to apply pressure to those set to lose from wielding diminished power at the IMF, since the losing parties are not members of the G20. To this end, Belgian Finance Minister Didier Reynders stated that his country might be able to consolidate with the Netherlands but called for his state and other small European Union (EU) states be given a place at the G20. Clearly, political bargaining and informal diplomacy on this issue is likely to continue despite the apparent clarity of the G20 commitments.

In short, the resolve of the BRICs and the United States to see a change in the IMF Executive Board composition through European consolidation continues to be tested and, as such, the latest stage of reforms by no means represents an end to governance reform debates. Perhaps more significantly, it should be noted that recent changes to the Executive Board do not represent the full range of governance proposals that have animated the IMF for over a decade. Beyond governance reforms, it is important to remember that the IMF's legitimacy deficit since the Argentine financial crisis stems not only from the inadequacy of its representational structure, but also from its perceived effectiveness as an international organization. Effectiveness does not simply imply imposing policy conditionality on borrowing members; it applies equally (at least in principle) to its ability to (1) be of use to, and (2) to have sway over, its powerful members. The recent proposal to institutionalize the Fund's management of global reserve assets via the expansion of the use of SDR applies to the first of these abilities. In the next section we examine the prospects and plausibility of this proposal.

While reforms to representation in institutions of global governance create winners and losers no matter what the outcome, there is one significant reform proposal that promises to lift all boats: the proposal to effectively elevate the IMF to something approaching a global central bank. That is, the reintroduction of the five-decades-old idea of an IMF-based substitution account. The idea calls for the widespread disbursal of an IMF-based accounting unit (already in existence but not widely utilized) called the Special Drawing Rights (SDR), with the intention that countries would multilaterally manage their national currency reserves at the IMF. Indeed, traction on this proposal has already been made with the G20 commitment of \$250 billion in SDR resources—a not insignificant start, but ultimately just a gesture with respect to the herculean task of effectively institutionalizing the use of this reserve currency at the global level.

The idea behind the SDR is quite simple but its implementation—its potential to supplant currencies like the dollar and the euro in the reserves of national central banks—is unavoidably complex and fraught with political uncertainty. Much of the renewed enthusiasm surrounding SDRs materialized as the global financial crisis raised the profile of the widening global imbalances in current and capital accounts, which resulted in part from the accumulation of currency reserves at the central banks of many large emerging countries, as well as advanced ones. As described above, whatever the motives of this accumulation (self-insurance, neo-mercantilism, or others), they had hitherto claimed the IMF as a victim, as the Fund found itself losing its most prolific borrowing clients. And whereas the imbalances are increasingly seen as a global problem of collective action, with the potential to provoke what the Brazilian finance minister in October 2010 called a global “currency war,” the IMF is increasingly seen as a solution.¹⁵

Many, but not all, of the reserve assets have been accrued in US dollars, making diversification out of the currency by large dollar holders like China and Japan counter-productive, as such a decision would cause a sharp devaluation of their dollar portfolios. Recently, Chinese, Russian, and Brazilian policymakers, as well as others, proposed that the IMF be used to help the world diversify out of US dollars by issuing SDRs in exchange for dollars. Instead of depressing the value of the dollar, official holders could deposit their unwanted dollar assets in this special account at the IMF in exchange for SDRs (which have nominal dollar, euro, yen, and sterling values). They would be credited with SDR-

denominated certificates, which could principally be used at any time to finance balance-of-payment deficits, to conduct monetary policy, or in other transactions. These certificates could then be exchanged at the IMF or for any other currency, or be transferred to other countries with shortfalls in their national balance of payments.

Details notwithstanding, this is the simple part of the proposal. The difficult part is making it work for everyone involved. In principal, the proposal would allow countries to diversify their national reserve assets as they see fit. Indeed, large emerging markets stand to benefit from this proposal because of their over-reliance on currencies that they have no direct control over. Nevertheless, monetary policy is never fully de-politicized even at the national level, and some outstanding questions will have to be worked out if countries are to allow the IMF to take on this unprecedented global role. Would SDRs be issued through the approval of the Executive Board? At present, an eighty-five per cent voting threshold is required to approve any and all issuances of SDRs. Given the potential for politicization of Executive Board decision-making, it is not clear how effective an SDR-based monetary system will be. To what extent would such a system allow the IMF to have discretion over the quantity and timing of reserve-currency issuance? In other words, will the IMF be able to issue SDRs as a form of global monetary policy? This would effectively make the IMF into a global reserve bank akin to national central banks, but we are yet to see if IMF members would be willing to grant it this responsibility. Moreover, if SDRs are to replace the dollar, they would need to comprise liquid financial markets of their own, and we are yet to see an actor willing to take on the burden of generating such liquidity.¹⁶

These issues are unresolved, and will remain so until key IMF members not only commit to, but follow through on strengthening global multilateralism through the Fund. However, there are currently real obstacles to such a commitment; namely, the lack of influence that the IMF currently wields with policymakers in both emerging and advanced member countries. To be sure, the current enthusiasm for the SDR proposal seems to be reflected on both sides of the advanced-emerging country divide. But there are reasons to be sceptical that the major advanced and emerging powers would so eagerly allow the IMF to assume the independent role that such a scheme requires. In the end, such a role would entail that the BRICs and the G7 alike be willing to accept IMF appraisals of their economies—to fulfill the role of “ruthless truth-teller,” as envisioned by one of its chief architects, John Maynard Keynes.

An Effective IFI? The Fund's Interaction with Non-Borrowing Members

73

With respect to the second function of effectiveness mentioned above—the IMF's ability to have sway over its lenders—the outlook is no better. There is little evidence that the Fund has been an effective institution of “ruthless truth-telling” with respect to its most powerful members. And presently, there is little to suggest that the latest round of reforms will make a substantial impact in this regard. Since the East Asian and Argentine financial crises, the IMF's surveillance-based interaction with many large emerging economies has declined, in part because the latter perceived the former's technical advice to be flawed and biased against them. In addition, in recent years, it has become equally evident that advanced economies are equally unwilling to acquiesce in the Fund's independent surveillance practices and policy prescriptions. Currently, the IMF's ability to “name and shame” members that receive poor macroeconomic appraisals is very limited. Recent IEO evaluations have revealed that rather than valuing the IMF's key macroeconomic surveillance function, both the advanced and large emerging members of the Fund have been unwilling to accept its evaluations and policy advice.

In principle, given the current status of reform, one might expect the IMF to be most closely aligned—strategically, and on policy issues—with large advanced economies and with large emerging markets. In fact, recent IEO surveys show the IMF staff-country official interactions were actually least effective between the IMF staff and advanced country officials. The surveys found that the staff's desire to avoid confronting or displeasing advanced country authorities was a clear obstacle to the Fund's independence as an international organization. The incentive to avoid “speaking truth to power” was, the IEO also found, reinforced by the Fund's management. Advanced economies simply did not see much value added in interacting with the IMF, and IMF staff, in turn, reported that the former only acquiesced in their advice when it was deemed favourable to existing national policies.¹⁷ Given the traditional assessment of the IMF as an agent of large advanced countries' interests, these survey results are perhaps surprising. But given the IMF's declining legitimacy in the past decade, the results are broadly reflective of the reality that we outlined above: the Fund may be endowed with new resources and a new mandate to stabilize debt-stricken members, but the questions surrounding its perceived legitimacy are far from settled.

Not surprisingly, large emerging markets were classified as the second to least satisfied grouping in IMF staff-country official interactions.

The main complaint from this group was the lack of trust on the part of emerging country officials in the even-handedness of IMF staff's approach to surveillance activities. Specifically, the general perception among large emerging economies was that surveillance was carried out in the interests of the largest IMF shareholders—namely, the United States and European countries. On the whole, as large emerging economies transferred to a surveillance-only relationship with the IMF in the 2000s, little value was attributed to the Fund's services.¹⁸ The focus on IMF quota and vote reform could therefore be seen as a direct response to such perceptions. But more than giving a voice, the IMF needs to regain respect from emerging country authorities in conducting policy dialogue; surveillance activities, in particular, need to be seen as useful by the respective country authorities.

Until this happens, it is hard to see how the IMF could be considered an effective IFI. If its ability to extract policy concessions (for example, by naming and shaming) is only limited to weaker—namely, the borrowing—members, then its role as global macroeconomic policy coordinator cannot be considered fully adequate or legitimate. We are thus presented with a paradox: IMF reforms have focused on striking a deal between borrowing members and advanced industrialized members, neither of which grouping will be affected by its policies or appears ready or willing to grant the Fund an independent role vis-à-vis themselves. To be sure, the G20 has reinvigorated the IFIs and especially the IMF. With a renewed mandate, funding, and interest in reform, the G20 has placed a lot of faith in the IMF. But without the kind of internal reforms that will renew Fund members' faith in the competence and necessity of technical advice and surveillance, we could see the G20 more frequently assume the informal role of global macroeconomic manager, and relegating the IMF to the role of secretariat.

Conclusions and Limitations

The IMF is yet to regain its once-privileged position in global economic governance. The recent round of reforms certainly accommodates the interests of emerging economies, and is a reflection of increasing global multipolarity. In order for the Fund to become an influential and independent international financial institution, it must be seen to be legitimate by its most powerful members, and an important step has been taken in this direction. But even significant governance reforms, by themselves, are unlikely to accomplish this task; there needs

to be a deliberate and concerted recognition and an acceptance of the IMF's authority on macroeconomic policy co-ordination. And in this respect, the IMF reform process faces an even greater array of obstacles, not least of which are the internal reforms required to make the Fund's lending policies, mandate, and day-to-day activities more acceptable and authoritative to its members.

One of the limitations of our analysis is our explicit focus on large emerging economies. Whilst the discussion of the IMF's relationship with low-income countries and small emerging markets, such as various South American countries and the European "periphery," is beyond the scope of this paper, it is worth remembering that the Fund's borrowers are most strongly affected by its policies. At the same time, they are perhaps least represented in the reform process. The \$1.1 trillion in loans contributed to the institution by the G20, tied as they were to the recently-passed governance reforms, went to rescue struggling economies in Eastern Europe and East Asia. It remains to be seen what impact, if any, the rebalancing of power at the Executive Board will have on the policy prescriptions these countries have and will adopt in repaying these loans.

Similarly, whilst we explored the perceived effectiveness of IMF staff and officials from emerging and advanced countries in the area of IMF surveillance and technical advice, we have left out the views expressed by the low-income country members. The greatest irony of the reform process is that, according to the IEO surveys, this group cares most about the effectiveness and quality of IMF staff expertise. Indeed, the low-income countries are neither dismissive of (as is the case with large emerging economies) nor indifferent to (as is the case with advanced economies) the dimensions of the Fund's policy advice. Yet they remain in the background of much of the present discussion surrounding IMF reforms. Indeed, governance reforms at best have a muted effect on many of the IMF's borrowing members and at worst disadvantage them, especially when we consider that a purely technical, contribution-based appraisal of governance structures would not add but rather remove low-income country seats at the Executive Board. Decades of compromise and considerations of equity and power have allowed low-income countries to be effectively *over*-represented at the Board, which allows those most affected by the Fund's lending to have more say over its policies and decisions. As such, now that significant governance reforms are out of the way, it would be more constructive to move towards a discussion of how to reform the function and mandate of the organization. ■

Appendix

Table 1: Breakdown of Lending Capacity Funding Committed to the IMF, by Country (2011)

Country	Amount Committed in US Dollars
Japan	\$100 billion
European Union	\$178 billion
Norway	\$4.5 billion
Canada	\$10 billion
Switzerland	\$10 billion
United States	\$100 billion
Korea	At least \$10 billion
Australia	\$5.7 billion
Russia	Up to \$10 billion
China	Up to \$50 billion
Brazil	Up to \$10 billion
India	Up to \$10 billion
Singapore	\$1.5 billion
Chile	\$1.6 billion

Source: International Monetary Fund, “Bolstering the IMF’s Lending Capacity,” October 12, 2010, <http://www.imf.org/external/np/exr/faq/contribution.htm> (accessed on May 9, 2011).

Notes

¹ Eric Helleiner and Bessma Momani, “Slipping Into Obscurity? Crisis and Reform at the IMF,” (working paper 16, Centre for International Governance Innovation, 2007); Leonard Seabrooke, “Legitimacy Gaps in the World Economy: Explaining the Sources of the IMF’s Legitimacy Crisis,” *International Politics* 44, No. 2/3 (2007): 250–68. Similarly, just as the crisis was beginning to unfold, some were quick to point out a significant contrast between the IFI’s leading role in the East Asian and Argentine crises and that in the recent crisis. See Mark Beeson and Andre Broome, “Watching from the Sidelines? The Decline of the IMF’s Crisis Management Role,” *Contemporary Politics* 14, No. 4 (2008): 393–409.

² Ariel Buira, “A New Voting Structure for the IMF,” (Research Paper, Intergovernmental Group of 24, Washington, DC, 2002), <http://www.g24.org/newvotig.pdf>; Edwin M. Truman, ed., *Reforming the IMF for the 21st century* (Washington, DC: Institute for International Economics, 2006); Ngaire Woods and Domenico Lom-

bardi, "Uneven Patterns of Governance: How Developing Countries are Represented in the IMF," *Review of International Political Economy* 13, No. 3 (2006): 480-515.

³ Eric Helleiner, "The Politics of the New Global Reserve System," *Journal of Globalization and Development* 1, No. 2 (2010); Barry Eichengreen, *Out of the Box Thoughts About the International Financial Architecture*, (Working Paper WP/09/116, International Monetary Fund, Washington, 2009), www.imf.org/external/pubs/ft/wp/2009/wp09116.pdf.

⁴ The IEO is an internal organ of the IMF, but also an independent auditor of the Fund's activities.

⁵ Andre Broome, "The Importance of Being Earnest: The IMF as a Reputational Intermediary," *New Political Economy* 13, No. 2 (2008): 125-151; Bessma Momani, "IMF Staff: Missing Link in Fund Reform Proposals," *Review of International Organizations* 2 (2007): 39-57.

⁶ Eric Helleiner, "The Strange Story of Bush and the Argentine Debt Crisis," *Third World Quarterly* 26, No. 6 (2005): 951-969.

⁷ For the IMF's definition of advanced economies, see International Monetary Fund, "World Economic Outlook (WEO): Recovery, Risk, and Rebalancing, October 10, 2010, <http://www.imf.org/external/pubs/ft/weo/2010/02/index.htm> (accessed on May 9, 2011).

⁸ See, for example, Gregory T. Chin, "Remaking the Architecture: the Emerging Powers, Self-Insuring and Regional Insulation," *International Affairs* 86, no. 3 (2010): 693-715.

⁹ G20, "The Global Plan for Recovery and Reform," (Communiqué, London, April 2, 2009), <http://www.g20.org/pub—communiqués.aspx> (accessed on October 4, 2010).

¹⁰ For a more detailed discussion of the NAB and its role in the Pittsburgh summit contribution to the IMF, see Ngaire Woods, "Global Governance after the Financial Crisis: A New Multilateralism or the Last Gasp of the Great Powers?" *Global Policy* 1, no. 1 (2010): 51-63.

¹¹ Woods, "Global Governance After the Financial Crisis," 2010.

¹² Zhou Xin and Chris Buckley, "China Wants Support on IMF Voting at G20," *Reuters.com*, September 15, 2009, <http://www.reuters.com/article/2009/09/15/us-china-imf-sb-idUSTRE58E29D20090915>.

¹³ International Monetary Fund, "IMF Quotas," (Factsheet, International Monetary Fund, Washington, DC, 2011), <http://www.imf.org/external/np/exr/facts/quotas.htm>.

¹⁴ Bretton Woods Project, "Implementing IMF Governance Reform: Baby Steps in Slow Motion," November 29, 2010, <http://www.brettonwoodsproject.org/art-567219>.

¹⁵ See Ambrose Evans-Pritchard, "Capital Controls Eyed as Currency Wars Escalate," *The Daily Telegraph*, September 29 2010, <http://www.telegraph.co.uk/finance/economics/8031203/Capital-controls-eyed-as-global-currency-wars-escalate.html>.

¹⁶ A move to create such markets on the part of a large emerging or status quo power would effectively constitute a real vote of confidence in the IMF. For a discussion on obstacles to the SDR proposal see, for example, Barry Eichengreen, "The Dollar Dilemma: The World's Top Currency Faces Competition," *Foreign Affairs* 88, no. 5 (2009): 53-68.

¹⁷ For a detailed outline of the results see Independent Evaluation Office, see "IMF Interaction with Member Countries," (International Monetary Fund, Washington, DC, 2009).

¹⁸ Independent Evaluation Office, "IMF Interaction with Member Countries."

Fuelling Ambition or Fending Off Risk? Revisiting the International Monetary Funds's Role in Sub-Saharan Africa

79

CHRISTIAN M. BRÜTSCH¹

ABSTRACT

What does the International Monetary Fund's (IMF) response to the financial crisis say about its past and future roles in Sub-Saharan Africa (SSA)? To find answers, this article explores the tensions between the "old" Fund's efforts to entrench "sound" macroeconomic policies and the "new" IMF's plans to insure its members against global volatility. The paper outlines the risks associated with the pursuit of IMF policy advice, reviews the Fund's engagement in Angola and Mozambique, and discusses how these experiences reflect on its future role. The case studies suggest that whilst countries that work with the Fund are more resilient than those that go at it alone, resilience comes at the cost of a more ambitious developmental state—not because the Fund hampers aspirations, but because it cannot leverage ambition. The study concludes that rather than glossing over the political cost of risk insurance, the IMF should target its assistance to governments that are prepared to make, explain, and follow-up on the difficult choices.

Introduction

The International Monetary Fund's (IMF) forays into Sub-Saharan Africa (SSA) usually evoke spectres of the ill-fated Washington Consensus which, its critics claim, constrained governments to shelve ambitious development plans to guarantee viable returns on some of the riskiest bets in global capital markets. As recently as 2005, activists' calls to "defund" the Fund were echoed by US officials according to whom "the IMF's financial involvement in low-income countries has gone terribly awry."² Unlike creditors, who expect the Fund to focus on short-term balance of payments problems rather than long-term development finance, African governments complained that they did not receive the help they needed to face the global economy.

Christian M. Brüttsch, "Fuelling Ambition or Fending Off Risk? Revisiting the International Monetary Funds's Role in Sub-Saharan Africa," *St Antony's International Review* 7, no. 1 (2011): 79–96

With the global financial crisis, the terms of the debate have started to shift. When the United States' debt bubble burst, African policymakers worried that lower external demand, capital flows, foreign aid, and remittances might reverse, as Tito Mboweni, Governor of the South African Reserve Bank has stated, "the policy gains we have made over the last decade, with the danger of pushing tens of millions of people over the poverty line."³ The IMF's Managing Director, Dominique Strauss-Kahn, promptly offered "advice, technical assistance, and financial support" to enable them to react "comprehensively and imaginatively" to the downturn.⁴ In addition, the Fund tweaked the terms of open credit lines, revamped its lending framework, boosted concessional lending resources, and temporarily waived interest payments. The message was clear: the IMF was back, and this time it would harness rather than harass distressed members' efforts to protect the poor.

Many of the Fund's critics remain unmoved. Activists maintain that the IMF "sort of fooled" them when it seemed to abandon its "very hard-core agenda of promoting markets above everything else."⁵ Conservatives contend that the Fund encouraged expansionary fiscal policies without assessing their impact on macroeconomic stability.⁶ African governments have been reconciled. In March 2009, finance ministers and central bankers of African countries, in conjunction with the IMF, jointly announced a stronger "partnership" to remind the Group of Twenty, (G20) of the plight of the poor and blameless.⁷ Since then, they have praised the Fund's efforts to protect African interests and have stressed that its financial support has helped them "weather the crisis" and put their economies "back on the path to sustainable development."⁸

The Fund is clearly enjoying greater prominence. Nevertheless, senior management insists that its burgeoning African presence and influence is not built on the injection of short-term finance alone. Improved access to substantially higher credit lines may have helped ease liquidity constraints and catalyse donor support, but African governments managed the crisis better than expected in large measure because they had followed the Fund's advice to strengthen monetary and fiscal policies whilst their economies were booming.⁹ The main lessons from the crisis—and the key to the IMF's future engagement in the region—is that without the "old" Fund's insistence on "sound" external and fiscal policies, the "new" Fund's support for "temporary countercyclical measures" would have been pointless.¹⁰

To further incentivize the notion that macroeconomic prudence trumps developmental ambition, the Fund announced plans to expand its "role as a provider of insurance... against global volatility and other shocks."¹¹ The reasoning is straightforward: in an uncertain geo-eco-

conomic environment, the benefits of a dependable working relationship outweigh the moral hazards that haunt any promise to fend off risk. The 12 SSA lending arrangements the Fund approved in 2009 can be seen as a bellwether. Besides “donor darlings” like Mozambique or Tanzania who had graduated to the Fund’s non-financial Policy Support Instrument (PSI), beneficiaries include first time borrowers like Angola or Ethiopia who had long opposed the Fund’s terms of assistance.

To gauge the political ramifications of the “new” Fund’s scramble for African hopes and mandates, this study examines how its endeavours to protect states against the crisis reflect on the “old” Fund’s efforts to promote “sound” macroeconomic policies. The next section outlines the risks and rewards of macroeconomic prudence in a development context. Sections two and three review the Fund’s engagement in Mozambique and Angola. Section four discusses what the Fund’s crisis response tells us about its future relations with members, whilst section five concludes and summarizes the argument.

The Risk and Rewards of Macroeconomic Prudence

Governments in the developing world have many reasons to resent the Fund. Austerity and adjustment programmes “imposed” by the IMF can strain social contracts and shift political fault lines, and there is no conclusive evidence as to whether IMF-supported stabilization programmes actually work. A large body of research suggests that IMF prescriptions are more likely to harm employment, widen inequality, and hurt the poor than to improve a country’s balance of payments position or growth prospects.¹² Even where adjustments are unavoidable, the Fund’s “off-the-rack” remedies might inflict “more pain than necessary.”¹³ Worse, its orthodox macroeconomic policy framework might prevent governments from tackling inequality and poverty, frustrate voters, and thereby, obstruct democratic consolidation.¹⁴

Poor governments also have numerous incentives to seek the Fund’s assistance as few can afford to tap international financial markets to compensate for low savings or insufficient export earnings. Those who rely on development finance from the World Bank, regional development banks, or bilateral donors, are usually expected to enter IMF programmes to reassure lenders that their loans will not be lost through inflation. Similarly, heavily indebted countries need the Fund’s approval to convince creditors that debt relief will not trigger yet another borrowing spree. Perhaps the best reason to work with the Fund is that no matter how harshly it treats its borrowers, it does not send in gunboats or troops to settle arrears.¹⁵

Whether IMF-financed reforms benefit the haves or the have-nots ultimately depends on programme design and implementation. IMF staff may feel that they need to articulate conditions and performance criteria to compensate for their limited ability to enforce compliance. But most are convinced that they can help create the necessary, if insufficient, conditions for broad-based growth and poverty alleviation if they can convince monetary authorities to control credit supply, ministries of finance to align medium-term obligations with their fiscal space, and policymakers to recognize the opportunities and constraints that come with “realistic” exchange rates.¹⁶

Unlike development banks or donors who have a strong incentive to lend, and who tend to encourage governments to spend, the IMF advises developing countries to establish a “sound macroeconomic policy framework ... that promotes growth by keeping inflation low, the budget deficit small, and the current account sustainable.”¹⁷ IMF missions routinely warn central bankers and finance ministers that without an appropriate macroeconomic stance, scaled up aid, rents, or investment can increase inflationary pressures, add upward pressure on the exchange rate and accentuate fiscal imbalances. To the dismay of activists, aid agencies, and ambitious politicians, the IMF is particularly insistent when windfalls or favourable economic conditions seem to encourage a more expansionary policy stance and the threat of a balance of payments crisis appears remote.¹⁸

Since most IMF loans to poor countries are drawn from special trusts that do not contribute to the Fund’s income, it could be argued that staff has a perverse incentive to keep the neediest states on a particularly tight leash. A much bigger problem, though, is to get “sound” policies right. As Stanley Fisher pointed out in the wake of the Asian crisis, the fact that current account sustainability formally depends on a country’s growth rate and the interest rate at which it can borrow does not imply that its resilience is equally “susceptible to formal analysis.”¹⁹ The rules of thumb analysts use to decide when external deficits or short-term capital flows set off alarm bells offer little guidance in countries that rely on foreign aid or windfall-backed credit to tackle economic distortions or infrastructure deficiencies.²⁰

Faced with such uncertainties, the Fund has consistently pressed its poorer members to curb expectations and manage monetary and fiscal resources prudently, if not austere. The available data suggest it has been quite successful. Although compliance with the programme’s conditions has been patchy, poor developing countries entered the global downturn with smaller fiscal and current account deficits, higher reserves, and lower inflation rates and public debt ratios than they had on

the eve of past crises.²¹ Because the crisis responses have drained these buffers, African states are, the Fund argues, once again “highly vulnerable to economic dislocation from many different sources” and should focus on rebuilding comparatively strong macroeconomic positions.²²

Considering the developmental costs of raising domestic revenues, containing public spending, or curbing external funding, the Fund’s proposal to insure prudent members against “global volatility” recognizes the need to reward the politically risky decision to place prudence before ambition. Still, the assumption surrounding the promise of insurance is that it will help governments convince electorates that, by slowing a recovery or boom, they protect future growth, jobs and standards of living, rather than pay for the developed world’s greed and mistakes. This assumption ignores that the decision to go with the Fund is itself a political wager, although not because governments have to assess how a lending arrangement would affect their chances of pushing through preferred policies.²³ Rather it is because their relationship with the Fund is key to their sovereign ability to design political solutions to socio-economic challenges.²⁴

The next two sections trace the practices of co-operation and contestation that defined the Fund’s pre-crisis engagement in Mozambique and Angola. Both countries suffered decade-long civil wars and were burdened with massive external debt, shattered infrastructure, low human development levels, and weak administrations. Both rank among the world’s poorest countries that are eligible for assistance from the International Development Association. However, they differ in terms of resource endowments, access to capital markets, and—critically—their relationship with the Fund. Angola—a petro-state “cursed” with SSA’s second largest oil reserves, a GDP of \$86 billion, and exports worth 75 per cent of GDP—relied on commercial loans until it secured a \$1.4 billion IMF arrangement in late 2009. Mozambique—one of the Fund’s “success stories” with a similar population, a nine times smaller economy, and exports worth less than \$2 billion—completed five IMF-supported economic programmes and entered the crisis as one of six PSI countries.

A Long Night’s Journey

When Mozambique joined the IMF in 1984, its prospects looked grim. A long civil war, severe droughts, and falling commodity prices weighed on the command economy President Samora Machel had hoped to establish after independence. Moreover, real GDP and exports were contracting, the fiscal deficit and external debt were soaring, and debt-servicing costs had reached 200 per cent of exports. Ten years on however, the outlook had improved as the 1992 peace deal stuck and the country held its first

multi-party elections. With the World Bank's assistance, the government dismantled price controls, initiated public sector and tax reforms, revamped the banking system, and realigned the exchange rate. Growth rates returned to almost 6 per cent, the share of exports almost doubled, tax revenues increased by half, and the budget deficit narrowed from 12.5 per cent to 4.8 per cent. Additionally, bilateral debt relief helped slash the debt-service ratio to 132 per cent of exports.

Taking stock of the Fund's first Enhanced Structural Adjustment Facility (ESAF, 1990–95), its Executive Board noted that Mozambique had made "good progress toward reversing economic decline, reducing macroeconomic imbalances, and liberalizing its economy."²⁵ Nevertheless, directors on the Board cautioned that the peace dividend remained at risk due to inflation that still hovered above 50 per cent, a "fragile" balance of payments position, and "unsustainable" external debt. Too many macroeconomic improvements were contingent on foreign aid, which amounted to more than 50 per cent of GNP and included grants worth 80 per cent of total revenue. To reduce the economy's vulnerability to aid swings, the Fund urged the authorities to curb increasingly inefficient investments, narrow the deficit before grants, and boost international reserves.

Despite the shockwaves caused by the Asian crisis, the second ESAF arrangement (1996–99) stayed on track. The Executive Board recognized that the authorities' "adherence to stability-oriented macroeconomic policies" had been a "key determinant" of average growth rates of 10 per cent (or twice the target), a sharp drop in inflation to below 2 per cent, the reduction of the share of net aid to 26 per cent of GNP, and the accumulation of international reserves worth the equivalent of six months of imports.²⁶ However, the directors also cautioned that despite the impressive macroeconomic achievements the government had to face the fact that more than 70 per cent of the population continued to live below the poverty line and that most social indicators were lagging behind regional averages. Mozambique had to become more orientated towards development without sacrificing macroeconomic stability.

Amid widespread concerns that the Fund would block any serious effort to reduce poverty, the government hatched its Action Plan for the Reduction of Absolute Poverty (PARPA) without IMF assistance. Nevertheless, it maintained the macroeconomic framework that underpinned the new parallel Poverty Reduction and Growth Facility (PRGF) arrangement (1999–2003). PARPA further recognized that the "fight against poverty means directing scarce budget resources at activities that contribute to sustained comprehensive economic growth and a better distribution of resources within the economy." In addi-

tion, it included the Fund's demand for a financial management system that would introduce "a medium-term vision into budget programming [and guide] the allocation of resources in accordance with the Government's objectives."²⁶

When the Executive Board agreed to finance PARPA, it welcomed the emphasis on "the efficiency and transparency of government operations" but urged the authorities to do more to strengthen the fiscal position and to curb the country's "heavy dependence on foreign aid."²⁷ In its 2004 evaluation of the PRGF, staff noted improvements on both accounts: revenues increased to 14.2 per cent of GDP, the public external debt to export ratio had fallen to 92 per cent, and priority spending was broadly in line with PARPA's targets.²⁸ Still, the economy remained vulnerable. The current account deficit remained above 10 per cent and a series of exogenous shocks and a feeble financial sector had prevented a reduction of the fiscal deficit, adding pressure on domestic interest rates and accentuating the government's dependence on foreign aid.

One year later, staff concluded that Mozambique had reached "a critical juncture in its development."²⁹ To entrench their achievements, the authorities had to raise tax revenues further and improve public sector operations. To reassure creditors, they had to come clean of the "slippages" that typically "coincided with the elections" and train for medium-term fiscal consolidation. To get ahead, they had to dismantle the aid economy, or at the very least, record and classify disbursements to line ministries and urge donors to move project-related expenditures onto the government's balance sheet. Finally, to spread opportunities, they had to reduce the costs of doing business, encourage labour-intensive growth, and promote rural development.

On the eve of the financial crisis, Mozambique seemed poised to succeed. Staff argued that the second PRGF arrangement (2004–07) had "helped stabilize the economy in the face of exogenous shocks" and prepared the ground for "second generation reforms."³⁰ Given the PRGF's largely symbolic price tag—purchases accounted for less than \$17 million over three years—staff were confident that the authorities did not need another financial arrangement to maintain decent growth rates, raise fiscal revenues, and control inflation targets. The crisis proved them right. In 2009, staff concluded that the authorities' "strong track record of prudent macroeconomic management" allowed them to "at least partially offset the impact" of declining exports, deferred foreign investment, and tighter external credit "with somewhat more expansionary fiscal and monetary policies."³¹ As a token of trust, the Executive Board authorized a one-year \$176 million

lending arrangement under the Exogenous Shocks Facility (ESF) on July 1, 2009.

The Fund's latest performance review suggests that its wager paid off. Mozambique has been "largely unaffected by the global crisis," although rising prices of fuel and food imports strained the balance of payments, increased inflationary pressures, and sparked social unrest.³² Nonetheless, the injection of liquidity did not derail the economic programme. A "remarkably strong revenue performance and prudent execution of the budget" allowed the government to reinstate subsidies and defuse social tensions without breaking the bank or their pledges to the Fund. The only remaining though far from trivial problem was that the general lack of progress in reducing poverty called for a reassessment of the government's poverty reduction strategy against the backdrop of a tighter macroeconomic policy mix.

Defying the Kindness of Strangers

In the late 1990s, Angola faced many of the problems that had threatened to paralyze Mozambique a decade earlier: the security situation was fragile, and despite the country's vast oil and diamond reserves, the government was struggling with external debt estimated at roughly \$12 billion. Debt-servicing costs amounted to one quarter of GDP and, as President José Eduardo dos Santos dryly remarked, 90 per cent of revenues.³³ Worse, a breakdown of relations with Paris Club creditors meant that commercial lenders already held more than 80 per cent of the country's external debt. Falling oil prices and dwindling currency reserves did not entice their appetite for more.

Cornered by the markets, the government decided to turn to the Fund. Government officials reckoned that an informal Staff Monitored Programme (SMP) would enable them to refinance, and perhaps, even restructure commercial loans without surrendering policy control to the Fund, though they alluded to future lending arrangements. They also assumed that the Fund would be "happy" with their economic programme and predicted that an agreement was within sight.³⁴ They were wrong; the negotiations failed, reportedly over staff concerns that the economic programme had been designed for effect rather than impact and that access restrictions and poor data made it impossible to verify its implementation.³⁵

An escalation of the civil war and a surge in defence spending exacerbated the pressure on public finances and the external balance of payment position. In May 1999, Finance Minister Joaquim David—a former

head of Sonangol, the state-owned oil company behind the bulk of government revenues—warned Parliament that the country was facing the “most profound crisis... since independence,” and that raising new loans was not “easy.”³⁶ Major offshore oil discoveries and a \$2.5 billion infusion of foreign investment provided some respite, but no relief. In April 2000, the government convinced the Fund to monitor a programme that aimed to tackle inflation, “strengthen the fiscal stance within the limits dictated by the need for economic and social reconstruction,” and prioritize social spending and investment.³⁷ In exchange, Angola accepted an independent audit of its national bank and a diagnostic study of the oil sector. The government also agreed to compile timely budget execution reports, monetary surveys, and external debt statistics.

Despite reassurances of the government’s strong desire to make the SMP work, the programme fell through.³⁸ In 2001, an IMF staff mission concluded that, notwithstanding a six-month extension, “many of the macroeconomic targets ... were not met.”³⁹ Staff recognized some progress on structural measures and commended the commissioning of the oil diagnostic and the audit of the 1999 accounts of the central bank. However, it warned that public finances were still vexed by opaque extra-budgetary expenditures, lacklustre controls over fiscal operations and foreign debt transactions, incomplete data on oil revenue and expenditure, opaque central bank accounts, Sonangol’s erratic bookkeeping, and a seeping procurement process. Staff tried to convince the government to work with the Fund “on the accounting of oil and other revenues and plan for their allocation in line with a comprehensive strategy to reduce poverty” without an SMP, but the response was tepid.

