Introduction: Money and Security

> Few persons will be so visionary as seriously to contend that military forces ought not to be raised to quell a rebellion or resist an invasion. . . . Under a vigorous national government, the natural strength and resources of the country, directed to a common interest, would baffle all the combinations of European jealousy to restrain our growth. This situation would even take away the motive to such combinations, by inducing an impracticability of success. An active commerce, an extensive navigation, and a flourishing marine would then be the offspring of moral and physical necessity. . . .
>
> Commerce is . . . the most productive source of national wealth. . . . Promoting the introduction and circulation of the precious metals [that is, money], those darling objects of human avarice and enterprise . . . serves to vivify and invigorate the channels of industry, and to make them flow with greater activity and copiousness. . . . Commerce . . . must of necessity render the payment of taxes easier, and facilitate the requisite supplies to the treasury. . . . A nation cannot long exist without revenues. . . . The necessities of the State . . . must be satisfied in some mode or other. . . . Unless all the sources of revenue are open to its demands, the finances of the community . . . cannot be put into a situation consistent with its respectability or its security. . . .
>
> —Alexander Hamilton (later Secretary of the Treasury), *Federalist* 25, 11, and 12 (1787)

> The appropriation of vast sums of money and a well-coordinated executive direction of our defense efforts are not in themselves enough. Guns, planes, ships and many other things have to be built in the factories and arsenals of America. . . . I want to make it clear that it is the purpose of the nation to build now with all possible speed every machine, every arsenal, every factory that we need to manufacture our defense materiel.. . . We must be the great arsenal of democracy. . . .
>
> —Franklin Delano Roosevelt (Fireside Chat, December 1940)

Security and the exchange of money are the subject of this book. Monetary matters are not just foundational to the "real" economy of domestic and international commerce, but also core to national and international security. Money and the economy are the means by which militaries are built and deployed op-

erationally. They are also ends in themselves that we try to secure. Indeed, economy, money, and security are inextricably linked as both means and ends. We draw analytic distinctions among them, but empirically they are inseparable.

In these introductory remarks we set the stage conceptually for the chapters that follow with sections on (1) money and security as social constructions accommodating national interests with subsections on security and economy, cooperative security and money, and managing exchange rates; (2) ideas and power, examining economic security, the globalization of capital, and the elites or individuals who *own* or *manage* it—referred to here as the OMC, the owners or managers of capital; (3) the monetary component of U.S. foreign and national security policy—the privileges and costs of maintaining reserve currencies and how the U.S. dollar relates to European and Asian currencies, with particular attention to the Chinese case; and (4) international monetary regime change, U.S. commerce, and national security served by a greater propensity toward multilateralism.

THE SOCIAL CONSTRUCTION OF MONEY AND SECURITY

Money is a social construction.[1] So are the rules for its exchange. We use money to measure value by setting prices or estimating worth, which in turn allows us to buy and sell, import and export, save, invest, and reap the rewards or suffer the losses from such activities. As such, money is socially constructed to provide a unit of account and store of value as well as a medium of exchange—a claim on goods and services both domestically and internationally.

Whether for consumption, saving, or investment, we engage in these activities as individuals or in firms and other groups. So do governments. Commerce—the exchange of money, goods, and services as well as the norms we set and rules we make for its conduct in the markets we construct—is not just a private, nongovernmental domain. Governments and their agents—treasury officials and central bankers in monetary matters as managers of "sovereign" or state capital,[2] foreign ministers and defense officials, military personnel, police, intelligence agents, and the like—are full participants, some playing decisive roles.

Security is also a social construction, although one not so easily achieved. Leaders of some states may seek gains through the use of armed force. Others genuinely may seek to avoid war, but following the age-old maxim *si vis pacem, para bellum*—avoiding war through military preparedness—still costs enormous sums. This defense spending has to be financed, capital drawn from

national resources through taxation or borrowed either domestically or from abroad.

Spending more on "defense" often leads others to spend more as well, thus precluding all parties from registering real gains in security. Arms competition may itself contribute to the outbreak of war. Notwithstanding this security dilemma,[3] military spending continues to consume extraordinary amounts of national product. Moreover, threats that motivate this spending come not only from other states but also from nonstate actors that engage in terrorism, insurgency, guerrilla warfare, or other forms of political violence.

Defense establishments and the armed forces they organize, finance, train, equip, and deploy depend upon the security of capital and capital flows that have become increasingly globalized.[4] Military capabilities are closely tied not only to the size of the economic base from which they are drawn but also to the viability of global convertibility and exchange arrangements. U.S. policymakers miss at their peril the potential for disruption of capital flows that can undermine U.S. economic security,[5] as well as the ability to maintain and deploy military units abroad.

