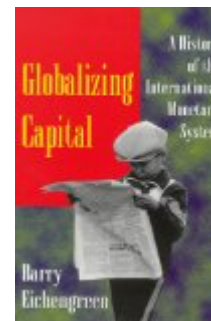


**Barry J. Eichengreen.** *Globalizing Capital: A History of the International Monetary System*. Princeton: Princeton University Press, 1996. viii + 223 pp. \$24.95, cloth, ISBN 978-0-691-02880-4.



**Reviewed by** George Selgin

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In 1892 the English economist Robert Giffen[1] published an article entitled "Fancy Monetary Standards." Objecting to a recent proposal for a new monetary standard aimed at stabilizing the purchasing power of money, Giffen observed that "Governments, when they meddle with money, are so apt to make blunders ... that a nation which has a good money should beware of its being tampered with." If we mess with the gold standard, in other words, "we can never tell ... what confusion and mischief we may be introducing" (p. 1).

A generation later, the gold standard was not only tampered with, but largely dismantled. The international monetary system has been witness to a great deal of "confusion and mischief" ever since, including such "fancy" payments arrangements as the IMF, the EPU, the BIS and the EMS, elaborate multinational structures designed by international committees, and regularly shorn-up by exchange controls, stand-by arrangements, SDR's, gold-pools, and other ad-hoc devices aimed at forestalling major devaluations.

The ultimate failure of all such arrangements, as well as the abandonment of the international

gold standard itself, has led Berkeley economist Barry Eichengreen to wonder whether any system of fixed, or at least relatively stable, exchange rates can survive in a world of democratic governments. His book, *Globalizing Capital: A History of the International Monetary System*, supplies a negative answer. Elaborating a thesis put forth by Karl Polanyi in 1944, Eichengreen argues that modern democratic governments are bound to yield to pressures to pursue goals, such as the avoidance of cyclical unemployment, that conflict with the maintenance of fixed or pegged exchange rates. The history of the international monetary system, according to Eichengreen, is largely a history of major governments' gradual, grudging acknowledgment of a conflict between internal and external monetary stability, and their generally unsuccessful efforts to overcome the conflict by means of international cooperation. Eichengreen's book tells the story in four meaty but easily digested chapters (plus an introduction and conclusion, both very brief), covering the gold standard, the inter-war period, the Bret-

ton Woods System, and post-Bretton Woods developments.

Eichengreen's general thesis offers a useful starting point for understanding the often Byzantine political economy of international monetary relations, and he is at his best when offering pithy public-choice explanations for major international monetary developments. For example, Eichengreen accounts for Germany's seemingly self-destructive support for monetary union by noting that "Germany desired not just an integrated European market, but also deeper political integration in the context of which [it] might gain a foreign policy role. Monetary union was the *quid pro quo*." Not the last word, perhaps, but as good and succinct an explanation as I've read so far.

Some of Eichengreen's explanations are perhaps a little too simple, as when he attributes the dollar's decline after the mid-1980s to the fact that an over-valued currency "imposes high costs on concentrated interests," whereas an undervalued currency "imposes only modest costs on diffuse interests." (Just how does America's involvement in the Louvre Accord of 1987—a failed attempt to restrain the fall of the dollar—square with this public-choice insight? Could it be that the dollar's decline was simply unavoidable?)

I also wonder whether Eichengreen's main point concerning the incompatibility of democracy with stable exchange rates really gets to the root cause of the move to floating exchange rates. In some loose sense, of course, democratic pressures fueled the abandonment of the international gold standard and of later schemes for pegging exchange rates. But we should not forget the context: previous changes in domestic monetary arrangements that subjected money to government control. Of particular importance was the establishment of central banks, which removed the enforcement of the gold-standard mechanism from the hands of private, competing bankers, increasing the risk of both a suspension of payments and subsequent yielding to inflationary pressures.

Twentieth-century voters might never have developed a taste for accommodative monetary policies had non-democratic governments of previous centuries not set a precedent for such policies by reshaping monetary arrangements to serve their own fiscal ends. After all, the survival of the pre-war regime was not so much a reflection of governments' "single minded pursuit of exchange rate stability" (as Eichengreen claims) as it was a largely unintentional byproduct of private financial firms' contractual obligations to their customers.

Eichengreen also tends, in my view, to overstate the extent to which democratic nations must rely upon accommodative central bank policies, unhindered by fixed exchange rates, to avoid financial and macro-economic turmoil. For example, in discussing the success of recent currency board-like arrangements, he argues that they have worked best where banking systems have been heavily internationalized, treating the openness of a nation's banking system as a given. But that openness is itself to some extent at least a matter of policy. The voters may well favor demand-management approaches to structural alternatives for avoiding financial instability; but this preference has more to do with special-interest politics standing in the way of desirable structural reforms than with sound economic theory.

Nor is it altogether obvious that the international gold standard promoted internal macro-economic instability. Although the standard proved deflationary until the mid-1890s, this deflation does not seem to have stifled economic growth. (Even Marshall, whom Eichengreen cites as a critic of gold, suggested that the deflation might actually have been beneficial.) This isn't to deny that the nineteenth century was marked by numerous financial crises in some countries; but those crises and later ones as well had more to do with faulty financial legislation than with any shortage of gold. Thus Scotland, with its relatively free banking system, was largely untouched by

the banking crises that forced English banks to seek last-resort aid while also forcing the Bank of England to increase its fiduciary issue; and during the 1907 "credit squeeze" in the United States, private Canadian banks helped make up for a shortage of U.S. currency due in large part to legal restrictions on U.S. banks. (The Canadian banks ran into legal limits themselves, which were then loosened.)

The restored gold standard of the 20s and 30s was another matter entirely. Here central banks played an active role, mainly by trying to run the gold standard on the cheap, supplementing gold reserves with holdings of foreign exchange (instead of further devaluing their currencies or enduring more deflation so as to achieve a higher, sustainable relative price of gold). This cartel-like arrangement could only work so long as creditor central banks resisted the temptation to cash in their foreign exchange holdings. It was, consequently, far more vulnerable to speculative collapse than its prewar counterpart.

In short, while Eichengreen credits "collaboration among central banks and governments" with the maintenance of the gold standard, I am inclined to think that government and central bank involvement tended to undermine the gold standard's success. The Canadian case is again relevant here, for Canada had little difficulty maintaining its gold standard until 1914 while avoiding financial crises without the help of a central bank, even while experiencing massive capital inflows. The point is of fundamental importance, because it suggests that, notwithstanding what Keynes argued in 1941, a stable exchange rate regime might be just as "automatic" and unreliant upon the chimera of "international cooperation" as one based upon free-floating rates.

On the whole, though, I highly recommend Eichengreen's book. It is largely compelling, thought-provoking, highly informative, and a pleasure to read.

Notes:

[1]. Robert Giffen, "Fancy Monetary Standards," in *Economic Inquiries and Studies* (London: George Bell and Sons, 1904), pp. 168-9.

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