Capital Politics: Creditors and the International Political Economy
Author(s): Jeffry A. Frieden
Source: *Journal of Public Policy*, Vol. 8, No. 3/4, International Monetary Cooperation, Domestic Politics, and Policy Ideas (Jul. - Dec., 1988), pp. 265-286
Published by: Cambridge University Press
Stable URL: https://www.jstor.org/stable/4007185
Accessed: 05-04-2019 14:45 UTC

Jnl Publ. Pol., **8**, 3/4, 265–286

Capital Politics: Creditors and the International Political Economy*

JEFFRY A. FRIEDEN *Political Science, University of California at Los Angeles*

ABSTRACT

This essay analyzes the relationship between international investment interests and foreign economic policy. The first step and level of analysis looks at nation-states as the relevant actors, and claims that a country's international investment position tends to affect its international economic preferences in ways that are easily understood and anticipated. Countries' international asset positions often have a predictable impact on their policies toward international monetary relations, cross-border investment, and trade.The second step and level of analysis looks inside national societies at the international asset positions of various domestic groups. It argues that sectors with varying interests related to their international investment positions contend for influence over national policy. The economic circumstances of each sector lead to sectoral policy preferences with predictable implications for domestic bargaining over foreign economic policy. The general argument is applied briefly to a number of modern creditor countries and sectors, most prominently the United States after World War Two.

International monetary and financial relations are at the center of today's international political economy. Currency values, short- and long-term capital movements, debtor–creditor relations, and related issues are crucial to the private sector, to intergovernmental relations, and to private–public sector interaction around the world. A fundamental analytical and practical question for those concerned about the future of the world economy is indeed the extent to which growing international financial ties will lead toward more cooperation among national policy

* The author would like to thank John Conybeare, I. M. Destler, Stephan Haggard, David Lake, Peter Lindert, Charles Lipson, Timothy McKeown, John Odell, T. M. Rybczynski, Arthur Stein, George Tsebelis, Michael Wallerstein, Tom Willett, and John Williamson for comments on earlier versions.

makers, and among nationally-based businesses, or more conflict among them.

The future of international financial relations, and especially the degree of conflict involved in them, is a function of both economic and political considerations. The scholarly literature on the economics of international capital movements grows daily in both quantity and quality. However, this large economic literature is not matched by a comparable body of work on the political factors involved in international money and finance; a *political economy* approach to the topic is only in its infancy. Just as informed academic and general discussion of international trade conflict and cooperation relies on an integration of economic and political considerations, so too must political economy be brought to bear on the study of international finance to improve the level of debate and the effectiveness of policy.

This essay suggests that the starting point for a political economy of international finance should be the relationship between international investment interests and the foreign economic policy preferences they imply. The argument proceeds in two steps, at different levels of analysis. The first step and level of analysis looks at nation-states as the relevant actors, and claims that a country's international investment position tends to affect its international economic preferences in ways that are easily understood and anticipated. Countries' international asset positions often have a predictable impact on their policies toward international monetary relations, cross-border investment, and trade. The second step and level of analysis looks inside national societies at the international asset positions of various domestic groups. It argues that sectors with varying interests related to their international investment positions contend for influence over national policy. The economic circumstances of each sector lead to sectoral policy preferences with predictable implications for domestic bargaining over foreign economic policy.

The general argument is applied briefly to a number of modern creditor countries and sectors, most prominently the United States after World War Two. The United States was a country rich in capital, and its international economic policies reflected the attempt to ensure as high a return as possible to American capital. At a more disaggregated level of analysis, the varied interests of leading sectors of the U.S. economy, with international economic policy preferences that flow from their domestic and international asset positions, provides the basis for an understanding of domestic debates over US foreign economic policy.

The argument and the examples are preliminary and illustrative. The purpose of the essay is only to present the rudiments of a framework for analyzing the domestic and international political economy of international finance, and to show that the framework fits a stylized review of the evidence. As such, the essay reflects the embryonic nature of attempts to develop a political economy of international finance.

International finance and the international political economy

There are powerful reasons to study the political economy of international capital movements. Economic theory shows that factor movements are substitutes for international trade, and may even perform similar functions more rapidly. If a labor-rich country maximizes its welfare by exporting labor-intensive and importing capital-intensive goods, it does so even more directly by exporting labor and importing capital; the converse holds for a capital-rich country (Mundell 1957; for related discussions see de Cecco 1976, and Strange, 1986). Trade is only a means to an end, maximizing profits on capital, and exports are only one way of earning profits on foreign activities; it makes as much sense to focus on the end as on the means.

Indeed, international capital markets are today the pivot around which the world economy rotates. The offshore financial markets hold well over a trillion dollars net of inter-bank claims, and hundreds of billions of dollars more are invested abroad in traditional portfolio and direct forms. International capital movements dwarf international trade in sheer size; by rough estimate, more money flows into and out of the United States in a day than goods in a month. In 1984, even according to the inadequate figures available, American overseas investment income was $87.6 billion on overseas private assets of $795 billion. In the same year, merchandise exports were $220 billion; assuming a generous five percent profit margin on overseas sales, this implied that foreign investment earned American businesses eight times as much as did foreign trade. International economic transactions of this size deserve close attention by scholars, especially since the study of the politics of international investment has a long and instructive history.