Players in currency and other markets now face cyber threats that further undermine confidence in the security of capital and the financial institutions constructed to sustain both its value and its utility in national and international commerce. Attacks on private-sector and central banks are every much a threat to national and international security as are the more conventional threats states and societies face from the use of armed force. "Warriors" on the monetary front thus understand viscerally the amazingly complex set of challenges or outright threats from both state and nonstate actors.

In this volume we identify this historic but often overlooked linkage between security and international monetary arrangements that protects domestic stakes in international commerce and helps finance expenditures for foreign policy and national security purposes. Constructing, maintaining, adapting, or transforming these international monetary arrangements or *regimes*—the rules that govern international monetary exchange—is part of a highly complex, often highly charged political process.[6]

Security also shares with international monetary regimes this complexity and political connection, but has proven to be the far more elusive construct. It seems always beyond our grasp, whether defined more traditionally in the balance between war and peace among states or, as many now do, in terms of human rights and socioeconomic well-being. What security means (much less

how it is to be achieved) seems daunting in a world still defined as the domain of states claiming rights to act independently by virtue of their sovereignty and in which nonstate actors also pose threats across national borders.

Given their importance to so many parties with diverse understandings of the interests at stake, both economy and security quickly enter the domain of politics. If, as is often said, war is too important to be left to the generals, so it is that money and commerce cannot be left just to economists, the owners and managers of capital, or others engaged in business or government pursuits! We need to grasp the threads that tie international monetary relations with security concerns, understanding them jointly as essentially political matters.

SECURITY AND ECONOMY

U.S. foreign and national security policy-makers depend to a greater degree than even they sometimes realize upon the purchasing power and continued acceptance of the dollar, which they use around the clock to finance military and other governmental expenditures abroad. Indeed, American policy-makers have faced fewer of the financial or monetary constraints that limit the foreign and security policies pursued by policy elites in other countries. Even oil is priced in dollars. This privileged position is due, of course, to the size and strength of the U.S. economy and, as a result, the dollar's standing since World War II as a principal reserve asset held by foreign finance ministries and central banks. Although the euro has assumed an ever-larger global role, the dollar is still the key currency used internationally as means of payment by those engaged in commercial, governmental, and other transactions. The dollar remains not only the most commonly used means to finance transactions globally—investing, buying and selling, importing and exporting—but also the unit of account in pricing and contracting.

The euro has joined the dollar in these reserve-asset and key-currency roles.[7] Although some predicted that the euro would challenge the dollar's preeminence, in fact thus far it has been more the partner than the competitor—as was the case earlier for the German mark, French franc, and Japanese yen—currencies from countries closely tied by shared interests with the United States commercially as well as for their collective defense and security. Notwithstanding predictions of its demise, the euro has weathered financial crises, particularly those occurring among Mediterranean countries within the eurozone. Unlike the United States, which has national monetary and fiscal policies centralized at the federal level, European Union countries coordi-

nate national monetary policies within a common central bank but still have separate fiscal policies.

These policy asymmetries among the participating eurozone states and the adverse political impact of remedies agreed or effectively imposed on member states are ongoing challenges to European unity. Moreover, some EU members—notably Britain—have not adopted the euro, preferring instead to maintain their national currencies. Politics in the United Kingdom have led it to vacillate across the decades between a European and a transatlantic identity, the latter augmented by commonwealth ties that are the residuum of empire lost.

The Japanese yen—as with other national currencies—does not have the standing in world markets the dollar has enjoyed. Nor is it in sufficient supply to assume a role coequal with the dollar as key currency for international exchange. The same is true for the Chinese yuan (the renminbi or RMB) and other rising currencies that, although their presence has grown substantially, still have a relatively smaller presence globally.[8] Indeed, their monetary authorities still find it in their interest to maintain present arrangements for the exchange of their currencies with the dollar—the euro now joining it in center stage as well.

We depart in this book from the conventional script that tells the international monetary story only in relation to international trade, investment, and other forms of commerce. Our focus here, then, is not just on money and economy—important as they are—but also on security. In this regard, money, exchange rates, and rules for currency exchange are social constructions integral to essentially political processes and grounded in both commercial and security interests. It is this relation between security and international monetary relations that most other accounts overlook.