In the wake of the April 2002 peace settlement, the directors renewed their offer to assist the authorities in their stabilization efforts, but made it clear that without “more transparency in the management of public institutions and the oil sector” it would be difficult to re-launch “a constructive dialogue with donors and creditors.”⁴⁰ Donors, in turn, declared that they considered an agreement with the Fund a prerequisite for a successful donor conference.⁴¹ Despite the pressure, the government implemented a home-grown Rehabilitation and Reconstruction Programme that cut inflation, strengthened fiscal discipline, and—thanks to rising oil revenues—pushed the country past the low-middle income threshold. Yet the tentative reform of the tax system and efforts to improve transparency did not quell the Fund’s concerns about the oil account and failed to convince donors to make more substantial pledges.

In April 2004, Finance Minister Jose Pedro de Moraes announced that “macroeconomic instability, high inflation, overvalued exchange rates, and unrecorded expenditures” were “a thing of the past.”⁴² How-

ever, he conceded that the government would still rely on oil-backed bonds to finance current and capital spending until it secured the Fund's help in restructuring the country's external debt. When the Fund insisted on more transparency, de Moraes denounced "international double standards" and official creditors who would not talk to Angola unless it implemented "first world" policies but who were happy to cancel 80 per cent of Iraq's debt at the stroke of a pen.⁴³

Rising oil prices, renewed interest from commercial lenders, and a \$2 billion concessional financing package for infrastructure development from China Eximbank provided Angola a way out. Exploiting the economic boom—annualized growth rates of 20 per cent were almost a given—the central bank increased the issue of Treasury Bills and started repaying its arrears to official creditors. In 2007, the Paris Club invited its members to normalize their relations with Luanda. Meanwhile, after yet another row over fiscal management, the Angolan government decided to call off further talks with the IMF. A defiant de Moraes observed that since Angola managed to sort out its problems with its creditors on its own, it surely would not need the IMF's help to navigate the calmer waters ahead.⁴⁴

Strong economic performance throughout 2007 seemed to vindicate the decision to dismiss the Fund. Angola entered the financial crisis with a fiscal surplus, adequate reserves, manageable debt, and a new \$2 billion credit line from China. International advisors complained that the government had become "arrogant" and "belligerent."⁴⁵ However, the sharp drop in oil revenues and capital inflows unhinged the expansionary fiscal and monetary policies that were lubricating the boom. As the economy ground to a halt, a failed attempt to defend the exchange rate drained foreign reserves. Threatened by a balance of payments crisis, Angola reluctantly turned to the Fund. Already in crisis mode, the Executive board approved a twenty-seven month \$1.4 billion Stand-By Arrangement on November 29, 2009.⁴⁶

A Tale of Two Countries

Disentangling the relationship between the "old" Fund and its members is neither simple nor straightforward. In principle, the IMF has to balance operational imperatives with members' expectations and, occasionally, great power preferences. Member governments typically tie their political fortunes to an array of norms and calculations that might not be consistent and which tend to evolve over time. Yet the way countries like Mozambique and Angola relate to the Fund also highlights the nuances

in what Hedley Bull once described as the “ordinary conduct of states”: the daily actions of governments who arrogate “to themselves the rights or competencies of principle actors in world politics” and who will do whatever it takes to deflect attempts to “wrest these rights and competencies from them.”⁴⁷ Indeed, the two cases show that, depending on their main source of income, governments can work either with or against the Fund to stay in charge of their political destiny.

In Mozambique, the political leadership made an early wager that a good relationship with the Fund would insulate it against fickle financial markets and keep donors at bay. The country’s resilience to the global downturn is only the most recent prize of an exceptionally long winning streak. After 30 years of engagement, concessional lending still accounts for three quarters of external debt. More importantly, the officials who turned Mozambique into a donor darling have, observers note, “developed advanced skills at managing complex relations with a diverse range of international agencies, juggling their different priorities and demands, and positively responding to their agendas, while at the same time maintaining internal political support.”⁴⁸

The downside of the resultant policies is a remarkable lack of social progress.⁴⁹ This is unlikely to change, whether the Fund offers insurance or not. As long as the authorities maintain their strong macroeconomic credentials, the Fund will attribute the overall lack of developmental ambition to capacity constraints rather than to complacency or political calculation. When pressed, the government will insist that even with an insurance cover, a heavily aid-dependent country “is not in a position to insist on its own priorities.”⁵⁰ If push comes to shove, it can always play on the frictions between the Fund’s attempts to curb aid dependency and donors’ refusal to scale down aid.⁵¹

Other “donor darlings” had similar experiences, even though those that shunned the Fund, like Botswana or Ethiopia, had more control over their policy agendas and outcomes.⁵² At the same time, the financial crisis showed that fair-weather policy space is hard to retain. Botswana held up well, but the global downturn forced Ethiopia into the Fund’s arms. In the past, getting a loan agreement would have required a commitment to reform, and disbursements would have been conditional on successful adjustments. However, the “new” Fund’s willingness to provide credit, revise performance criteria and grant waivers to countries that lack a strong record casts an awkward light on its ability to steer less docile members, like Angola, towards resilience.

Unlike Mozambique, Angola bet on markets and oil rather than aid. When Finance Minister David signed the first SMP in 2000, he recognized that its success depended on “rigorous discipline and [a] profound

transformation of our mentalities and perceptions.”⁵³ Two weeks later, President dos Santos was already complaining that the Fund forced African governments to “satisfy a number of political conditions without offering true economic returns.”⁵⁴ In breach of the SMP, the government secured two commercial loans, worth \$1 billion, as a hedge against fickle donor support. The authorities also dismissed the Fund’s concerns about the “system of parallel state finance” that, according to some estimates, channelled as much as 40 per cent of oil revenues past the budget but kept creditors interested.

Whilst the international community was mulling over the terms of a donor conference, Angola’s new Finance Minister, Julio Bessa, even urged the Fund to avoid “the rhetoric of transparency and of corruption, because in the end, those matters create difficult internal political situations.”⁵⁵ Arguably, he had a point. A fragile peace settlement was not the best time to dismantle a finely tuned payments system that enabled the country’s political leadership to route oil revenues through secure offshore accounts to purchase arms and other “necessary” items. Yet the sheer scale of the operation undermined Bessa’s claim that “transparency cannot be a goal in itself.” The auditors in charge of the oil diagnostic established that, in 2000 alone, Sonangol had funnelled over \$2 billion past central bank accounts—a sum worth half of government revenues and one fifth of Western aid to Africa.⁵⁶

When the Fund cited the “missing billions” as evidence of the authorities’ lacklustre commitment to the SMP, President dos Santos countered that Angola could not afford the “unjust political and economic conditions” that the IMF imposed at the international community’s behest, and announced that his government intended to exploit “bilateral co-operation and national and foreign private investment.”⁵⁷ Encouraged by Nigeria’s plans to clean up its energy sector, and wary of the other regional oil-exporters’ meek endorsement of international efforts to lift the oil curse, the “old” Fund held its ground, a persistence which paid off.⁵⁸ With the exception of Angola and Equatorial Guinea, all SSA oil exporters have signed up to the Extractive Industries Transparency Initiative (EITI). The Fund has commended countries like Gabon and Chad for the “good progress” and “exemplary transparency” of their petroleum revenue management.⁵⁹ Others, like the Republic of Congo, remain on a watch list.

It is too early to say whether the “new” IMF’s decision to approve the Angolan request for an SBA worth 300 per cent of quota will undermine the “old” Fund’s plans to “foster the efficient use of public funds, reduce the risk of unstable macroeconomic policies, and improve confidence in the budget process” in resource-rich economies.⁶⁰ Angola agreed to

publish the audited accounts of Sonangol, but as President dos Santos smugly observed at the margins of the Group of Eight (G8) Summit in L'Aquila, "the IMF is no longer the same institution it was last year; it is a great deal more flexible."⁶¹

Conclusion

The "new" Fund's plan to insure prudent members against global volatility is a commendable attempt to protect the weak and blameless. It emphasizes the Fund's role as crisis manager and gives it a mandate to promote "sound" macroeconomic policies as a means of crisis prevention. Moreover, it has a good chance of success. The two case studies suggest that co-operation with the Fund can improve resilience and that members have an incentive to adhere to IMF advice. Mozambique will not abandon its policy stance simply because it gets insurance. Yet, Mozambique's trajectory also shows that IMF-instilled resilience comes at the cost of a more ambitious developmental programme—not because the Fund prevents governments from investing in social or infrastructure development, but because adherence to the Fund's advice is a sufficient condition to tap into aid flows donors are only too happy to provide. In this respect, the "old" Fund's failure to convince governments to spread stability dividends bodes ill for the "new" Fund's hopes to harness ambition.

Angola's decision to go at it alone produced only slightly better development outcomes, despite the massive income differential. To fend off international demands to clean up its oil account, it turned to the markets, which simply priced in the weak monetary and fiscal policies that undermined development and exacerbated the country's vulnerability to global volatility. An insurance scheme would hardly affect the economic policies of a government that has shrugged off market pressures in harsher times. Although the Angola SBA might give the IMF a lever to improve fiscal management, the government's record suggests that \$1.4 billion will not get it very far. In any case, Angola still balks at the idea of joining the EITI or of following Nigeria's example of publishing reconciled oil sector accounts.⁶²

Although the provision of insurance does not cause moral hazard, it may still be a political miscalculation. The Fund's failure to corral donor or market support to wean its members off either their aid or oil addictions should give its strategists pause for thought. In 1988, Susan George argued that the IMF was not the "global ogre" that it was made out to be since it merely acted as a "messenger, watchdog, international alibi,

and gendarme” for international banks that had pushed their loans onto “improvident” borrowers.⁶³ It would be a shame if the new IMF’s desire to shed its ogre-like past convinced it to assist reckless rulers in running their fiefs. The challenge is to offer protection to those governments that accept the need for a transparent and accountable use of government revenues. Instead of downplaying the political cost of risk insurance, the IMF should consider targeting its advice and assistance to governments that are prepared to explain, make, and follow-up on the difficult choices poor countries must make to navigate the turbulent times ahead. ■

Notes

¹ I would like to thank the School of Economics at the University of Cape Town for hosting me in 2007–08, current and former IMF staff, government officials and advisors who spoke to me on and off the record, as well as the editors and the anonymous reviewers at *STAIR* for their helpful comments. The usual caveats apply.

² Timothy D. Adams, “The US View on IMF Reform,” Speech at the Conference on IMF Reform, Institute for International Economics, Washington, DC, September 23, 2005, <http://www.iie.com/publications/papers/paper.cfm?ResearchID=564>.

³ International Monetary and Financial Committee, “Statement by Tito Mboweni, Governor, South African Reserve Bank” (Statement at the Seventeenth Meeting of the International Monetary and Financial Committee, Washington, DC, April 12, 2008), www.imf.org/External/spring/2008/imfc/statement/eng/zaf.pdf.

⁴ Dominique Strauss-Kahn, “Remarks to the Board of Governors of the IMF,” (Speech at the Annual Meeting of the IMF and the World Bank Group, Washington, DC, October 13, 2008).

⁵ Patrick Bond, “Is Africa Still Being Looted? Let Us Count the Ways,” (Counterpunch Online, August 17, 2010), <http://www.counterpunch.org/bond08172010.html>.

⁶ Allan H. Meltzer, “The IMF Returns,” *Review of International Organizations* (forthcoming).

⁷ “Joint Declaration,” (Challenges Conference, Dar es Salaam, March 11, 2009), <http://www.changes-challenges.org/story/joint-declaration>.

⁸ Simon Willson, “Africa Seeing Signs of Recovery After Global Crisis,” *IMF Survey online* (March 8, 2010).

⁹ John Lipsky, “What the IMF is doing for its African Members such as Ghana,” (Opening address at the Meeting with the Parliament, Accra, February 17, 2010).

¹⁰ In a 2007 survey by the Independent Evaluation Office (IEO), a majority of African policymakers agreed that the Fund’s advice on fiscal and monetary policy improved macroeconomic stability and harnessed regional growth. See IEO, *The IMF and Aid to Sub-Saharan Africa* (Washington, DC: IMF, 2007).

¹¹ Dominique Strauss-Kahn, "An IMF for the 21st Century," (Speech at the Bretton Woods Committee Annual Meeting, Washington D.C., February 26, 2010). For a comprehensive discussion of the Fund's instruments and intents, see IMF, *The Fund's Facilities and Financing Framework for Low-Income Countries* (Washington, DC: IMF, 2009).

¹² See, for instance, Tony Killick, *The Impact of the IMF Stabilisation Programmes in Developing Countries* (London: Overseas Development Institute, 1982); Gopal Garuda, "The Distributional Effects of IMF Programmes: A Cross-Country Analysis," *World Development* 28, no. 6 (2000): 1031–1051; James R. Vreeland, *The IMF and Economic Development* (New York: Cambridge University Press, 2003).

¹³ Joseph E. Stiglitz, *Globalization and Its Discontents* (New York: W.W. Norton & Company, 2002), xiv.

¹⁴ Thandika Mkandawire, *Disempowering New Democracies and the Persistence of Poverty*, Democracy, Governance and Human Rights Programme Paper no. 21 (Geneva: United Nations Research Institute for Social Development, 2006).

¹⁵ William Easterly, *The White Man's Burden. Why the West's Efforts to Aid the Rest Have Done So Much Ill and So Little Good* (New York: Penguin Books, 2006), 214.

¹⁶ IMF, *The IMF and the Poor* (Washington, DC: IMF, 1998).

¹⁷ Stanley Fischer, "Capital Account Liberalization and the Role of the IMF," (Speech at the Seminar on Asia and the IMF Hong Kong, September 19, 1997), <http://www.imf.org/external/np/apd/asia/fischer.htm>.

¹⁸ The IEO found that between 1999 and 2005 staff used 2–3 months of imports thresholds to determine whether aid to SSA countries should be used to build-up reserves, and a 5–7 per cent inflation range to decide whether the inflows should be saved or spent. It also noted that both parameters were in line with the Fund's official policy line. See IEO, *The IMF and Aid to Sub-Saharan Africa*.

¹⁹ Fischer, "Capital Account Liberalization and the Role of the IMF."

²⁰ Cesar Calderón, Alberto Chong, and Luisa Zanolini, "Are African Current Account Deficits Different? Stylized Facts, Transitory Shocks, and Decomposition Analysis," (Working Paper No. 01/04, IMF, Washington, DC, 2001).

²¹ IMF, *Emerging from the Global Crisis: Macroeconomic Challenges Facing Low-Income Countries* (Washington, DC: IMF, 2010). Compliance data on recent programmes can be found in the IMF's (online) database for Monitoring Fund Arrangements (MONA).

²² Dominique Strauss-Kahn, "Africa's Economic Transformation: The Road Ahead," (Speech at the Kenya International Conference Centre, Nairobi, March 8, 2010), <http://www.imf.org/external/np/speeches/2010/030810.htm>.

²³ James R. Vreeland, "Why Do Governments and the IMF enter into Agreements? Statistically Selected Cases," *International Political Science Review* 24, no. 3 (2003): 321–343.

²⁴ Lindsay Whitfield, ed. *The Politics of Aid: African Strategies for Dealing with Donors* (Oxford: Oxford University Press, 2009).

²⁵ IMF, "IMF Approves Three-Year Loan for Mozambique under the ESAF," (Press Release, IMF, Washington, DC, June 21, 1996), <http://www.imf.org/external/np/sec/pr/1996/pr9633.htm>.

²⁶ IMF, "IMF Concludes Article IV Consultation with Mozambique," (Public Information Notice, IMF, Washington, DC, July 14, 1999), <http://www.imf.org/external/np/sec/pn/1999/pn9961.htm>.

²⁶ Government of Mozambique, *Interim Poverty Reduction Strategy Paper* (Washington, DC: IMF, 2000).

²⁷ IMF, "IMF Approves ESAF Loan for Mozambique" (Press Release, Washington, DC, June 28, 1999), <http://www.imf.org/external/np/sec/pr/1999/pr9925.htm>.

²⁸ IMF, "Republic of Mozambique: Ex-Post Assessment of Mozambique's Performance under Fund-Supported Programs," (Country Report No. 04/153, IMF, Washington, DC, 2004).

²⁹ IMF, "IMF Concludes Article IV Consultation with Mozambique" (Public Information Notice, IMF Washington, DC, September 6, 2005), <http://www.imf.org/external/np/sec/pn/2005/pn05120.htm>.

³⁰ IMF, "Republic of Mozambique: 2007 Article IV Consultation," (Country Report No. 07/262, IMF, Washington, DC, 2007), 31.

³¹ IMF, "IMF Mission Calls for Fiscal Stimulus in Mozambique" (Press Release, Washington, DC, May 13, 2009), <http://www.imf.org/external/np/sec/pr/2009/pr09165.htm>.

³² IMF, "Republic of Mozambique: First Review under the Policy Support Instrument," (Country Report No. 10/375, IMF, Washington, DC, 2010), 3.

³³ *BBC Summary of World Broadcasts* "President Dos Santos Sets Out Government Goals," February 12, 2000.

³⁴ *BBC Summary of World Broadcasts* "Official Previews IMF Talks, Forecasts No Difficulties," September 8, 1998

³⁵ *BBC Monitoring Africa*, "Angola, IMF Postpone Further Talks until 2000," October 14, 1999.

³⁶ *BBC Monitoring Africa*, "Finance Minister Briefs Parliament on 1999 Draft Budget," May 7, 1999. In late 1998, media first reported that a \$650 million oil-secured bond issue had fallen through and that the government was struggling to raise \$2.8 billion to cover upcoming interest and principle payments. *Africa Analysis*, "Luanda," October 22, 1998.

³⁷ Government of Angola, *Letter of Intent: Memorandum of Economic and Financial Policies* (Washington, DC: IMF, April 03, 2000).

³⁸ *BBC Monitoring Africa*, "Angola: Economic Reform Agreement Signed with IMF," April 4, 2000.

³⁹ IMF, *Angola: Preliminary Conclusions of the IMF Mission* (Washington, DC: IMF August 14, 2001).

⁴⁰ IMF, "Angola: 2003 Article IV Consultation," (Country Report No. 03/291, IMF

Washington, DC, 2003).

⁴¹ United Nations Development Programme, *Defusing the Remnants of War. Economic Report on Angola in 2002-2004* (Luanda: UNDP, 2005).

⁴² José Pedro de Morais, "Angola and the IMF," (Speech at the British Angola Forum, Chatham House, London, April 19, 2004).

⁴³ BBC Summary of World Broadcasts, "Angola expresses Anger at IMF Aid Conditions," November 25, 2004.

⁴⁴ *The Nation*, "Angola Gives IMF the Cold Shoulder," March 25, 2007.

⁴⁵ Stephanie Nolen, "Angola Chooses Home-grown Economic Remedy," *The Globe and Mail*, September 19, 2008.

⁴⁶ IMF, "Angola: Request for Stand-By-Arrangement," (Country Report No. 09/320, IMF, Washington, DC, 2009).

⁴⁷ Hedley Bull, *The Anarchical Society: A Study of Order in World Politics* (Basingstoke; New York: MacMillan, 1977), 68.

⁴⁸ Paolo de Renzio and Joseph Hanlon, "Contested Sovereignty in Mozambique: The Dilemmas of Aid Dependence," in *The Politics of Aid*, 248.

⁴⁹ The United Nations Development Programme's recalculated 2010 HDI projections put Mozambique's performance at three quarters of the regional average, and well below the performance of the other six PSI participants.

⁵⁰ Tony Killick, Carlos N. Castel-Branco, and Richard Gerster, *Perfect Partners? The Performance of Programme Aid Partners in Mozambique in 2004* (Report to the Programme Aid Partners and Government of Mozambique, Maputo, 2005), 50.

⁵¹ de Renzio and Hanlon, "Contested Sovereignty in Mozambique."

⁵² Lindsay Whitfield, "Aid and Power: A Comparative Analysis of the Country Studies," in *The Politics of Aid*.

⁵³ BBC Monitoring Africa, "Angola: Economic Reform Agreement Signed with IMF," April 4, 2000.

⁵⁴ "Discurso do Presidente José Eduardo dos Santos na Cimeira do Grupo dos 77 Países em Desenvolvimento em Havana, Cuba, *Angop*, April 15, 2000 [Video].

⁵⁵ International Monetary and Financial Committee, "Statement by Julio Marcelino Bessa, Minister of Finance of Angola," (Statement at the Annual Meeting of the International Monetary and Financial Committee, Washington, DC, September 28, 2002), <http://www.imf.org/external/am/2002/imfc/state/eng/ago.htm>.

⁵⁶ Most of the "missing billions" were probably used to finance "legitimate or quasi-legitimate state projects under direct presidential control." See Alex Vines et al., *Drivers for Change: An Overview* (London: Chatham House, 2005), 17.

⁵⁷ IRIN, "Deciding to go it Alone," February 18, 2005.

⁵⁸ Menachem Katz et al., *Lifting the Oil Curse: Improving Petroleum Revenue Management in Sub-Saharan Africa* (Washington, DC: IMF, 2004).

⁵⁹ IMF, *IMF Executive Board Completes the Second and Third Reviews under Gabon's Stand-By Arrangement* (Press Release, IMF, Washington, DC, 2009); IMF, *Chad: 2010 Article IV Consultation*, (Country Report No. 10/196, IMF, Washington, DC, 2010).

⁶⁰ IMF, *Guide on Resource Revenue Transparency* (Washington, DC: IMF, 2007), 2.

⁶¹ *Angop*, "José Eduardo dos Santos recebe presidente do FMI," July 9, 2008.

⁶² Campaigners complain that currently available data are "inconsistent." See Global Witness and OSISA Angola, *Oil Revenues in Angola: Much More Information but Not Enough Transparency* (London: Global Witness, 2010).

⁶³ Susan George, *A Fate Worse Than Debt: A Radical New Analysis of the Third World Debt Crisis* (Harmondsworth: Penguin Books, 1988), 47.

Social Values and the Future of Global Finance

97

AN INTERVIEW WITH HAROLD JAMES

On November 4, 2010, *STAIR* co-editor Julian Gruin, along with Andrea Rüdiger, sat down with Professor Harold James to discuss the future of global finance. Professor James holds a joint appointment as Professor of History at Princeton University and Professor of International Affairs at the Woodrow Wilson School of Public and International Affairs. His most recent book is *The Creation and Destruction of Value: The Globalization Cycle*, published by Harvard University Press in 2009.

STAIR: One of the basic themes of your book is the notion that the value system operating within the economy is conceptually different from that in the state and wider society—monetary value on the one hand, and the role of social values of trust and social cohesion on the other. Given that international financial institutions (IFIs), and particularly the International Monetary Fund (IMF), were historically intended to ensure the sustainability of economic globalization, do you see the second of these values systems—social values—playing a significant role in their approach to questions of global financial governance?

Harold James (HJ): Well, in general I think it would be fair to say that the major multilateral IFIs have really experienced a decline in their influence and their role. This trend was partly arrested during the current financial crisis during which they have been much more active and the Fund is again more vigorous. But the question about what kind of values inform the actions of the multilateral financial institutions is, I think, a very good one. It's a debate that people in London are very keenly aware of and, to different degrees, so are the managing directors of the Fund. They try to engage with some of these issues, but the outcome is not always very clear in the work of these institutions. So I think that on a theoretical level there is an interest in this. For instance, Michel Camdessus, the Fund's Managing Director back in the late 1990s at the height of the Asia crisis, was discussing with Anwar Ibrahim, the Deputy Prime Minister and Finance Minister of Malaysia, what role his values could play in dealing with financial crises and broader issues. He was clearly thinking of this. And his successor invited the noted theologian Hans Küng to deliver presentations on values at the Fund. But I think that it is more a kind of abstract or rather intellectualized interest than a concern that translates itself into operations and specific details.

STAIR: There is a general perception that the Fund has regained its importance through the financial crisis and has overcome the existential dilemma of legitimacy it was in before the crisis. Do you share this assessment?

HJ: The short answer is no. Having said that, there is no doubt in my mind that the IMF has played a very positive role in the current crisis, in particular at the April 2009 London G20 meeting, where the expansion of the Fund's resources was agreed. That was the turning point, because at that point there really was the possibility of financial contagion catalyzing further severe crises, beginning with a domino like process from the collapse of Hungary and then Ukraine. The Fund played its role in many ways absolutely perfectly and classically there in stopping the early stages of the crisis. Through that phase, the Fund generally gets very high marks.

The problem that still remains is one that critics of the Fund identified long before the 2007/08 crisis. The Fund is not an international lender of last resort in the sense that it can't create its own money and is dependent on the amounts that governments decide to put into it. It can deal very nicely with Hungary and Ukraine, whose situations were really ideally modelled for Fund operations. Here are relatively small economies whose collapse might threaten systemic consequences but in which you can effectively intervene. What happens when you get a crisis in the People's Republic of China (PRC) or in Brazil? Those were always going to be too big for the Fund to do anything about. Or, what would happen with a US fiscal crisis if people decide that they do not want to buy US government bonds anymore? The Fund is clearly not capable of responding to this. The Fund is a very good instrument for stopping contagion from relatively small crises, stopping their expansion. But it is not a good instrument for dealing with big problems in major economies.

STAIR: There were a number of other financial crises in the 1990s, such as the Mexican, Russian, and Brazilian, and Asian crises. But they have not provoked a similar process of questioning the foundations of the financial system in the way that the recent crisis has or that the Great Depression did. I am wondering why that is. Is it a question of scale—that they were simply not as severe—or, historically speaking, is there a particular set of social circumstances in these two crises that make them qualitatively different from the financial crises in the 1990s?

HJ: Yes, that is an interesting question. In some ways, if we are thinking of the debate about the IFIs, the criticism of the Fund was much, much greater in the late 1990s than it is today. In particular, there was the

widespread charge that the Fund was giving inappropriate advice when it came to dealing with periods of turmoil such as during the Asian financial crisis. But there was also the charge that it was advice that fitted in with the interests of US financial institutions, which were gaining the opportunity to buy up Asian institutions at bargain basement prices. So that was a moment when both in the region with Mahathir Mohamad and the Chinese leadership worked very much together in an attempt to formulate an idea of Asian values that were separate to those of the United States. They heavily criticized the Fund's management, and it was not only from Asian leaders either; this criticism also came from quarters such as the World Bank and elsewhere.

I think part of the aftermath of the Asian crisis was that Asian countries learnt from that experience that they needed to start to invest in each other so that they were never to come into this situation again. They built up big reserves so that they wouldn't be in a position to have to take the Fund's advice again. In the views of some people, though this is obviously a complex set of issues, the origins of the current crisis lay in this big pile up of reserves in the Asian economies that were designed specifically in reaction to the former criticisms of the Fund. Today, there isn't much actual criticism of the Fund. I think it is largely irrelevant. So in that sense the debate has moved on. In addition, the Fund has tried to re-brand itself, and Strauss-Khan as the executive leader of the institution stresses that it doesn't have much so many continuities with the old institution.

STAIR: In talking about the influence of different values, even at an abstract level within financial governance, you mention a quite discernible weakening of western-generated conceptions of how these institutions ought to operate. I am curious as to who, if not institutions like the Fund or the World Bank, is going to be increasingly responsible for fulfilling this co-ordinating role. I am thinking about the rise of private regulation and voluntary standards setting, and also the fact that the multilateral institutions are no longer the first port of call for development funding or investment. This itself is connected to China's rising economic influence around the globe. If we have these two trajectories—the waning of the influence of the major institutions, and the increase in the influence of countries like China as well as private interests—who do you see as being more influential in setting the values agenda?

HJ: First of all, I think the Fund will only be able to play a central role in managing international financial issues if there is a really radical redistribution of votes and influence. This is an issue that many people have raised, and there are small moves in this direction, but they are really not enough. The question is whether there is going to be confidence

in how issues like current account imbalances are managed. In those conflicts the Fund inevitably looks as if it is simply an instrument of the United States, and therefore China is not going to take it seriously in terms of devising a mechanism for determining whether current account imbalances are sustainable or not. This is something that the Fund was already supposed to do a few years ago, but it never really eventuated. Current proposals for tightening that system are really not likely to work either. So this is the first point: unless the Fund is fairly fundamentally reconstituted, it is not likely to be an institution with major say.

Secondly, the World Bank is associated much more than the Fund is with a particular view of how development occurs. It is a view that has been shown not to offer a terribly effective set of mechanisms for development. Many people in Africa are pointing out, whether you are taking geopolitical sides or not, that Chinese engagement in Africa is actually producing much more growth and being much more effective. So I think that we've already seen this kind of shift away from the Bank in terms of its development model. First, there was a basic model for development, to which people added many more conditions concerning governance, environmental sustainability, social stability, gender equality and anti-corruption measures. By the time all of this happened, recipient countries came to view this as insanely complicated, and interfering too much in what they wanted to do, and so if then an actor like China comes along and simply gives them money then it is clearly likely to engender much more responsiveness from recipient governments.

Having said that, I think it's really only a matter of time before decision-makers in Beijing concerned with development realize that they're going to encounter similar problems, since simply dealing with corrupt governments in poor countries simply isn't a very good way of doing development, and they are bound to find some examples of the adverse outcomes becoming apparent. Nevertheless, the Bank in a way has become quite discredited simply by having been associated with the development process for too long and having taken too many hard knocks.

I come to your question then, about who is going to be responsible for thinking about this, and it's rather difficult for me to imagine any kind of institution being able to do this effectively. It's something that will come more from outside the world of the IFIs than from inside, perhaps not surprisingly, for I think that we've always had some kind of external influence upon how governance and development need to occur. It was the evolution in the way that economists thought about development, and especially how people in developing countries thought about development in the 1970s and 1980s, that changed how these issues were approached, and I wouldn't be surprised if change came from outside again.

STAIR: It's interesting that you say that you don't expect change to come from within. The dominance of the economics profession and the hegemony of ideas within the IFIs might be seen as a product of the uniformity of staff in their perspectives and worldviews, and thus as a contributor to the existential crises of the IFIs and their inability to predict the financial crisis. I'm wondering whether the crisis has prompted any kind of momentum towards reducing this kind of epistemic hegemony within the IFIs?

HJ: It does. However, I would be a bit careful in thinking about whether analysts and staff within these institutions were really the most at fault in failing to predict the crisis. This is something that people have often commented on about the IMF and its relationship to particular countries—why didn't it predict the Asian financial crisis, why didn't it predict Mexico in 1994–95. In part there is a kind of answer to that which also applies to the global level, in that the Fund is are reluctant to say overly critical things for fear of triggering a crisis. This is because there is an acute awareness that a lot of economic interchange depends on confidence, and, if you speak out too critically, then you can really undermine a country's economic position very quickly. It's an issue that doesn't just apply to the Fund but to ratings agencies as well, and it has earned the ratings agencies a lot of criticism more recently as well with regard to the European economies.

There's also another point to be made that in particular the research departments of the Fund and other international institutions were actually more outside the consensus evident within the financial sector, and amongst university economists and American policy-makers about the crisis. So if you were to ask me who were actually in some ways almost prescient in giving warning, I would say first of all the research department of the Bank for International Settlements, the former chief economist of which, William White was extremely worried about the development of the credit bubble. Someone who also sounded quite similar and who gave a rather infamous (and in retrospect completely accurate) presentation at the Federal Reserve conference at Jackson Hole was the former chief economist of the Fund, Raghuram Rajan. Both White and Rajan were really outside the mainstream and were heavily criticized by academic economists, particularly US academics. The academic economists were probably, on the whole, more wrong than the institutional research departments. Having said that, the research departments are not necessarily involved closely in the policy-making process, and so I'm not sure the extent to which the views of people like White and Rajan were actually integrated into the practices of the institution.

*STAIR: On this topic of who was thinking what and when, and how much of an impact this had, I'm curious as to what you think of the notion of history repeating itself. To contextualize that, we've had a huge resurgence of interest in Keynesian macroeconomic policy—for example, suddenly Hyman Minsky's book, *Stabilizing An Unstable Economy*, shot up bestsellers lists—and this has echoes of how Keynesian economic thinking was instrumental in the development of the welfare state. I'm wondering whether, given that we're seeing new trends in financial governance as non-western states exert more influence, you think that this will provide greater scope for avoiding the repetition of history or do you think that capitalist development along a volatile and potentially unsustainable financial model is set to continue?*

HJ: There are lots of interesting issues in there. First of all, are we going through a kind of replay of the 1930s? In an obvious sense, we're not, for we don't have the Great Depression, and although the world economy went through a phase of six months or so between September 2008 and March 2009 when some of the processes of the Great Depression seemed to be being repeated, since then there has been vigorous growth in emerging markets which has prevented a deeper recession. On the other hand, there are parts of the world that have to suffer the consequences of an over-financialized process of globalization over the past twenty years and will pay this price for a considerable length of time. Ireland is the most extreme example of this, as well as Iceland, Greece, and Portugal, but it may also be true of the UK, whose economy is heavily dominated, and has become ever more so over the past fifteen years, by its financial sector. That brand of financially driven globalization doesn't seem to me to be likely to recur, so when people worry about all of this taking off again, I'm not sure that it will. On the contrary, what we're likely to see is a shift in attitude of development and financial institutions located in the major creditor regions—in emerging markets—that are not really going to be willing to trust US and European institutions again. And so we're going to see the Gulf and Asia being much more important. The idea of debtor countries being able to finance themselves without external influence, whether it be the US, the UK, Spain, or Ireland, is probably not going to happen again. Some of this adjustment has already taken place, and I think it will continue to take place.

You raised secondly the issue of new Keynesianism—there certainly is that in terms of the arguments currently being made. In another sense, we're also back to the 1930s in terms of people being worried about the sustainability of fiscal imbalances, and so the scope for Keynesian action is really much smaller when policy-makers are concerned that they will hit the buffers in terms of the financial sector's ability to absorb a

great deal of public sector debt. Again, I think there are questions about sustainability that are very obvious to everybody in Europe: look at the UK government that is almost bankrupt and has thus introduced severe austerity measures. But it hasn't really hit home yet in terms of the US political system, and in this way the US is certainly still a bit behind Europe. So I don't think we're going to see a lot of Keynesian policy in the big industrial countries.

The irony is that there is really more of this being done in some of the big emerging markets, in India and China in terms of making use of public sector stimulus. People are going to ask hard questions about this, but they are clearly more sustainable than the immediate and rather short-sighted approaches that were adopted in the US.

STAIR: I'm curious about trust. You say that in the future there will be limited trust in American institutions and scepticism of their authority. You also say that China's stimulus programmes through heavy public investment might be more effective in generating sustainable economic activity, but, at the same time, a huge proportion of this investment is funnelled directly through state-owned enterprises that are notorious for corruption and lack of transparency. This is perhaps related at a conceptual level to the failures of the financial sector in the US, which were highly skewed towards a lack of transparency, and which gave rise to what was essentially a form of private sector corruption and knowledge-driven exploitative behaviour. Both an image and the reality of being trustworthy will be essential for any move to usher in a new alternative mode of regulation and governance. Is China trustworthy?