Another reason to focus systematically on international monetary and financial relations is that there is substantial evidence that these relations themselves help explain developments in other realms of the international political economy. The most obvious example is the effect of real exchange rates on trade: a significant rise in the real exchange rate often leads to protectionist sentiment from traded goods producers whose competitive position is eroded by the currency's appreciation, while a real depreciation tends to dampen protectionist pressure by improving the competitive position of local producers. One simple illustration of this is contained in Table 1, which exhibits the number of anti-dumping petitions filed in the United States between 1976 and 1984 and the real effective exchange rate

TABLE 1: *Real exchange rates and protectionist pressure: The US dollar and anti-dumping petitions filed, 1976–1984*

Year	*Real effective exchange rate, US dollar, previous year. 1976 = 100.*	*Anti-dumping petitions filed*
1976	100	12
1977	105	17
1978	105	34
1979	96	31
1980	94	21
1981	94	15
1982	106	65
1983	118	46
1984	125	72

Regression details: Constant 126.46; Standard Error, Y estimate 15.42; R squared 0.57; X coefficient 1.54; t-statistic 3.04

Data on real exchange rates and anti-dumping petitions are from Alan Deardorff and Robert M. Stern, 'Current Issues in Trade Policy: An Overview,' in *US Trade Policies in a Changing World Economy* Ed. Robert M. Stern (Cambridge: MIT Press, 1987), pp. 23, 26.

for the US dollar in the previous year. The regression thus tests the effects of movements in the real effective exchange rate, with a one-year lag, on the number of anti-dumping petitions filed, and finds a strong positive correlation (for related findings see Clifton 1985, De Grauwe 1988, and Magee and Young 1987; but see Feigenbaum and Willett 1985 for a weaker correlation). If international monetary and financial conditions can so significantly affect the level of protectionist pressures, surely they deserve concentrated scholarly attention.

Perhaps most obviously, international financial and monetary flows and policy deserve attention from political scientists because they are poorly understood. Trade policy is traditionally a legislative affair, at least in large part, and is thus quite amenable to examination: regional and sectoral interests, trade-offs, and coalitions can be tracked easily. International monetary and financial policies, on the other hand, are almost everywhere centralized in the Treasury and the Central Bank, often in deep secrecy. Yet we know how important foreign economic policy decisions in the monetary and financial arenas can be, from Britain's return to gold in 1925 and America's interwar debts and reparations debates to the 1971 Nixon shocks and the debt crisis of the 1980s.

Many issues in the political economy of international capital movements deserve study. These include the effect of political variables on such economic developments as cross-border capital movements themselves. Our purpose here is more modest: to discuss the origins of government policies directly or indirectly concerning the international movement of capital, especially international monetary policy, the protection of overseas investment, and trade policy.

In analyzing the political economy of international finance, we can draw on two divergent strands within political science. The first, generally associated with what is called the systemic approach to International Relations, ignores domestic politics, focuses on the interaction of national states that it assumes to be unitary, and explores how at the level of the international system this inter-state interaction affects the making of foreign economic policy. The second, generally associated with interest-group or class-analytical approaches, focuses explicitly on bargaining among domestic socio-economic and political groups, and investigates how this domestic political interaction affects the making of foreign economic policy.

Systemic studies of international relations contribute two insights to the analysis of the politics of international economics. The first is that the international economic order generally reflects the preferences of the most important states in the system. This bit of common sense is not so trivial as it might seem; its insistence on *states* as the basic ordering principle of the international system highlights the incompleteness of international economic approaches that look only at market forces. The second insight is that, like all atomistic actors, states face difficulties in coordinating their interaction, even when such coordination would be to their mutual benefit. The point here is that inter-state behavior is subject to the same strategic considerations as interaction among firms or individuals. These two insights have been applied, most prominently and with mixed success, to such issues as the construction of an open international trading system by 'hegemonic' powers – the United Kingdom in the 19th century and the United States after World War Two (Krasner 1976; but see McKeown 1983 and McKeown 1986).

However, systemic International Relations has not been very successful at going beyond these observations to more systematic analyses of the international political economy. The problem is simple: the two insights mentioned above can only be brought to bear for real analysis if the preferences of the actors (states) can be specified. Scholarship in the systemic tradition regards states as rational units interacting strategically in the international system, but the units have nothing to be rational *for*, no utility function to maximize. Indeed, the strategic interaction of states in the international economic policy arena cannot be understood without a clear picture of the states' prior preferences: a state that wants to be integrated into the international economy will behave very differently in trade negotiations than one that prefers economic autarky. Some have tried to evade the problem by assuming that states maximize their power or prospects for survival and building up from there (Waltz 1979), but since national power or survival are goals consonant with a myriad of economic policies, the preferences imputed on this basis are *ad hoc*.