Security and economy are clearly intertwined.[9] Economic objectives—sustaining domestic economies, international commerce and monetary arrangements—rest on a security rationale. Moreover, foreign and national security policies pursued by decision-makers in the United States and other countries also depend on the economic and military capabilities (the "hard" power) they have (and others see them as possessing).[10] Indeed, military capabilities—the obverse side of the economic, hard-power coin—depend fundamentally on the capacity of the economic base and the willingness of policy-makers to allocate necessary resources to organize, train, equip and deploy armed forces. Government purchases—whether for nonmilitary purposes or for military deployments abroad—cannot take place or be sustained without international

acceptance of the national currencies they use to finance these foreign policy outlays.

Our focus in these pages, then, is on the international monetary component of hard power. We take up exchange rates—in effect the price for which a currency can be bought or sold—and the norms and rules by which currencies are traded. As noted above, the relative value and acceptance of national currencies reflect understandings in markets and among monetary officials about the strength or weakness of the economies that underlie them. Whether commercial or governmental expenditures are made in one or another key currency and whether that currency is held as part of a country's reserves matter, as do changes in exchange rates that directly affect purchasing power, whether for private or governmental purposes. Obviously not just technical matters left to specialists, these important, often contentious, matters quickly become political.

COOPERATIVE SECURITY AND MONEY

As we review the historical record, we find substantial evidence of collaboration among governments, particularly their treasury or finance ministry officials and central bankers—the latter in the United States, United Kingdom, and other countries performing quasi-governmental roles that still reflect their private-sector origins. Maintaining international monetary arrangements or regimes, influencing currency exchange rates, and sustaining the international flow of capital require various forms of multilateral collaboration. These are essentially political processes—coordinating central bank interventions in currency markets, setting or influencing interest rates that affect international capital flows, extending credit to central banks and other financial institutions, or meeting to adapt or change the regime by which money is exchanged.

This is really *cooperative security*, although the term is usually not applied to international monetary matters.[11] We do so here on two grounds. First, the security of a currency—maintaining its acceptance as medium of exchange, unit of account, and store of value—has significant implications for trade, investment, and government expenditures for foreign policy and national security purposes. Second, this monetary security cannot be provided unilaterally. It depends on constructive engagement by governments and their monetary officials—the *managers* of capital—finding interest-based grounds for cooperative, often collaborative, measures that fit collectively under the rubric of cooperative security.

The concept of achieving security through cooperative, not just competitive, means has been applied in the post–Cold War period primarily to military contexts, as in the pursuit of arms control or confidence- and security-building measures among states. It has also been a means by which states deal cooperatively with terrorist or other asymmetric threats posed by nonstate actors or "failed" states often torn by civil war or intercommunal strife. We extend the concept in this volume to international monetary politics in which the key players are the international managers of capital, principally central bankers and treasury or finance ministry officials, their representatives, and the staffs that support them.

Their cooperative security, collective task is to maintain the stability of an international monetary regime in which both state and nonstate actors are free to exchange their currencies to finance both governmental and nongovernmental purchases and sales, imports and exports, capital investments, and other commercial transactions. Although we readily recognize their contribution to sustaining the global commerce of private-sector banks, corporations, other firms, and individuals, we focus in this volume on the often-overlooked security dependence by the United States and other state actors that rely on the international monetary regime to finance official purchases in support of the foreign and security policy actions they conduct abroad.

Failure to cooperate monetarily (as in the early 1930s during the Great Depression, when governments turned inward, devaluing their currencies competitively to discourage imports and promote their exports) tends to reduce the volume of trade, impede international capital flows, and have adverse implications for both economic and national security—conflicts that may result in war. At least that was the experience in the lead-up to World War II.

As the historical record makes clear, however, even the late-nineteenth- and early-twentieth-century gold standards required cooperative or collaborative measures to make them work. The alleged automaticity of gold standards also proves to be the stuff of myth or legend—widely believed by many then and some now, but not really so. In fact, as managers of capital, central bankers coordinated interest rates, garnered official currency deposits held as reserves, and took other measures in tandem with their counterparts to secure their currencies—sustaining their acceptance as legal tender for payments and their convertibility to gold (or silver) and other currencies for use internationally.

MANAGING EXCHANGE RATES—ACCOMMODATING NATIONAL INTERESTS

High levels of collaboration by treasury officials and central bankers were also necessary to sustain fixed exchange rates in peacetime and during two twentieth-century world wars. Formal adjustments were required from time to time—either revaluing a particular currency upward or devaluing it. As in earlier periods, efforts were made to avoid these diverse effects by fixing or keeping exchange rates relatively constant. The Bank of England was de facto manager of the nineteenth- and early-twentieth-century gold exchange standard in which sterling was principal reserve currency. In the post–World War II Bretton Woods regime, the dollar served this function—governments or their central banks able to hold dollars as reserves or, until 1971, exchange them for gold at $35 per ounce.