HJ: That is an absolutely excellent question. Historically, I think what has happened is that there have been waves of trust in particular regions or economic sectors by the international community, IFIs or international markets, and by economists as well, but then those economies or sectors collapse, and so you go and look to another area and then that collapses too. So the classic case I think is in the 1980s and the late 1970s, the big oil surpluses from price increases were recycled to developing countries, especially Latin American countries and people thought that some kind of automatic, miraculous growth was happening there. That broke down in the Latin American debt crisis and then it all went into US fixed savings and loans which looked much more trustworthy, then the savings and loans turned out to be not so good, and so they went into Asian markets and then they went into the US housing markets and then into emerging markets again. Over the past several decades, we have been seeing this kind of herd-like behaviour, and I think that there are many signs already that people have identified the kind of questions that

you posed just now. Many of the big German exporting companies, for instance, just very frankly and candidly laid out their absence of trust in China; they thought that it was much easier and much more reliable to deal with Brazilian authorities or even, amazingly, with the Russian authorities than with the Chinese authorities. When they started to talk about Brazil and Russia being trustworthier than China, I thought to myself that this is already a sign that something is indeed problematic here. So your question also has an interesting broader implication. Could it be that people will actually, in the longer run, once we have a new emerging market crisis, which seems to me to be not implausible, begin to realize that continuing to move around in this herd-like way to find miracle areas to invest is fundamentally not the right way of doing business?

STAIR: So in a sense this implies that from a western perspective, counter-posing Brazil to China involves perhaps a mistaken distinction, in terms of financial trustworthiness, between more western liberal values as opposed to a soft authoritarian form of government. Picking up on the notion of the “end of the financial revolution” as you phrase it in the book, the reconfiguration of how we approach trust may be something that is inextricably linked to how we approach western values, but it is also linked to the end of the financial revolution. If we don’t trust non-liberal politics, are you anticipating a darker, more negative movement?

HJ: I think it is going to be a movement to more competition in terms of the behaviour of big states. In particular, what big states are going to do is to secure access to energy supplies, to raw material supplies, to water supplies, and all of those areas are going to be inherently conflictual. We’ve been taught over the last 20 years that market processes could solve those things. If you are thinking of access to scarce materials, market prices don’t work very efficiently and you can get much more of an intrusion of power-infused, geo-political thinking. This was a discussion that began before the crisis. People started noticing how Chinese state-owned enterprises were buying the sources of raw material and the facilities for energy production in other countries. Why would you need to do that? Conventional economic wisdom would have you believe that you can always buy whatever you want in the market. The fact is though that many governments clearly think that this doesn’t always work that way, and thus want to have a more hard-headed and more politically anchored process to secure these resources. Clearly, the growth of the Chinese economy poses immense issues in terms of the energy requirements, and the move to energy conservation is already a very big priority for them. But that won’t generate enough savings to fill the energy gap,

so people who see some kind of power-based non-market competition there, I think, are correct.

STAIR: You have identified the alter-globalization movement as originally stimulating your interest in studying globalization. Once we start introducing social values into our assessments of sustainable capitalist systems, you start having to unpack the dynamics of public political action. I'm wondering what role you see these movements as having. Are they able to play a reformist role in seeking to repair the financial system rather than simply trying to tear down those principal actors that they perceive as being responsible for financial breakdown? Or, are they neither, in that they have a fundamentally alternative model for development and globalization that may just be feasible?

HJ: In general, I think you would have to say that their influence has not been very great. When it comes to the break-up of the international financial system, I would say that the bankers have been much more effective in doing that, and much more disruptive, than the anti-globalization protesters! So it's really the insanities and excesses of the financial world that wrought the destruction rather than any critique from outside the system. In terms of building an alternative, the answer is no. I don't really see that they do have any kind of blueprint for any kind of systematic overhaul of the system. Insofar as they do have any such blueprint, it's naïve in the sense that it demands going back to local production and simply doesn't consider the mechanics of how to deal with the food, energy and water needs of six billion people.

So how then do we organize this? I think it's fair to say that there can't be some simple organizational plan that would be acceptable to all governments and all people. What you're going to have to think of are lots of individual entrepreneurial actions to introduce new technologies and to stimulate them through public policy. This is likely to be a world in which the solution, if one is to emerge successfully, doesn't come from top-down planning, but rather from local initiatives that really work. One example—it's so often cited that it's become a kind of platitude, but it's still enormously interesting and important to see how it works—is the extension of micro-credit, and the work of Muhammad Yunus and the Grameen Bank. This is widely replicated, and in some situations it works well and in others it doesn't. It doesn't work well where there are very powerful state institutions, or where there is a lot of corruption, but it's something that is genuinely locally generated rather than implemented from the top. So that's the kind of model for any kind of positive change to take place.

STAIR: So you still have some faith in the potential of local initiative and agency for any kind of remaking of the global economy.

HJ: Yes, that's really important, for ultimately I think what we have is really a crisis of global management. Global management hasn't really been doing well on any of these issues. We need to be open to a much broader range of measures rather than simply trying to decide if one measure is singularly the right thing to do or is a universal recipe for sustainable development.

STAIR: And you would say that the crisis has created some degree of momentum for such ideas to spread.

HJ: Yes, absolutely. ■

Global Financial Governance in an Interdependent World

107

AN INTERVIEW WITH PAUL MARTIN

On February 25, 2011, *STAIR* co-editors Julian Gruin and Jiajun Xu spoke with the Right Honourable Paul Martin and discussed the future of global financial governance. Mr Martin was the twenty-first Prime Minister of Canada from 2003–06, its Finance Minister from 1993–2002, and the Member of Parliament for LaSalle-Émard in Montreal, Quebec from 1988–2008. Amongst other public offices, he is currently a member of the International Monetary Fund (IMF)'s Western Hemisphere Regional Advisory Group.

STAIR: One of the greatest challenges facing the International Financial Institutions (IFIs) today is the perception that they remain controlled by and rooted in the policy attitudes of the Western developed world. To what extent do you share this assessment?

Paul Martin (PM): As a G7 Finance Minister I was actively involved in the Asian financial crisis and was a governor of both the World Bank and the International Monetary Fund at that time. The fundamental issue in terms of the IFIs is that there's a tremendous herd instinct amongst economists, and so ideas which are considered absolute given truths and sacrosanct today, may well be revised five years later and rejected five years after that. But heaven forbid that anyone would try and challenge them now. The best example of this is the question of the liberalization of capital flows. At the time of the Asian crisis, it was a given belief that you had to liberalize capital; that you could not erect any kind of obstacles to hot money flowing into a developing country. Countries simply had to suffer the consequences whether or not they had deep capital markets that were able to absorb this hot money. That was the problem in Thailand, Indonesia and a number of the Asian countries. Well, as we've seen today, the imposition of capital controls in these circumstances is now largely accepted, and in some cases actually advocated by the IMF.

I was very much in favour of limited capital controls as long as they were imposed before the fact, not after. This is not something that can be done retroactively. In fact, when Canada negotiated a free trade agreement with Chile, and Chile wanted to retain its ability to place a tax on

incoming hot money, I supported it, and received a great deal of criticism from various people because I was breaking with the sanctity of views at the time. The reason I give you that example is to make the point that in a developed country, as when I was Minister of Finance in Canada, if my officials, let alone the IMF, gave me advice that I did not think was politically appropriate at the time or that I simply disagreed with, I had the ability to withstand pressure from institutional economists. This was possible as long as your country was in reasonably good financial shape, as we were when we emerged out of deficit, whereas prior to that, we were susceptible to pressure. One of the problems that the developing world has is that if you're the finance minister of a developing country, even one that is being reasonably well run, you have a very difficult time resisting the conventional wisdom advocated by an international financial institution.

What I believe has happened since the Asian crisis, and I argued for this very strongly at the time, is that the IFIs have become aware of this pressure. They were not at the time of the Asian crisis. I think this is a result of the combination of the work of the Independent Evaluation Office of the Fund (IEO)—which was headed by a Canadian named Tom Byrnes, and which closely examined the way the Fund approaches these issues—and the appointment of Dominic Strauss-Kahn, who was a finance minister with me in the G7. He brought what I regard as a very worthwhile perspective as to the appropriate role of the Fund in its involvement with recipient countries.

STAIR: A former chief economist at the Fund, Simon Johnson, has laid a lot of blame for the financial crisis at the feet of national regulatory agencies and the power of oligarchic groups, operating especially within the United States, in terms of the relationships between regulators and the financial sector. If the Fund has undergone this kind of sea change in its attitudes, to what extent do you see it coming into conflict with national agencies?

PM: I think there was a major problem during the Asian crisis in the Fund imposing their orthodoxy of the time. A lot of national finance ministers, including myself, opposed the Fund orthodoxy at that time, because we recognized its defects. If the question is whether the Fund has cleaned up its act since then, the answer is unequivocally yes, it has. And I think they did it as a result of the Asian crisis. I also think they did it, and we'll get into this later, because of the creation of the G20, which has brought a very different perspective to these issues.

I also believe, just to go back to my earlier comments, that the IEO became a very powerful institution within the Fund following the Asian

crisis. It has played an incredibly important role because its actions were independent of the Fund's management, and it was not reluctant to be critical.

STAIR: You mentioned the G20. What are the limitations of the G20 in playing an important role in long-term financial governance, and what is the state of its relationship with more formal arrangements like the IMF and the World Bank?

PM: I think that the G20 is probably the most important innovation in global economic governance, and global governance generally, that we have seen in a very long time. The G20 first of all was a Canadian initiative, supported by the US and the UK, that arose out of the inability of the G7 finance ministers to deal with the Asian crisis. This became evident when the countries involved in that crisis, all of whom had quite sophisticated economic and finance ministries themselves, refused to accept that solutions could be imposed on them when they were not even at the discussion table. I should note that all of those solutions imposed by the IMF reflected the economic orthodoxy of the time, despite the fact that a number of the G7 ministers themselves had real doubts about them. Not having China and India at the table, let alone countries like Indonesia which were directly affected by the Asian crisis, led to the creation of the G20 meeting of finance ministers, which of course led to the summit level meetings ten years later.

What was the effect of the G20 on the IMF? Let me give you two examples. Firstly, it was the G20 that insisted upon quota reform within the IMF. With China and India leading the charge, it insisted that emerging economies' quotas be increased substantially, and that this increase come at the expense of the European quota. This was a change that people had been urging for decades, and finally it happened as a result of the financial crisis and the increasing influence of the G20.

A second example is that at the time of the Asian crisis, Korea found its financial reserves depleted, as did of course a number of other Asian countries. Subsequently, as a result of this, Korea built up its reserves massively. When the current crisis hit Korea felt that it was in very good shape, but those reserves, which I think were about \$270 billion, dropped by about \$70 billion. In short, there was a real run on the reserves of many of the emerging economies. At that point they had to seek help from the US Federal Reserve in the form of substantial bank swaps. This demonstrated quite clearly to Korea that there was going to have to be both a regional and global set of swaps that would support other economies. They insisted that this be run through the IMF

at the G20 meeting that took place in Seoul last year, and thus the IMF is now implementing the Korean suggestion through co-operation with the Association of Southeast Asian Nations (ASEAN). That never would have happened had it not been for the G20. It is a fundamental reform within the IMF, and one that reflects the needs of the emerging economies rather than those of the G7 countries. So the G20 is unequivocally having an effect on the IMF.

STAIR: That raises the obvious question of how effective these institutions are going to be. Some argue that the G20 needs to evolve into a more formal and supranationally institutionalized organization. Do you see that happening, and do you think it would improve its role by doing so?

PM: As a crisis responder the G20 has certainly proven its worth by saving the world from a global depression. Its ongoing ability to function as a steering committee is going to be dependent on a number of things, one of which is the way it works with the IFIs. As an example you have this debate between the US and China over exchange rates and the competitive devaluation of currencies. You also have this debate about global imbalances and how to handle them. Only the IMF can perform the work that is necessary to analyze the spillover effects of a country's economic policies, as it is the only institution that has the requisite staff and global legitimacy. However they cannot do it effectively unless it is supported by the G20 because that's where the power and the authority are to be found. Of course you're not going to get instant success at any G20 meeting; that's not the way the world works when you've got fundamental differences between the various powers. However, if this analysis is taking place, and in meeting after meeting there is further recourse to the analysis of the IMF, what you will see over time is the development of a consensus on the way that countries have to handle their macroeconomic differences. And that will be the direct result of the co-operation between the IMF and the G20. You require both bodies in order to get it done.

So the first thing that the G20 has to do in order to succeed is to give life to existing IFIs. The second thing is to understand that sometimes there are new organizations, such as the Financial Stability Board (FSB), that must be created or significantly developed if the global system is going to work.

STAIR: You mentioned the notion of developing a new kind of consensus that will have to emerge from the G20's role as a broad steering committee in conjunction with other institutions. In your opinion, bearing in mind that in the immediate aftermath of the crisis there were calls for fundamentally

rethinking our financial system which haven't quite been realized, has the international community, in beginning to form this kind of consensus at the international level, been effective in striking a balance between the immediate survival of the financial sector, and implementing mechanisms to ensure the long-term sustainability of the system?

PM: No, not at all. First of all, I don't think there was any serious consideration of the demise of the capitalist system. The free-market system, in terms of the allocation of capital, has proven its validity and effectiveness unequivocally. Whether it is the free-market system as exercised by the United States, or the slightly different version practised in Europe, or the very different versions found in India and China, what you're talking about is capitalism in all three cases.

However the fundamental issue is that the free-market system requires state support. Without state support, and thus without the ability to enforce contracts or the ability to have sound regulation, the free-market system is simply not possible. The free market is, and can only be, free up to a point. The difficulty to be recognized is that these economies are now so interdependent that if you're going to provide the support that the free market needs, you cannot hope to do it only on a national basis, you have to provide it on a global basis. Coming to grips with that is what the G20 is now doing.

People keep talking about this in terms of the debate between East and West, between the US and China. The fact is however, that this is not the first line of attack. We are a long way from beginning to address the debate in constructive terms because of the stark differences between the US and Europe. This banking crisis was not an Asian banking crisis, it was a Western banking crisis, and there are very significant differences between the UK and Continental Europe on one hand, and even greater differences between Europe and the US on the other hand. Addressing that gulf must be where we first act. The banking system in Europe, the UK, and North America are all interlinked at a fairly fundamental level, yet the governments and legislatures of all three regions keep coming up with different answers. The Dodd-Frank legislation in the US is very different from what the Europeans have come up with, and of course we see the constant debate over different approaches between the UK and Continental Europe. The West had better get its act together pretty soon, if we are to fulfill the need for global co-ordination of banking regulation. In fact, if the G20 is to live up to its press releases this must be at the top of its priority list.

STAIR: One important question is whether you place greater faith in stronger international financial institutions that seek to develop global standards, or a greater role for regional regimes?

PM: I think there has to be both. For instance as Europe struggles its way toward a closer economic union, it's going to do its thing, and we are already seeing the formation of a closer relationship between China and ASEAN. So I wouldn't say that you need to have either global or regional at the expense of the other. Nor am I saying that you're not going to have national solutions. Bank regulation has to first and foremost take place on a national basis, for the influence of individual national circumstances is too great and knowledge of local markets is too important to ignore. So you begin with the national regulator. That is the first line of defense. Then you go to regional co-operation efforts. In the end, however, those regional co-operation efforts have to be consistent on a global basis so it's nonsensical for the Europeans to go off in one direction, and the Americans to be going off in another. Sooner or later they have got to come together. And sooner or later they are going to have to come together with the Chinese and the Indians.

STAIR: You raise the role of emerging powers here. Do you think that they are rule-takers or rule-makers?

PM: I think that everyone is going to be a rule-taker. Your question is a very good one, and the way in which the answer will be interpreted in the days ahead will be crucial. We have to understand that this issue of rule-taking or rule-making arises very much out of the past and is not so much about the future. The days in which the West can impose its views upon the East are over, but likewise I don't think that the East can impose its views on the West. That's the whole purpose of this exercise in global governance. Both sides are going to have to understand that the protection of their own sovereignty requires global co-operation, and this means that whilst both can develop their approaches, there's going to have to be a compromise between them.

It is here that the G20's informality will be important because it can work on compromise without the parties backing each other into corners from which there is no exit. The G20 doesn't have the quota system of the IMF, nor does it have the absurd veto system of the UN Security Council, and as a result compromise and consensus are more easily achieved. As time goes on this will become more and more important. For example, China has the two biggest banks in the world,

and will in the next twenty years have the most powerful economy in the world in absolute terms. In those circumstances, if the West believes that it can simply dictate the rules to China, or to India for that matter, they are going to run into a stone wall. On the other hand, China's and India's banks are going to want to operate internationally, in the United States and in Europe. Unless they follow the rules that are being followed internationally, and which are accepted in those existing markets, they will run into a host of national regulations that will make it impossible for them to do so. So I think that the essence of what we're aiming for through the G20 is that it is no longer a question of who is going to be a rule-taker or a rule-maker. It's going to have to be about working this out together on a global scale, in much the same way that we end up having to do at home. And it's going to be messy. People are going to say, "Oh my God, they're not getting there, they're taking too much time." But guess what? The world's messy, and in some of these things, where you've got powerful national constituencies, it does take time.

STAIR: The US, always having to deal with domestic populist tendencies in Congress, might be expected to struggle more than most with the kind of process that you describe. With delicate issues such as monetary imbalances becoming more and more critical, do you see such struggles heightening the risk of economic nationalism, and ultimately, conflict?

PM: Sure there are going to be difficulties for the US, and you identify why, but not that much more than Europe or the UK is going to have. American populism is a bit more in your face, just simply because of the checks and balances in their system. But a similar kind of populism pervades the UK, which is one of the reasons that it didn't join the Euro. The same thing has occurred in Europe, where Germany and France are trying to run the whole thing, and other countries are objecting strongly to this. So yes, I agree that there are going to be difficulties with populist tendencies—not all of which are wrong by the way.

This is the reason that it is so important that the FSB be created. What you have to do—in terms of the co-ordination of bank regulation, and the imposition of sanctions on countries that don't live up to the rules—is to recognize that you can't have every decision negotiated in individual legislatures. What you really have to do is create international bodies that have the ability to negotiate the answers to these issues, leaving some of the scope in the interpretation of how these answers are to be operationalized. The World Trade Organization (WTO), when it worked well, was an example of that. It's not working very well right

now, but the great strides made in global trade liberalization were in fact made because these governments negotiated agreements between themselves at the WTO, and the WTO then interpreted these agreements as required. The FSB has to be made up of an internationally accepted set of regulators, who are going to force national regulators to live up to the rules. In the end none of us knows what its rules will be; they will evolve with time. And that is why we need the FSB, so that the world can operate with, and institutions can operate within, a set of rules that are not subject to populist measures.

Another reason for the importance of the FSB is that the G20 is spending a lot of time on exchange rates, current accounts, and global imbalances. These are very complicated issues and will take a lot of analysis to resolve effectively. But if the G20 is not able to get the FSB up and running, with much greater authority, more staff, and better financing, I don't know how it is going to try and work out questions far more complicated than bank regulation. The FSB is a very straightforward organizational solution to the problem of global banking crises. There is no total solution—we're still going to have problems—but the best answer right now is an effective FSB. And it's simply not being dealt with adequately. My own view is that it is going to be the ultimate test of the G20.

STAIR: You alluded to the fact that none of us can know what these rules are going to be, but that we can envisage the procedures and institutions necessary to formulate, which raises normative issues of representation and the design of these institutions. Of course the G20 is more representative than the G7 was, but how do you see this regulatory architecture evolving in a way that will take account of the views and interests of weaker developing countries, which, whilst not as integrated, are still profoundly affected by the global financial system?

PM: First of all, I think that the great strength of the G20 is its informality and its small size in numbers. I don't believe that the G20 should be creating a great new bureaucracy, but instead should be delegating to the existing IFIs or any new ones that are to be created. The IMF represents all the economies of the world, large and small. But the question is nonetheless a very good one. In the case of the FSB, it is at the present time limited to the G20 and a couple of others. Thailand is not in the G20, neither is Nigeria. They should be, but they are not and I don't believe that that's acceptable. The FSB, although created by the G20, is the body that should interpret and enforce international financial regulations, and therefore it must have as its membership all the countries of the IMF.

STAIR: As you say, the question that we should really be addressing is of course that of China and India, as they become increasingly more significant. There are questions of internal stability and growth that are currently meriting a great deal of attention in Western Europe and North America, and some would say perhaps at the expense of consideration of the larger question of how Asian economies are going to affect the future global financial landscape. Would you say that the leadership in these countries is in any way being complacent or naïve about this?

PM: No, I think that they are fully aware of what's involved. Their problem is that they are currently so pre-occupied with their own financial difficulties. The Europeans are focused on a growing number of insolvent nations and a larger pile of insolvent banks. The scale of the problem in the US is horrendous, and they have a series of checks and balances in Congress that makes it very hard to move. So I think that they are very much aware of the issue that you've just raised, but I think that their greater problem right now is the scale of their own difficulties.

STAIR: Well, let's talk about the US deficit and its implications for how the international financial architecture is going to evolve. Of course there are periodic threats of—or allusions to—downgrading the US government's credit rating, and these are not necessarily credible threats, but underlying them of course is a fiscal situation of immense concern, and one which, objectively speaking, probably wouldn't warrant the credit rating that it is guaranteed by virtue of the dollar's reserve currency status. The Chinese government has increasingly dropped hints in recent months of their doubts about the dollar's long-term reserve status, and of course much more trade in the Asian region is now being settled in renminbi (RMB). Do you lend much credence to the notion of medium-term fundamental change in the global reserve currency situation?

PM: I don't think that it's going to change in the short-term. In the medium to longer term I think it's inevitable that it will change, for ultimately it has to reflect the reality of the world. I don't think that it's going to be as easy as some people seem to think. It was not that long ago that people were talking about the euro as the answer, and we've seen the problems of the euro recently. So things can change. But ultimately, if you're going to have a change in reserve currency, then the Chinese are going to have to come to the table with their own currency. The RMB is not going to be a reserve currency if the Chinese continue with their current policy. It is one thing to allow it to be used in trade exchange in East Asia, but it will have to be freely convertible, and if this happens then there may well be a shift in reserve currencies. The US dollar will always be there,

but there will be others alongside it. They'll negotiate this, but it will happen quite naturally as other events take place, the most important of these being the move to convertibility of the RMB.

STAIR: Last year when the World Bank Development Committee met they decided to increase the quota of the emerging powers such as China. Do you think that an increase in the formal authority of such powers will actually increase their de facto influence in World Bank governance?

PM: That's an interesting question. I certainly believe strongly that the quotas for emerging economies should be increased, but the fact is that the power of individual countries was reflected in the IFIs before the quota increase. In other words, your influence within the IFIs doesn't come from the quota increase; the quota increase comes from the fact that your influence is now greater. So today I believe that the quota increases are probably insufficient, but I think that it's more of a symbolic issue for most countries. India, China and other emerging economies are very powerful countries today, far more powerful than ever before, and their influence is being felt. The problem isn't one of whether the world should be allowing China and India to have greater influence, the real problem—and I think we all understand this—is that China and India consistently refrain from exercising that influence. That's a bigger issue than that of quotas.

For example, within the World Bank, China's constant insistence on operating alone, rather than through the institution, is a problem for the multilateral framework. It isn't that the world is telling these countries not to exercise their influence or preventing them from exercising it, it's that these countries are claiming that their domestic problems are such that they don't want to take a leadership role.

STAIR: Yet in 2007 China made the first contribution to the International Development Agency of the World Bank. So in a sense China, through such actions, is seeking to increase its voice within the World Bank.

PM: I think that if it wanted to it easily could. China's contribution to the multilateral institutions, which hopefully will continue to grow as a proportion of what it spends in the developing world, is much smaller than that of other countries, which contribute a much greater slice of their foreign aid budgets. The institutional makeup of global governance has to reflect the reality of the world. China's role in the IMF should increase as a result of the strength and size of its economy. That being said it should be prepared to put a lot more resources into the multilateral institutions.

STAIR: In some ways, one of the most pressing questions that we have about how emerging powers are going to exercise more influence in these institutions, and the fact that they're yet to do so, is whether they are refraining from doing so solely in order to focus on their domestic reasons, or because they don't have such an acute need to right now. Of course it's in their interest to be part of the G20 and to be engaged at that more informal level, but they haven't been leading the way there either. With its growth rate only dipping slightly during the recent crisis, and through its engagement with the rest of the developing world, China seems to be developing a somewhat more autonomous position from established institutions and systems. Is it simply the case that they are biding their time and are quite content for Western decline to continue, making it easier to usher in a new kind of order?

PM: This dilemma somewhat mirrors the way in which the US and Europe have been totally concerned with their own internal problems, and justifiably so. Quantitative easing in the US, which has driven up the value of currencies around the world, has been justified on the basis of their having to get their own economy going; otherwise, the rest of the world is not going to see a significant recovery. In the case of China or India, there is no doubt about the importance of them focusing on their domestic economies. Whilst they are both globally wealthy countries in absolute terms, they are still very poor on a per capita basis. If they don't do well, the rest of the world is going to suffer. For instance, Australia's exports are heavily dependent upon demand from China, and so China's ongoing success is as important to the rest of the world as it is to its domestic population.

On the other hand, if they hang back from exercising global influence then they are not going to succeed to the extent that they would like. Firstly, if you go to Africa or to Brazil there is a huge backlash against China and the importation of cheap Chinese goods, which are seriously hurting local economies. Secondly, the Chinese economy is heavily dependent on its exports to the US and Europe. If those economies don't turn around then China's exports are going to suffer immensely, and although domestic consumer demand is increasing it is currently insufficient to sustain China's economy in its current guise. So ultimately, what's happening here is that the nationalistic impulse of countries, which is the first impulse we all have and which is a natural impulse, is slowly giving way to the realization that acting on this impulse is counterproductive unless the rest of the world works together. I hope that this will get China and India to the table sooner rather than later.

STAIR: Overall therefore, you would say we might currently see a way out of this global problem of collective action; with the interconnectedness of contemporary financial systems, the world really has no choice but to take this on, and as such we are moving slowly in the right direction.

PM: That is exactly my view. We all talk about globalization, and I have said that the rationale for the G20 is to make globalization work. Understand that we've had globalization since the time of the Roman Empire. In fact we have traded with each other and exchanged money around the world since before that time. What's going on right now, and I think that the financial crisis and the question of climate change have brought this home in ways that nothing else ever could, is that we are embarking on a paradigm shift, the effects of which will potentially be felt for hundreds of years, such that globalization and the interdependence of nations is now so great that it is virtually impossible for a nation to survive in isolation from the chaos around it. This realization should force the US Congress and the Chinese to come to the table in order to make the global economy work. And it would be really helpful if the Europeans would cease their internal squabbling and joined in as well. ■

Training Is Not Enough: Economic Development and Military Professionalism in Turkey

NATHAN W. TORONTO¹

ABSTRACT

Western states engage in security assistance for many reasons, but the focus of these efforts at the operational level is often the professionalization of foreign militaries. To date, those assistance operations aimed at professionalizing foreign militaries have focused on training and equipping foreign forces and have generally not taken into account the aggregate level of economic development in recipient states. The history of Turkish economic development and military professionalization, however, suggests that operations aimed at professionalizing foreign militaries should take deliberate account of a recipient state's level of economic development. Turkey endured decades of frustrated military reform, followed by an episode of significant economic development that ushered in a period of remarkable development in professional military institutions. If the Turkish case is any indication of how militaries in developing countries could become professional, then it should give leaders pause before committing to train the militaries of states with under-developed economies, and it should inform security assistance operations on the ground when circumstances dictate who partners will be.

Introduction

Western states provide security assistance to non-Western states for a variety of policy reasons—to ensure political loyalty, to develop military interoperability, to help sustain domestic arms industries—but more often than not the operational focus of these efforts is the professionalization of foreign militaries. That is, state leaders may have

Nathan W. Toronto, "Training Is Not Enough: Economic Development and Military Professionalism in Turkey," *St Antony's International Review* 7, no. 1

(2011): 119–143

policy reasons for ordering security assistance missions, but the military officers sent to execute these operations often focus on military professionalization.

Typically, these operations have focused on training and equipping foreign enlisted personnel and educating foreign military officers, but the lesson of military professionalization in states like Turkey is that economic development greatly increases the likelihood that military training, equipment, and education efforts will result in military professionalism in the long run.² So, in order for security assistance to result in long-term professionalism—as opposed merely to achieving short-term interoperability, international political loyalty, or domestic political convenience—policies and operations aimed at building the military capacity of Western partners should take deliberate account of economic development.

Without modern economies in partner states, efforts at foreign military professionalization may go to waste after Western training, equipment, and educational support ceases, or is dramatically reduced. This is of particular concern in Iraq and Afghanistan, where the professionalizing of military forces is an important policy as well as operational objective. However, there has been little discussion regarding how these forces will maintain the level of professionalism they achieve once there is a significant reduction in funding for training, equipment, and education programmes.³ The development of long-term professionalism in Iraqi and Afghan security forces is by no means a foregone conclusion, but there has been little effort thus far to identify how developing militaries become professional, nor has there been an attempt to apply these lessons to ongoing security assistance efforts.

The military professionalization experience of Turkey illustrates the importance of this observation. From the late eighteenth century onwards, Turkish authorities accepted intensive French, German, and even British military training, equipment support, and officer education, but Turkish military reforms met with only limited success until the Turkish economy had become significantly modern about half-way through the twentieth century. The Turkish case is especially relevant because the highest-profile security assistance missions are now ongoing in developing, predominantly Muslim countries—Afghanistan, Egypt, Iraq, Saudi Arabia, and Yemen. As political unrest continues to spread throughout the Muslim Middle East, Western leaders may need to decide which other countries in the region to support with security assistance and which to not. What is more, the presence of professional military institutions in these countries may be critical for avoiding a similar spasm of unrest in future decades. Thus, if military professional-

ism is both a policy and operational objective of security assistance missions to developing Muslim countries—as it is now in Afghanistan and Iraq—then the level of economic development should inform, firstly, strategic decisions about whether to accept potential partners for Western security assistance and, secondly, operational decisions about how to conduct security force assistance to ensure long-term success.⁴

Military Professionalism and Security Assistance

What does military professionalism mean for foreign security assistance efforts? In operational terms, the US Department of Defense instructs that “SFA [security force assistance] activities must directly increase the capacity or capability of a foreign security force or their supporting institutions,” while the US Army enjoins that security assistance should result in partner forces that are “legitimate, credible, competent, capable, committed, and confident.”⁵ The UK *Strategic Defence and Security Review* requires “co-ordinated cross-government effort overseas to build the capacity of priority national security and fragile states to take increasing responsibility for their own stability.”⁶ Western states recognize that they cannot secure a favourable global order by force of Western arms alone, which makes the dissemination of Western military norms to non-Western countries even more important than it may have been during the Cold War. Not only do professional militaries tend to be more efficient and effective than their non-professional counterparts, but the societies they are meant to defend also tend to regard them as more legitimate and trustworthy.

With that said, the professionalization of foreign militaries often results in a tension between two ideals. On one hand, there is the professional military ideal in which liberal civilian control over the military is institutionalized—the democratic ideal. On the other hand, there is the professional military ideal of deploying forces that are effective at suppressing challenges to state authority—the security ideal. Thus, security assistance comes face-to-face with an age-old dilemma in civil-military relations: foreign security assistance empowers the military to protect the state, but what ensures that state leaders will be able to keep the military from taking over that state? While these two ideals do not necessarily conflict—for example, at the time of writing, Colombia appears to be balancing democracy and security in the context of American security assistance—it is worth noting that conflict between these two ideals is always a possibility. At the very least, the potential conflict between democracy and security is an ever-present concern as the West seeks to professionalize foreign militaries.

Historically, American conventional wisdom has linked military professionalism closely to the democratic ideal. Samuel Huntington's *Soldier and the State* is most often associated with this school of thought. In this study on military professionalism in the United States, Huntington identifies three major characteristics of a professional military—expertise, social responsibility, and “corporateness”—and contends that they are the key to what he terms objective control.⁷ Building on this tradition, Eliot Cohen examines the difficulties in US civil-military relations, Peter Feaver asks how civilians can achieve democratic control over the military, and Dale Herspring seeks to understand how this control plays out in day-to-day civil-military relations.⁸

This tendency to view American military professionalism in terms of the democratic ideal has coloured interpretations of military professionalism outside the United States as well. S. E. Finer, for instance, asks what explains the rash of coups d'état in developing countries after World War II, Alfred Stepan studies military intervention into politics in Brazil and other South American countries, and Eric Nordlinger investigates the sociological underpinnings of praetorianism and its effect on how military officers govern after interventions into domestic politics.⁹ Understandably, this democratic ideal has influenced how the American military lends assistance to foreign partners. American security assistance programmes often include classes on respect for human rights and democratic political processes, and when foreign military officers who were once students at American military schools are involved in overthrowing civilian governments, it is a source of some consternation. In both theory and practice, then, the democratic ideal is alive and well in Western security assistance.

This does not mean, however, that institutionalized liberal civilian control is a necessary characteristic of military professionalism. Civilian control can be authoritarian as opposed to liberal. Finer notes that in “despotisms or autocracies of a totalitarian type ... the military are subordinated to the civilians as much as or even more than in the liberal-democratic régimes.”¹⁰ Sam Sarkesian points out that “each military profession is distinct in the way it serves its own state and society.”¹¹ While in Western states this implies an unquestioning commitment to liberal civilian control, this need not be the case elsewhere. Rather than a model of civil-military relations based on control, then, Sarkesian offers an “equilibrium model,” or one

that is based on “equilibrium” with an emphasis on “balance,” “parallelism,” and “friendly adversary.” Rather than separation, this model argues that the military and society are an integrated part of the same political-social system. Moreover,

military professionalism is perceived in broad terms, including a dimension in which the military are political actors in a liberal democracy.¹²

123

This equilibrium model of civil-military relations allows for a conception of military professionalism that balances the democratic and security ideals, as opposed to being principally defined by one of them. This is particularly important in a post-9/11 world in which democratic states are forced to confront persistent non-state threats to both their security and their authority. As the American *National Military Strategic Plan for the War on Terrorism* contends, developing partner military forces capable of securing state territory “is key to creating a global environment inhospitable to terrorists.”¹³

So, while liberal civilian control over the military is a desirable ideal for Western security assistance missions, how recipient states reconcile a commitment to liberal civilian control and an imperative to protect the state can be thought of as a function of political-social systems. Generally speaking, Western security assistance efforts have usually recognized the need to tread a middle path between the two ideals of democracy and security. As Lieutenant General William B. Caldwell, Commanding General, NATO Training Mission–Afghanistan, contends, “[t]he payoff for this patience and investment [in Afghanistan] are professional security forces that are able to provide security, stability, and prosperity today while preserving hope and opportunity for generations to come.”¹⁴

In broader terms, rather than focusing on effectively securing the state or institutionalizing civilian control over the military, professionalizing foreign forces through security assistance means improving the recipient state’s management of violence.¹⁵ This captures the Huntingtonian principles of expertise, corporateness, and social responsibility while taking into account the practical concern of securing the state. In addition, military professionalism is something usually associated with a country’s officer corps, not its enlisted personnel, since officers manage violence while enlisted personnel apply it. Thus, the development of military professionalism refers principally to the development of institutions that allow officers to command, control, and co-ordinate the application of violence more efficiently and rationally.¹⁶ In practical terms, markers of military professionalism often deal with institutions like military academies and schools, the publication of military periodicals and other fora for the production of military knowledge, evidence of the growth of a military-specific body of knowledge that is distinct from that found in civilian sectors, the development of rules and regulations governing membership in and advancement within the officer corps, and evidence of the officer corps’ loyalty and duty to defend society as a whole as opposed to pursuing its own parochial interests.