One way to avoid this problem is to focus on specific issue-areas in which national economic preferences appear self-evident. There are many studies on the strategic interaction of debtor nations and creditor banks in which, quite plausibly, both debtors and creditors are assumed to be purely economic utility maximizers: debtors trade off the benefits of unilateral reductions in debt service against the costs of creditor retaliation, while creditors do the opposite, all in the context of implicit or explicit bargaining toward an equilibrium outcome (Crawford, 1988, Lipson 1985a, and Sachs 1984, are representative examples). Yet this method has not been generalized to other issue-areas, and it is rarely extended to inter-state interaction in more than one issue-area.

The first cut proposed here to analyze the political economy of international finance is systemic, and focuses on the ways in which nation-states interact in bargaining over global monetary, financial, and trade relations. In line with the systemic focus on unitary state action, we ignore domestic politics, derive the interests and preferences of nation-states from their international investment positions, then discuss their behavior as they bargain with other nation-states over international financial, monetary, and trade issues.

Even the most cursory knowledge of the politics of international financial relations is enough to make clear how unrealistic is the fundamental assumption of the systemic approach, that domestic politics do not affect foreign economic policymaking. Different domestic groups have varied, sometimes diametrically opposed, interests in relation to the international economy, and they fight for their interests in the domestic political arena.

The domestic-level alternative to systemic International Relations, then, seeks to specify how national economic preferences are derived from bargaining among individuals, firms, and sectors within the nation-state, each of which has preferences derived from its position in society. The analytical bases for this method, which has firm roots in modern political economy, are of course far more developed than systemic interpretations of the international economy. Nevertheless, even at the level of generality of interest to scholars of International Relations the task is extraordinarily complex, since it requires a level of disaggregation sufficient to capture the specifics of various individuals, firms and sectors, and then a re-aggregation that is able to assign accurate weights to the relevant actors. This is a daunting task in so detailed and variegated a field as international trade, since goods differ so enormously; it is only slightly less daunting in international financial matters.

Our second cut is thus to examine the effect of the different international economic situations of various groups within national societies on the making of national policies related to international investment. Socio-economic groups with overseas assets are expected to have different interests from those without, and are expected to exert political pressure on policymakers to protect their international interests. These pressures will be brought to bear in issue areas directly related to international investment, such as international monetary and financial policies, as well as in issue areas that affect returns on international investment indirectly, such as trade policy.

The remainder of this paper is an attempt to develop and apply these intersecting approaches. First we examine how the international investment position of a nation-state as a discrete unit might be expected to affect its interests and actions in bargaining over international monetary policy, cross-border capital movements, and international trade. Then we explore how the international investment positions of various groups *within* each nation-state might be expected to affect the groups' positions in domestic political bargaining over national foreign economic policies on international monetary, investment, and trade issues. For tractability we look only at countries with net external assets, creditors. This restriction in the scope of the analysis is artificial and limiting, since the existence of creditors implies the existence of debtors, and they can be expected to interact in important ways. However, the discussion of creditor interests and actions is complex enough for a preliminary essay.

'National' creditor interests and the political economy of international finance

In the process of economic growth and development, countries pass through a series of stages in their capital accounts. It is intuitively obvious that, inasmuch as economic development involves capital accumulation, the less developed a country is the more poorly endowed with capital it will be, and the more likely the relative capital scarcity will lead to capital imports. There are of course a number of reasons why the process might take the form, not of capital imports, but of an entirely domestically-driven increase in the country's capital stock and capital-to-labor ratio. Nonetheless, a few not particularly strong assumptions are enough to ensure that almost any model will reflect the empirical observation that relatively poor countries tend to import capital, while relatively rich ones tend to export it.[1]

This secular trend can of course be interrupted by shorter-term fluctuations, for example when a wealthy country borrows heavily abroad (the United States in the Reagan years, Weimar Germany) or when a poor country invests abroad (Argentina and Venezuela in the early 1980s). We ignore the fluctuations and focus on the trend. We also begin our analysis not at the beginning, but at the point at which a country ceases to be a debtor and becomes a creditor.

Creditor countries share certain attributes, but it is useful to distinguish between new lenders and mature creditors. The fundamental distinction between the two is the degree to which overseas assets have been accumulated; a specific indicator might be the relationship between new overseas investments and earnings on existing overseas assets.

When a country begins to export capital, its earnings on overseas assets are substantially less than its new overseas loans and investments. Put another way, a *new lender* pays for most capital exports out of the country's trade surplus. After many years of overseas investment, however, the country's existing stock of foreign assets is large enough that repatriated earnings approach or even surpass new capital exports.[2] Earnings from financial and other services directly related to the country's international financial status (insurance and foreign exchange trading, for example) can be added to this. At the point at which the country is, so to speak, living off its existing overseas assets and international financial sector, it is a *mature creditor* or, in less flattering terms, a rentier state.

A country rich in capital and interested in protecting its overseas investments has a number of interests in international monetary and financial relations. In the global arena, a capital-exporter wants to ensure that capital can move across borders smoothly and without undue interference. This implies a need for formal or informal, bilateral or multilateral, arrangements to facilitate cross-border capital flows. One concern is the adjudication and enforcement of property rights across borders, which can include everything from gunboat diplomacy to investment treaties. Another concern is relatively predictable currency values, whether in the form of the gold standard, the Bretton Woods system, or well-developed forward markets. Creditor countries thus take the lead in maintaining a market for their currency as an international reserve asset, developing international contract law and a mechanism to enforce it, and other such features of financial and monetary stability.