The move to a floating-rate regime in the 1970s did not remove the need for treasury and central-banking collaboration. Favoring an idealized or "pure" float, some said such interventions no longer would be necessary. Global markets would be self-adjusting—currencies finding their "natural" or equilibrium exchange rates. In fact, whatever the theoretical merits of the claim, economic, security, and other domestic stakes in exchange rates remained so high that the international monetary regime quickly became, at best, one of "managed" flexibility. Moreover, avoiding the adverse experience of the 1930s required some degree of coordination to avoid the competitive devaluations and other measures in search of trade advantage that disrupted global commerce. Critics in any event dubbed it a "dirty" float—their way of describing government or central bank intervention in (or efforts to manage) currency markets.

To a greater degree than those in other economic sectors, central bankers understand and, for the most part, accept the need from time to time to intervene in financial markets. During the more than four decades of a managed-flexibility international monetary regime, treasury or finance ministry officials and central bankers have developed collaborative norms legitimizing these interventions. Laissez-faire liberal ideological arguments aside, leaving currency values entirely to the market in practice continues to be a political nonstarter. Whatever their rhetoric, governments tend not to leave things entirely to the market. The stakes for them typically are too high for laissez faire. For them, money is too important simply to be left to markets.

Continental Europeans in particular—displeased with the adverse effects on

regional trade and investment stemming from exchange rate turbulence—began efforts in the 1970s initially to reduce fluctuations and later to fix their own exchange rates in a European Monetary System (EMS). The EMS became the basis, a quarter of a century later, for the emergence of the euro—its exchange value ultimately set in a managed float vis-à-vis the dollar and other currencies outside the euro area. To Europeans "management" meant providing stability to exchange rates—avoiding large swings in favor of smaller adjustments related to market supply and demand for particular currencies.

Stability within the euro zone (or euro currency area) requires coordination of national monetary policies within the European Central Bank (ECB) but, as noted above, this also depends on coordination of fiscal (tax, spend, and borrowing) policies—country-by-country expenditures not exceeding revenues beyond agreed limits. Not surprisingly, this macroeconomic coordination of both fiscal and monetary policies and national (or "sovereign") debt across the participating European countries has proven difficult, particularly given different national levels of development and political priorities.

Germany and other countries with relatively strong economies see themselves as shouldering a heavy burden—paying a high price to sustain the euro positions of weaker economies. "Bailouts"—loaning capital to Greece and Spain beginning in 2010—underscored the economic asymmetries that make sustaining the euro politically difficult. Indeed, the divergence in macroeconomic policy—some pursuing more expansionary fiscal policies than others—has contributed not only to the need for monetary adjustments within the euro zone but also to substantial swings in the exchange value of the euro vis-à-vis the dollar and other currencies.

IDEAS AND POWER

Ideas grounded in interests matter, as do the capabilities or power mustered to advance them in the construction of international monetary regimes. Economic and military capabilities are what Joseph Nye identifies as the bases of *hard power*, which he contrasts to the *soft* component that rests on the values and cultural understandings as well as diplomatic, bureaucratic, and other capabilities that lead others to follow.

When we unpack the international monetary component of "hard" power in Nye's formulation, we find that it also rests on rather "soft" interpretive judgments that go into the construction of money and the modalities of its exchange. How we organize the transfer and exchange of currencies—the rules

we set forth and the institutions we create to facilitate this process—depends as well on the understandings that serve interests held by those in a position to construct, maintain, adapt, or transform these regimes. Correct or not, what matters are the *understandings* of interest held by those among the owners or managers of capital and others who also engage in day-to-day market transactions.

Our focus here is on the economic, particularly the monetary, component of "hard" power that not only drives military capabilities but also has implications for various forms of "soft" power. Although often overlooked, what becomes apparent is a dependent relation of the military on the economic component of "hard" power. Militaries cannot exist, much less operate, apart from the economic base that sustains them. Indeed, the size and quality of the armed forces that political and military leaders in a country are able to organize, finance, train, equip, and deploy are a function of the aggregate size and level of development of the domestic economy.

Moreover, soft-power capabilities are also linked to the magnitude of hard-power assets. Put another way, soft-power potential is substantially diminished in the absence of hard-power underpinnings. Quite apart from the quality of their ideas or other professional attributes, officials from countries possessing substantial military or economic, hard-power capabilities are usually taken more seriously in global markets and international organizations than those from smaller countries lacking these hard-power assets. The soft power that officials are able to exercise, then, is directly related to shared understandings other parties have of their hard-power assets.