How Does Military Professionalism Develop?

There are three broad approaches in the literature for explaining why military professionalism develops in a state. The first approach looks to pressures external to the state and has seen wide acceptance in the field of international relations. Kenneth Waltz, in *Theory of International Politics*, argues that military institutions will tend towards similarity in the system of states because of competition. States with ineffective military institutions will either be destroyed or will conform after witnessing the adverse experience of other states with similarly ineffective institutions.¹⁷ João Resende-Santos uses this logic of competition to explain how militaries developed in the southern cone of South America, as does Barry Posen to explain why Prussia adopted the institutions that underpinned its mass national army after defeat at the hands of the French in the early nineteenth century.¹⁸ By the same token, it could be argued that the US military's success using networked military technology in the 1991 Gulf War drove many other states, such as China, to adopt comparable capabilities.¹⁹ By this logic, insofar as professional military institutions have credited themselves as successful in the international system, it is external pressures that explain why states adopt professional military institutions.

A second approach to understanding military professionalization looks to developments within a state. As the logic goes, as the state in general becomes more rational, and as bureaucratic forms of governance become more institutionalized, then a professional military results. Morris Janowitz, for instance, posits that a rational state organization is important to military professionalism, and Max Weber argues that "military effectiveness rests on bureaucratic discipline."²⁰ There seems to be evidence to bear this contention out, as with the external pressure approach—states that boast more efficient, competent bureaucracies also tend to have more professional militaries. It is also arguable that Western professional military institutions began to develop earliest in states, such as France and Prussia, with very well-developed bureaucracies. Indeed, there seems to be as much to commend the internal rationalist approach as there is the external pressure approach to military professionalization.

A third approach is more ideational in nature, and focuses on how the ideas of military professionalism have spread. Guiseppe Caforio, for example, examines how professional military ethics diffuse through an officer corps.²¹ Military professionalization could also be the result of simple innovation, which is the logic that John Mueller employs in *Remnants of War*.²² The ideational approach points to the hundreds of

military missions and officer educational exchanges between countries to explain why professional military traditions look so similar from one country to another. For example, the rank insignia and rank structures of most militaries usually bear a striking resemblance to those in one of a handful of militaries, especially the French and British. It could also be argued that prolific American efforts at liaising with and assisting other militaries since the start of the Cold War have contributed to an international coherence in military professional norms.

While the truest explanation for why military professionalism develops is probably some complex involving all three of these schools, there is a fourth approach that is no less plausible than the other three: an economic development approach. While this approach is akin to the internal rationalist approach, it is also distinct from it, insofar as it is not a bureaucratic logic but a logic of capacity and potential. So, for example, Adam Smith argues that professional militaries (in this case he meant non-militia, regular forces) are more likely to develop in countries where the division of labour is advanced, since these countries have more wealth to defend.²³ Charles Tilly argues that the most successful Western states were those that developed militarily as well as economically.²⁴ In a more recent argument, Michael Beckley demonstrates that the level of gross domestic product (GDP) per capita is a better predictor of military effectiveness than human capital, culture, or industrial or demographic potential.²⁵ While effectiveness is different from professionalism, the two are often linked, and this study draws on argumentation that is similar to Beckley's, in that economically-developed societies have the resources and technical know-how to educate a sufficient number of officers in the management of violence.

There are at least three reasons why economic development and military professionalism are linked. First, a modern economy usually means that there is a greater amount of wealth in society; wealth from which the state can draw to finance expensive military reforms and maintain a professional officer corps indefinitely. Devoting manpower to the military is generally not an economically productive activity, but devoting military personnel to officer development often runs counter to short-term military expediency. During the world wars, for example, the US Army cut short its officer education courses at Fort Leavenworth, Kansas, in an effort to provide officers to the field.²⁶ Even in peacetime, when operational pressure is lessened, the extent of an officer's schooling is rarely, if ever, considered more important to advancement than his performance in a line unit. Similarly, there is a material cost to maintaining the educational institutions that often underpin the professionalism of the officer corps, be it in peace or war. The professionalization of the military—and

the maintenance of this professionalism in the long-term—is not a cheap endeavour. A developed economy helps pay for it.²⁷

The second link between economic development and military professionalization is urbanization. As the economy modernizes, the level of urbanization also increases, which makes military professionalization easier to institute. Living in an urban setting means living with many other, densely-packed people, which requires more restraint and discipline than rural life does. In urban settings, authority structures are more impersonal than in rural areas, and urban life requires working with other people on complex tasks, often involving machines. The skills that predispose one to success in urban life also contribute to success as a military professional.²⁸

But what of the martial qualities prevalent in tribal societies? Should not the warrior ethos—unheard of in urban settings—also be associated with military professionalism? The answer is no. The warrior ethos is driven by the desire to demonstrate one's personal bravery, not necessarily to play one's role in a team. If all are heroes, then all are dead when confronted with modern military organization. This was in evidence during the 1967 Six Day War, during which Arab soldiers often demonstrated remarkable bravery under fire but were unable to co-ordinate their actions to combat Israeli forces.²⁹ Indeed, professional militaries cultivate the warrior ethos only insofar as it does not affect the ability of the greater whole—the officer corps—to act in the best interests of society.

A third reason that economic modernization facilitates military professionalization is the accumulation of human capital. A modern economy requires workers to be very specialized in their fields. This human capital helps sustain military professionalization. The modern battlefield requires more than the illiterate fighters of the past. It requires educated officers and men capable of solving complex problems. It requires personnel that have an understanding of, and can act in conjunction with, other arms. It requires officers and enlisted personnel who understand the benefits of teamwork and can reliably learn their roles on that team. It requires personnel that can learn to use and maintain intricate modern weaponry.³⁰ Thus, the better educated a society, the more likely it is to offer the military the personnel it needs to maintain a professional officer corps.

This argument linking economic development and military professionalization is not one of sufficiency, nor even of necessity. Economic development does not guarantee military professionalization—the Belgians did not make it a priority prior to World War II—nor is economic development required in order for military professionalization to occur. Senegal, for instance, is relatively under-developed economically, but has nonetheless managed to develop a fairly professional military tra-

dition. What this paper argues, and what the Turkish case suggests, is that economic development should not be ignored as an explanation for military professionalization. At the very least, efforts to professionalize foreign militaries should take economic development into account.

Is Economic Growth Endogenous to Military Professionalization?

There is a possibility that economic growth could be the result of military professionalization processes, as opposed to being a cause of the same. By this reasoning, as military institutions become more rational and efficient, the state's application of violence also becomes more predictable. This predictability is important for economic development, as it presents conditions ripe for successful entrepreneurship—as long as the costs of doing business are predictable, however high these costs are in an objective sense, then entrepreneurs can still make a profit by pursuing the activity that offers them the lowest opportunity cost. Military professionalization may actually lead to economic development, not the other way around.³¹

The evidence supporting this contention is, however, mixed. While the military in some countries began professionalizing prior to the outbreak of economic development—Prussia is a prototypical example—there are just as many cases where military professionalism either occurred in conjunction with or followed economic development. France, for example, radically reformed its military on the heels of the Franco-Prussian War, which occurred after thirty years of remarkable French economic progress. In Brazil, professional military institutions developed at the same time that the economy developed in the first half of the twentieth century.³²

Settling this question of endogeneity requires the comparison of a large number of cases of military professionalization over a long period of time, something most efficiently done using statistical analysis. This is outside the scope of this study, although previous research has identified a positive link between prior economic development and military effectiveness, which relies on some of the same institutions as does a professional military.³³ So, while this study will not answer the endogeneity question definitively, it does offer a case—Turkey—where a period of sustained economic development preceded successful professionalizing military reforms.

Military Professionalization in Turkey

Why study how the Turkish military became professional? In many ways, the Turkish military today embodies various characteristics that Western military aid providers hope that less-developed security assistance recipi-

ents will acquire: it has robust training and education programmes, it incorporates modern technology and doctrine, and it has generally shown itself to be an effective force. What is more, it is a Muslim country in a region of the world that is a security hot spot, and where some of the highest-profile security assistance missions are ongoing.

The Turkish case is also relevant because, from 1768 to 1923, Turkey fought—and lost—wars against every great power except the United States.³⁴ If states make war and war makes the state, then one would expect that, if any military were to professionalize, it would have been the Turkish one.³⁵ Moreover, from the late eighteenth century on, a parade of Western military advisers from France and Prussia, the two most professional armies of the era, assisted Ottoman Turkish military authorities. Despite this, Turkish military institutions continued to lack a robust professional quality until well after the beginning of the Republican era. The question then becomes, if Turkey could not professionalize its military under these conditions, then how did it professionalize at all?

The answer is that professionalizing Turkish military reforms did not endure until after a period of sustained economic development in the first half of the twentieth century, a period in which levels of economic wealth, urbanization, and human capital—the key drivers in the link between economic development and military professionalism—also increased dramatically. The timing of these long-term historical trends holds valuable lessons for the policymakers and military practitioners ordering and conducting security assistance operations around the globe, especially in the Muslim Middle East.

Turkey's path to military professionalism can usefully be divided into three eras: the Ottoman era, the Young Turk era, and the Republican era. The first era began with the reforms of Sultan Selim iii (begun in 1792) and continued with a number of Ottoman reform efforts throughout the nineteenth century. The second era includes the Young Turk reforms at the beginning of the twentieth century. The final era began with the abdication of the Sultan and the creation of the Turkish republic in 1923 and continued through the post-World War II reforms and nato membership half-way through the twentieth century.³⁶

Ottoman Era Military Professionalization

The need for Turkish military reform became obvious after Turkey's defeat in the 1787–92 Second Russo-Turkish War. In the war-ending Treaty of Jassy, the Sultan was forced to recognize Russian control over Georgia and the Crimea, and the backbone of the Ottoman Army, the Janissary Corps, were found wanting in terms of both training and equipment. In

an effort to remedy the situation, Selim III created an entirely new army using French training and weapons. The Sultan had brand new barracks built and offered new recruits exceptionally high salaries. His reforms also standardized salaries, pensions, rations, and promotion procedures throughout the army. These reforms also established military regulations and banned the insidious practice of officers over-reporting the number of men in their units so that they could pocket the excess salaries, a ban that new government agents enforced. Selim also opened or revived military schools to train officers, employing French instructors who used European methods.³⁷

As one historian remarks, however, “[n]one of these innovations proved lasting.”³⁸ By 1806 there were still only 22,685 men and 1,590 officers in the army, and existing training facilities could not even accommodate these. After 1794, furthermore, most new recruits were Anatolian peasants and tribesmen, not residents of Istanbul accustomed to discipline and restraint in close quarters. As a result, there were frequent reports of troops making off with weapons and uniforms to form robber bands that plagued Anatolia and the Balkans.³⁹

When Mahmud ii succeeded Selim iii in 1808, he attempted to revive his predecessor’s reforms, but he had to back down in the face of Janissary opposition. Mahmud finally overcame this opposition in 1826, and a flurry of reforms ensued, though they, too, did not last. Mahmud’s reforms saw the rejuvenation of the officer education system, with the establishment of a military academy in 1834. Both instructors and cadets at this academy were paid high salaries, in order to lure the most qualified candidates. The year 1826 saw the establishment of a Ministry of War, and 1836 a Council of Military Affairs, to plan and implement further reforms. In 1827, Mahmud began sending Turkish officers to various European capitals to learn European military practices and then return to the Empire to train their colleagues. The Turkish government once again began instituting a formal salary system and built new training facilities across Anatolia.

However, these changes also faltered after a few years. In 1840, Prussian officer Helmuth von Moltke, retained to help reorganize the Ottoman military, gave a dim appraisal of the Turkish officer corps, complaining that their positions were attained not by competence but by social connection. The curricula of the schools never improved to the level of their European counterparts, the trickle of officer-cadets to Europe never turned into a stream, and funding for training and equipment dried up after a few years. What is more, the military academy established in 1834 did not graduate its first class until 1847.⁴⁰

In the *Tanzimat* period (1839–76), professionalizing military reform did not fare much better. During the Crimean War, the Ottoman army

neglected training and the pay and administrative services did not perform well. Although the Military Academy continued to operate—one of the few lasting effects of the Mahmud-era reforms—it produced a paltry 200 officers per year, never enough in an army that numbered 750,000 by the 1890s. The vast majority of officers were promoted from the enlisted ranks and could neither read nor write, let alone understand war on a theoretical level. On top of this, the general staff section of the War College did not graduate its first class until 1860, fully twelve years after it opened its doors.

The one bright spot to emerge from this era was the continued development of Turkey's military education system. In contrast to the typical Ottoman education at religious schools, the military established a separate system in 1855 to train young men to be officers from the age of ten or twelve. The best graduates went on to the general staff course of the War College, but only after serving with a line regiment for two years. Other graduates continued on to the Military Academy. This competitive military schooling system led to many careers based on merit, although the proportion of academy-trained officers did not constitute a simple majority, let alone an overwhelming one, for decades. In the 1840s, the average size of the graduating class from the War College was 25 officers. This average increased to more than 100 by the 1870s, and to 500 by 1900, but it was never enough to keep pace with an expanding military.⁴¹

In the period 1876–1908, during the reign of Sultan Abdul Hamid II, any professional quality that the army possessed atrophied. The Sultan approved all officer assignments personally, which politicized the officer corps. Officers' pay was often in arrears, and enlisted men—if they were paid at all—often received over-valued government “IOUs.” The paranoid Abdul Hamid did not allow field manoeuvres, live-fire target practice, or the distribution of artillery shells to outlying districts. He even ordered that the Mauser rifles he purchased from Germany not be distributed to the troops until six years after they had arrived. Having well-educated officers was also a low priority—as late as 1894, eighty-five per cent of officers had no formal officer education at all, and as many as one-third of all officers may still have been illiterate.

Young Turk Era Military Professionalization

The 1908 Young Turk revolution ushered in another series of short-lived reforms. The Sultan's personal influence on the military ended, and the Young Turks established a Supreme Military Council in 1909 to co-ordinate reforms, promotions, and appointments. In July, 1909, a General Inspectorate of Education and Instruction was established to improve

officer education. In addition, operational planning improved under the reformed General Staff, and regular exercises and firing practice—not held since 1881—were instituted.

The Young Turks also sought to purge the officer corps of its less professional members. A 1909 law purged those officers who had gained their positions by palace favouritism, and the Young Turks made efforts to purge those who had been commissioned from the ranks. All told, approximately 10,000 officers were cashiered as a result of these reforms.

These reforms, too, did not last. Many of the purged officers were called back to the colours after Italy's invasion of Libya in 1911. The Balkan Wars (1912–13) and World War I undermined the legitimacy of Young Turk leadership and forced the military to expand dramatically before it was ready, and training was still inadequate. The 1909 military manoeuvres in Thrace had been the first in thirty years, but after holding manoeuvres again in 1910, they were not held in 1911 due to budgetary constraints. In the three years before the outbreak of war, these reforms could hardly reverse the decades of neglect from the Abdul Hamid era. In short, as one historian has observed, “these post-1908 military reforms aimed to change much in the Ottoman army in a short time. In practice, they failed to do so.”⁴²

Republican Era Military Professionalization

The presidency of Kemal Atatürk (1923–38) witnessed only token efforts at reforming the Turkish military, although by the middle of the twentieth century the Turkish military was on its way to becoming a professional fighting force. While the years after World War I saw the gradual de-politicization of the officer corps, as well as a slow increase in the proportion of academy-trained officers, promotion in these years was more often based on seniority than ability.

In the mid-1940s, military training and education programmes infused new life into Turkish military professionalization. The gradual increase in the proportion of academy-trained officers meant they finally began to reach predominance, due in large part to the gradual institutionalization of the military education system. In September 1947, furthermore, the army demobilized an entire class of conscripts—reducing the size of the army from 485,000 to 350,000—and used the savings for more thorough training. When the Soviet Union demanded guaranteed access through the Dardanelles and the leasing of bases along Turkey's Black Sea coast, the United States offered Turkey \$687 million worth of military aid from 1948 to 1952. Welcoming this aid,

Turkey also invited American military advisers to oversee training and joint military planning, and Turkish forces received training on US equipment. In addition, Turkish officers began attending US and European military schools, and the newly-created Personnel Section of the General Staff began promoting officers based more on proven ability than simply on seniority.

Even before the advent of US military aid, though, Turkey had begun devoting more resources to the military—1946 saw a 31.7 per cent increase in the defence budget from 1945, and the following year witnessed a further 44 per cent increase. In 1950, Turkey sent a brigade to fight with UN forces in Korea. The allies regarded the Turkish contingent as a quality force, even though it suffered withering casualties. Associate membership in NATO in 1951—and full membership in 1952—were the culmination of a five-year military professionalization effort in Turkey. This effort was not ephemeral, either. Turkey has been able to sustain a high level of military expenditures per soldier in the years since, which suggests that Turkey has devoted many resources to developing the expertise of its force. Figure 1 suggests a significant and steady increase in such expenditures at the same time that these other reforms were going on. In the 1970s, furthermore, there were still thousands of US personnel in Turkey, working to further train and professionalize the armed forces.⁴³ In sum, by the middle of the twentieth century, Turkey had finally begun developing a modern, professional military, something it had not achieved previously, despite 150 years of reform efforts.

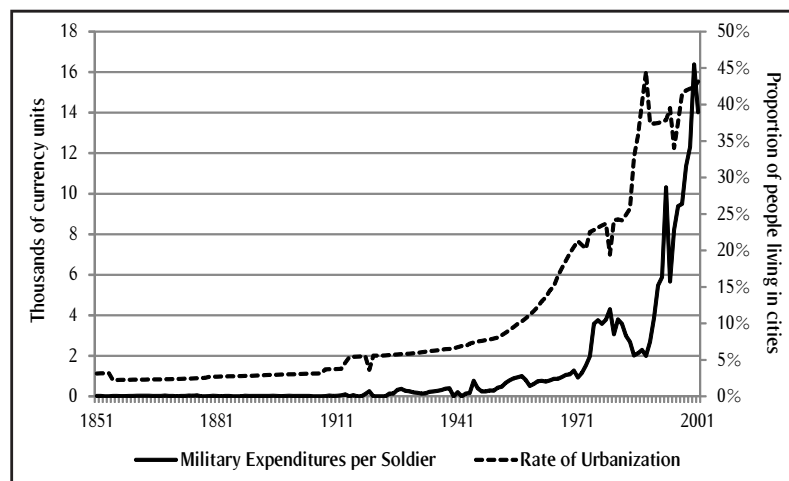
Turkish Economic Development

In addition to depicting the growth in Turkish military expenditures, Figure 1 also shows a concomitant growth in the level of urbanization, suggesting a link between economic development and military professionalization. In fact, a cross-national comparison of urbanization and military expenditures per soldier suggests that when the level of urbanization exceeds the world average—a level that Turkey had reached by 1960—a country is more likely to launch professionalizing military reforms.⁴⁴

This link between economic development and military professionalization is also borne out by Figure 2, which plots Turkish GDP per capita, a measure of national wealth, against the number of Turkish military periodicals. Military periodicals are an important indicator of the level of professionalism in a military force, as they suggest a commitment to

the production of a military-specific body of knowledge. Figure 2 indicates that, after a significant drop in national wealth in the late Ottoman period, significant growth preceded the publication of the first modern Turkish military periodicals in the 1950s.

Figure 1: Military Expenditures per Soldier and Rate of Urbanization in Turkey (1851–2001)

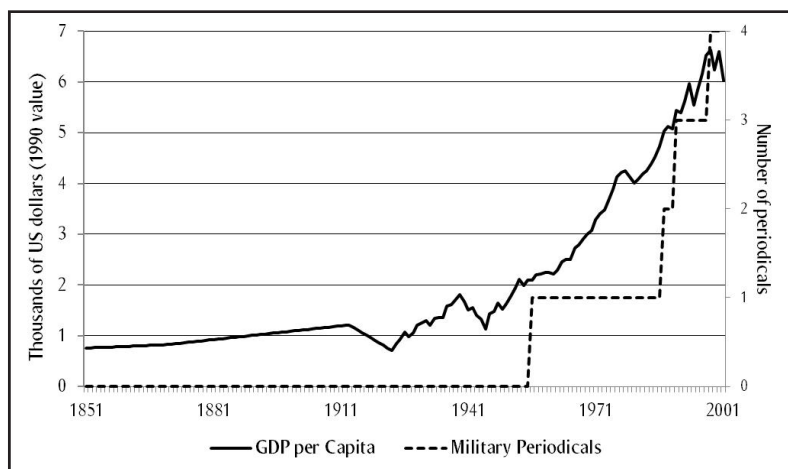


Obs.: Unit of military expenditures is sterling pounds until 1914, and US dollars afterwards. Source: Correlates of War Project, "National Material Capabilities Data Set (v3.02)" (2001), <http://www.correlatesofwar.org> (accessed January 19, 2010); J. David Singer, Stuart Bremer, and John Stuckey, "Capability Distribution, Uncertainty, and Major Power War, 1820–1965," in *Peace, War, and Numbers*, ed. Bruce Russett (Beverly Hills, CA: Sage, 1972), 19–48; J. David Singer, "Reconstructing the Correlates of War Dataset on Material Capabilities of States, 1816–1985," *International Interactions* 14, no. 2 (1987), 115–32.

The trends depicted in Figures 1 and 2 also hold up to closer historical scrutiny. The relatively backward economy of late Ottoman Turkey helps explain why professionalizing Ottoman era military reforms did not endure, and Turkish economic growth in the first half of twentieth century made Turkish military professionalization possible.

In the Ottoman era, the first half of the nineteenth century witnessed an absolute decline in Ottoman textile manufacturing, a mainstay of the Ottoman economy. Worse still, small urban industry felt this decline sharply, and the state-run factories established earlier in the nineteenth century had to be closed. The decline in textile manufacturing was such that even the production of cotton yarn—once a staple of Ottoman manufacture—ceased entirely in Turkey in favour of raw, unspun cotton.

Figure 2: GDP per Capita and Military Periodicals in Turkey (1851 – 2001)



Sources: GDP data come from Angus Maddison, "The World Economy: Historical Statistics," <http://www.ggdc.net/maddison/> (accessed June 1, 2005). Military periodicals data come from Ulrich's Periodicals Directory, <http://www.ulrichsweb.com/ulrichsweb/> (accessed June 1, 2005); and FirstSearch, "WorldCat Advanced Search," <http://newfirstsearch.oclc.org> (accessed June 1, 2005).

Government policies did not aid Turkish economic development, either. Tax farms were not abolished until 1839, and until the end of the nineteenth century craftsmen faced strict regulation from both the guilds and the government. Government tariffs were oppressive; in 1847 there was a 12 per cent internal tariff on silk products, a tax that at other times reached as high as 50 per cent. The requirement for joint ownership of land with the state hindered the creation of capital for new sectors.

As a result, the Turkish economy experienced little growth in the nineteenth century. In comparison to Europe, the Ottoman Empire's economy was weaker in 1800 than it had been in 1550, and may even have suffered absolute deterioration. The Turkish economy also proved unable to finance the needs of the state—the government contracted nineteen loans from European creditors from 1854 to 1879, and "the greater part of what was received was used to pay the principal and interest on the debt itself."⁴⁵ In the fiscal year 1872–73, the Empire spent twice as much on servicing public debts as it did on the army and navy. Turkey's economic situation became so dire that in 1876 the Ottoman Empire declared bankruptcy.

The rate of Turkish urbanization was slow until the twentieth century. Where more than 10 per cent of Turkey's population lived in towns of ten thousand or more in 1800—a fairly high level of

urbanization by European standards of the time—this level had only increased to 18 per cent by 1945. In fact, “no significant increase in urbanization seems to have taken place” from 1800 to 1914, during which time urbanization in Europe far outstripped that in Turkey.⁴⁶

In the absence of economic modernization, Ottoman era reforms failed to generate professionalism in the Turkish military. On the one hand, there was a consistent shortage of monetary capital with which to fund reforms, as illustrated by persistent Ottoman indebtedness and the Ottoman Empire’s inability to pay officers and men consistently or to dedicate significant resources to the military. On the other hand, there was constant scarcity of human capital. The military education system was never robust enough in the Ottoman era to provide the officers that the army needed, the level of urbanization declined relative to Europe throughout the nineteenth century, and the Ottoman army exhibited suspect levels of literacy and training.

In the Republican era, the modernization of the Turkish economy made Turkish military professionalization possible. Even before World War I, Turkish agriculture was becoming more focused on a variety of cash crops and more and more land area was dedicated to large-scale, commercial farming. In addition, both the mining and manufacturing sectors of the Turkish economy grew significantly from 1881 to 1914. Just before World War I, industry, capital-intensive agriculture, and the bourgeois and industrial working classes all grew significantly. Between 1885 and 1913, coal output grew by an average of 8.7 per cent annually and the extraction of other minerals increased by 15 per cent. Also, there were as many private industrial companies founded in the years 1901–15 as were founded in the entire nineteenth century.

The Kemalist reforms of the 1920s and 1930s encouraged economic development. The government extended the railroads by three thousand kilometers, established commercial and industrial banks, adopted a Western civil code, alphabet, and system of weights and measures. Whereas in 1943 there were 421 joint stock companies with a capital value of 245 million Turkish pounds, by 1950 this number had grown to 782, with a value of 875 million Turkish pounds. This growth continued thereafter—from 1951 to 1957, 1,703 new companies were founded, representing a capital value of 1.5 billion Turkish pounds.

The growth in overall Turkish economic productivity was also significant after World War I. GDP per capita, adjusted for inflation, increased by 86.6 per cent from 1923 to 1938. Where urbanization had been stagnant in the nineteenth century, one-quarter of Turkish citizens were living in urban areas by 1960. There were also advances in Turkish education. The growth in the number of students in schools far out-

stripped population growth from 1923 to 1938—the population grew by 43.3 per cent, while the number of students enrolled in school increased by 163 per cent.⁴⁷

These economic advances suggest that the Turkish state had an increasing amount of human and material capital at its disposal to put towards professionalizing the military. It is no coincidence, then, that the resources devoted to the Turkish military increased dramatically as the Turkish economy developed. It is also not a coincidence that Turkish military training programmes became more rigorous at the same time that Turkish public education and the level of specialization in the Turkish economy expanded.

Conclusion

During both eras of Turkish military professionalization, there was a notable constant—considerable foreign support. This training and equipment support came principally from the French during the reign of Selim III, from the Prussians from the reign of Mahmud II through that of the Young Turks, and from the United States during the Republican era. One factor that changed from the Ottoman era to the Republican era was the level of economic development. Until the twentieth century, urbanization and manufacturing were regressing, suggesting that economic development was at best stagnant. The first half of the twentieth century, on the other hand, saw the development of new economic sectors and the educational system, as well as dramatic increases in levels of national wealth and urbanization. That Turkish military professionalism became entrenched only at the mid-point of the twentieth century—despite battlefield defeats and reform programmes for over 150 years previous—is less puzzling when one considers the timing of Turkish economic development.

Of course, the case for economic development making military professionalization possible in Turkey is not airtight. There is, first of all, the problem of endogenous economic growth, a question that is difficult to parse without cross-national statistical analysis. Still, while one case study cannot determine whether economic development causes military professionalization, or the other way around, it has not been the argument of this paper that economic development exerts a truly independent effect on the development of professional military institutions. Rather, economic development is one of a complex of factors that influence this long-term historical process, so addressing the endogeneity question conclusively will have to await future research.

There is also another potential problem in the Turkish case: Turkish military professionalization largely coincided with the beginning of

the Cold War superpower rivalry, by which time the nature of foreign military advising had changed. Whereas before the world wars the state receiving security assistance generally paid for foreign advisers to train its forces and for equipment from arms-producing countries, after the world wars the superpowers typically picked up the tab. While Turkey had begun reforming its military shortly after World War II, the level of American resources invested in Turkish military development at the beginning of the Cold War was substantial.

This pattern of security assistance has not changed since the end of the Cold War, but that does not mean that the Turkish case is irrelevant for today's security assistance efforts. This is because the foundations of economic development had already been established once American military aid started flowing into Turkey in the late 1940s, and the link between economic development and military professionalism relies on more than just material wealth. It also relies on human capital and the mores of urban living. If one were to conduct a thought experiment and put this substantial American monetary aid aside, the provision of American advisers was not decisive for Turkish military professionalization. After all, had advising been sufficient to achieve Turkish military professionalism, then it would have occurred decades earlier, with French and Prussian advisers.

As with the endogeneity critique, firmly addressing the question of the Cold War's impact will also require further research. Only by examining a large number of cases over a fairly long period will researchers be able to ascertain just what effect the Cold War and the shift to provider-paid assistance have had on security assistance and military professionalization world-wide. Again, however, this does not undercut the larger point that the Turkish case suggests a link between economic development and military professionalism; this study argues that economic development is one of many factors that contribute to military professionalization. Determining the relative effect of these factors is a subject for future research.

What is clear from the Turkish case, however, is a striking correlation between indicators of economic development and military professionalization, not to mention the absence of the theoretical mechanisms—urbanization, national wealth, and human capital—before Turkish military professionalization took place. In taking heed of this case, then, Western state leaders would be well served to take deliberate account of economic development in foreign security assistance. This would imply closer co-ordination at the national level between security assistance and development aid programmes. It should push Western states to choose security assistance recipients whose economies are relatively well-devel-

oped, since that is where training and equipment efforts are most likely to be effective.

Circumstances, of course, sometimes dictate who Western security assistance recipients will be, as in Afghanistan. The Afghan economy is still a long way from being modern, but this does not mean that there is no hope for military professionalization there. After all, intensive external support did have *some* positive effects on military professionalism in Ottoman Turkey, even absent a modern economy. The evidence presented in this study suggests that developing long-term military professionalism absent a modern economy is very difficult, but not necessarily impossible. It also suggests that withdrawing training and equipment support from such states as Afghanistan before their economies are significantly developed can have very negative consequences for building the desired level of military professionalism.

Security assistance operations in countries such as Afghanistan—those with less-developed economies—can take this lack of economic modernization into account in a number of ways. Prior to deployment, when conducting pre-deployment site surveys, military units assigned to security assistance missions could assess the ability of foreign military forces to incorporate the intended training. Survey teams could also co-ordinate with Western diplomats to assess the likelihood that foreign governments will be able to institutionalize the professionalizing gains achieved during security assistance missions. These assessments could in turn inform both in-country and regional commanders' estimates for the level and type of resources required to achieve long-term professionalism in foreign security forces, which can also shape policy discussions regarding Western states' level of commitment to a foreign state's military.

A lack of economic development could also inform the conduct of security assistance operations. Western military units assigned to such missions could work with foreign security forces to identify and recruit the most capable individuals possible from society for military service, and military leaders could work with the senior military leadership of states receiving security assistance to develop a strategy for devoting the necessary resources to long-term professionalization. Where feasible, Western military advisers could assist foreign security forces in focusing recruitment in areas where governmental and non-governmental development aid programmes are either ongoing or have achieved development goals—as opposed to areas where little development has occurred—and could advise military leaders on the retention of the most capable military officers and enlisted personnel.

This study suggests one final note of caution—training is not enough to build established, professional militaries. Intensive external training

support was present before both failure and success in Turkish military reforms. At the same time, however, Turkey did not professionalize its military in the absence of external training, equipment, and officer educational support. In other words, such support makes developing professional foreign militaries more likely, but it is not sufficient. Economic development is no less important. Western advisers are very adept at training foreign security forces to a high level of competence, but this is not enough to ensure long-term professionalism. Recognizing this can only make current and future Western security assistance efforts more effective. ■

Notes

¹ I thank Les Grau, Kevin Freese, Marcus Kurtz, John Mueller, Brian Pollins, Tim Thomas, Ben Wilson, Thomas Wilhelm, and anonymous reviewers for comments on earlier versions of this article. The views expressed herein are those of the author and do not necessarily represent the official policy, or position, of the US Department of the Army, the US Department of Defense, or any other agency of the US Government. The author can be reached at nathan.toronto@us.army.mil.

² US Department of Defense, *National Defense Strategy* (Washington, DC: US Department of Defense, June 2008); US Department of Defense, *Quadrennial Defense Review Report* (Washington, DC: US Department of Defense, February 2010); UK Ministry of Defence, *Securing Britain in an Age of Uncertainty: The Strategic Defence and Security Review* (London: UK Ministry of Defence, October 2010); US Department of Defense, *Instruction 5000.68, Security Force Assistance* (October 27, 2010).

³ Najim Abed al-Jabouri, "Iraqi Security Forces after U.S. Troop Withdrawal: An Iraqi Perspective," *Security Forum*, no. 245 (2009); White House, "Remarks by the President in Address to the Nation on the Way Forward in Afghanistan and Pakistan," *United States Military Academy* (December 1, 2009), <http://www.whitehouse.gov/the-press-office/remarks-president-address-nation-way-forward-afghanistan-and-pakistan> (accessed January 15, 2010); Thomas Dempsey, "Rule of Law (RoL) and Security Sector Reform (SSR) in Stability Operations: Lessons Learned and Best Practices," *US Army/US Marine Corps Counterinsurgency Center Webcast* (January 8, 2010); William B. Caldwell with Nathan K. Finney, "Security, Capacity, and Literacy," *Military Review* (January–February 2011), 23–7.

⁴ Chairman of the Joint Chiefs of Staff (CJCS), *National Military Strategic Plan for the War on Terrorism* (Washington, DC: US Department of Defense, February 2006), 23–6.

⁵ US DoD Instruction, *SFA*, 2; *US Department of the Army, Field Manual (FM) 3-07.1, Security Force Assistance* (Washington, DC: Headquarters, Department of the Army, 2009), 2–2.

⁶ UK MoD, *Securing Britain*, 11.

⁷ Samuel P. Huntington, *The Soldier and the State: The Theory and Politics of Civil-Military Relations* (Cambridge, MA: Harvard University Press, 1957); see also Morris Janowitz, *The Professional Soldier: A Social and Political Portrait* (New York: Free Press, 1971).

⁸ Eliot A. Cohen, "Civil-Military Relations," *Orbis* 41, no. 2 (1997): 177–86; Peter D. Feaver, *Armed Servants: Agency, Oversight, and Civil-Military Relations* (Cambridge, MA: Harvard University Press, 2003); Dale R. Herspring, *The Pentagon and the Presidency: Civil-Military Relations from FDR to George W. Bush* (Lawrence, KS: University Press of Kansas, 2005).