An important aspect of creditor-country status is the financial-center function, by which the country becomes a reliable place for economic agents from other countries to carry out international financial transactions. A financial center's currency must be easily convertible into other currencies and generally trusted, and its financial markets must be strong and reasonably protected from the whims of politicians.

Creditor countries also have important interests in international trade policy. In general, they should be concerned to make their own markets more accessible to their debtors. After all, unless the capital-receiving countries are able, directly or indirectly, to earn the currency of the capital-sending country, creditors will be unable to repatriate their profits. For foreign investing nations, indeed, it is more important that *their own* market be open than that other markets be open; their capital exports can jump trade barriers, but unless foreigners can earn the creditor's currency capital exports can never pay off.

From the standpoint of a major creditor country, such as Great Britain in the nineteenth century and the United States after World War Two, the principal concern is to promote long-term capital movements and short-term exchange stability. World-wide trade liberalization may be of less importance in itself. For a creditor that wishes to enjoy the earnings on its foreign assets, after all, it is *one's own* receptiveness to imports that matters most, for service payments and profit remittances depend on the capital importers' ability to earn or purchase the currency of the lender or investor. Similarly,as the Articles of Agreement of the International Monetary Fund make explicit, short-term currency stability may require trade protection rather than liberalization.

New lenders and mature creditors share a common interest in the security of property outside their borders and international monetary and financial stability, but their positions lead to somewhat different trading considerations. New lenders actively accumulate overseas assets, financing this accumulation out of their trade surplus, while mature creditors consume the returns on already-accumulated assets, so that a trade deficit is a necessary concomitant of receiving the fruits of their previous capital exports. New creditors thus have a stronger interest in securing export markets, and less need to open their own markets, than do mature creditors, while mature creditors have a stronger incentive for inward trade liberalization, and a less powerful one for commercial openness on the part of others.

The brief description of creditor-country interests fits the relevant evidence quite well. Holland in its heyday, Britain before World War One, and the United States since World War Two, are indeed quite adequately described as creditor countries with predictable creditor preferences. In all instances, the countries in question engaged in large outflows of long-term capital, a general commitment to help stabilize the international monetary system, and a reduction in barriers to imports. The central economic aspects of such creditor policies thus gave the rest of the world access to the creditor's capital, medium of exchange, and markets. As other nations joined the ranks of the creditors, especially Germany in the 1960s and Japan in the 1970s, their policies also began to reflect traditional creditor concerns.

Holland's domination of European trade in the seventeenth and early eighteenth centuries eventually permitted the Dutch to invest enormous fortunes abroad. The Dutch became the world's most militant partisans of free trade and investment, invented modern international contract law, and acted as Europe's principal center for international finance and related services for many years. In their quest for lucrative outlets for their capital, Dutch investors looked especially to Europe's most dynamic economy, England. Dutch investors purchased huge quantities of English government securities, a well as shares in developing British private enterprises. By the 1770s well over 40 percent of the English national debt was owed to Dutchmen, and wealthy Amsterdam financiers like the Barings and Ricardos were themselves migrating to London. Throughout, the Dutch maintained their classical creditor commitments (for example, De Vries 1976).

In the oft-cited British case, massive foreign investments shifted Britain's economic weight from the domestic market toward the foreign sector, and from industry toward finance. By 1914 over one-quarter of Britain's national wealth was invested overseas, and the steady flow of finance out of England made the country the greatest creditor and most important international financial center the world had ever seen. The central role of the United Kingdom in enforcing property rights abroad, stabilizing the international gold standard, and liberalizing its trade relations, are all well-known (de Cecco 1975 and Lipson 1985b, 8–26 are summaries).

The United States after World War Two similarly pursued policies expected of a country extraordinarily rich in capital. Every effort was made to smooth the flow of capital and goods, and to rebuild an environment in which normal patterns of international investment and trade might resume. The ability of the United States to construct a stable and lasting international investment position depended on the reliability of a number of American commitments. First, US goods markets were generally open to the country's real or potential debtors. Second, the market for US dollars was open and predictable, so that savers and investors at home and abroad would be willing to engage in foreign-currency operations; this also required some form of international monetary cooperation. Third, US capital markets were free enough from major government manipulation to overcome investors' and borrowers' fears of political risk. All over the world, investment was spurred by American capital, demand enhanced by American imports, and international payments made predictable by the gold-backed US dollar.

The pattern of international cooperation among creditor countries on issues of mutual interest can also be examined with the tools discussed here. For example, there would appear to be a strong correlation between creditor status and interest in international monetary cooperation. To take two examples, the important Tripartite Monetary Agreement of 1936 eventually came to include all major creditors (the United States, Great Britain, France, the Netherlands, Switzerland, and Belgium), but never attracted the attention of such debtor countries as Germany and Italy (Kindleberger 1973, 257–261). By the same token, as Japan's overseas investments have expanded, its willingness to take an active role in international monetary matters has grown. Past experience with other creditors would indicate that, although the evolution of Japanese policy has been too slow for the tastes of most American policy-makers, it will continue and accelerate as the country accumulates foreign assets.