Stated more formally, this distinction in Joseph Nye's account between "hard" (military and economic) and "soft" power leads us to explore how these components are related: (1) the dependent relation of the military on the economic component of hard power; and (2) the dependent relation of soft power on both economic and military capabilities that constitute this hard power. Military capabilities depend upon the strength of the underlying economy that provides the human and physical resources that can be allocated to military purposes. The soft power Joseph Nye describes is substantially diminished in the absence of hard power underpinnings.

Although we may draw analytical distinctions between hard and soft power, empirically these factors are always a function of *interpretive understandings* held by elites and mass publics both at home and abroad. Thus, economic, military, and "soft power" capabilities do not exist in a vacuum, as if they were

objective realities "out there." Yes, a currency's (like the dollar's) exchange value is a function of supply and demand, but these are themselves subjective judgments in markets about its relative worth in relation to other currencies. These judgments are heavily influenced as well by subjective appraisals of a country's economic base—its magnitude and growth potential relative to other national economies. Also influential are the rules or accepted norms of the international monetary regime within which the currency operates.

The focus, then, is on which ideas serve whose interests, the relative capabilities—measured in large part by the capital base or productive capacity of the players (both state and nonstate actors) that empower or constrain the actions of their officials or representatives. In this regard, it is a mistake to reduce power or relative power merely to military capabilities, which themselves depend so heavily upon the capital base or productive capacity in a society—what Adam Smith called the wealth of nations.

Viewed in the aggregate, then, the economy is the foundational measure of a state's overall capabilities or power—economy understood broadly not just in terms of access to capital and natural resources but also in human-resource terms (the education, skills, and the ideas or values people hold related to savings and investment). These are essential to production and all forms of commerce and other social activities in and outside of governments pursued by both international and nongovernmental organizations. Of particular interest to us here, however, is that these are essential components that facilitate or constrain the size and overall capabilities of the armed forces political and military leaders are able to assemble. Understandings held by policy elites of the relative distribution of these capabilities profoundly influence the scope or range of alternatives from which policy-makers are free to choose.

ECONOMIC SECURITY, THE GLOBALIZATION OF CAPITAL OWNERS AND MANAGERS

Economic security matters to states and people in their societies. Indeed, security is not just a project for military, police, and paramilitary forces to attend, but also relates to capital and the stakes societies and their populations have in the value of their properties, investment, trade, the currencies they exchange, and other forms of commerce. The armed forces a country can raise, maintain, and deploy in combat, as noted above, also depend upon a society's capital base—the economy's productive capacity.

Functioning of the economy as a whole and the economic well-being of

peoples nationally and in global society depend on security—maintenance of the security that facilitates and sustains all forms of commerce. Access to human and natural resources is an essential element of economic security, and this access depends upon the global flow of capital. Maintaining these capital flows that enable and facilitate the regional and global movement of labor and natural resources is a core security task for states as well as international and nongovernmental organizations (to include business firms) operating in a globalized economy.

Security calculations affect (and are affected by) international monetary regimes—the ways and means of managing capital flows in war and peace. The dollar, euro, and other currencies that play so important a role in the present-day global economy face substantial threats or challenges in global markets, particularly as officials who seek a balance between their domestic and international priorities confront market forces they may influence, but are essentially beyond their direct control. Economic and military security depends, in part, on successful use of the ways and means taken to sustain a currency's position within the international monetary regime.

Ideas or norms in the applied form of common practices and institutionalized rules (and the international organizations and practices in which these rules typically are embedded) facilitate international monetary exchange. These capital flows are essential to buying and selling, importing and exporting, investing, and realizing returns from all of these activities. Governments and their foreign policy and military establishments depend on the value and acceptance of their national currencies to finance the purchases they make abroad. It is the ideational component embedded in monetary-exchange rules, however, that defines the policy space in the construction, maintenance, adaptation, or transformation of international monetary regimes. Integral to the viability of capital and global capital flows are the adaptations or changes made from time to time in and to the regime itself.

Experts matter in these processes, particularly given the technical complexity of the subject matter. These "experts" are diverse, but crosscutting or overlapping elite groups are composed of central bankers, finance ministry or treasury officials, economists, and other academics. Of these, central bankers constitute what Peter Haas refers to as an *epistemic community*—"a network of professionals with recognized expertise and competence in a particular domain and an authoritative claim to policy-relevant knowledge within that domain or issue-area."[12]