⁹ S. E. Finer, *The Man on Horseback: The Role of the Military in Politics* (New York: Praeger, 1962); Alfred Stepan, *The Military in Politics: Changing Patterns in Brazil* (Princeton, NJ: Princeton University Press, 1971); Eric A. Nordlinger, *Soldiers in Politics: Military Coups and Governments* (Englewood Cliffs, NJ: Prentice-Hall, 1977). See also Sheldon W. Simon, ed., *The Military and Security in the Third World: Domestic and International Impacts* (Boulder, CO: Westview Press, 1978); Amos Perlmutter and Valerie Plave Bennett, *The Political Influence of the Military: A Comparative Reader* (New Haven, CT: Yale University Press, 1980); Alfred Stepan, *Rethinking Military Politics: Brazil and the Southern Cone* (Princeton, NJ: Princeton University Press, 1988).

¹⁰ Finer, *Man on Horseback*, 3.

¹¹ Sam C. Sarkesian, "Professionalism, Military," in *International Military and Defense Encyclopedia*, ed. Trevor N. Dupuy (Washington, DC: Brassey's, 1993), 2196.

¹² Sam C. Sarkesian, *Beyond the Battlefield: The New Military Professionalism* (New York: Pergamon Press, 1981), 238.

¹³ CJCS, *National Military Strategic Plan*, 7.

¹⁴ Caldwell, "Security, Capacity, and Literacy," 27.

¹⁵ Huntington, *Soldier and the State*, 13–6; Morris Janowitz, "Some Observations on the Comparative Analysis of Middle Eastern Military Institutions," in *War, Technology and Society in the Middle East*, ed. V. J. Parry and M. E. Yapp (London: Oxford University Press, 1975), 417.

¹⁶ Sarkesian, "Professionalism, Military."

¹⁷ Kenneth N. Waltz, *Theory of International Politics* (Reading, MA: Addison-Wesley Publishing Company, 1979).

¹⁸ João Resende-Santos, "Anarchy and the Emulation of Military Systems: Military Organization and Technology in South America, 1870–1930," *Security Studies* 5, no. 3 (1996): 193–260; Barry R. Posen, "Nationalism, the Mass Army, and Military Power," *International Security* 18, no. 2 (1993): 80–124. See also W. B. Hazen, *The School and the Army in Germany and France, with a Diary of Siege Life at Versailles* (New York: Harper & Brothers, 1872); Eliot A. Cohen, *Citizens and Soldiers: The Dilemmas of Military Service* (Ithaca, NY: Cornell University Press, 1985).

¹⁹ Qiao Liang and Wang Xiangsui, *Unrestricted Warfare* (Beijing: PLA Literature and Arts Publishing House, February 1999), www.c4i.org/unrestricted.pdf (accessed

on September 15, 2010); Makhmut Gareev and Vladimir Slipchenko, *Future War*, with an introduction by Jacob W. Kipp (Moscow: Polit.ru O G I, 2005).

²⁰ Janowitz, *Professional Soldier*; Max Weber, "The Bureaucratization of Politics and the Economy," in *Essays in Economic Sociology*, ed. Richard Swedberg (Princeton, NJ: Princeton University Press, 1999), 109. See also W. F. Gutteridge, *Armed Forces in New States* (London: Oxford University Press, 1962); Otto Hintze, "Military Organization and the Organization of the State," in *The Historical Essays of Otto Hintze*, ed. F. Gilbert (New York: Oxford University Press, 1975), 178–215.

²¹ Guiseppe Caforio, "The Military Profession: Theories of Change," *Armed Forces & Society* 15, no. 1 (1988): 55–69.

²² John Mueller, *The Remnants of War* (Ithaca, NY: Cornell University Press, 2004).

²³ Adam Smith, *An Inquiry into the Nature and Causes of the Wealth of Nations: A Selected Edition* (Oxford: Oxford University Press, 1998 [1776]).

²⁴ Charles Tilly, *Coercion, Capital, and European States, A.D. 990–1992* (Cambridge, MA: Blackwell, 1992).

²⁵ Michael Beckley, "Economic Development and Military Effectiveness," *Journal of Strategic Studies* 33, no. 1 (2010): 43–79.

²⁶ Henry G. Gole, *The Road to Rainbow: Army Planning for Global War, 1934–1940* (Annapolis, MD: Naval Institute Press, 2003); Peter J. Schifferle, *America's School for War: Fort Leavenworth, Officer Education, and Victory in World War II* (Lawrence, KS: University Press of Kansas, 2010).

²⁷ Hoffman Nickerson, *The Armed Horde, 1793–1939* (New York: G. P. Putnam's Sons, 1940); Tilly, *Coercion, Capital, and European States*; Adam Smith, *Wealth of Nations*.

²⁸ J. P. Gibbs and W. T. Martin, "Urbanization, Technology, and the Division of Labor: International Patterns," *American Sociological Review* 27, no. 5 (1962): 667–77; Anthony H. Pascal, Michael Kennedy, and Steven P. Rosen, *Men and Arms in the Middle East: The Human Factor in Military Modernization*, report no. R-2460-NA (Santa Monica, CA: RAND Corporation, 1979), 38; Anthony H. Pascal, *Are Third World Armies Third Rate? Human Capital and Organizational Impediments to Military Effectiveness*, Report No. P-6433 (Santa Monica, CA: RAND Corporation, 1980); Kenneth M. Pollack, "The Influence of Arab Culture on Arab Military Effectiveness" (Doctoral Dissertation, Massachusetts Institute of Technology, 1996), 148.

²⁹ Kenneth M. Pollack, *Arabs at War: Military Effectiveness, 1948–1991* (Lincoln, NE: University of Nebraska Press, 2002).

³⁰ Emile Durkheim, *The Division of Labor in Society* (New York: Free Press, 1964); Max Weber, "The Three Types of Legitimate Domination," in *Essays in Economic Sociology*, ed. Richard Swedberg (Princeton, NJ: Princeton University Press, 1999); Stephen D. Biddle, *Military Power: Explaining Victory and Defeat in Modern Battle* (Princeton, NJ: Princeton University Press, 2004).

³¹ I am indebted to John Mueller for raising this possibility.

³² Peter M. Beattie, *The Tribute of Blood: Army, Honor, Race, and Nation in Brazil, 1864–1945* (Durham, NC: Duke University Press, 2001).

³³ Beckley, "Economic Development and Military Effectiveness."

³⁴ Charles Issawi, *Economic History of Turkey: 1800–1914* (Chicago: University of Chicago Press, 1980), 4. The Republican era is typically considered to have begun in 1923, when Kemal Atatürk founded the modern Turkish republic. See also Efraim Karsh and Inari Karsh, *Empires of the Sand: The Struggle for Mastery in the Middle East, 1789–1923* (Cambridge, MA: Harvard University Press, 1999).

³⁵ Tilly, *Coercion, Capital, and European States*.

³⁶ Bernard Lewis, *The Emergence of Modern Turkey*, 2nd edition (London: Oxford University Press, 1968), 39, 56–7; J. C. Hurewitz, *Middle East Politics: The Military Dimension* (New York: Frederick A. Praeger, Publishers, 1969), 35–9; Stanford Shaw, *Between Old and New: The Ottoman Empire under Sultan Selim III, 1789–1807* (Cambridge, MA: Harvard University Press, 1971), 112–37; William Hale, *Turkish Politics and the Military* (London: Routledge, 1994), 12–4; Emily O. Goldman, "The Spread of Western Military Models to Ottoman Turkey and Meiji Japan," in *Sources of Military Change: Culture, Politics, Technology*, ed. Theo Farrell and Terry Terrif (Boulder, CO: Lynne Rienner Publishers, 2002); Feroz Ahmad, *Turkey: The Quest for Identity* (Oxford: One-world, 2003), 25–9; Handan Nezir Akmeşe, *The Birth of Modern Turkey: The Ottoman Military and the March to World War I* (London: I.B. Tauris, 2005), 2–7.

³⁷ Niyazi Berkes, *Development of Secularism in Turkey* (Montreal: McGill University Press, 1965), 55–60, 71–2, 75; Stanford Shaw, *Empire of the Gazis: The Rise and Decline of the Ottoman Empire, 1280–1808*, vol. 1 of *History of the Ottoman Empire and Modern Turkey* (Cambridge: Cambridge University Press, 1976), 257–60; Lewis, *Emergence*, 49–50, 56; David B. Ralston, *Importing the European Army: The Introduction of European Military Techniques and Institutions into the Extra-European World, 1600–1914* (Chicago: University of Chicago Press, 1990), 47; Hale, *Turkish Politics*, 14–6; Shaw, *Between Old and New*, 114–6, 119, 130–1.

³⁸ Akmeşe, *Birth*, 3.

³⁹ Shaw, *Between Old and New*, 132–3.

⁴⁰ Berkes, *Secularism*, 82–5, 89–91, 102, 111–2; Lewis, *Emergence*, 70, 78–84; Eliezer Be'eri, *Army Officers in Arab Politics and Society* (London, UK: Praeger, 1969), 301–2; Hurewitz, *Middle East Politics*, 36–7; Roger Owen, *The Middle East in the World Economy, 1800–1914* (London: Methuen, 1981), 58; Ralston, *Importing*, 55–7, 62–3; Hale, *Turkish Politics*, 16–21; Akmeşe, *Birth*, 4–6.

⁴¹ Be'eri, *Army Officers*, 303; Hurewitz, *Middle East Politics*, 38; Ralston, *Importing*, 59–62, 64–65; Hale, *Turkish Politics*, 23–4, 29; Akmeşe, *Birth*, 2, 6–8.

⁴² Akmeşe, *Birth*, 120. See also pages 109, 115–21; Ralston, *Importing*, 70–1; Hale, *Turkish Politics*, 29, 42–6, who notes that, by World War I, "[Turkey's] fighting forces remained woefully defective in training and equipment" (46).

⁴³ Paul M. Pitman, III, *Turkey: A Country Study*, Library of Congress, Federal Research Division, *Area Handbook Series* (Washington, DC: Headquarters, Department of the Army, 1988), 318; George McGhee, *The US-Turkish–NATO Middle East Connection:*

How the Truman Doctrine Contained the Soviets in the Middle East (New York: St. Martin's Press, 1990), 42-4, 77-8, 92; Nur Bilge Criss, "U.S. Forces in Turkey," in *U.S. Military Forces in Europe: The Early Years, 1945-1970*, ed. Simon W. Duke and Wolfgang Krieger (Boulder, CO: Westview Press, 1993), 331-44; Hale, *Turkish Politics*, 96-7; Mark Smith, *NATO Enlargement during the Cold War: Strategy and System in the Western Alliance* (New York: Palgrave, 2000), 68; Ahmad, *Turkey*, 104-7.

⁴⁴ Nathan W. Toronto, "Why War Is Not Enough: Military Defeat, the Division of Labor, and Military Professionalization" (Ph.D. dissertation, The Ohio State University, 2007), Chapter 2.

⁴⁵ Owen, *Middle East*, 105.

⁴⁶ Issawi, *Economic History of Turkey*, 11. See also pages 1, 33-4; Charles Issawi, ed., *Economic History of the Middle East, 1800-1914: A Book of Readings* (Chicago: University of Chicago Press, 1966), 46; M. A. Ubicini, "Letters on Turkey," in Issawi, *Book of Readings*, 43; Omer Celal Sarç, "Tanzimat ve Sanayimiz," in Issawi, *Book of Readings*, 48-51, 54-7; Reşat Aktan, "Agricultural Policy of Turkey," in Issawi, *Book of Readings*, 111; Charles Issawi, "Economic Change and Urbanization in the Middle East," in *Middle Eastern Cities: A Symposium on Ancient, Islamic, and Contemporary Middle Eastern Urbanism*, ed. Ira M. Lapidus (Berkeley, CA: University of California Press, 1979), 103-10; Owen, *Middle East*, 58-9, 62, 100-5, 118-9, 122.

⁴⁷ Berkes, *Secularism*, 134; A. D. Novichev, "Ocherki ekonomiki Turtsii," in Issawi, *Book of Readings*, 68; Issawi, "Economic Change and Urbanization," 111-2; Issawi, *Economic History of Turkey*, 13-5, 37, 202, 204, 272-4, 277, 367-70; Alan Richards and John Waterbury, *A Political Economy of the Middle East: State, Class, and Economic Development* (Boulder, CO: Westview Press, 1990), 187; Hale, *Turkish Politics*, 52.

The Arctic: Avoiding a Polarized Pole

TOM KARSTEN¹

ABSTRACT

The prospect of a strategically stable Arctic—where commercial activity and exploitation take place in a peaceful, co-operative, and environmentally responsible fashion—is under threat. The main challenge, aside from the physical difficulties associated with operating in such a harsh and climatically dynamic area, arises from the growing division and disagreement between the Arctic states themselves and non-Arctic stakeholders. This is hampering a shared understanding of the environment at a time when rapid change is evident. Rather than allowing potentially contentious issues, such as governance and concerns over growing regionalism to delay progress, the opportunity now exists to facilitate shared solutions. This applies to a number of problems, principally in the scientific, maritime, and commercial domains, which maximize the opportunity for co-operation and which recognize a common international equity in a benign Arctic future. There is a genuine role for the United Kingdom and others who seek a collaborative future for the Arctic in this process. This should include supporting United Nations and Arctic Council efforts in the Arctic and assisting in the development of workable NATO and EU Arctic policies, which reassure strategic partners and accommodate other stakeholder interests. The paper aims to set the wider context in which the United Kingdom—a country ideally placed in terms of polar credibility and global engagement—might approach a rapidly changing Arctic in a way that complements broader engagement in the Arctic and helps to avoid a potentially destabilizing stand-off in the region.

Introduction

The Arctic is again becoming polarized. More than thirty years after the end of the Cold War, political differences are once more in danger of characterizing the region. This time, however, the most pressing difficulties and divisions are not those between East and West—although they clearly remain—nor are they primarily concerned with military security, despite some press reporting to the contrary.² Instead, the Arctic's future is at a juncture between a broadly co-operative, globalized agenda, representative of the approach non-Arctic rim stakeholders would wish to take, and the increasingly regional views of the five Arctic rim countries

Tom Karsten, "The Arctic: Avoiding a Polarized Pole," *St Antony's International Review* 7, no. 1 (2011): 144–165.

themselves—a group that consists of Russia, the United States, Canada, Norway, and Denmark (through Greenland).

On its own, this might not matter much. However, the danger is that as climate change accelerates unchecked in the region—and dramatic, often unpredictable environmental consequences follow—fundamental questions concerning climate science, access, resource exploitation, governance and, indeed, security will remain unresolved. These questions, then, may be overtaken by the effects of uncontrolled commercial exploitation of an unstoppable nature. In this event, competition is likely to increase and co-operation decrease, emphasizing divisions in what has already been called a fractured region and resulting, potentially, in a stand-off between the Arctic rim states and those beyond.³ In turn, this could lead to just the sort of stressed governance and over-dramatized scenarios popularized by the media. To avoid this, early accommodation and agreement on *governance* is necessary between those who increasingly see themselves as sole guardians of the Arctic, and those who believe they hold a stake in the region. Only then can the prospects for more substantive co-operation be explored and exploited. This paper aims to consider how this might be achieved and what leading non-Arctic stakeholders, such as the United Kingdom, might offer to help avoid an increasingly polarized approach to meeting Arctic challenges.

Is there an Arctic Stand-off?

The logo of the Arctic Council—the main, if not only, instrument of broader regional dialogue—depicts a snow fox, curled defensively in front of a map of the Arctic, facing towards the South. This image, accompanied by the language that the Arctic states occasionally use, provides a strong, although doubtlessly unintentional, suggestion of an isolated Arctic setting its face against the world.⁴ There are also more substantive examples of the way that the Arctic rim countries are collectively seeking exclusive oversight of Arctic business, such as the 2008 Illulisat Meeting of the inner group of the Arctic “five.” But this meeting deliberately excluded other Arctic Council members including Sweden, Finland, Iceland, indigenous groups such as the Inuit Circumpolar Council, and all official state and non-state observers. There is a general reluctance to consider wider questions of shared concern including security in the Arctic, as the Arctic Council’s refusal to allow UK and French input into their 2010–11 Search and Rescue (SAR) task force report illustrated. Finally, the Arctic Council failed to invite the European Union (EU) to their discussions, other than in an ad hoc fashion, despite the EU’s legitimate interests in the region.

Individually, as well as collectively, the Arctic rim nations are also taking a harder line when it comes to defining their own interests. Examples of this include Canada's recent unilateral declaration of tighter navigation oversight in waters adjacent to their territorial seas, and assertions made in various National Security Strategies, such as Russia's, that the "ownership of energy resources" in the Arctic will become the focus for international politics. Also, there is a suspicion—certainly in Russia, if not Canada—of the North Atlantic Treaty Organisation's (NATO) motives in the area.⁵ Of course, these divisions between Arctic and non-Arctic states also accompany well-publicized disagreements between the Arctic rim countries themselves; most notably, a number of long-standing disputes over territorial boundaries and rights of access.⁶

However, in practice these disputes are fairly minor in nature, and do not generally include disagreement over areas that include sizeable oil and gas deposits. More importantly, they are also beginning to be resolved, or are at least being placed in an "agree to disagree" category.⁷ Therefore, the likelihood is that shared regional interests might increasingly lead to stand-offs between the Arctic rim nations and those at the periphery. This view might be contested, but efforts by the Arctic states to allay fears that they are pursuing purely nationalist or protectionist agendas—and to acknowledge that development in the region has global implications which require stakeholder input—have been notably thin on the ground.

"So What?" Why the Arctic Matters

The degree to which Arctic issues matter in a world grappling with perhaps more pressing short-term problems is debatable. Obviously, the region is of fundamental long-term importance to the Arctic states themselves (and, of course, the region's indigenous peoples), for whom Arctic exceptionalism is nothing new.⁸ Others—including China—are, to a greater or lesser degree, significant players in the Arctic region.⁹ And a number are state "observers" on the Arctic Council and retain genuine equity in the Arctic's future. They are, or see themselves as, genuine stakeholders in the region, in the sense that their futures—not least in economic terms—are to some degree tied to developments there.

This is reflected in the specific reasons behind the Arctic's move up the international agenda. Firstly, the region is experiencing some of the most rapid climate change on earth, described as the equivalent of an "environmental state change," bringing with it enormous uncertainty and the prospect of economic, cultural, and political instability.¹⁰

Secondly, there is the danger that an unsettled physical environment in the Arctic may presage even more dramatic “wild card” climate change, such as drastic impact on the atmospheric circulation patterns of Northern Europe resulting from the sensitivity of the Great Ocean Conveyor.¹¹ For some, these more extreme projections might appear overly dramatic, but there are uncomfortable historical precedents for rapid climate change resulting in conflict, such as the fifth century European drought, which led to the sack of Rome by the Visigoths.¹² A more current example of Arctic exceptionalism is the fact that the Arctic region provides an urgent example of a global climate change issue whose resolution, in terms of the required critical adaptation and mitigation, rests solely in the hands of leading powers in the “first world.” As such, it offers an urgent opportunity to set an example of responsible trans-national development in response to global warming.¹³

All of these dynamics (few of which are well defined) make the Arctic an area of particular unpredictability and genuine concern to the wider world. Against this backdrop, there are also a number of constants, such as the unalterable reality that—in a region displaying so much rapid change across a range of environmental, economic, and geopolitical areas—there will inevitably be opportunities and threats and, in turn, winners and losers. One of the key unresolved issues is whether competition or co-operation defines the way ahead—assuming a binary win/lose scenario can adequately sum up the situation—and what the implications are for Arctic states and stakeholders.

Competition or Co-operation?

Environmental change, leading in turn to increased access and as a result expanded opportunities for commercial exploitation, represents the logic flow underpinning future Arctic development. At each stage, opportunities are likely to exist either for wider engagement and stakeholder co-operation or, in some cases, a more restrictive form of competition. As such, the region offers a valuable model for analysts as a practical test case for how various components of economic development and conflict avoidance are best served.

On the one hand, there is the view that boundaries such as the Arctic Circle no longer claim the relevance they once had and, as a concept, have become problematic in an era of intensified globalization.¹⁴ This chimes with the perspective of those who support the concept of a global civil society and the environmentalist claim that strong global governance needs to replace the allegedly petty squabbles of competing nation

states. On the other hand, it is argued that the world is reverting to a period akin to the end of the Cold War with nation states pursuing their own agendas, regardless of the legitimate interests of the international community.¹⁵ Alternatively, the region might also be seen in terms of the competition that exists between states and alliances, where the potential for conflict develops as a result of the interchange between declining and rising powers (perhaps, in the Arctic context, Russia and China).¹⁶ Either way, there are a number of different political routes which could be followed in the Arctic, with harmonious co-operation not necessarily heading the list of likely outcomes.

Nevertheless, a review of the factors at play in the region clearly serves to emphasize the critical advantage of co-operation over competition, not least in terms of pooling resources in the face of significant challenges. This should come as no surprise. And, indeed, a degree of multilateral co-operation is already relatively well established in some limited aspects of Arctic life, albeit mainly in the scientific domain.¹⁷ The danger remains, however, that the opportunity for broader agreement over the fullest range of issues is not taken and that practical co-operation and determined action lag dangerously behind changes already taking place in the region.

Environmental Challenges

The starting point for any consideration of Arctic issues is the nature of the environmental changes taking place there. Firstly, however, it is worth noting the well-publicized speculation about global, not just regional, climate change. This includes the uncertainty resulting from, amongst other things, the controversy at East Anglia University (known as “climate gate”) and the Intergovernmental Panel on Climate Change’s (IPCC) flawed report claiming that the Himalayan glaciers would melt by 2035.¹⁸ As a result, there is considerable scientific and popular doubt, not so much that climate change is happening (the IPCC says warming is unequivocal—the only time it uses the word), but more regarding its causes (most notably, whether they are man-made or not).¹⁹

Concentrating on the outcomes rather than the causes, the Arctic has seen a three-degree Celsius temperature rise over the last fifty years, with potential for a further fifteen-degree rise this century.²⁰ The key impact of this rise is that on sea ice cover and thickness. Statistics from the US National Snow and Ice Data Centre (NSIDC) show a decline in summer ice of some 11.7 per cent per decade over

the last thirty years. Of particular relevance in terms of accessibility is the long-term loss of hard, multi-year ice. Predictions are notoriously difficult, but some suggest that the whole Arctic, which is uniquely sensitive to climate change, could be largely ice-free as early as summer 2013, although perhaps a time-frame of 2030–40 might appear a more realistic bet.²¹

Aside from the loss of sea ice, there are further dramatic issues arising from global warming, such as melting land ice, which could result in as much as a 7.3 metre rise in global sea levels if the Greenland ice cap were lost. And thawing of the Siberian permafrost may have major implications for the emission of methane (a particularly virulent greenhouse gas). Furthermore, increasing fresh water in the Arctic will lead to greater acidification with serious bio-diversity consequences.²² Finally, increasing temperatures will also lead to changes in the patterns of polar cyclones and instability in upper air temperature patterns. This last consideration illustrates that, even without the ice, the region would remain a climatically-hostile place to operate in, and that weather systems are—by their very nature—global features that pay no attention to artificial boundaries.

The uncertainty over the nature of climate change points to a key problem for our effective environmental understanding in the Arctic: there is a fundamental lack of comprehensive and shared scientific knowledge. Not enough is known about the interrelated elements of the global climatic system, particularly regarding key predictions relating to the rate of sea ice decline. The Arctic is the least sampled of all the world's oceans. The climate models employed there are inadequate for the highly complex tasks they have been set, and expectations of certainty, particularly amongst the business community and the public, are high.²³ Addressing these problems underlines the importance of undertaking collaborative science, harnessing global expertise, and the need for maximum transparency in pinning down the best predictions. In the absence of greater scientific co-operation, which conversely is routine in the Antarctic, the likelihood of being able to make any predictions of sufficient credibility to allow appropriate policies to be formulated seems slim and further encourages climate sceptics and alarmists. Consequently, given the exceptional environmental dynamics at play, this does not seem a sensible time for regionalism, when the opportunities for pooling resources, sharing expertise, and fostering wider global acknowledgement of the dangers of “getting it wrong” (for example, on climate adaptation and mitigation) seem so compelling.

Maritime Challenges

One of the chief consequences of the loss of Arctic sea ice will be significantly improved access to, and via, hitherto impassable Arctic waters. Some relevant examples include: the Northern Sea Route, which saves 40 per cent of passage time and has seen recent commercial east to west transits; transit through the North West Passage between Yokahama and Rotterdam, which will save 4,860 nautical miles over the Panama Canal route, although it is not expected to be open before 2020; and the Trans-Arctic route, which will take, when it clears, fifteen days from Japan to Europe (compared to some twenty-two days via Suez), and has already been subject to commercial interest by China.²⁴ The Arctic Council's 2009 Arctic Marine Shipping Assessment (AMSA) concluded that maritime development in the region is inevitable, with natural resources and trade representing key drivers for Arctic shipping, and that future activity will include many non-Arctic stakeholders. Moreover, given the threat of piracy elsewhere in the world, Arctic shipping lanes may appear doubly attractive from a maritime security perspective.

However, some significant maritime challenges lie ahead before open use of Arctic waters is achieved, in addition to the obvious physical difficulties presented by residual ice. These challenges will need early resolution. From a commercial standpoint, there is the risk of building highly expensive ice-capable vessels when the precise environmental conditions likely to be encountered in a relatively brief ice window are so uncertain. Secondly, there is uncertainty as to how shipping would be governed in the region alongside existing principles of the freedom of navigation. Thirdly, there are material constraints to developing widespread commercial shipping in the Arctic regardless of the state of the ice. The lack of port infrastructure and the absence of genuine SAR coverage in such a vast sea area (not least in response to increased tourism off Greenland and Svalbard) are serious enough.²⁵ Yet it is the total inadequacy of comprehensive hydrographic services to the standard that are available and expected elsewhere in the world that is likely to hamper activity to the greatest extent.²⁶

As such, the reality is that the Arctic—both a markedly fragile ecosystem and a uniquely challenging area to operate in, with or without ice—will require a greater level of maritime governance. This should take the form of properly constructed ships, robust infrastructure, and well developed supporting services, if it is to become a safe operating area and avoid the sort of disaster suffered as a result of the *Exxon Valdez* grounding of 1989. The aim of the Arctic Council's 2009 AMSA report

was to address these challenges. However, it did not go far enough in seeking solutions and failed to take the United Nations (UN) sufficiently to task over the issue of developing appropriate maritime regulations. After all, the International Maritime Organization's (IMO, the competent UN body) recently-produced Polar Code is voluntary and not retrospective (so existing ships do not have to comply).²⁷ Moreover, the code does not come into force until 2015 and does not include fishing activity, something that is likely to increase significantly if access improves and global demand for fish continues to rise.

Consequently, there is the danger that sufficient levels of tough, mandatory assurance—supported by appropriate inspection and safety regulations, as in the Antarctic—will not be developed in enough time to establish the necessary co-operative regime *ahead* of the seas opening, with all participants and maritime users engaged (including non-Arctic stakeholders). Demand for this sort of approach, both at sea and on-shore, can only be strengthened by the 2010 events on BP's *Deepwater Horizon* rig in the Gulf of Mexico.

Resource Challenges

Receding ice and open access routes will, in turn, inevitably lead to greater opportunities for resource development, ranging from oil and gas extraction, through exploitation of an array of nickel, zinc, diamond, ruby and methane hydrate deposits, to fishing and tourism. With respect to oil and gas, the (perhaps inconvenient) fact is that the world still needs energy; a certainty to set alongside climate change uncertainty. This is not to accept as inevitable that commercial exploitation should take place, but merely to point out that it probably will. Projections are being constantly updated, but the International Energy Agency currently predicts something in the region of a 40 per cent increase in global energy demand by 2040, 75 per cent of which will have to come from fossil fuel.²⁸ This is of direct relevance to the Arctic where, according to the US Geological Survey, possibly up to 20 per cent of the world's undiscovered hydrocarbon resources are located.²⁹

The opportunity to take advantage of these extensive resources sharply distinguishes the region from the Antarctic, where there is a total ban on commercial exploitation under the Antarctic Treaty System (ATS) until at least 2041. In the absence of an ATS equivalent in the Arctic, and with little support for one from the Arctic rim countries (given, among other things, the ATS's robustly global and inclusive approach), this will be a challenging issue to work through.

Much of the problem, of course, lies with the commercial operators and multi-national corporations, which have already invested in the Arctic and are eyeing further opportunities as they seek to formulate long-term (twenty-five-year-plus) business plans. For them, climatic conditions and trends, environmental pressures, and market dynamics are the major factors. For instance, the pre-eminent concern in the energy industry is the oil price (still sitting above \$100/barrel at the start of May 2011) at which exploration in the region becomes economically viable.³⁰ Practically, development will need greater knowledge (of the ice and the skills associated with cold weather operations), more capital (to invest in the high cost of infrastructure), and better developed business services (such as insurance and logistic support to sustain distant operations). All of this will have to be at a scale and level of competence not necessarily seen elsewhere and is unlikely to be achieved, even with greater co-operation between the rim states themselves, without the support of non-Arctic countries.

In addition, there are fundamental questions of commercial governance to resolve. Who is going to take charge of determining whether various forms of economic development take place? How will that development be regulated?³¹ What roles will the environmentalist and Inuit agenda play in shaping commercial plans? How will commercial ambition overlap with national rights and responsibilities? It seems inevitable that the answers to these challenging questions must, in time, be included in any consideration of broader Arctic, if not global, governance.

Challenges for Arctic Governance

Ever since the end of the Cold War, the future of wider governance in the region has been ill-defined. Today, the issue is an emotive one. Whilst there may be a growing recognition that greater governance (in terms of oversight and control) is needed to meet the dynamic transitional challenges the region faces, there is significant doubt as to how, or indeed when, it should be developed, and the implications of such developments for sovereignty.³² However, as argued earlier, the issues seem too complex and the requirements too great (for scientific knowledge, maritime assurance, and so forth) to rely on the status quo. Time is also pressing, and the tendency to wait for problems to become acute before dealing with them would seem, in the Arctic context, irresponsible in the extreme.³³ So, the degree to which development of effective governance happens unilaterally, under regional leadership or, alternatively, becomes recognized as an area of international co-operation and engagement is the

leading question in assessing the future of the Arctic. At the very least, a stand-off between the five Arctic rim states and other legitimate stakeholders would see both sides suffer.

This dilemma has been heightened by what some, notably the press, have interpreted as the prospect of rampant unilateralism in the Arctic, with a resurgent Russia as the main alleged protagonist. Perhaps there is some truth in this view. Certainly, there is real concern as to Russian ambitions, notably in Norway.³⁴ There is also little doubt that Russia has much to gain as one of the winners from climate change—for example, via the opening of the Northern Sea Route and the huge opportunities in energy markets—with currently 20 per cent of Russian GDP derived from the sector. Moscow also views its Arctic flank predominantly in terms of security; the Russian National Security Strategy states that the government will include plans to “increase the effectiveness of State border defence particularly in the Arctic zone.”³⁵ The resumption of Russian bomber patrols in the region indicates that Russia is serious about protecting its interests. However, others dismiss the rhetoric accompanying Russian “flag-planting” at the North Pole (and other disagreements, such as between Canada and Denmark over Hans island) as mere alarmism and of little legal relevance. After all, it is argued, stories about co-operation and agreement do not sell newspapers.

A more plausible view is that the Arctic rim states are now beginning to reluctantly recognize their dilemma and the fact that they cannot go it entirely alone when it comes to Arctic governance.³⁶ Despite somewhat contradictory pronouncements over sovereignty, there is genuine acknowledgement that nationally they do not have the knowledge, competence, resources, or authority to deal with the full range and scale of Arctic challenges.

In this regard, the Russians might actually be leading the way. They have been punctilious—at least in respect to the other Arctic states—in their observance of the UN Convention on the Law of the Sea (UNCLOS). They have also recognized, somewhat belatedly, that commercial exploitation will only come with the introduction of external technology and capital, and that the use of energy as a weapon (notably in Europe) is not necessarily a productive way to conduct foreign relations or earn foreign income. The recent agreement over the Barents Sea with Norway demonstrates their changed approach and their developing willingness to negotiate issues of sovereignty, at least with their immediate neighbours. Similarly, the May 2010 Memorandum of Understanding (MOU) between Denmark and Canada on Arctic security co-operation indicates some internal Arctic alignment on military matters, even though both countries belong to NATO. So instead of unilateral action, it is more likely

that the Arctic rim will collectively seek to protect their interests from the rest of the world.

In terms of shared governance, it is possible that as a group they hope that the Arctic Council—and perhaps existing instruments, such as UNCLOS—will provide the necessary credibility and authority for their co-operative actions in the region. As such, they may believe that exclusively pursuing a form of limited multilateralism through these bodies alone, perhaps on an issue-by-issue basis, will be sufficient to avoid accusations of isolationism and to resolve pressing issues with their immediate neighbours.³⁷

However, there are practical problems with this “governance lite” approach, certainly as viewed by non-Arctic stakeholders. The Arctic Council, only set up in 1996, remains—for the time being—primarily an environmental body (succeeding, to a degree, in drawing together the Arctic rim states in a manner that has not been managed in other fields). However, it is institutionally uncomfortable with the idea of the Arctic as a common home for humanity, and takes the view that no new legal arrangement is necessary to provide Arctic governance. In short, its members believe the Council to be entirely fit for the task. However, the evidence suggests that to deal with the challenges discussed earlier, the knowledge, competence, and resources of the Arctic Council will need to be developed. Aside from its apparently isolationist tendencies, it does not include any consideration of security—its AMSA report chooses to ignore military presence in the region, a significant element of Arctic maritime activity—nor does it have a permanent secretariat or an established headquarters. As such, it appears to be not only a strangely nomadic organization, but also the bare minimum that the Arctic states feel they can get away with. It gives the impression that it might merely provide a convenient front to more genuine unilateralist tendencies in the region. In these circumstances, it is unlikely to enjoy wide-ranging authority over Arctic issues.

Regarding the UN, some would argue that it cannot cope with the accumulation of complex global problems that requires the functional equivalent of a world government. The United States is also ambivalent toward UN-style multilateralism (they have still to sign the UNCLOS agreement), and the Canadian press regularly questions the UN’s authority in the region.³⁸ More tellingly, several factors suggest that the UN is neither nimble nor tough enough to deal with dynamic and pressing Arctic challenges that are emerging. These include: the fact that it takes so long for the UN’s twenty-one part-time members of the Commission for the Limits of the Continental Shelf (CLCS) to deal with individual submissions seeking to secure offshore claims (they have warned that it

may take them until 2035 to review all claims), the fact that the volume of these submissions is likely to increase significantly anyway, not just in the Arctic, and the fact that the IMO has not pushed Arctic legislation harder.³⁹ Consequently, the UN also does not appear to offer a comprehensive solution to Arctic governance.