In another arena, since all creditors share an interest in cross-border property rights, this function has often been carried out in concert. Before World War One, strategic interaction among countries with clear creditor interests in securing foreign investments was of great importance. Multilateral financial control committees to protect the rights of creditors in shaky underdeveloped countries were common. In Serbia, Greece, Tunis, Persia, Egypt, Morocco, and elsewhere committees of private financiers and government officials of the capital-exporting nations were established. In the most limited sense they were charged with ensuring continued debt service, but this task soon involved them in running major portions of the debtors' economies. The best-known example is that of the multinational Ottoman Public Debt Administration, which eventually came to manage a wide variety of the Empire's modern business activities, and to control about one-quarter of Ottoman government revenues (Blaisdell 1967, Feis 1964, 313–341, Platt 1968, 181–218).

In the 1920s, during a financial expansion led by the United States and joined by Great Britain, monetary and financial cooperation among creditors was primarily managed by the largest private and central banks of the leading lenders, along with the Economic and Financial Committee of the League of Nations. The Dawes and Young plans to stabilize German finances were emphatically multilateral. The Young Plan indeed gave rise to the Bank for International Settlements (BIS), a formal institution designed to facilitate cooperation among major financial centers (Clarke 1967, Costigliola 1972, Meyer 1978).

Since World War Two, multilateral creditor cooperation has evolved along the lines begun in the inter-war period. The IMF-World Bank system has raised the multilateral principles inherent in the BIS to much higher levels, and has come to provide and supervise an extraordinary degree of creditor coordination (Lipson 1981).

The distinction between new lenders and mature creditors is also useful. It helps explain some of the trade-policy differences among creditor countries, such as why pre-World War One Great Britain was so much more willing to keep its markets open than France or Germany. It also helps explain some of the pattern of evolution in the behavior of creditor nations, such as the gradual shift from moderate neo-mercantilism toward free-trade observed as new lenders become mature creditors. Thus Great Britain in the mid-19th century, the United States in the 1940s, Western Europe since 1960, and Japan in the last decade reflect the transition from aggressive export promotion and moderate to high controls on imports to a reduction in import barriers.

None of this is to imply that there are not problems of competition and coordination among creditor countries. Nor is it to discount the large variations found even where creditor preferences and policies are similar. For example, one creditor's enforcement of property rights in an underdeveloped area makes it possible for other creditors to free-ride on this enforcement; the first creditor might in this circumstance find it attractive to privatize the benefits of enforcement by annexing the underdeveloped area. The approach simply allows the analyst to think more systematically about inter-state relations in such circumstances, in an attempt to understand the conditions in which creditor countries are able to arrive at a cooperative solution (the Ottoman Public Debt Administration) or are driven toward conflict (the late nineteenth-century rush for annexation). Similar exercises could be carried out in the analysis of international monetary cooperation and conflict in the interwar period, or of macroeconomic policy coordination today – all of them attempts to understand how creditor countries with similar preferences can interact in ways that lead to cooperation, conflict, or a combination thereof.

Sectoral creditor interests and the political economy of international finance

Instead of looking more deeply into the strategic interaction of nation-states with creditor interests, we now turn to a less aggregate level of analysis. It is in fact undeniable that a great deal of the interaction among creditor countries, and between creditor and debtor countries, is driven by domestic rather than international politics. There is, for example, copious evidence that in both the British and American cases much of the impetus for their 'hegemonic' international economic policies came from major domestic economic sectors whose interests may not have been identical with those of the nation as a whole. The powerful financial institutions of the City of London are widely regarded as having had a major impact on British international economic policy from the early nineteenth century up to the present; analogous groups, especially American-based international banks and corporations and their employees, have probably played a similar role in the United States. (For some examples, see Cain and Hopkins 1980, Helleiner 1977, and Milner 1987.)

To speak of *countries* that are rich in capital can indeed be misleading; the capital does not normally belong to 'the country' but to economic agents in it. In other words, a capital-rich country is one that has more individuals and firms with a great deal of capital than a capital-poor country. This does not imply that *all* firms and individuals in the country are capital-rich, for the accumulation of capital take place very unevenly. The most accurate inference would be that, in a capital-rich country, the economic agents well-endowed with capital outweigh those that are poor in capital but, presumably, well-endowed with other factors.

A policy that can be deduced to be in the interests of a creditor country is not necessarily in the interests of everyone in that country. There are of course many examples of conflict among particular groups over national economic policies, in creditors as in all nations. The protection of overseas property rights may benefit overseas investors a great deal, and peasants very little, but the costs may fall primarily on peasants drafted and sent abroad to do the protecting.

Our previous discussion of creditor-country interests is thus quite incomplete. We cannot simply assume that because some local firms and investors have overseas assets, policy will reflect the interests of those with overseas assets. Even where we have reason to believe that overseas asset-holders will dominate foreign economic policy, such as where most firms with strong preferences about policy are overseas investors, there is always the possibility that the political process will be dominated by economic actors with interests different from or opposed to those of creditors. A more detailed analysis of creditor-country preferences requires us to consider the conflicting interests of those *within* creditor countries. In what follows we discuss some characteristic sectoral interests in creditor countries.

We can distinguish two very broad groups of sectoral interests. First are those whose assets are internationally diversified, and who can thus take advantage of both domestic and overseas investment opportunities. This includes most prominently the creditors themselves, those with existing assets abroad. We define this group to include also those involved in the financial-center functions of a creditor country, whose principal function is to service those with foreign investments. This group should also include producers whose domestic output is competitive on world markets but who have not engaged in overseas investment: those that could invest abroad, but at present have no need to. The second group is made up of import-competing sectors and/or those whose assets are not internationally diversified. This encompasses uncompetitive producers, whose domestic output cannot compete with imports and who have not invested abroad, for whatever reason. It also consists of producers of non-traded goods and services, indifferent to international economic conditions. The categorization is schematic but useful; we can demonstrate its utility by discussing how the different sectors respond to several important policy issues in creditor countries.

Government protection of overseas assets is of interest primarily to those who are real or potential holders of such assets. The rest of the economy bears the costs of such protection – insurance, military intervention, membership in consortia – but receives few of the benefits. A similar calculation holds for international financial and monetary cooperation in general; if such cooperation has costs for the country as a whole, those who receive few benefits will oppose it. This can be brought to bear in the analysis of domestic opposition to colonialism, or to multilateral organizations.

Monetary and fiscal policy, which primarily affect international economic policy through the exchange rate, also give rise to different sectoral interests. Overseas investors and competitive producers (and, if they are organized, consumers of imported products) are expected to exert what might alternately be call deflationary, internationalist, or 'monetarist' pressures. Their competitive and/or international asset position is such that, other things equal, they are profitable with a strong exchange rate. Where a strong currency makes their domestic production less competitive, these investors can respond simply by transferring production overseas. Unless information and currency futures markets are perfect, which they rarely are, investors with international portfolios also have an interest in currency stability and predictability, which domestic inflation endangers. They thus fight against fiscally expansionary policies, and for monetary restraint.

On the other hand, uncompetitive, domestically-bound, and non-tradables producers exert pressures that might alternately be called inflationary, weak-currency, nationalist, or 'fiscalist.' They can only gain from a fiscal stimulus and monetary looseness. A strong currency makes uncompetitive producers even less competitive; depreciation improves their position. By the same token, in most circumstances domestic fiscal stimulation increases demand for domestically produced non-traded goods and services (including goods protected by trade barriers). These groups are thus in the forefront of opposition to monetary stringency and fiscal orthodoxy.

Trade policy is another area of potential conflict. Creditors, along with exporters, have a general interest in inward commercial openness, to avoid retaliation against exports, to allow for profit and interest repatriation and, in the case of multinational firms, for intra-firm trade.

For reasons discussed above, creditors in a new lender are less concerned about home-country free trade than creditors in a rentier state. Competitive producers similarly support inward liberalization, for straightforward trade-bargaining reasons. Uncompetitive producers are protectionist; the non-tradable sector is indifferent.

Examples of these sectoral developments recur in the history of creditor states. The Dutch experience is legendary. Even as the country's industries became increasingly unable to compete with foreign manufacturers (especially those protected by British mercantilism), the country's powerful foreign-investment, financial, shipping, and trading interests were able to maintain free trade. We can do no better than to cite Charles Wilson's impassioned summary of his masterful study of the process (Wilson 1941, 187–188): 'Originally, Dutch finance had been the servant of Dutch trade, but as that trade dwindled, Holland's lending services became more and more precarious; meanwhile . . . the elements on the Bourse who had forgotten that finance should be servant and not master, were getting more powerful. . . . While British industry was being concentrated on a war basis and British textile industries protected and subsidized, the coincidence of the interest of the Dutch foreign investor and the free-trade traditions of the staple merchants drew capital and energy away from industry.' Wilson concluded (ibid, pp. 200–201), 'So far from stimulating Dutch industrial development, Holland's eighteenth-century loans almost certainly obstructed and postponed it, directly and indirectly. . . . Dutch economic development was postponed by a leakage of capital into international finance.' Despite some domestic discontent, only after the Napoleonic Wars and the creation of Belgium did the country move away from free trade.

A similar dynamic was at work in Great Britain even at the height of its international creditor status. Industrially-based protectionists, especially supporters of Imperial Preferences, grew steadily stronger after 1880 but were only able to triumph politically, and then only temporarily, in the interwar years. Here, as in Holland, the outcome was not so much national decline as a change in the *domestic* balance of economic and political power as the nation's role in the world was redefined from that of a new lender to a mature creditor. As British investors built up huge international holdings British industry became increasingly uncompetitive, and sectoral conflicts over monetary and exchange-rate policy were particularly striking. To take one famous example, London's City was a primary pressure group for, and a major beneficiary of, Britain's return to gold in 1925 at an overvalued parity. Sterling overvaluation maintained the value of Britain's overseas investments, and helped keep sterling and the City at the center of international finance. Sterling overvaluation also drove Britain's already weak traditional industries into a recession that only ended when it was superseded by the Depression. (Longstreth 1979 is a good survey.)