Nevertheless, Arctic stakeholders would argue that effective international governance of the region that includes players beyond the “five” is a fundamental necessity. This is because the central Arctic Ocean represents the High Seas (in the legal sense), regardless of who might or might not own the sea bed, because globalization has created a different dynamic for approaching these issues, and in order to avoid the Arctic states resolving regional issues to their exclusive satisfaction at the expense of others’ legitimate interests. For them, in the absence of something akin to the ATS, either the Arctic Council should be expanded and strengthened or the UN, NATO (given that all of the Arctic rim countries bar Russia are members), or potentially the EU should play a greater role, perhaps separately assuming responsibility for discrete areas of business.⁴⁰ However, there would be significant concerns to overcome in expanding international governance in this way. For example, any ATS solution might lead to the Arctic being designated a “zone of peace,” thereby demilitarizing the area against US and Russian wishes. Moreover, using nato as a governance forum would cause more problems than it could solve, both due to Russian suspicions of Alliance motives, and because nato—in the absence of a cohesive Arctic policy—has already been bypassed by its own most affected members, as evidenced by the Canadian–Danish bilateral defence agreement. Also, collectively, the Arctic Council believes that the EU lacks competence and understanding, being most interested—in their perception—in stopping indigenous sealing activity.

As such, talk of multilateral governance resolving pressing Arctic issues seems premature. In any case, perhaps the opportunity to craft a workable model has already been overtaken by events. A Chinese military officer, Rear Admiral Yin Zhuo, in the *South China Morning Post* on March 5, 2010, argued that “China should have a share of the Arctic, which belongs to all people around the world.”⁴¹ This represents a sober warning (official or not) of a developing stand-off in the region.

So, as an alternative, there might be better prospects in at least agreeing to the nature of the challenges facing the region and, in turn, collectively starting to seek a shared approach. In time, once the habit of mutual co-operation is better established between Arctic states and non-Arctic stakeholders, wider governance and security might then be considered. In any event, some consideration of the practical solutions that might help to address these Arctic challenges is necessary.

Success in addressing the widest range of Arctic challenges will depend on careful navigation of a track that leads to a high degree of sustainable development alongside an acceptable measure of regulated access. Any approach will need to accommodate not only an expansionist Chinese perspective, but also avoid a risky cycle of growing military activity (after all, the Russian Northern Fleet is currently being expanded), closer security co-operation amongst Western powers at Russia's expense, and inflammatory rhetoric that limits opportunities for co-operation.⁴² It will also require tacit acceptance by the Arctic states that unilateralism is not the answer, as they do not possess sufficient capacity or capability to meet all the region's challenges. This will demand subtlety in order to achieve a workable collaboration that respects Arctic exceptionalism and concerns over sovereignty, alongside the ambitions of the wider stakeholder community. In short, it calls for the exercise of soft power.

How might this be facilitated? Clearly, despite their various shortcomings, the UN, Arctic Council and perhaps NATO still have a significant and central part to play. Individual states may also help in finding and encouraging solutions to some, if not all, of the various Arctic challenges. This complimentary (and seemingly vacant) interlocutor role could be undertaken by one of the Arctic Council countries. However, the selection of appropriate candidates who might take a demonstrably even-handed approach is limited. From the US perspective, the Arctic remains, at least in security terms, either a Cold War relic whose strategic importance has yet to recover to its pre-1989 prominence or simply a homeland security front in the Global War on Terror. Significant US military infrastructure in the Arctic has been closed down. The US Coast Guard icebreaker fleet is atrophying, and in 2006 the United States moved out of Keflavik airbase in Iceland, marking the end of more than half a century of military presence there.⁴³ So, despite encouraging comments made recently by the US secretary of state regarding the need for global engagement on Arctic issues, the aspirational tone of the Bush Arctic Presidential Directive, and the fact that the United States is clearly well-placed to apply stronger, harder-edged influence to the process of resolving shared Arctic issues and ensuring maximum collaboration, the United States has yet to embrace a larger Arctic role.⁴⁴ Elsewhere in the region, Canada is no longer the leading exponent of multilateralism it once was, and appears too strident in terms of protecting its Arctic rights.⁴⁵ Denmark is too small, although that in itself may be of some advantage, and Russia remains perhaps too unpredictable and bellicose.⁴⁶

Similarly, many non-Arctic stakeholders lack the appropriate profile, despite possessing some of the necessary skills. China is too big and too overtly ambitious (and its reading of UNCLOS, as exposed by Admiral Yin Zhuo, is markedly flawed). The EU is too diverse (and it has lost environmental credibility following the Copenhagen summit). South Korea is too small and too distant. Germany, whilst certainly engaged in Arctic science, is too reliant on Russia (for energy). And finally, France and Spain are, in outlook, more focused on the greater Mediterranean region. In these circumstances, a middleman is required. Several might claim this role; for instance, Norway, which is within the Arctic Council, has a reputation for mediation (not least in and around Svalbard), and is a member of NATO, potentially making it well-positioned to bridge the divide outwards. But the stakeholder community also needs a representative who can effectively help to articulate their case without causing undue alarm. This is a role that the United Kingdom could fill.

The Potential Role of the United Kingdom

The United Kingdom seems uniquely placed to help address a number of the Arctic issues with a high degree of credibility. This is not intended as a parochial view, but merely as a recognition of the distinctive centre ground that London occupies on Arctic matters. In the multilateral framework, the United Kingdom is a permanent member of the UN Security Council, an observer on the Arctic Council, a signatory to the Svalbard Treaty and a prominent member of the Group of Eight (G8), Group of Twenty (G20), Commonwealth, NATO, ATS and the EU. It also enjoys comprehensive membership of a range of lesser Arctic bodies.⁴⁷ Individually, too, the United Kingdom has an enviable Arctic curriculum vitae and a sizable Arctic equity. It is not geographically peripheral to the region, the Shetland Islands are only about 100 miles away, and it has significant Antarctic and Arctic historical standing. In addition, it remains a leading maritime nation (playing host to the IMO), retains comprehensive mercantile and military experience of operating in the ice, is a major proponent of the need for maritime security, and has been closely engaged with commercial operations in the Arctic since the days of whaling.⁴⁸

Less positively, but of some relevance given the need to encourage a shared agenda, the United Kingdom also carries a degree of responsibility for current environmental degradation in the Arctic as a result of, amongst other things, the spread northwards on the Gulf Stream of Sellafield pollutants. Although it has yet to formulate a definitive Arctic policy (possibly an advantage in itself), London shares the common

view—consistent with emerging EU thinking—of the need for sustainability in the region, the requirement to avoid ungoverned spaces, and the importance of encouraging the rule of law.⁴⁹

In short, the United Kingdom is a sympathetic, well-qualified, and closely engaged stakeholder, ideally placed to offer a bridge between two sides in any Arctic stand-off and to help address at least some of the key shared Arctic challenges, particularly in the fields of science, maritime assurance, and commercial governance noted above. The following illustrative suggestions (which clearly do not seek to provide solutions to all of the Arctic's challenges) demonstrate not so much what the Arctic can do for the United Kingdom (although, clearly, there may be long-term benefits involved), but rather suggest areas of activity where the United Kingdom might contribute to practical Arctic solutions leading to greater Arctic collaboration.⁵⁰ Naturally, other stakeholders could provide complementary input.

First, the United Kingdom could benefit Arctic science through greater and more consistent transparency, as envisaged by the recent International Polar Year. The UK scientific community is already on the leading edge of prominent areas of polar research. The CryoSat-2 satellite launched recently to measure sea ice thickness in the Arctic has a British director, and the British Antarctic Survey (BAS) also carries out limited operations in Svalbard and in the northern seas. These activities could be enhanced—though not necessarily at the expense of core operations in the Antarctic—and greater effort made to share the output. Giving the BAS a wider and better-resourced polar view would also improve scientific coherence between the Arctic and the Antarctic. Greater efforts might also be made to find British resources for the EU's Aurora Borealis project, as a means of offering ice-breaking and afloat research capability to the global scientific community, as well as reinforcing the UK's commitment to the EU's Arctic interests. In the absence of additional funding, London could encourage the adoption of the more valuable elements of the ATS, without the accompanying resource, security and sovereignty implications, by creating a more open exchange of Arctic science.⁵¹ There might be further advantages to this approach. On the one hand, open science could help to bridge the significant gap between scientific knowledge, political perspectives and public perception, while on the other hand, science could also be seen as a promising area for co-operation with Russia, given its generally un-contentious nature.

Second, a greater effort to pool resources should also be the head-mark in the maritime domain, in order to overcome the challenges that shipping faces in the region. The United Kingdom has a prominent part to play here as well, not just as a leading maritime power, but also through

the role of the UK Hydrographic Office (UKHO), which could assist in developing much needed hydrographic services in the region. The UKHO represents a global brand when it comes to charting; its products are used worldwide, and it has a near-monopoly on the sale of paper charts, which are of particular import in the Arctic Ocean because receding ice is exposing sea areas about which little or nothing is known. In addition, there is significant effort being made by the Arctic rim countries to understand the nature of the seabed off their continental shelves to support claims to the UN Commission on the Limits of the Continental Shelf (CLCS). This is taking time, not only because of inadequate UN capacity, but also because of the huge amounts of data to be collected. Engaging the UKHO in this process—to oversee, license, or perhaps assist some of the civil maritime work—might reduce the prospects for disagreement (for instance, over the Lomonosov Ridge).⁵² It might also offer the opportunity for developing a more sophisticated mechanism for achieving wider domain awareness and for generating greater understanding of ice and weather; important elements in building comprehensive maritime assurance in the region.⁵³

Finally, alongside scientific and maritime assurance solutions, the challenges of resource management and associated commercial governance need to be addressed. As noted, there are significant UK commercial interests in the Arctic region, and the state of co-operation between various multinational corporations is advanced, albeit changeable; the link between BP with TNK and Rosneft being a case in point.⁵⁴ Any future exploitation will require international financial and technological collaboration, and much of this can be sourced through UK markets.⁵⁵ This might also include assistance in the setting up of essential commercial assurance mechanisms and services, as has been the case in the Antarctic where the United Kingdom has led efforts to provide governance in the tourism and fishing markets.⁵⁶ Energy security would also be greatly enhanced by closer, integrated relationships across Arctic borders. In any event, settled commercial links—representing a global economic two-way street—would perhaps succeed in lowering tensions in the region better than anything else.

Conclusion

A shared goal, common to Arctic states and stakeholders, of a strategically stable Arctic where commercial activity and exploitation can take place in an environmentally-responsible fashion is clearly worth pursuing. Achieving this outcome will be challenging, not least given the physical

difficulties associated with operating in such a harsh and unpredictable area. Avoiding making it harder still by allowing division and disagreement to, at best, limit co-operation, or, at worst, risk a breakdown in security should be the primary aim of Arctic states and stakeholders alike. Agreement as to how to achieve this is necessary and, given the climate change dynamic, some urgency is required. Rather than allow potentially contentious issues such as governance and the concerns with regionalism or multilateralism to delay progress, the opportunity exists in the short term, before further significant environmental change takes place, to facilitate solutions to a number of problems that maximize opportunities for co-operation and recognize a shared equity in a benign Arctic future.

There is a genuine role for the United Kingdom, and others who seek a collaborative future for the Arctic, in this process. This should include assisting in the development of workable NATO and EU policies in the region, which reassure strategic partners. Alongside the United Kingdom, the United States—which has extensive interests in the region, but which remains focused elsewhere—must soon come to pay more strategic attention to the Arctic. The emerging view that co-operation must be the way ahead—shared by London, Washington, and other stakeholders—should greatly assist in dissuading those who see the Arctic merely in regional terms. It might also help to avoid any isolationist misinterpretation of the Arctic Council's protective snow fox logo. ■

Notes

¹ The opinions expressed in this article are the author's own, and do not represent the official policy position of the Royal Navy, the UK Ministry of Defence, or any other branch of HM Government.

² Margaret Blunden, "The New Problem of Arctic Security" *Survival*, 51, no. 5 (2009): 121–142; "The Battle for the Arctic," *The Week*, April 26, 2008.

³ Charles Emmerson, *The Future History of the Arctic* (London: Bodley Head, 2010), 7.

⁴ For example, Stephen Harpur's widely reported "use it or lose it" remark regarding sovereignty, made during a tour of Canada's Northern Territories on August 10, 2007.

⁵ NORDREG, "Radio Aids to Marine Navigation 2009", January 19, 2010; "Russian National Security Strategy to 2020," paragraph 11. <http://rustrans.wikidot.com/russia-s-national-security-strategy-to-2020> (accessed on May 8, 2011).

⁶ For example, between the United States and Russia in the Bering Sea and Chukchi Sea; Canada and United States in the Beaufort Sea and Canada and Denmark in the Davis Strait/Greenland.

⁷ For example, the Barents Sea Agreement reached in April 2010 between Russia and Norway; an agreement seen in Norway as resolving the most important outstanding issue between the two countries: see *The Barents Observer*, "Maritime border agreement drawback for Russian oil and gas – Russian expert," <http://www.barentsobserver.com/maritime-border-agreement-drawback-for-russian-oil-and-gas-russian-expert.4871153-116320.html> (accessed on December 8, 2010). On the latter point, the US and Canadian dispute over the North West Passage resulted in the 1988 Arctic Co-operation Agreement, which sets the framework for US and Canada to agree to disagree (the US agrees to seek Canadian approval for movement of ice breakers but Canada will always say yes).

⁸ This paper does not seek to address specific issues relating to the region's indigenous population. This deliberate exclusion is not intended to diminish the importance of their views, nor the contribution they make to articulating key environmental issues. However, this contribution is yet to make a conclusive impact at the highest international level (the focus here). Perhaps, when it does, a more comprehensive, global view might be achieved.

⁹ Major states in this group—in addition to China—include South Korea, Japan, the United Kingdom, Poland, France, Spain and Germany.

¹⁰ Paul Berkman, "Arctic Ocean State-Change: National Interest and Common Interests," www.spri.cam.ac.uk/research/aog/publications/berkman2009-2.pdf (accessed on May 8, 2011).

¹¹ William James Burroughs, *Climate Change: A Multi-disciplinary Approach* (Cambridge: Cambridge University Press, 2001), 207.

¹² Alan Dupont, "The Strategic Implications of Climate Change," *Survival* 50, no. 3 (2008): 29–54; Elizabeth Kolbert, "The Climate of Man-II: The Curse of Akkad," *New Yorker*, May 2, 2005, <http://www.newyorker.com/archive/2005/05/02/050502fa—fact3> (accessed on May 8, 2011).

¹³ Anthony Giddens, *The Politics of Climate Change* (Cambridge: Polity, 2009), 63–64.

¹⁴ David Held et al., *Global Transformation: Politics, Economics and Culture* (Cambridge: Polity, 1999), 1–30.

¹⁵ Robert Kagan, *The Return of History and the End of Dreams* (London: Atlantic, 2008).

¹⁶ For International Relations theoretical arguments that look at how shifts in the balance of power can contribute to interstate tension, see Dale C. Copeland, *The Origins of Major Wars* (Ithaca, NY: Cornell University Press, 2000) and Robert Gilpin, *War and Change in World Politics* (Cambridge: Cambridge University Press, 1981).

¹⁷ For example, the Barents Euro-Arctic Council (BEAC), Barents Co-operation Agreement, the Council of the Baltic Sea States (CBSS) and the Northern Research Forum (NRF). The problem is that whilst these, and similar organizations, certainly represent a diverse range of Arctic issues, a single forum might allow more effective multi-disciplinary dialogue to take place between the widest range of (Arctic and non-Arctic) stakeholders.

¹⁸ Jonathan Leake, *The Sunday Times*, January 31, 2010.

¹⁹ Intergovernmental Panel on Climate Change, *4th Assessment Report (AR4)* (Cambridge: Cambridge University Press, 2007).

²⁰ Arctic Climate Impact Assessment, *Arctic Climate Impact Assessment: Impacts of a Warming Arctic* (Cambridge: Cambridge University Press, 2004); UK Met Office, "Four degrees and beyond," September 28, 2009, <http://www.metoffice.gov.uk/news/releases/archive/2009/four-degrees> (accessed on May 8, 2011).

²¹ Professor Wieslaw Maslowski, address to a meeting of the American Geophysical Union, December 2007; Giddens, *The Politics of Climate Change*, 20.

²² Parliamentary Office of Science and Technology, *Postnote*, no. 334 (June 2009); Burroughs, *Climate Change: A Multi-disciplinary Approach*, 207. It is also worth noting that even the modest rise predicted without the loss of land ice would have world wide impact on a number of heavily populated cities.

²³ The Arctic Council, *Arctic Marine Shipping Assessment 2009 Report* (Oslo: Arctic Council), 157. Summer melting of Arctic sea ice has accelerated far beyond the expectation of climate models. The area of sea ice melt during the 2007–08 season was about 40 per cent greater than the average prediction from the IPCC AR4 report, and shrinking sea ice appears to be some 30 years ahead of climate model projections: Nalan Koc et al., *Melting Snow and Ice: A Call for Action* (Oslo: Norwegian Polar Institute, 2009), 36.

²⁴ Beluga Shipping's MVs Fraternity and Foresight, two 12,000-ton vessels, left Korea late in July 2009, delivering cargo to the River Obb and passed Novaya Zemlya outbound in mid September 2009. Reuters, "German ships successfully make 'Arctic passage,'" September 12, 2010, <http://www.reuters.com/article/2009/09/12/us-climate-shipping-arctic-idUSTRE58B01K20090912> (accessed May 8, 2011); Clive Schofield and Tavis Potts, "Across the Top of the World? Emerging Arctic Navigational Opportunities and Arctic Governance," *Carbon and Climate Law Review* 4, (2009): 472–482. Recent analyses and feasibility studies support these estimates.

²⁵ The recently established North Atlantic Coast Guard Forum, which the United Kingdom is a member of, is in its infancy and the Arctic Council has yet to issue its SAR task force report (from which the United Kingdom and France were, somewhat surprisingly, excluded). The dangers inherent in polar navigation were demonstrated by the sinking of *MV Explorer* in the Antarctic in 2007, and *MV Polar Star* and *MV Antarctic Dream* running aground off Svalbard in July and December 2008.

²⁶ The Arctic Council, *Arctic Marine Shipping Assessment Report 2009 Report*, 5.

²⁷ The IMO's Maritime Safety Committee (MSC), 86th Session: May 27 to June 5, 2009, approved revised guidelines for ships operating in polar waters.

²⁸ International Energy Agency, "World Energy Outlook, 2009," <http://www.worldenergyoutlook.org/docs/weo2009/WEO2009-es—english.pdf> (accessed on May 8, 2011).

²⁹ US Geological Survey, "Arctic Resource Appraisal: Estimates of Undiscovered Oil and Gas North of the Arctic Circle," *USGS Factsheet 2008-3049* (2008).

³⁰ The technological challenges associated with extraction are significant and the advent of alternatives such as gas from shale, coal bed and light sands may well drive some, but perhaps not all, exploration elsewhere.

³¹ This will, for instance, influence the potential for increased fishing on the open High Seas outside Arctic rim waters.

³² Arctic rim states are particularly sensitive to the use of the “governance” word, as they believe it implies, in some way, a lack of competence on their part, or presages a neo-colonial approach to their heritage that ignores the rights to self-determination of, for instance, the indigenous people in the region.

³³ Giddens, *The Politics of Climate Change*, 106.

³⁴ Norwegian Foreign Minister Jonas Gore Store recently described Russia as “not yet a stable, reliable, predictable state”: *The Barents Observer*, “Store described Russia as “not yet a stable, reliable, predictable state,” April 30, 2010, <http://www.barentsobserver.com/.4767464-116320.html> (accessed on May 8, 2011).

³⁵ *Russian National Security Strategy to 2020*, paragraph 42.

³⁶ Even in the potentially sensitive area of avoiding environmental damage Western influence is being seen as positive: Emmerson, *The Future History of the Arctic*, 246.

³⁷ Schofield and Potts, *Across the Top of the World?*

³⁸ “From our point of view, any minerals this side of the North Pole are Canada’s – part of our sovereignty, regardless of what the UN or any international court might say,” *Toronto Sun*, “Standing up for the North,” August 20, 2007.

³⁹ Added to these issues is the fact that the UN cannot actually adjudicate in any territorial disputes.

⁴⁰ For example, the Arctic Council possibly leading on indigenous people issues, science and the environment, NATO on security, and the UN on maritime governance.

⁴¹ Gordon G. Chang, “China’s Arctic Play,” *The Diplomat*, March 9, 2010, <http://the-diplomat.com/2010/03/09/china%E2%80%99s-arctic-play/> (accessed on May 15, 2011).

⁴² On Russian regional naval activity, see Blunden, “The New Problem of Arctic Security,” 121–142. It may currently be smaller in numerical terms than at its Soviet height, but reductions (in both numbers and activity) are now being reversed.

⁴³ Only the US Navy retains a serious interest in Arctic security matters, with wider Department of Defense focus concentrated since the end of the Cold War on first the Balkans, then Iraq, and now Afghanistan: Emmerson, *The Future History of the Arctic*, 137–142.

⁴⁴ Mary Beth Sheridan, “Clinton rebukes Canada at Arctic Meeting,” *Washington Post*, March 30, 2010, <http://www.washingtonpost.com/wp-dyn/content/article/2010/03/29/AR2010032903577.html> (accessed on May 8, 2011); US Secretary of State Hillary Clinton stated that “significant international discussions on Arctic issues should include those who have legitimate interests in the region and I

hope the Arctic will always showcase our ability to work together, not create new divisions." Canada had invited the five Arctic rim countries to the meeting in Chelsea, Canada, on March 29, 2010, but none of the other Arctic states or any of the observers. On the latter point, see National Security Presidential Directive 66 on Arctic Region Policy (NSPD-66), January 9, 2009, <http://www.fas.org/irp/offdocs/nspd/nspd-66.htm> (accessed May 8, 2011). The directive, coming (unhelpfully) right at the end of the Bush presidency, might make a good case for US engagement in Arctic matters, but is handicapped by—amongst other things—the failure of Congress to ratify UNCLOS.

⁴⁵ Canada now "lags 56th in the world in its contribution to U.N.-backed international missions," according to Dominique Willet: Dominique Willet, "Pearson's dream withering to nothing," *Canadaworld*, February 24, 2010, <http://canadaworld.wordpress.com/category/peacekeeping/canada-and-multilateralism> (accessed on May 8, 2011).

⁴⁶ Denmark's view is also somewhat distorted by the prospect of Greenland's bid for full independence. Should this occur, there is no guarantee that Greenland's current strategic alignment would remain unaltered: Emmerson, *The Future History of the Arctic*, 140.

⁴⁷ For example, the Arctic Military Environmental Co-operation Programme (AMEC); the Arctic Ocean Science Board (AOSB) and the International Arctic Science Committee (IASC).

⁴⁸ Today, this is focused on BP and Anglo American (for oil and metals), Lloyds (for insurance), and Clarksons (for shipping).

⁴⁹ The United Kingdom's 2010 National Security Strategy does not focus on the Arctic directly, but it does comment on environmental and energy security issues. The document also emphasizes "Britain's distinctive role," which seems to neatly fit the unique description of an interlocutor state helping to broker Arctic agreement and co-operation. See UK National Security Council, *The National Security Strategy of the United Kingdom: Security in an Interdependent World* (London: Cabinet Office, 2010).

⁵⁰ In terms of becoming part of the climate change "solution," as called for by Al Gore and Jonas Gahr Store at the Copenhagen summit in 2009; this is quoted in the report that they commissioned, *Melting Snow and Ice* (Oslo: Norwegian Polar Institute, 2009).

⁵¹ Recent suggestion of additional National Environment Research Council (NERC) funding for Arctic science, potentially in support of the UK-Canada Science MOU, is a welcome initiative. Likewise, the Scientific Committee on Antarctic Research (SCAR) is a widely acknowledged leader in multilateral scientific co-operation.

⁵² UKHO may have a number of options here, including Military Data Gathering (MDG) as part of a more active freedom of navigation initiative.

⁵³ Freedom of navigation also includes freedom to carry out scientific research: Bo Johnson Theutenberg, *The Evolution of the Law of the Sea* (Dublin: Tycooly International Publishing Ltd, 1984).

⁵⁴ Russia accounts for 22 per cent of BP's worldwide oil and gas production and has a 50 per cent share in TNK-BP, the second-largest integrated oil company in Russia. In addition, the Cambridge Arctic Research Programme (CARP), funded by the commercial sector, is undertaking regular research in the Canadian Arctic.

⁵⁵ Of note, the Gulf of Mexico experience may not have been *all* bad for BP. Despite potential law suits, the costs of attempting to cap the Deepwater Horizon, and the significant impact on the share price, they—and other British-based companies, such as offshore engineering market leader AMEC—will have gained invaluable experience in the immensely demanding task of trying to cap a deepwater well, standing them in good stead for any future deepwater activity in the Arctic.

⁵⁶ The United Kingdom has valuable transferable expertise in the running of Antarctic fishing and tourism through the Committee for the Conservation of Antarctic Marine Living Resources (CCAMLR) and the International Association of Antarctic Tour Operators (IAATO).

Are Democracies Aggressive? Is the United States Aggressive? An Exchange

SETH JOHNSTON, DAN REITER, JOHN SCHUESSLER,
AND RICHARD NED LEBOW¹

In the February 2011 issue of *St Antony's International Review (STAIR)*, Richard Ned Lebow argued that democracies can be more aggressive than non-democracies in their dealings with other states.² He attributed the variance seen between countries to an array of unit-level political and ideational variables, rather than regime type—a finding with significant implications for the Democratic Peace research programme. Moreover, he found that the contemporary United States represents a “perfect storm” of aggression-promoting domestic political factors—a concerning conclusion.³ In light of the potential for debate generated by “Aggressive Democracies,” the editors of *STAIR* invited three scholars of International Relations to respond to Lebow’s arguments. Their responses are presented below, followed by a rejoinder from Lebow.

Seth Johnston

Aggressive Democracies: A Reply to Richard Ned Lebow

Richard Ned Lebow’s article “Aggressive Democracies” considers a question of serious importance in International Relations theory and practice: the record of democratic states in starting wars. Whereas the literature on the Democratic Peace explores the evidence that democracies tend not to fight other democracies, this article concerns democracies and war initiation in general. Lebow’s arguments—that democracies are the most aggressive type of regime as measured by war initiation, that the United States is the most aggressive democratic state by this measure, and that America’s aggressiveness is due to factors other than its democratic constitution—are extraordinary. The implications of these conclusions for both the Democratic Peace literature and the practical effects of democracy promotion are profound. Nevertheless, the evidence in support of the aggressive democracies thesis is decidedly less clear than the bold argument itself. Shortcomings in the data on war initiation cast some doubt on the

Seth Johnston, Dan Reiter, John Schuessler, and Richard Ned Lebow, “Are Democracies Aggressive? Is the United States Aggressive? An Exchange,” *St Antony's International Review* 7, no. 1 (2011): 166–188.

record of democracies as aggressive war initiators, and a shortage of supporting evidence about American idiosyncrasies diminishes the forcefulness of Lebow's latter analysis on why the United States fights. Although "Aggressive Democracies" considers an important question and advances thought-provoking ideas, it ultimately fails to convince on its own.

The arguments in "Aggressive Democracies" are based on a list of post-1945 conflicts that Lebow constructed along with Benjamin Valentino. This data set suffers from flaws of completeness, clarity, and temporal scope. Regarding its completeness, no criteria are set out to explain how conflicts were chosen for inclusion in the list of wars, and a brief glance at the data reveals some surprising omissions. Although American wars in Vietnam and Afghanistan are listed, France's war in Indochina and the Soviet Union's war in Afghanistan are not. The Soviet invasion of Hungary in 1956 is listed, but the Warsaw Pact crackdown of the Prague Spring in 1968 is not. The brief Anglo-French-Israeli action in the Suez Crisis of 1956 is mentioned, but the brief US invasion of Panama in 1989 is not. The inclusion of some of these conflicts—particularly those involving the United States—may have strengthened the Aggressive Democracies argument, while others would likely have diminished it. There may be good justifications for why some wars are included in the data while others are not, but the criteria and rationale for these decisions should be clearly stated for the reader. This is especially important given the use of a data set that the author himself created. Although any list of wars is likely to be controversial in some regard, a justification of the criteria used to generate this list would have lent the data greater credibility, and thus greater transparency and objectivity for the argument. At a minimum, the debatable completeness of the data set raises questions about the population of conflicts that "Aggressive Democracies" purports to consider, with implications for the usefulness of its conclusions.

Uncertainty about the completeness of the data is compounded by a lack of clarity within the data set on how key variables are coded. Although the list of wars provided includes information about military victory and the achievement of war aims (curiously, variables that are not discussed elsewhere in the article), the data does not show coding for which state(s) initiated the various wars. As war initiation is at the centre of the article's argument, its omission as a variable from the data table poses obvious problems for assessing the record of democracies as war initiators. Even if one accepts the data as a full and complete list of wars since 1945, the initiating state in each war is not always self-evident. For example, the United States appears in the data set as a participant in six wars: the Korean War, Vietnam War, Cambodian War, the Gulf War, War in Afghanistan, and Iraq War. Lebow states in the narrative text that the United States

initiated four of these six wars, but it is not clear which four.⁴ One could potentially argue that the North began the Korean War, Iraq began the Gulf War, Al-Qaeda struck the first blow from Afghanistan, and that the Vietnam War was a pre-existing civil war of which the Cambodian incursion was merely a part and not an altogether separate conflict. But this would mean the United States only began one war during this time period, not four. Conversely, one could argue that the element of choice the United States exercised regarding its involvement and the scope of conflict makes it the initiator of all six of these wars. For example, Iraq may have annexed Kuwait in 1990, but would there really have been a wider “Gulf War” without the US decision to challenge it? The important point here is not that some of the wars mentioned above should be coded one way or the other, but that their coding is uncertain in the original article. The absence of clear information in the data set undermines the reader’s ability to understand how Lebow’s conclusions about war initiation are drawn. Furthermore, the lack of clearly stated and justified criteria for defining a war initiator means that these conclusions will be controversial, even if the coding were more clearly shown. As the example of US war initiation shows, a country’s war initiation record is highly sensitive to different criteria or interpretations of how wars begin.

A third weakness of the data set is its limited temporal scope, only considering conflicts since 1945. Although there may be useful observations to make about democracies and war initiation in the period since World War II, Lebow does not explain why he selected this time period or how it affects his analysis. An explicit discussion of why “Aggressive Democracies” only considers post-1945 wars would be especially beneficial for clarifying how it differs from the Democratic Peace research programme, to which “Aggressive Democracies” responds, and which often employs data stretching back two hundred years or more.⁵ Although Lebow is careful to introduce “Aggressive Democracies” as distinct from the Democratic Peace literature, the contrast he introduces and the implications of his work for the Democratic Peace would be more potent if both shared a common scope of data. More important than the relationship to the Democratic Peace programme, however, are the implications of using post-1945 data in light of the literature on links between democratization and war. Although mature democracies may be less likely to fight one another according to the Democratic Peace thesis, the Democratization and War literature shows that new democracies and democratizing states are more likely to fight wars, and even to play a role in their initiation.⁶ It is significant, then, that the post-1945 era saw the creation of many new democracies.⁷ Notwithstanding some definitional uncertainty about which states qualify as democracies (a subject that Lebow also does not

dwell on), the Democratization and War thesis would seem to predict that a period of time that experienced great democratization would also see a higher incidence of war initiated by newly democratized states. Although this logic does not apply to the aggressiveness among mature democracies, Lebow could be more forceful in articulating how his arguments differ from conclusions that could be drawn from a post-1945 reading of the existing Democratization and War literature.

Although the arguments about the record of democracies as war initiators offer some of the most thought-provoking ideas for generalizable theory, Lebow devotes most of his attention to an analysis of the United States and war initiation. As an example or case study of a democratic state that may conform to the Aggressive Democracies thesis, it is not entirely clear why the United States is singled out for more extensive examination. Lebow identifies the United States, Israel, and India as “the democracies most responsible for war initiation,” with the United States and Israel having each initiated four wars (India’s record is not as plainly described) according to the article’s narrative.⁸ He acknowledges the contribution that the Democratization and War thesis could have in explaining India’s record as a “transitional democracy,” and he briefly describes Israel as a “special case” because it faces serious, existential security threats from its neighbours.⁹ But it is not clear why the cases of India and Israel do not merit greater attention. The United States might also be dismissed briefly as a special case of its own due to its hegemonic role in international politics after 1945. A more liberal view might even characterize conflicts such as the Korean War or the Gulf War not as wars between the United States and other countries, but rather as peace-enforcement actions taken under Chapter VII of the United Nations Charter, in which the United States merely played a role consistent with its standing in the international system. In any event, there are likely to be both brief and detailed explanations for the war record of any democracy, and a more detailed consideration of India’s, Israel’s, or other states’ records of war initiation would be helpful for developing the general thesis about the aggressiveness of democracies. A more thorough discussion of other cases might also lend greater clarity to the claim that the United States is the most aggressive democratic state as measured by war initiation—a point which is confused by the admission that at least one other democratic state initiated the same number of wars during the same time period.

Even if an analysis of the US record of war initiation is but one case study of the larger thesis on Aggressive Democracies, questions about why the United States fights are clearly important in their own right and deserve consideration. Here, Lebow makes one of his most important points: that regime type is difficult to isolate as a causal variable for war initiation.

Rather, “idiosyncratic” unit-level political, social, cultural, and ideational considerations also play a role. At the very least, this argument is important for guarding against an uncritical understanding of the meaning of democracy. No two democratic regimes are identical; all have peculiarities that might be important for explaining war initiation, or even for determining whether we include a state in our list of democracies. To the extent that the war records of democratic states vary, this could be due to differences in the democratic constitution of the state. Does a presidential or parliamentary system, the separation of powers, independence of the judiciary, voting system, or other aspect of democratic governance affect war initiation? This line of questioning is not the focus of Lebow’s inquiry, but his attention to unit-level factors is helpful for problematizing the concept of democracy for these purposes.

Lebow goes beyond differences in the character of democratic governance and argues instead that the United States’ record of war initiation is better explained by other, unit-level factors. He raises thought-provoking ideas that draw on creative insights about American government and society. Ultimately, however, many of these ideas do not draw on enough objective evidence to demonstrate the causal mechanisms by which these factors affect war initiation. These arguments are bold, but mostly speculative and unconvincing.