A sketch of crucial episodes in domestic conflict over the foreign economic policy of the United States since World War I demonstrates a similar sectoral dynamic. In the 1920s the relatively new creditor sectors that arose during and after the Great War pressed for American membership in the League of Nations and other multilateral organizations, international financial and monetary cooperation, and trade liberalization. Creditors and the financial services sector, led by the New York banks, were allied with America's highly competitive industrial producers, who were already beginning to expand their overseas direct investments. Their opponents were to be found in the uncompetitive heartland industries and non-traded sectors, the bulwark of Taft Republicanism and isolationism. Although creditor and exporting sectors pressed consistently for the United States to revise its traditional protectionism and lack of involvement in international economic negotiations, they were continually defeated in a Congress fundamentally opposed to 'internationalism,' in economic as in other affairs. It was not until the late 1930s and 1940s that the tides of American politics began to shift toward a less isolationist international economic posture (Frieden 1988).

In the aftermath of World War Two, with most foreign competition wiped out and economic nationalism discredited, American policy moved in a more traditional creditor direction. Nonetheless, domestic political battles over foreign economic policy continued, on different fronts. 'Fiscalist' forces, represented by Henry Morgenthau's Treasury Department, and by the Keynesians more generally, did battle with a powerful strong-currency lobby, based once more in the financial sector. With much of their international and domestic influence eroded by the global and domestic financial disasters of the 1930s, international financial interests were on relatively weak grounds until international trade and payments revived. Thus, while much of American policy accorded with creditor interests, the New York bankers did initially lose the battle to make the International Monetary Fund a tool of financial orthodoxy and to base international monetary relations on a gold-backed dollar (Eckes 1975 and Van Dormael 1978).

Over the course of the late 1940s and early 1950s, however, as the US and world economies returned to normalcy, 'monetarist' groups reasserted themselves. The Treasury Accord of 1951 reestablished traditional Federal Reserve control over monetary policy. Under orthodox American leadership, the IMF evolved into a paragon of financial rectitude. The crucial question was that of the conditions under which member nations would be allowed to borrow from the Fund, and in successive decisions in

1952, 1955, and 1956, the IMF established rigorous standards upon which borrowing was to depend. By the late 1950s the Fund was often making its loans contingent upon such strict quantitative economic conditions as government spending ceilings and credit supply limits (Dell 1981, and Guitian 1980). In addition, international monetary relations as they evolved in the 1950s and 1960s looked far more like the key-currency approach of the New York bankers – with the dollar 'as good as gold' and used as an international payments medium – that they did like the wartime plans of American and British Treasury officials.

This framework can also be brought to bear on the political economy of recent US international economic policy. One set of sectors is internationally integrated and/or competitive; another is uncompetitive and/or internationally insulated. In the American context the position of military contractors is especially important within the latter group, because of the widespread acceptance of relatively high levels of military spending in the United States – which can be regarded for our purposes as a fiscal stimulus to goods producers sheltered from international competition. Whether one sees this military spending as motivated primarily by real security concerns, by an ideologically acceptable military Keynesianism, or by the inordinate power of military contractors, the fact is that a degree of economic nationalism in pursuit of military preparedness has long been politically acceptable in the United States (for example, Nincic and Cusack 1979).

When private international capital movements began to accelerate after Europe's 1958 return to convertibility, the tension in the United States between deflationary and inflationary, monetarist and fiscalist, groups was a central problem. The position of the country's creditor sectors was endangered by the erosion of international confidence in the dollar, itself a result of the American government's domestic and international fiscal laxity. Rather than capitulate completely to deflationary pressures – for a more stringent monetary policy, for budgetary restraint, for a compression of domestic consumption – the Kennedy and Johnson administrations attempted to shield the domestic economy from trends in the country's capital account. The outflow of American capital was worsening the country's payments balance, thus exacerbating the deflationary pressures on domestic economic policy, but policymakers attempted to avoid domestic deflation without reducing the overseas activities of American firms. This attempt took a number of forms, leading up to the imposition of capital controls that permitted, perhaps even encouraged, American banks and corporations to engage in offshore funding of their overseas investments. The capital controls, which lasted until 1974, only postponed and may ultimately have magnified the conflict. Surveys of the offshore markets include Frieden (1987), Mendelsohn (1980), Lomax and Gutman (1981), and Versluysen (1981).

The Nixon administration also faced conflicting sectoral pressures as it continued to try to square the circle of American international economic policy. Creditor groups encouraged the government to restrain spending enough to strengthen the dollar, and failing that supported a revision of the Bretton Woods system on a cooperative multilateral basis. Meanwhile, domestically based and uncompetitive sectors were under increasing pressure, and support grew for government policies to stimulate the economy, provide trade protection, and devalue the dollar. Much of this sentiment was expressed in Congress, where protectionist sentiment increased rapidly, and through Treasury Secretary John Connally, who was quite sympathetic to domestic business. In August 1971 Nixon appeared to give in to pressures for a revision of traditional American foreign economic policies, much to the chagrin of internationalists around the world.