Lebow reminds readers that the United States is what he considers a “parvenu power,” a concept he develops in *A Cultural Theory of International Relations*, to describe the tendency of emerging powers to compete against other states with comparatively greater intensity, often investing heavily in military forces and pursuing aggressive foreign policies, even after achieving great power status.¹⁰ Rather than summarizing the explanation for why and how the ideational legacy of emergent great power status actually causes the United States to pursue more aggressive policies, however, Lebow backs away from the parvenu power argument by distinguishing the United States from other states in this group. For example, Lebow points out that the United States has not pursued wars of conquest in the twentieth century in the way that other parvenu powers such as Sweden under Gustavus Adolphus or Japan in the late-nineteenth and twentieth centuries did. This observation would seem to suggest that the United States may be less aggressive than other parvenu powers. Although references later in the article mention nineteenth-century wars of conquest against Mexico, Spain, and the Native Americans, a more prominent discussion of this historical legacy might strengthen the parvenu power argument.¹¹

To be most effective, though, the parvenu power argument should also more clearly show causality. Lebow does not fully demonstrate the causal relationship between the parvenu ideational legacy and the United

States' war initiation record. Although the argument is developed in greater detail in *A Cultural Theory of International Relations*, the evidence cited in this article does not show the impact on America's war initiation record.¹² For example, Lebow emphasizes the feelings of humiliation harboured by successive American presidential administrations about the constraints on their power levied by the Congress and other domestic actors. But he does not offer the evidence here to document how this has affected American aggressiveness. Indeed, Lebow's point here—that Congress limited US involvement in inter-war Europe and brought an end to US involvement in Vietnam in the 1970s—seems to suggest that its domestic politics may make the United States less aggressive, not more.¹³

Although Lebow engages in a discussion of US military and economic power, the politics of the arms industry, and the use of propaganda or rhetoric to fuel threat perceptions, perhaps the most unique and original variable cited for its effect on American aggressiveness is that of the "Southern honour culture."¹⁴ Lebow marshals evidence about the over-representation of Southerners in the ranks of the US armed forces to make this point. But, again it is not clear how or whether this evidence bears significance on the war-initiation record of the United States. In the first instance, this honour culture is not precisely defined beyond a comparison to that of the Junkers in Prussia and imperial Germany. The interests or culture of Elbian landed aristocracy do not have obvious parallels with constituencies in a modern democratic state, and the exact meaning of the "Southern honour culture" is left somewhat ambiguous. Second, it does not necessarily follow that the presence of Southerners in the US armed forces (even in disproportionate numbers) is caused by any distinctive Southern culture, or that a Southern culture dominates the non-Southern majority. There may be other demographic, economic, or bureaucratic factors that explain the representation and culture in the US military.¹⁵ Third, and most significantly, cultural trends within the armed forces do not necessarily impact state decisions on whether to initiate war. As Lebow writes, "American officers differ from their Prussian counterparts in that they only have indirect input into the policy-making process." And as Leslie Gelb and Richard Betts have demonstrated, "it is civilian officials, not the military, who generally push for the use of force..."¹⁶ This insight would seem to reduce the importance or relevance of the "Southern honour culture" argument for the purpose of understanding the US war-initiation record. To be sure, there may be other social and political consequences of a military that is decreasingly representative of the society at large in a democracy.¹⁷ But if the US military plays a limited role in state-level war initiation decision-making, then any internal attributes of the military culture must also be of limited relevance to these state-level decisions.¹⁸

In the end, the most important contribution of “Aggressive Democracies” is the conclusion that regime type is not a simple or straightforward attribute on which to judge the war-initiation record of states.¹⁹ Problems with the completeness, clarity, and scope of the data set weaken the force of the initial arguments about the aggressive nature of democratic states in general, and of the United States in particular. As shown, both arguments are sensitive to changes in the interpretation of, or criteria for, what counts as a war, a democracy, a war-initiating state, or the time period of relevant inquiry for the purpose of constructing a data set. It is difficult to make a strong case for the aggressiveness of democracies on this basis. By implication, both research programmes—on Aggressive Democracies, and on the Democratic Peace—would benefit from further diligence in the construction and use of complete, clear, and appropriate data. On Lebow’s assessment of why the United States fights, if the factors he cites in this article are speculative or controversial, they do at least serve to foster the kind of vigorous debate on the use of military force that should occur in democracies.²⁰

The evidence presented does not convincingly demonstrate causal connections between the United States’ decisions to initiate wars and the attributes of American military and economic power, “parvenu power” ideational legacy, or “Southern honour culture.” But this is not to deny the prospect of further debate. In particular, the opportunity costs of large defence budgets, the special-interest politics of the military-industrial complex, the representativeness of the armed forces in a democracy, and the cultural norms on the use of force are topics that deserve attention in their own right and already enjoy distinct literatures. Further study into the unit-level factors that may promote war initiation would benefit from greater attention to evidence-based tracing of causal processes, and the examination of cases of war initiation by countries other than the United States. To the extent that the data would encourage a more detailed examination of the war record of Israel or India, the Aggressive Democracies thesis will also have to engage more directly with the literature on Democratization and War, as well as on the Democratic Peace.

Dan Reiter

Democratic Aggression and the Search for Victory

I very much enjoyed the insights that Richard Ned Lebow provided in his article “Aggressive Democracies.” He does the entire field a service by encouraging it to look past the findings that democracies have not fought each other and confront the reality that democracies have initiated wars, especially since 1945. I also applaud his consideration

of why societies come to favour going to war, including contemporary democratic societies.

In this short essay, I try to frame Lebow's observations in a larger theoretical context. Note first that the "Democratic Peace theory" to which Lebow refers is not a theory per se, but rather an observed empirical regularity—democracies tend not to fight each other. Multiple theories attempt to explain this empirical pattern. One theory proposes that democracies embrace peaceful norms of conflict resolution such as mediation, arbitration, and diplomacy because of democratic political culture. The democratic initiation of war under a variety of conditions is evidence against the normative explanation of the democratic peace, though some propose that the normative explanation allows for democracies to initiate wars defensively, against states unlikely to embrace peaceful means of conflict resolution.²¹

A second explanation of the empirical pattern of democratic peace focuses on democratic political institutions and structures. This explanation draws on Immanuel Kant's observation that republics are less likely than monarchies to go to war. The population hates war more than its leaders do, because the people bear more of the costs of war. Elected governments are therefore less prone to war than autocratic governments, because elected leaders must avoid unpopular policies in order to stay in power. The institutional explanation can account for why democracies might initiate wars better than can the normative explanation. As Allan Stam and I describe in our 2002 book *Democracies at War*, if one assumes that democracies avoid wars because the public is highly sensitive to the costs of war, then as the expected costs of war go down and the expected benefits of war go up, the constraints of public opinion ought to be loosened and democracies in turn should become increasingly likely to initiate war.²²

How does this play out? Within the assumptions of this institutional approach, when might we expect democracies to become more likely to initiate war? Consider four different sets of factors: expectations of victory, expectations of casualties, expectations of war duration, and the stakes of war. Regarding victory, the prediction is that when a state considers launching war, the public becomes less opposed to war as the expected likelihood of victory increases. A higher chance of victory means that a state is more likely to realize the expected benefits, and less likely to pay the costs of defeat. So democracies that are more powerful (and hence more likely to win their wars) are more likely to initiate wars—a point that Lebow concurs with.

There is a substantial body of empirical evidence that supports this claim. Two studies found that among states considering initiating wars,

democracies are much less likely than autocracies to initiate war when their prospective chances of victory are lower, but as their chances of victory increase, the likelihood of democratic war initiation increases at a faster rate than does the probability of war initiation for autocracies. In other words, as the likelihood of victory increases, the constraints of public opinion in a democracy fall away, and democratic and autocratic foreign policy behaviour begin to converge.²³ Furthermore, the unwillingness of democracies to initiate wars when the chances of victory are lower means that when democracies do initiate wars, they ought to be especially likely to win. Empirical studies have borne out this expectation, finding that democracies almost never initiate wars that they go on to lose.²⁴ Studies have revealed other patterns consistent with the proposition that public support for war correlates with expectations of victory. One study found that American public support for the Iraq War has ebbed as the expectations for victory declined.²⁵ In a related vein, American public support for the Korean War fell dramatically in the winter of 1950–51, when China intervened and the likelihood of rapid victory seemed to disappear.²⁶

The second factor that the institutional approach predicts will affect democratic war initiation is the expectation of casualties. A democracy is more likely to initiate wars when the expected casualties promise to be low. Empirical evidence supports this point, as democratic belligerents suffer significantly fewer casualties than do other kinds of belligerents.²⁷

The casualties question gets at one point of disagreement between Lebow and myself. He implies that American tolerance for casualties is growing. However, there has been mania for war and empire in the United States going back to the nineteenth century. When the American Civil War first broke out in 1861, members of Washington society travelled to a nearby battlefield with picnic baskets and opera glasses to watch the spectacle, hoping to witness the “excitement.”²⁸ The anti-imperialist US congressman Thomas Reed bemoaned the public stampede to war against Spain in 1898. When asked by the governor of New York to dissuade other congressmen from voting for war, Reed remarked, “Dissuade them! The Governor might as well ask me to step out in the middle of a Kansas waste and dissuade a cyclone!”²⁹

In my view, there has been American intolerance for casualties, and this intolerance may have grown across time.³⁰ Prior to 1975, America fought a number of wars with higher levels of casualties, some in the hundreds of thousands (the Civil War, and World Wars I and II), and some in the tens of thousands (Korea and Vietnam).³¹ Since 1975 in particular, US foreign policy has become more wary of public casualty

sensitivity, either avoiding conflict or engaging in conflicts only when American deaths are few. The 1983 Grenada invasion cost nineteen US deaths, the 1989 Panama operation cost twenty-three deaths, and the 1991 Gulf War cost 146 US deaths. American casualty sensitivity over this period was demonstrated by a number of foreign policy actions and inactions. They include the decision to launch only a minor operation in 1979 to rescue the US hostages held in Iran; withdrawal of US forces from Lebanon following the 1983 bombing of the American military barracks in Beirut; the refusal to land US Marines in Haiti in 1993 when a small, lightly-armed crowd threatened violence; the withdrawal of US forces from Somalia following the 1993 “Black Hawk Down” incident, which killed eighteen US Rangers; conducting the world’s first zero-casualty war against Serbia in 1999 over human rights abuses in Kosovo; and the American unwillingness to dispatch troops to stop genocide in Rwanda or Darfur.³² Support for the war in Iraq has steadily declined as casualties have mounted, even though casualties remain relatively low by historical standards, with 4,436 dead at the time of writing (January 2011) being less than a tenth of the casualties in the Vietnam War, and barely a hundredth of the casualties in World War II.³³ US casualties in the Afghanistan War (1,466 at the time of writing) are even lower, and support for ending that war is high. In one November 2010 poll, 20 per cent of Americans support the 2014 withdrawal timetable, and nearly twice that (38 per cent) want to see withdrawal sooner.³⁴ In sum, though Lebow makes an important point about the presence of honour culture in the United States, it has not in the past few decades negated a high and perhaps growing American intolerance for casualties.

The third factor affecting the democratic initiation of war is war duration. When democracies expect a war to be short-lived, they become more willing to initiate war (brevity of war being linked to low casualties, low financial costs, and perhaps assured victory as well). There is evidence supporting this claim, as wars are significantly shorter when democracies are involved. Furthermore, as wars endure, democratic leaders feel increasing pressure to end the war, and become increasingly likely to accept a draw as a means of ending the war rather than fighting on in hopes of victory.³⁵

Fourth, democracies become more likely to initiate war as the public’s perceived benefits of war—whether in terms of empire, prestige, honour, or some other factor—increase. I take this to be the central theme of Lebow’s essay: that much of the literature in International Relations fails to consider conditions under which democratic publics might support or even welcome war, and that publics do sometimes favour war. Some scholars have explored similar questions, trying to

understand conditions under which democratic publics favour war, whether for empire, honour, or other reasons.³⁶

In short, Lebow's argument fits nicely within a domestic political institutional theory of democracy and the initiation of war: though democratic political institutions in general make elected leaders less likely to initiate conflict, there are conditions under which those constraints are relaxed. Let me stress that I do not intend to minimize Lebow's contribution. He is filling an important lacuna in the literature, trying to understand the conditions under which a public will support the use of force.

I close with three observations about some of the implications of Lebow's argument. First, I do not think his argument does heavy damage to the empirical observation that democracies do not fight each other. I concur with his observation that war initiation is a complex process resistant to a single explanation, but I am perhaps more confident than he that statistical techniques like multivariate regression can help assign causality to individual explanations. And such techniques have revealed that even after accounting for a number of factors, including power, trade, geography, international institutions, and international alliances, democracies are significantly less likely to fight each other than are other pairs of states.³⁷ Note that even in the post-1945 period, a period in which there have been several episodes of democracy-initiated aggression, democracies have avoided war with each other, with the exception of the 1999 Kargil War between India and then-democratic Pakistan.³⁸ Furthermore, democracy and peace have clearly reinforced each other since 1945 in the North Atlantic-European zone, especially within the European Union. Democracy has also strengthened peace in other regions, such as Central and South America. From a policy point of view, therefore, building democracy around the world can be a means of spreading and strengthening international peace (although I will discuss the problems of using force to spread democracy later).

Second, the pro-war honour culture—even in more conservative regions, such as the American South, where I reside—may not be able to endure in the face of growing combat casualties. Studies of both the Vietnam War and the Iraq War have revealed that an individual's support for war and the president declines as the number of combat deaths increases within his or her geographical or social network.³⁹ Hence, if honour-culture states are providing many of America's soldiers, those states will suffer many of the casualties, and support for war and pro-war policies in those states will decline. These effects have already had real political consequences, as citizens in American states suffering disproportionately more war deaths were more likely to vote for the opposition Democratic Party in the 2006 mid-term Congressional elections. This includes the

Southern state of Virginia, an honour-culture state at the heart of the 1860-61 secession which led to the American Civil War.⁴⁰

Third, Lebow broaches the question of whether belief in the democratic peace has contributed to democratic aggression, implying that the desire to democratize nations like Afghanistan and Iraq motivated the decisions to invade those nations and overthrow their governments. On the purely historical point, I take a different view, as the original motivations for war were purely geopolitical and strategic. It was only after war, in the case of Iraq, when no weapons of mass destruction or links to terrorist groups were found, that the Bush administration's rhetoric shifted to the argument that the war was justified because of the imperative of democratizing Iraq.⁴¹

But there is a larger point. Should powerful democracies like the United States invade authoritarian nations with the aim of democratizing them? We are now starting to amass more systematic evidence regarding the consequences of imposing regime change on other countries. The picture is mixed. On the one hand, there is powerful evidence that if one state imposes regime change on a second state, then those two states are extremely unlikely to fight each other again in interstate war. The imposed regime changes of Germany, Japan, and Italy in World War II certainly helped demilitarize those states.⁴² And, although Iraq and Afghanistan present a number of vexing problems to the international community, no one fears that either state is likely to attack another state anytime soon. On the other hand, imposing regime change also substantially increases the chances that the target state will experience civil war.⁴³ Furthermore, history indicates that democracy has difficulty flourishing when imposed by external powers.⁴⁴ In short, even those who embrace the idea of spreading democracy should hesitate before supporting war as a path to democratize the world.

John Schuessler

Liberalism and Regional Hegemony: A Recipe for Aggression

In "Aggressive Democracies," Richard Ned Lebow introduces evidence from the post-World War II period to suggest that democracies are responsible for more than their fair share of war initiation, with the United States being the most aggressive of the lot (initiating four of the six wars in which it fought during this period).⁴⁵

What makes the United States so aggressive: the fact that it is a democracy, or other elements of its political, economic, and social culture? Lebow argues that culture trumps democracy in the US case. Specific-

ly, he attributes the United States' aggressiveness to six factors: political constraints on the president's war powers, which have led various administrations to use force to demonstrate toughness and resolve abroad; ample wealth and the high levels of military spending that it allows; an honour culture that valorizes military service; a religious fervour that softens the blow of sacrifice; and the predominance of Southerners in the armed forces, who, being more religious and more bound up in the honour culture than other Americans, provide a willing supply of manpower for the country's foreign wars. Lebow's general conclusion is that regime type may not have the overriding importance that scholars often claim, either in pacifying relations among democracies or in making some of them aggressive.

In this response, I argue that, if confirmed, Lebow's findings are quite damaging for Democratic Peace theory. I also offer an alternative explanation as to why the United States has been so aggressive: the United States is both a liberal great power and a regionally hegemonic one, which has allowed it to pursue ideological crusades abroad at moderate cost. In short, structure goes a long way toward explaining the pattern of US aggression that Lebow ascribes to idiosyncratic aspects of American culture.

Aggressive Democracies: Implications for Democratic Peace Theory

Despite finding that democracies are unusually aggressive, Lebow is reluctant to directly criticize the Democratic Peace thesis, or the idea that democracies are exceedingly unlikely to fight each other. He concludes only that "great care must be exercised in making attributions on the basis of regime type."⁴⁶ If, however, democracies are unusually aggressive, then the implications for Democratic Peace theory are quite damaging. As Sebastian Rosato has argued, the democratic peace finding may be dyadic, but the logics advanced to explain it are largely monadic.⁴⁷ That is, most explanations of the democratic peace begin with the claim that democracies are, on average, less prone to war than non-democracies, because of a combination of normative and institutional constraints.⁴⁸ The democratic peace then emerges from a "multiplier" effect: in Rosato's words, "if a state with a low propensity for violence comes into contact with another state that also has a low propensity for violence, then the likelihood of war breaking out is very low indeed."⁴⁹ If it can be shown that democracies are unusually aggressive, as Lebow demonstrates for the post-World War II period, then the causal logics underpinning the democratic peace, if not the finding itself, are called into question. After all, if democracies are relatively unconstrained in their use of force, what is preventing them from fighting each other?

Democratic peace, in short, is hard to reconcile with the fact of aggressive democracies, unless it is explained by something other than joint democracy. One possibility is that democratic peace is in fact an imperial peace based on American power.⁵⁰ In this case, democratic peace becomes easier to square with the relative aggressiveness of the United States, acting as an imperial enforcer.

Liberalism and “Imprudent Vehemence”

Why, exactly, has the United States been so aggressive? Of the six conditions that Lebow cites to explain US aggressiveness, almost all are permissive conditions. Ample wealth and a preponderance of military power, I would argue, are the most important, but an honour culture, high levels of belief in God, and the predominance of Southerners in the military fall into this category as well. What remains to be explained is what is driving US aggression, as opposed to what is enabling it. I would argue that democracy, or at least liberal democracy, plays an important role here. Specifically, the United States is a liberal great power, and, as others have argued, liberalism can engender a crusading spirit that leads to aggression abroad.

Michael Doyle, in his seminal treatment of the Democratic Peace, argues as much, noting that liberal foreign policy suffers from characteristic shortcomings, the most important being a tendency toward what David Hume called “imprudent vehemence” in relations with the non-liberal world, periodically leading to “costly crusades” and “spasmodic imperialism.”⁵¹ Ironically, “the very constitutional restraint, shared commercial interests, and international respect for individual rights that promote peace among liberal societies can exacerbate conflicts in relations between liberal and non-liberal societies.”⁵²

Michael Desch has applied Doyle’s insights about the mixed legacy of liberalism to the problem of US aggression. He demonstrates both that the international behaviour of the United States has been powerfully shaped by liberalism, and that liberalism, when married to a preponderance of power as in the post-Cold War period, can lead directly to illiberal policies like the pursuit of hegemony and preventive war.⁵³ If one is looking for a culprit to explain US aggression, perhaps democracy, or least liberal democracy, has more to do with it than Lebow allows.

Regional Hegemony and the “Freedom to Roam”

Liberalism is not solely to blame, however. As Lebow points out, liberal states in Europe, Asia, and Latin America have hardly been as war-prone

as the United States.⁵⁴ I would argue that a geopolitical factor—regional hegemony—has interacted with liberal ideology to explain the pattern of US aggression.

The United States is the only regional hegemon in modern history; that is to say, it is the only great power that has not had to share its region of the world, the Western Hemisphere, with another great power. “This impressive achievement,” as John Mearsheimer argues, “is the real basis of American exceptionalism in the foreign policy realm.”⁵⁵ For starters, the fact that it is a regional hegemon explains why the United States has traditionally played the role of an offshore balancer, preventing great powers in other regions from dominating their areas of the world. Regional hegemons do not want peer competitors that can interfere in their backyards.⁵⁶ An offshore balancing logic explains why the United States ultimately intervened in both World Wars to turn back German aggression, and why it contained Soviet expansion during the Cold War.⁵⁷

The fact that it is a regional hegemon also explains why the United States has been able to pursue ideological crusades abroad. The United States is probably the most secure great power in history, surrounded by weak neighbours and protected by two giant moats—the Atlantic and Pacific Oceans.⁵⁸ This margin of security has allowed the United States to opt into wars of choice against “rogue states” like Serbia and Iraq, rather than focus its energies on local threats. Because the stakes are less than existential, the United States has been able to retrench when the costs of fighting these wars began to accumulate, preserving political space for the next adventure. The implication is that, as long as the United States is secure in the Western Hemisphere and not preoccupied with a potential peer competitor, it will be “free to roam” and forcibly export its values.⁵⁹ Precisely because it has been a “poster child” for offensive realism and gained regional hegemony, the United States is free to act in more aggressive ways than most realists would counsel.⁶⁰

Christopher Layne argues along these lines in *The Peace of Illusions*, his book on American grand strategy. In this work, he explains why the United States has pursued hegemony in other regions, the merits of a more restrained strategy notwithstanding. The primary culprit is liberal ideology, specifically the United States’ commitment to an “Open Door” that is underpinned by the spread of market democracy. The perception is that if the United States does not underwrite security globally then the “Open Door” will close, forcing the United States to forego the political and economic benefits that come from interdependence. The irony is that the United States is only able to define its interests in such expansive terms because, as a regional hegemon, it is exceptionally secure.⁶¹

In sum, structure goes a long way toward explaining the pattern of US aggression that Lebow ascribes to idiosyncratic aspects of American culture. If the United States were not a regional hegemon, it would not be free to pursue a liberal foreign policy and the wars of choice that this entails. The cultural factors that Lebow cites, I would argue, are symptoms of the problem, rather than root causes of it. The implication is that the United States will continue to succumb to the “hegemon’s temptation” and become over-committed abroad as long as it faces few powerful rivals.⁶²

Richard Ned Lebow *A Reply to Johnston, Reiter, and Schuessler*

The three responses represent three different positions. Seth Johnston disputes my empirical findings and inferences based on them; Dan Reiter offers a parallel argument to critique the Democratic Peace research programme; and John Schuessler offers a structural explanation in lieu of what he alleges are my merely enabling conditions for American aggressiveness. Let me address each author in turn.

Seth Johnson criticizes my data set for its completeness, clarity, and temporal scope. I believe these complaints are unfair—and largely irrelevant—as a modified data set would not significantly alter my findings. Johnston claims that there are “surprising omissions,” including France’s war in Vietnam and the USSR’s war in Afghanistan. The latter is in my data set but somehow did not make it into the version I provided for the journal. The former is not included because it does not qualify as an interstate war; it is a colonial conflict, as was France’s war in Algeria. The Hungarian intervention is listed but not the Prague Spring. Johnston complains, but 1,000 battle deaths has been for a long time the conventional threshold of war used by almost all data sets, and the Soviet-led occupation of Czechoslovakia in 1968 does not qualify. The same is true for the US invasion of Panama. Its inclusion in any case would only strengthen my claim that the United States has initiated more wars since 1945 than other powers. Most of Johnston’s other complaints are easily dismissed. North Korea did indeed begin the Korean War, and it was the United States that initiated the second stage of this conflict, the invasion of North Korea. Johnston’s coding of Afghanistan as a war begun by al-Qaeda represents a political judgment open to dispute. The United States had a range of possible responses to the events of September 11, 2001, of

which an invasion of Afghanistan was only one of them. There is substantial evidence that the Bush administration invaded Afghanistan to create the preconditions for invading Iraq and used al-Qaeda as a public rationalization, just as it did in Iraq.⁶³ Moreover, once in Afghanistan, US forces, following instructions from Washington, made only the most half-hearted effort to go after Osama Bin Laden and al-Qaeda. More complete information is provided about my coding of many of the wars in question in *A Cultural Theory of International Relations* and *Why Nations Fight*.⁶⁴ Johnston criticizes me for limiting my data set to wars after 1945. My reasons are perfectly clear: it is an era when there are more democracies and also the period during which the United States was a dominant power. It is a common practice to bracket the post-1945 world for many analytical purposes.

Johnston objects to my failure to develop at greater length my discussion of India and Israel in contrast to my treatment of the United States. One must make choices in articles given length requirements, so this criticism is unavoidable. Meanwhile, his description of my analysis of the United States as “idiosyncratic” is unfair. The restrictive way that Johnston uses this term would apply also to Alexis de Tocqueville’s *Democracy in America*. Like Tocqueville, I examine the United States with reference to more general analytical categories like parvenu powers, honour culture, belief in a deity, and military spending. Most of these are time-honoured categories of analysis and I use them to show how the United States is an outlier. My single case is thus comparative. What Johnston really objects to are my substantive findings, perhaps because of their implications for Democratic Peace theory. He thus challenges every aspect of my data set and method of argument. Interestingly, he does not dispute my claim that the United States is the world’s most aggressive nation in the post-1945 period.

Dan Reiter has made significant contributions to International Relations theory. His 2002 co-authored book, *Democracies at War*, is based on the reasonable premise that democratic public opinion is highly responsive to the costs of war and that democracies tend to initiate only wars they can win. Given that the United States is a powerful democracy, as India and Israel also are in their respective regions, his theory predicts the same pattern of behaviour that I describe. Reiter assumes that leaders and publics can do a reasonable job of estimating their chances of military success, an assertion which, in the case of the United States, I find belied by the Korean, Indochinese, Afghan and Iraq Wars—that is, by every major war that the United States has fought since World War II. Each of these conflicts turned out to be far more costly than leaders envisaged, and Indochina ended in a humiliating defeat. It is difficult to

consider either Afghanistan or Iraq a success, especially when we take into account the political goals that the Bush administration sought. Such failures are part and parcel of a wider pattern I identify: initiators of all kinds generally lose the wars they initiate. This is true not only for the post-World War II era, but, as I demonstrate in *Why Nations Fight*, initiators have lost more than half of the wars that they began since 1648. As war initiation is a choice, one would think that leaders would only draw their swords under favourable conditions, as Reiter maintains. This is simply not true. There is little that is rational about war initiation, so efforts to model or study it as a rational process are deeply suspect, if not entirely misleading. Rather than filling in a lacuna, as Reiter suggests, my article—and the larger argument in *Why Nations Fight*—constitutes a direct challenge to all existing theories of war.

On one point, Reiter appears to misunderstand my argument. Nowhere do I assert that democratization was a motive for intervention in Afghanistan or Iraq. Rather, I contend that it was from the outset a rationalization propagated to sell these wars to the American public. Reiter and I agree on this interpretation.

Contra Johnston, John Schuessler understands my argument as damaging for Democratic Peace theory. He nevertheless offers a different explanation for the phenomenon of an unusually aggressive United States. As a liberal and hegemonic power, it has been able to pursue ideological crusades abroad at moderate cost. He is right in describing most of my six conditions as permissive causes; that is, they enable US aggression. What remains to be explained, Schuessler maintains, is what drives this aggression. His preferred explanation is liberalism, which, he argues, leads to a crusading spirit abroad. This strikes me as inadequate, because Britain was also a liberal power for most of the nineteenth and twentieth centuries, yet rarely engaged in liberal crusades. The United States has also had a Hamiltonian tradition, which consistently opposed intervention on ideological grounds. From the Roman Empire to the Soviet Union and present-day Iran, we also have examples of decidedly non-liberal states waging ideological crusades. This is not to suggest that liberalism is not important, nor do I discount Schuessler's second explanation, regional hegemony. I interpret it differently. The United States has regularly intervened in Latin America, but not for ideological reasons. Overwhelmingly, US administrations intervened for crass economic reasons, and most frequently in support of authoritarian dictatorships and often against progressive, liberal regimes. Schuessler's second explanation is thus at odds with his first one, but could be made supportive if we argue that the United States created a pattern of intervention in Latin America that it extended to other parts of the world when it

became a hegemonic power. But here too, I maintain, the United States rarely intervened for ideological reasons, if by that we mean to support democracy or reformist regimes. The ideology of anti-Communism was indeed important, and so were economic considerations. Both led the United States to frequently oppose liberalism abroad and to support the worst kinds of autocrats.

Among my six ways in which the United States differs from other developed countries, there are two explanations, as opposed to merely enabling conditions for aggression. The first is the extraordinary amount the United States spends on its armed forces. This is more than an enabling condition, as it actively encourages intervention as a means of justifying such extraordinary military expenditure. It encourages policymakers to form maximal goals, which can rarely be achieved through negotiation. This mindset encourages intervention. The second is my labelling of the United States as a parvenu power, a theme I develop at length in *A Cultural Theory of International Relations*. Sweden, Prussia, Russia, Japan and the United States all qualified as parvenu powers for some decades of their history and were among the most aggressive states of these eras. I have never believed that there are simple answers to complex questions, so it is more satisfying to admit multiple reinforcing explanations for something like US aggression. Along these lines, arguments emphasizing that under some conditions liberal democracies engage in crusades have a role to play.

As for Democratic Peace, as Schuessler notes, I am careful not to challenge it directly, since most of my arguments stand independent of regime type. This is also true for Israel and India, whose aggressiveness I attribute to local conditions and political cultures and not to regime type. That said, I have never been persuaded by the Democratic Peace thesis, and regard it as a questionable statistical finding in search of an explanation. It is time for International Relations, and Political Science more generally, to leave behind the conceit that some parsimonious theory can explain something as complex as aggression when, like most international phenomena, it is generally rooted in local conditions and context. Variation cannot be understood without taking this and the influence of leaders into account. ■

Notes

¹ Seth Johnston thanks Jessamyn Liu and Tomio Toyama for their feedback on his response. John Schuessler thanks Michael Desch, Justin Logan and Sebastian Rosato for help in preparing his response, and also notes that the views expressed in his contribution are his own and do not reflect the official policy or position of the US Department of Defense or the US Government.

² Richard Ned Lebow, "Aggressive Democracies," *St Antony's International Review* 6, no. 2 (2011): 120–33.

³ David Blagden, Justin Hempson-Jones, and Linda van der Horst, "Editorial Introduction: China's Rise and Adapting Global Structures," *St Antony's International Review* 6, no. 2 (2011): 3–9, 7.

⁴ Lebow, "Aggressive Democracies," 121.

⁵ Probably the best known is the Correlates of War (COW) data set that runs from the end of the Napoleonic Wars, first published as David Singer and Melvin Small, *The Wages of War, 1816–1965: A Statistical Handbook* (New York: John Wiley, 1972). Other works go back even further; for example, Bruce Russett, *Grasping the Democratic Peace: Principles for a Post-Cold War World* (Princeton, NJ: Princeton University Press, 1993).

⁶ Edward D. Mansfield and Jack Snyder, "Democratization and the Danger of War," *International Security* 20, no. 1 (1995): 19–21.

⁷ According to one well-known account, there were more than sixty democratic transitions throughout the world in less than twenty years after 1974. Samuel P. Huntington, *The Third Wave: Democratization in the Late Twentieth Century* (Norman, OK: University of Oklahoma Press, 1991).

⁸ Lebow, "Aggressive Democracies," 121.

⁹ *Ibid.*

¹⁰ Richard Ned Lebow, *A Cultural Theory of International Relations* (Cambridge: Cambridge University Press, 2008).

¹¹ Lebow, "Aggressive Democracies," 130. On the latter point see, for example, Max Boot, *Savage Wars of Peace: Small Wars and the Rise of American Power* (New York: Basic Books, 2002).

¹² Lebow, *Cultural Theory*, chapter 9.

¹³ Lebow, "Aggressive Democracies," 122–123.

¹⁴ *Ibid.*, 127.

¹⁵ See, for example, a 2009 study by three US Army officers that documents the impact of economic and budgetary pressures on changes in the sources of officer recruitment. Casey Wardynski, David S. Lyle, and Michael J. Colarusso, *Towards a U.S. Army Officer Corps Strategy for Success: A Proposed Human Capital Model Focused Upon Talent* (Washington, DC: Strategic Studies Institute, 2009).

¹⁶ Lebow, "Aggressive Democracies," 127.

¹⁷ Samuel P. Huntington, *The Soldier and the State: The Theory and Politics of Civil-Military Relations* (Cambridge, MA: Harvard University Press, 1957). For a contemporary assessment, see Suzanne C. Nielsen and Don M. Snider, eds., *American Civil Military Relations: The Soldier and the State in a New Era* (Baltimore, MD: The Johns Hopkins University Press, 2009).

¹⁸ This point on the limited effect of any military cultural attribute on the war initiation record of the United States is also relevant to Professor Lebow's discussion of the religious character of the armed forces. If the US military has only limited impact

on decisions about war initiation, then the religious character of military personnel is of likewise limited relevance to the central argument.

¹⁹ Lebow, "Aggressive Democracies," 131.

²⁰ For more on the use of thought experiments to probe the complexities of causation in international relations, see Richard Ned Lebow, *Forbidden Fruit: Counterfactuals and International Relations* (Princeton, NJ: Princeton University Press, 2010).

²¹ On normative/cultural and institutional/structural explanations of the democratic peace, see: Bruce Russett and John Oneal, *Triangulating Peace: Democracy, Interdependence, and International Organizations* (New York: Norton, 2001).

²² Dan Reiter and Allan C. Stam III, *Democracies at War* (Princeton, NJ: Princeton University Press, 2002), especially chapter 6.

²³ Reiter and Stam, *Democracies at War*, chapter 2; Bruce Bueno de Mesquita, James D. Morrow, Randolph M. Siverson, and Alastair Smith, "Testing Novel Implications from the Selectorate Theory of War," *World Politics* 56, no. 3 (2004): 363–388.

²⁴ Reiter and Stam, *Democracies at War*, chapter 2. See also Michael E. Brown, Owen R. Coté, Sean M. Lynn-Jones, and Steven E. Miller, eds., *Do Democracies Win Their Wars?* (Cambridge, MA: MIT Press, 2011).

²⁵ Christopher Gelpi, Peter D. Feaver, and Jason Reifler, *Paying the Human Costs of War: American Public Opinion and Casualties in Military Conflicts* (Princeton: Princeton University Press, 2009).

²⁶ Dan Reiter, *How Wars End* (Princeton, NJ: Princeton University Press, 2009), chapter 5.

²⁷ Benjamin A. Valentino, Paul K. Huth, and Sarah E. Croco, "Bear Any Burden? How Democracies Minimize the Costs of War," *Journal of Politics* 72, no. 2 (2010): 528–544.

²⁸ Reiter, *How Wars End*, 142.

²⁹ Quoted in Barbara W. Tuchman, *The Proud Tower: A Portrait of the World Before the War, 1890–1914* (New York: Bantam Books, 1966), 174.

³⁰ John Mueller has made the broader argument that World War I marked a sharp change in global attitudes towards war, away from pro-war militarism and towards opposition to war. *Retreat From Doomsday: The Obsolescence of Major War* (New York: Basic Books, 1989).

³¹ John E. Mueller, *War, Presidents, and Public Opinion* (Lanham, MD: University Press of America, 1985), 51; Scott Sigmund Gartner and Gary Segura, "War, Casualties, and Public Opinion," *Journal of Conflict Resolution* 42, no. 3 (1998): 278–300.

³² Reiter and Stam, *Democracies at War*.

³³ Scott Sigmund Gartner, "The Multiple Effects of Casualties on Public Support for War: An Experimental Approach," *American Political Science Review* 102, no. 1 (2008): 95–106. Casualty data from Michael Clodfelter, *Warfare and Armed Casualties: A Statistical Reference to Casualty and Other Figures, 1500–2000*, 2nd edition (Jefferson, NC: McFarland and Company, 2003).

³⁴ USA Today/Gallup, November 19–21, 2010.

³⁵ Reiter and Stam, *Democracies at War*, chapter 7; D. Scott Bennett and Allan C. Stam III, "The Declining Advantages of Democracy: A Combined Model of War Outcomes and Duration," *Journal of Conflict Resolution* 42, no. 3 (1998): 344–366; Branislav Slantchev, "How Initiators End Their Wars: The Duration of Warfare and the Terms of Peace," *American Journal of Political Science* 48, no. 4 (2004): 813–829.

³⁶ See, for example, Reiter and Stam, *Democracies at War*, chapter 6; Patrick M. Reagan, *Organizing Societies for War: The Causes and Consequences of Societal Militarization* (Westport, CT: Praeger, 1994); Errol A. Henderson, *Democracy and War: The End of an Illusion?* (Boulder, CO: Lynne Rienner, 2002).

³⁷ Russett and Oneal, *Triangulating Peace*.

³⁸ There have been a small number of democracy-democracy conflicts since 1945 that have not met the conventional definition of "war" requiring at least 1,000 battle dead. Examples include the clashes of Icelandic and British fishing vessels in the 1970s and the 2006 Lebanon–Israeli conflict.

³⁹ Scott Sigmund Gartner, "Ties to the Dead: Connections to the Iraq War and 9/11 Casualties and Disapproval of the President," *American Sociological Review* 73, no. 4 (2008): 690–695; Scott Sigmund Gartner, Gary M. Segura, and Michael Wilkening, "All Politics Are Local: Local Losses and Individual Attitudes toward the Vietnam War," *Journal of Conflict Resolution* 41, no. 5 (1997): 669–694.

⁴⁰ Scott Sigmund Gartner and Gary Segura, "All Politics are Still Local: the Iraq War and the 2006 Midterm Elections," *PS: Political Science and Politics* 41, no. 1 (2008): 95–100.

⁴¹ On Iraq, see Ron Suskind, *The One Percent Doctrine: Deep Inside America's Pursuit of Its Enemies Since 9/11* (New York: Simon and Schuster, 2006).

⁴² Nigel Lo, Barry Hashimoto, and Dan Reiter, "Ensuring Peace: Foreign-Imposed Regime Change and Postwar Peace Duration, 1914–2001," *International Organization* 62, no. 4 (2008): 717–736.

⁴³ Goran Peic and Dan Reiter, "Foreign-Imposed Regime Change, State Power, and Civil War Onset, 1920–2004," *British Journal of Political Science*, forthcoming in print (online 2010).

⁴⁴ Andrew J. Enterline and Michael Greig, "Beacons of Hope? The Impact of Imposed Democracy on Regional Peace, Democracy, and Prosperity," *Journal of Politics* 67, no. 4 (2005): 1075–98; Andrew J. Enterline and Michael Greig, "Against All Odds? The History of Imposed Democracy and the Future of Iraq and Afghanistan," *Foreign Policy Analysis* 4, no. 4 (2008): 321–47; Bruce Bueno de Mesquita and George W. Downs, "Intervention and Democracy," *International Organization* 60, no. 3 (2006): 627–49; William Easterly, Shanker Satyanath, and Daniel Berger, *Superpower Interventions and their Consequences for Democracy: An Empirical Inquiry* (Washington, DC: Brookings Institute, 2008).

⁴⁵ Lebow, "Aggressive Democracies," 121.

⁴⁶ *Ibid.*, 131.

⁴⁷ Sebastian Rosato, "Explaining the Democratic Peace," *American Political Science Review* 99, no. 3 (2005): 467–472, 467. See also Sebastian Rosato, "The Flawed Logic of Democratic Peace Theory," *American Political Science Review* 97, no. 4 (2003): 585–602.

⁴⁸ On the normative and institutional logics for the democratic peace, see Bruce Russett, *Grasping the Democratic Peace: Principles for a Post-Cold War World* (Princeton, NJ: Princeton University Press, 1993), chapter 2.

⁴⁹ Rosato, "Explaining the Democratic Peace," 467.

⁵⁰ Rosato, "The Flawed Logic of Democratic Peace Theory," 599.

⁵¹ Michael Doyle, "Kant, Liberal Legacies, and Foreign Affairs," in *Debating the Democratic Peace*, eds. Michael E. Brown, Sean M. Lynn-Jones, and Steven E. Miller (Cambridge, MA: MIT Press, 1996), 30–31.

⁵² Ibid. See also John Owen, "How Liberalism Produces Democratic Peace," in *Debating the Democratic Peace*, eds. Brown, Lynn-Jones, and Miller, 124–125.

⁵³ Michael C. Desch, "America's Liberal Illiberalism: The Ideological Origins of Overreaction in U.S. Foreign Policy," *International Security* 32, no. 3 (2007–08): 7–43. Desch makes the important point that liberalism is ideologically hegemonic in the United States, which means that its inherent tendency toward absolutism is unchecked by any ideological alternative. This explains why liberalism is especially likely to lead to illiberal behaviour in the US case. See also Louis Hartz, *The Liberal Tradition in America* (San Diego: Harcourt, Brace, Jovanovich, 1955).

⁵⁴ Lebow, "Aggressive Democracies," 122.

⁵⁵ John J. Mearsheimer, *The Tragedy of Great Power Politics* (New York: Norton, 2001), 236.

⁵⁶ Ibid., 40–2, 140–143.

⁵⁷ Ibid., chapter 7.

⁵⁸ Ibid., 127.

⁵⁹ I am indebted to John Mearsheimer for this language.

⁶⁰ Christopher Layne, "The 'Poster Child for Offensive Realism': America as a Global Hegemon," *Security Studies* 12, no. 2 (2002): 120–164. There is a developing consensus among realists that the United States should adopt a more restrained grand strategy. See, for example, Barry Posen, "The Case for Restraint," *The American Interest* 3, no. 2 (2007): 7–17; and John J. Mearsheimer, "Imperial by Design," *The National Interest* 111 (2011): 16–34.

⁶¹ Christopher Layne, *The Peace of Illusions: American Grand Strategy from 1940 to the Present* (Ithaca, NY: Cornell University Press, 2006). See also Colin Dueck, *Reluctant Crusaders: Power, Culture, and Change in American Grand Strategy* (Princeton, NJ: Princeton University Press, 2006).

⁶² On the hegemon's temptation, see Layne, *The Peace of Illusions*, 152–153.

⁶³ See Lebow, *Cultural Theory*, chapter 9, for a fuller discussion of this case.

⁶⁴ Lebow, *ibid.*, and *Why Nations Fight* (Cambridge: Cambridge University Press, 2011).

Louis W Pauly and William D Coleman, eds.
***Global Ordering: Institutions and Autonomy in a
Changing World.***

Vancouver: UBC Press, 2008. 352 pp. £22.50 (pbk).

ISBN: 978-0-7748-1434-8.

HELEN COSKERAN (Trinity Hall, University of Cambridge)

It has long been acknowledged that globalization has caused states to “[reduce] their respective collective autonomies and [pool] their authority to expand their options for giving themselves laws” leading to “increased heteronomy” in international affairs (p. 11). But—as Louis Pauly (Canada Research Chair in Globalization and Governance at the University of Toronto) and William Coleman (Canada Research Chair in Global Governance and Public Policy at McMaster University) highlight in the introduction to their edited volume *Global Ordering*—“human beings continue to place a high value on their autonomy” (p. 1). Be that individually or collectively, the editors emphasize the value of “institutions [in providing] a window on how globalization is shaking up established patterns in the exercise of collective and individual autonomy” (p. 16). And they go on to exploit that window.

The introductory theoretical framework raises the questions tackled in the ensuing thirteen case studies on how institutions are adapting to tensions between globalization and autonomy; why the most significant institutional changes are occurring; and what the most important implications are for the autonomy of key actors. The book contains two sections. The first analyzes the adaptation of established institutions alongside the creation of new ones as a response to globalization—ranging from Coleman’s insights into agricultural negotiations at the World Trade Organization (WTO) to Petra Rethmann’s tale of the International Whaling Commission’s struggle. The second section examines these themes at the regional level in areas as diverse in size as North America (Stephen Clarkson) and small European states (Ulf Hedetoft).

Pauly’s own chapter focuses on the international financial institutions (IFIs). In it, he uses “the deepening tension between globalizing processes and the political need to accommodate persistent variations in the actual autonomy of UN [United Nations] members” to explain why and how the UN mandate in global economic governance continues to exist—albeit

shallowly—alongside the Bretton Woods institutions (p. 24). After outlining his theoretical underpinning—social learning processes facilitated by Ernst Haas’ “epistemic communities” framework (p. 31)—Pauly uses the financial crisis of the late 1990s and the ensuing Monterrey Conference to showcase the emergence of increased collaboration between the UN and the IFIs. He explains this development from both sides: the International Monetary Fund (IMF) and World Bank had lost credibility through the “tattered” Washington Consensus and needed the UN’s legitimacy—based on its universal membership—to regain it (p. 37); the UN, having passed a resolution to hold an international conference on Financing for Development, adapted its traditional rhetoric on political redistribution in support of developing countries in an attempt to accommodate the IFIs (p. 38). For Pauly, Monterrey signified the beginning of an “intensified collaboration” between the UN and the IFIs (p. 42), later strengthened by the reform of the UN Economic and Social Council (ECOSOC) (p. 40). And this collaboration illustrates the role of “a shifting multilateral compromise between the necessity of providing legitimate governance to markets of supraterritorial and cross-regional scope and the insistence of still distinct and still diverse collectivities on the maximum degree of political autonomy feasible in such a context” in IFI reform (p. 42).

Other chapters also provide analyses useful to the question of IFI reform: Sarah Eaton and Tony Porter use the International Accounting Standards Board (IASB) to exemplify the importance of global financial governance for the avoidance of crises, and Michael Webb (with Emily Sinclair) analyzes the efforts of transnational non-governmental organizations (NGOs) in lobbying for increased openness and transparency at the IFIs by way of a reduction of the clout of established Western powers and increased communication with civil society.

These and the other rich analyses provided by *Global Ordering* make it a valuable tool for studying the interplay between globalization and institutional reform through the lens of state autonomy. Though the volume underlines the “continuing series of crises in identity and confidence” experienced by the IFIs and other institutions (p. 276), it also stresses the positive role of crises in highlighting the need for this overarching political authority to remain. Even the shift from individual to collective autonomy, exemplified by the regional chapters, has enhanced the relevance of global institutions. And, despite the fact that increasing organizational complexity means that “the path ahead in each of the institutional arenas examined will not be a straight one” (p. 274), a statement which resonates all the more given the role of the IFIs in the latest financial crisis, Pauly and Coleman leave us in no doubt as to the continued usefulness of global institutions, which others would do well to bear in mind. ■

Andrew Sheng. *From Asian to Global Financial Crisis: An Asian Regulator's View of Unfettered Finance in the 1990s and 2000s.*

New York: Cambridge University Press, 2009. 504 pp. £20.99 (pbk).
ISBN: 978-0-521-13415-6.

LUKE FLETCHER (St. Edmund's College, University of Cambridge)

In the history of finance and political economy, it seems that there are always events and episodes which remain sites of contestation between competing explanations. One of these sites of contestation is the Financial Crisis which gripped the Asian economies, in particular Thailand, South Korea, Malaysia and Indonesia, at the end of the 1990s. Stepping into this intellectual battleground is Andrew Sheng, a financial regulator who had a box seat during the unfolding events of 1997/98, first as Deputy Chief of the Hong Kong Monetary Authority (1993–98) and then as Chairman of the Securities and Futures Commission of Hong Kong (1998–2005). Unsurprisingly, given its provenance, the book is centrally concerned with the role of domestic banking systems and national and international banking regulation in recent financial crises. The four chapters at the end of the book discuss the recent financial crisis. Unfortunately, they offer little new analysis and the few links that are drawn between the two crises are not so compelling as to justify such extended treatment. An epilogue discussing the recent global financial events would probably have been sufficient.

Sheng positions his analysis as one that balances a “blame the victim” approach to the crisis with one that also critiques the role of foreign capital: a kind of fusion, if you like, between Eastern and Western perspectives. Superficially, at least, this is how the book presents. Chapters Three and Five discuss the flaws of a naïve belief in free, self-regulating markets and the merits of an Asian approach to policy and governance. In this vein, Sheng does criticize aspects of the International Monetary Fund's role in 1997/98: its controversial austerity requirements (especially the enforced increase of interest rates) and its overly tough new banking requirements, both of which devastated a number of domestic economies, especially that of Indonesia, and failed to halt the withdrawal of funds by foreign banks.¹ One new contribution he makes to this debate is with respect to the controversial scotching of the Asian Monetary Fund, which many observers have attributed to malign US realpolitics, but which Sheng suggests was

also because of Japanese awareness of their own financial vulnerabilities, and because of general Asian suspicion of Japanese motives.

Indeed, the work's most interesting contribution to the understanding of the Asian Financial Crisis comes in the second chapter, a thorough examination of the role played by the penetration into East Asia of Japanese finance. Here Sheng highlights the extent of Japanese financial flows into peripheral Asian economies from the early 1990s, to help its economy recover from the 1991 recession. Sheng insists that the peculiar organization and the vulnerability of the Japanese banking system helped to precipitate its withdrawal of significant investment in the East Asian economies, just when Japan's export figures were weakened by exchange rate pressures, thus hastening the ensuing crisis.

Though a focus on the importance of banking systems may shed new light on the Japanese connections to the crisis, it is less successful when applied elsewhere. In the chapter on South Korea, for example, Sheng argues that a weak financial system was the root cause of the country's financial problems. In fact, work by Korea specialists such as Ha-Joon Chang and Linda Weiss has shown that much more significant was the retreat of government officials from their central role in development policy, itself a result of the influence of neoliberal economic orthodoxy among Korea's bureaucratic elites. This led to poor investment decisions on the part of the powerful *chaebols* and the resulting inflexibility and vulnerability in the South Korean economy. This work makes clear that a weakening of the developmental state was the real driver of the Korean decision to open up its capital markets to the world. The South Korean example, especially when contrasted with that of Taiwan, shows that any banking system vulnerabilities must be seen in the context of the broader political economy in which they are located.²

Sheng's underlying agenda is to argue for a system with less reliance on domestic banking (and domestic savings) and more reliance on foreign investors, who "impose stronger discipline on domestic players through competition or the threat of additional competition" (p. 106). Asia, he says, must leave the legacy of the developmental state behind, open up and learn to compete in the new global economy: "the longer you delay, the more the risks of marginalization" (p. 108). The belief that Asia should move to a more Western-style banking system and open up to the global economy is thus the recurring theme of the book, although one which should remain controversial. A rejection of the Asian development model would be more convincing if Sheng showed greater awareness of the model's subtleties, including its varying manifestations in different countries. ■

¹ To this end Sheng is building on well-established critiques about the role of external actors in the Asian Financial Crisis. See, for example, Joseph Stiglitz, *Globalization and Its Discontents*, W.W. Norton, New York and London, 2002, Linda Weiss, "State Power and the Asian Crisis" *New Political Economy*, 4(3), 1999, 317-342 and Robert Wade, "The Asian Debt-and-development Crisis of 1997-?: Causes and Consequences," *World Development*, 26(8), 1998, 1535-1553.

² See Linda Weiss, "State Power and the Asian Crisis," and Ha-Joon Chang, "Korea: the Misunderstood Crisis," *World Development*, 26(8), 1998, 1555-1561.

Grigore Pop-Eleches. *From Economic Crisis To Reform: IMF Programs in Latin America and Eastern Europe*.

Princeton, NJ: Princeton University Press, 2009. 344 pp. £19.95 (pbk). ISBN: 978-0-691-13952-4.

JONAS HEIRMAN (Green Templeton College, University of Oxford)

Grigore Pop-Eleches has succeeded in writing a book of importance to all interested in international relations, political economy, and the interactions between economic crises and international financial institutions. Through the systematic analysis of Latin American and Eastern European experiences, the book challenges any assumptions of homogeneity in the initiation and implementation of International Monetary Fund (IMF) programmes. By focusing on the political economy of reform programmes from the international, the IMF, and domestic perspectives, the book consistently defends the argument that the impact of international financial institutions is ultimately dependent on context and timing.

Pop-Eleches begins by outlining a series of contextual and theoretical research questions, and by explaining the quantitative models employed in his book. After providing this foundation, the book focuses on answering five questions: Why and how economic crises trigger and sustain IMF programmes? Are IMF programmes impartial in their support? How do IMF programmes mirror the demands of international financial markets and Western priorities? What domestic interests and institutions are needed to initiate and implement IMF reforms? How do domestic politics filter the pressure of IMF conditionality?

Pop-Eleches' approach is a true test of mixed-method research. By combining quantitative and qualitative methods, he is able to make cross-country and cross-regional comparisons between external and internal drivers of IMF programmes, without losing sight of contextual specificity. Cross-regional and cross-temporal comparisons are made between the Latin American debt crises of the 1980s and transitional Eastern Europe in the 1990s. Additionally, the book provides a detailed look at the cases of Argentina, Bolivia, Chile, Peru, Bulgaria, Moldova, Slovakia, and Romania.

Not surprisingly, Pop-Eleches finds that financial need is a central driver of IMF programme initiation in both Latin America and Eastern Europe. Governments are motivated by both the availability of IMF lending and by the chance that programme initiation will trigger other lenders' approval. However, the analysis of external drivers uncovers a great deal of variation in both IMF approaches and country experience. In Latin America, Pop-Eleches finds that IMF decisions were influenced by the importance

of countries to global financial markets. Large-economies with large debts were given more attention and more lenience than indebted small economies. In post-communist Eastern Europe, the low-debt and low-foreign reserve combination meant that countries posed less of a systemic threat to the global economy. In such circumstances, IMF lending followed more closely with Western geopolitical agendas. Case studies confirm that a country that already adheres to IMF ideology, such as Chile under Augusto Pinochet, had an easier time initiating and implementing programmes. Rejection of IMF programmes was only successful when governments could maintain political support and access to outside finance (e.g. Slovakia after 1995).

When analyzing the domestic drivers of IMF reform programmes, the impact of the type of economic crises, partisan interests, and domestic institutional and political constraints, as well as interactions between variables, are all closely examined. Even though financial crises do appear to drive domestic reforms, a great deal of variation exists in terms of the contexts that lead to IMF programme initiation and implementation. In crises where debt service was the main driver, only “right-leaning” governments were pushed towards IMF programmes. However, when crises involved high-inflation and liquidity pressures, government reactions were more uniform in IMF initiation.

The compatibility of democracy, partisan politics, and IMF-style reform is a central debate throughout the book. Pop-Eleches finds that the image of IMF programmes as a Western imposition meant that democracies in Latin America were less likely to initiate programmes before elections, or to comply with conditions after initiation. In Eastern Europe, democracy was found to aid IMF compliance, but only when it gave a greater voice to parties opposing former communist regimes. The impact of democracy and partisan politics is largely dependent on context, but a more consistently positive trend was found between bureaucratic capacity and programme initiation and implementation.

The theme of the book is contextual and temporal variation, and Grigore Pop-Eleches successfully brings out the specific economic drivers and political elements of observed IMF interactions. The book defends its approach by applying lessons learnt from the 1980s and 1990s to disillusionment with neoliberalism and retraction from IMF programmes in Latin America during the late 1990s and 2000s. However, as the world today struggles with economic recovery, and post-Washington consensus IMF reforms, readers are left wondering if future interactions will look anything like the past. Regardless of whether IMF approaches and geopolitical drivers change, the methods that Pop-Eleches uses can be re-applied to almost any circumstance. Because of the book’s contributions to method and theory, it will remain a must-read for anyone interested in understanding the interaction between economic crises and international financial institutions. ■

Barry Eichengreen. *Exorbitant Privilege: The Rise and Fall of the Dollar and the Future of the International Monetary System*.

Oxford: Oxford University Press, 2011. 224 pp. £14.99 (hbk).
ISBN: 978-0-19-975378-9.

STEVEN MASSON AND JOHN HOWELL (Carleton University)

The international monetary system serves as the foundation upon which the global economy is built. Exchange rates affect the allocation of resources between economies and play a critical role in the direction of global trade and capital flows. The existence of a stable reserve currency is essential for completing trades in goods and services, intermediating savings between foreign borrowers and lenders, and providing a universal unit of account. The US dollar has served this function since the end of the Second World War, but in the aftermath of the 2008 global economic crisis and the unprecedented peacetime fiscal deficit and debt levels of the United States, some are beginning to question whether an international monetary system centered on the US dollar is sustainable.

Against this context, Barry Eichengreen's book, *Exorbitant Privilege: The Rise and Fall of the Dollar and the Future of the International Monetary System*, appears, at first glance, to be so promising. The title of the book hints at the possibility of an extensive treatise on the future structure of the international monetary system from one of the world's foremost economic historians. However, even though the book does provide a useful account of the history of the international monetary system and the problems facing the United States, it fails to provide any new insights into where the international monetary system is heading, nor of how the demands placed on the system have evolved over time.

Eichengreen's book is an excellent primer for anyone interested in deepening their understanding of the evolution of the international monetary system. His narrative on the development of the gold standard and transition from the pound sterling to the US dollar is rich in detail and insightful anecdotes. Meanwhile, his later chapters on the development of the European Monetary Union illustrate the opportunities and constraints of Franco-German co-operation, whose tensions remain ever present in contemporary economic and political debates in Europe. At the same time, his description of the inevitable collapse of the Bretton Woods system in the early 1970s provides useful insights into the challenges of co-ordinating macroeconomic policies. His omission of the Plaza and Louvre Accords in the 1980s, however, is surprising.

Eichengreen begins his book with a concise survey of the arguments suggesting that the importance of the US dollar will diminish over time and that the dollar could lose its international status. On these issues, Eichengreen concludes that while the US dollar may lose its preeminent status, it is not in danger of losing its role as a key international currency. The only factor that could change this calculus is if American policymakers pursue undisciplined fiscal policy and provoke a debt crisis that leads to a crisis in confidence in the US dollar. Assuming that the United States succeeds in righting its fiscal affairs, the most likely scenario is that the US dollar will be joined by a rejuvenated Euro and, possibly, the Chinese Renminbi in a system with multiple reserve currencies. Over time, these currencies might also be joined by the Brazilian Real and the Indian Rupee. Equally important, Eichengreen argues that the emergence of a multipolar system will, if anything, be a reversion to a steady state in the global economy. Aside from the second half of the twentieth century, the international monetary system has always been based on more than one international currency.

Where the book falls short, however, is that Eichengreen spends too much time discussing the historical evolution of the international monetary system and does not present anything more than a cursory analysis of its future. He spends a disproportionate amount of time explaining the well known history of the pound sterling, US dollar, and various attempts at European Monetary Union, while neglecting to provide any insight on the new currencies, particularly the Renminbi, that may stand alongside the dollar and Euro in the future. In this regard, *Exorbitant Privilege* would benefit greatly from an analysis of the drivers of China's exchange rate policy, including the fundamental question of how quickly Chinese officials might move to transform the Renminbi into an international currency. Arguably, China continues to enjoy significant advantages from the use of capital controls and other restrictions to support its export-oriented growth model, fuelled by pressure from influential export sectors and policymakers determined to guide the process of internal economic rebalancing at their own pace. This calculus ensures that the opening of China's capital market, a prerequisite for the internationalization of the Renminbi, will only occur over a relatively long time horizon.

The second shortfall in Eichengreen's analysis is his failure to contextualize the international environment in which systemic change will occur. He does this when discussing the impact of the First World War in facilitating the shift from the pound sterling to the US dollar, and again when he describes the impact of liquidity shortages in the 1960s and the oil price shock of the 1970s in hastening the demise of the Bretton Woods System. Yet, he fails to consider the institutional features of

the modern global economy and whether these features are more or less amenable to systemic change.

As an example, reserve currencies are the most important source of liquidity, but they are not the only one. Recent reforms to International Monetary Fund (IMF) precautionary lending facilities (such as the Precautionary Credit Line and the Flexible Credit Line, which some countries view as substitutes to holding reserves), the creation of reserve pooling initiatives (Chiang Mai Initiative), increased reliance on central bank swap lines (not only in dollars but also Euros) and a potential expansion of the role of the IMF's Special Drawing Rights (SDRs) are all aimed at improving global liquidity provision. Have these changes to the international institutional framework made transition away from the US dollar less urgent? Likewise, how has the rise of the G20 and the strengthened voice and representation of the major emerging economies in the key forums for international economic co-operation changed the calculus for reforming the international monetary system?

Herein lays the main deficiency of *Exorbitant Privilege*. It contains a masterful, though often tangential, account of the history of the international monetary system, but it does not provide the analysis of the new economic environment and new economic players that is essential for understanding where the system is heading. Hopefully, future economic historians will seek to fill this gap and provide answers to the many questions that Eichengreen leaves unanswered. ■

Manuela Moschella. *Governing Risk: The IMF and Global Financial Crises*.

Houndsmills, UK: Palgrave Macmillan, 2010. 256 pp. £57.50 (hbk).

ISBN: 978-0-230-23687-5.

MICHAEL URBAN (Balliol College, University of Oxford)

The policies employed by the international community in pursuit of financial stability have varied significantly over the past twenty years, often seeming to lurch from one position to its opposite in rapid succession. According to Manuela Moschella, this variation is best explained by examining the influence of ideas on International Monetary Fund (IMF) policy-making. Specifically, she highlights the competition between two ideas about how international finance ought to be liberalized, which she labels *orderly* and *market-led liberalization*. Ultimately, however, while her tracing of this competition's evolution through her examinations of the Mexican, Asian, and subprime crises—and the ideational contestations which they occasioned—is interesting and informative, she falls short of providing compelling evidence for this argument.

Governing Risk begins theoretically with Moschella elaborating her model of how and why ideas come to influence actors' behaviours. Drawing explicitly on existing constructivist theorizing, Moschella dismisses materialist models as indeterminate. Simultaneously, she also argues that existing bureaucratic/constructivist explanations are too narrowly focused and do not take the highly political character of actors' interpretations of events and environments sufficiently into account. Instead, she argues that for ideas to influence IMF policy, they must first be accepted by what she calls its social constituencies for legitimation—which she essentially identifies as member states, academic economists, and private sector actors engaged in international finance.

The bulk of the book is then given over to empirical analysis. Each empirical chapter focuses on one of the aforementioned crises and follows much the same pattern: they begin with background information followed by a discussion of how the IMF interpreted the events of the crises, especially their interaction with the IMF's preferred concept of *orderly liberalization*. Next come examinations of how these interpretations were contested within the IMF's constituencies, of how this contestation was resolved, and of the resulting policy outcomes. These empirical chapters form the most interesting part of the book as they showcase the large body of empirical research assembled by Moschella. Drawing

on extensive archival sources and a host of interviews with relevant officials, Moschella is able to clearly trace the IMF's advocacy of *orderly liberalization* and the battle against this concept's marginalization in favour of policies of *market-led liberalization*, especially insofar as it is played out in the IMF staff's ultimately unsuccessful attempt to amend the organization's Articles of Agreement. That being said, the empirical coverage in these chapters is uneven with discussion of some theoretically important information, for example the position of academic economists vis-à-vis the Mexican crisis, being neglected.

Unfortunately, Moschella's strong descriptive accounts do not translate into a sustained cultivation of her theoretical arguments. Indeed, in the final chapter, she presents a number of conclusions, which she asserts have been borne out by evidence, but actually feel more like hypotheses that were only previously discussed in the introduction. It may well be that many of these are valid, but Moschella provides the reader with limited analysis in which these points are explicitly developed and argued. A good example of this is the treatment of the alternative explanations mentioned earlier: throughout the empirical section, they are rarely mentioned and explanations of why a particular piece of evidence demonstrates the superiority of Moschella's model are rare.

At a deeper level, while Moschella claims to be examining how and why ideas influence policy, she ends up treating ideas in a way that deprives them of much of their substance. Ideas seem to matter to the extent that the actors who hold them enjoy some level of legitimacy and are thus able to actualize them. But why and how they are held and evolve is left largely unexplored. For instance, Moschella argues that the IMF staff failed to secure their desired amendment not because the underlying justification was found wanting, but because the staff itself had lost legitimacy due to the Asian Crisis. If this is indeed Moschella's position, then her theory is not so much one which describes the causal role of ideas, but rather one in which the distribution of legitimacy is the key factor.

Overall, *Governing Risk* is an engaging text that provides some good and timely analysis of an issue of contemporary importance. While it suffers from some flaws, these flow more from poor presentation than from inadequate analysis; indeed, Moschella has presented an argument about the role of legitimacy as if it addressed the role of ideas more generally. And while the two are certainly related, the role played by ideas' *substantive* content remains very much a black box waiting to be opened. That Moschella has not been able to provide an answer to this fundamental question should not come as too great a surprise: after all, it is a question that is currently baffling the discipline of International Relations as a whole and one that will likely continue to do so for some time. ■



The Knowledge Commons: Research and Innovation in an Unequal World

201

Call for Papers

Abstracts due July 30, 2011

Papers due November 18, 2011

The problem of common-pool management is an ancient and enduring question in public policy and governance. Discussed and elaborated by a variety of theorists, from Thucydides to Aristotle, it was perhaps given its best-known formulation by Garrett Hardin:

Each man is locked into a system that compels him to increase his herd without limit—in a world that is limited. Ruin is the destination toward which all men rush, each pursuing his own best interest in a society that believes in the freedom of the commons. Freedom in a commons brings ruin to all. (“The Tragedy of the Commons,” 1968)

Yet much of the literature concerning the problems and benefits of common-pool systems does not obviously apply to the knowledge commons. Knowledge is distinct from limited resources like pastures in several regards. First, knowledge is composed of individuals’ cognitions, rather than material objects. Second, while pastures might be depleted by overgrazing, the knowledge commons seems to be threatened by what Paul David calls “over-fencing”: if key bodies of knowledge are closed off, then it is difficult to innovate. Third, knowledge exchange and innovation are arguably crucial for economic growth. Finally, a lack of knowledge about oneself and one’s environment deprives one of an essential human virtue: the ability to act as a knower.

The *St Antony’s International Review* (STAIR) invites contributors to develop the burgeoning literature on the knowledge commons in comparative, global directions. In particular, we aim to further conceptual and empirical work on global asymmetries in the management and generation of research and innovation. Authors may wish to reflect on the following issues:

- **Conceptual Clarity:** STAIR seeks a fuller understanding of the concept of a knowledge commons. Can the management of knowledge, particularly with regards to research and innovation, be usefully characterized as a knowledge commons? What are the implications of conceptualizing knowledge exchange and management as a common good, rather than a private, club, or public good?
- **A Knowledge Commons Model:** STAIR seeks insightful and innovative models of the exchange and common management of knowledge. Does this

model differ in interesting ways from established models of natural resource commons? How do considerations about imperfect information and uncertainty help identify and clarify possible threats or limits to the knowledge commons with regards to research and innovation?

- **Comparative Context:** *STAIR* encourages comparative analyses of the establishment and operation of knowledge commons. Analyses of the rise of research and innovation in the global South, or along a North/South axis are particularly welcomed.
- **The Impact of Inclusion and Exclusion:** What effect do imbalances in power and agenda control have on the substantive content of the knowledge commons? How are poor individuals, institutions, and economies included or excluded from the knowledge commons? What are the implications of such exclusion or inclusion in political, economic, or ethical terms?
- **Agency and the Knowledge Commons:** How important is trust between agents to the evolution and application of common knowledge resources? Is the role of individuals as knowledge mediators and interpreters significant for asymmetries in access to the knowledge commons? How might interdisciplinary and transdisciplinary exchanges open up new space for inclusive research and innovation?

STAIR accepts abstracts of up to 500 words in length. In addition, we seek to publish book reviews of works that relate to this theme. Please send abstracts and review proposals to stair.knowledge@gmail.com.



General Section of *STAIR*

203

Call for Papers

Having successfully published wholly themed issues between 2005 and 2010, forthcoming issues of the *St Antony's International Review (STAIR)* will also include a General Section. *STAIR* therefore invites authors to submit original research manuscripts on topics of contemporary relevance in international affairs. Submissions from the fields of political science and international relations, international law, area studies, international economics, development studies, philosophy, and international history will all be considered. Articles may take either a theoretical or a policy-oriented approach. We caution, however, that *STAIR* has a broad readership and prizes accessibility of language and content.

STAIR is the only peer-reviewed journal of international affairs at the University of Oxford. Set up by graduate students of St Antony's College in 2005, the *Review* has carved out a distinctive niche as a cross-disciplinary outlet for research on the most pressing contemporary global issues, providing a forum in which emerging scholars can publish their work alongside established academics and policymakers. Distinguished past contributors include John Baylis, Valerie Bunce, Robert O. Keohane, James N. Rosenau, and Alfred Stepan.

Please note that *STAIR* will continue to devote at least half of each issue to a special theme of contemporary significance. Potential authors should therefore refer to the themed Calls for Papers, available at www.stair-journal.org, to ascertain whether forthcoming themes fit with their particular research interests before proceeding with a general section submission.

STAIR will review manuscripts that contain original, previously unpublished material of up to 6,000 words (including footnotes with complete bibliographic information). Authors are asked to include a word count and an abstract of no more than 300 words. Submissions are sent to external reviewers for comment. Decisions can generally be expected within three months. For further information on manuscript preparation, referencing, and diction, please refer to the "Notes for Contributors" available at www.stair-journal.org.

Please send submissions to stair@sant.ox.ac.uk.

BLACKWELL

THE LARGEST SELECTION OF
INTERNATIONAL
RELATIONS
BOOKS IN OXFORD

VISIT OUR POLITICAL
& REGIONAL STUDIES
DEPARTMENT TO BROWSE OUR STOCK



RESERVE ONLINE, COLLECT INSTORE

Blackwell are delighted to support St. Antony's International Review

Contact us:
Blackwell
48-51 Broad Street
Oxford OX1 3BQ
Tel: 01865 333661
Email: politics.ox@blackwell.co.uk

www.blackwell.co.uk



BLACKWELL

THE KNOWLEDGE RETAILER