Conflict continued through the 1970s and into the 1980s. The early Carter administration stimulated the economy, but the result was a serious loss of confidence in the dollar by international investors. The dollar depreciation aided the competitive position of domestically based producers, but seriously worried those whose international investment interests were threatened by inflation and currency instability. In late 1978, as the dollar dropped vertiginously, Carter moved to defend the currency, with little success until in 1979 Paul Volcker and the Federal Reserve moved resolutely to deflate the economy and strengthen the currency. At the same time, the Administration began to exercise some fiscal restraint, but most of the adjustment burden was borne by monetary policy, an arena dominated by the Federal Reserve, which generally reflects the concerns of those who are committed to the international economy and to an anti-inflationary posture.

The conflict between monetarists and fiscalists, deflation and inflation, internationalism and nationalism, accelerated in the Reagan administration. Three varied sets of interests reflected in the Republican Party and the administration can be pointed to. One was based in non-traded sectors, especially trade, real estate, and military contractors from the 'Sunbelt' area. These groups were clear influences in favor of fiscal expansion, although the non-traded nature of their activities made them hostile or indifferent to trade protection. A second broad grouping was declining industrial sectors in the Midwest and Northeast – these inflationary *and* protectionist. Of course, traditional internationalist and creditor groups maintained their fundamental opposition to both fiscal stimulation and economic nationalism.

The Reagan administration's policies, and its frequent internal disagreements, reflected the disparate pressures on it. Anti-inflationary internationalist creditor sectors dominated monetary policy, including policies to manage international financial and monetary matters. However, reflationary non-traded or uncompetitive sectors had substantial influence on the fiscal side, and had some trade-policy successes as well. One outcome of the pulling and hauling between fiscal and monetary policies was a massive capital inflow as foreigners fund Federal deficits. By 1986 the United States was a net debtor; although American investors still have enormous overseas interests, the US government has built up huge debts to the international capital markets. The effect of these contradictory American policies has become the central issue in the world economy. The story is still being played out, but there is no doubt that in the future, as in the past decade, the conflict between sectors with contending international financial interests will play a crucial role in American economic policy.

Tension similar to that found in the United States since World War Two has characterized debates over economic policy in most of the rest of the OECD. As international markets have become more and more integrated, the general trend has been for national policy to reflect more and more the interests of internationally diversified investors. Yet policy-makers have also tried to meet some demands for protection from international competition by more insular and immobile economic actors. In virtually all countries, groups with important international economic ties have dominated, while groups for whom the rest of the world was a threat rather than an opportunity have fought for protection. Here too, domestic bargaining continues; perhaps the most striking topic of debate is the future of the European Community as 1992 approaches.

Prudential disclaimers and observations

The framework presented here does not pretend to be a full-blown theory of the laws of motion of the international political economy. There are many issues that the approach does not address, and many questions it does not answer.

As mentioned at the outset, the initial causes of national-level creditor status are not clearly explained. It is especially important to be able to separate the secular or 'natural' evolution of a national economy and sectors within it, from developments that are simply driven by government policy. It would hardly be justified to regard Great Britain in 1914, with a century of international investment experience, as equivalent to a country that became a net creditor solely for perverse policy reasons – as some Third World borrowers with overvalued currencies did after 1980. The same might be said about the United States today: it clearly is not a 'natural' net debtor. In this regard a distinction between short- and long-term, and between public- and private-sector, capital movements may be useful.

In much the same way, it is hardly satisfactory simply to assert that some sectors are 'natural' overseas investors while others are not. Government action, from tax policy through colonialism, can change the incentives to overseas investment in important ways. Long-term prediction on the basis of the framework presented here requires a stronger prior notion of what kinds of economic agents are more likely to engage in foreign investment.

In other words, the causal arrows implicit in this analysis are not unambiguous. National or sectoral creditor status may itself be the result of prior conditions that are not examined in the model, such as resource endowments, culturally determined savings propensities, or strategic considerations. Nor does the framework presented here provide determinant predictions of the *outcomes* of the sectoral clashes it forecasts. It claims only that the pattern of sectoral conflict, and the policy preferences of the various sectors, will be as set forth above; it says little about the institutional, political, strategic, and other factors that might influence the success of the various sectoral coalitions. These are important points for the extension of this analysis, and for more systematic tests of it.

Despite its preliminary nature, the discussion in this paper demonstrates that only the careful analysis of the roots of national economic preferences can allow International Relations scholars to analyze international monetary and financial interaction in fruitful ways. The implications of the paper are, further, that national economic interests cannot be derived from the system; while a first cut can be extrapolated from national factor endowments, a far more accurate picture requires a sectoral approach. Throughout, we have used the international investment positions of countries and sectors to explain national policies toward both global monetary and financial relations and such related arenas as international trade.

This paper analyzes the implications of national and sectoral international asset positions for national and sectoral economic interests and interaction. By way of example, it argues that creditor countries have certain identifiable international economic interests, and exhibit certain predictable behavior in line with these interests. Illustrations are drawn from a variety of historical and contemporary cases.

National-level phenomena are not sufficient to explain national economic interests, however, for domestic politics impinges strongly on the making of foreign economic policy. For this reason, the article develops a sectoral approach that distinguishes among domestic socio-economic actors with different international portfolios. It identifies the interests, and the expected behavior, of sectors within nations in domestic bargaining over foreign economic policy; illustrations are drawn from historical and contemporary cases. The analytical framework and empirical evidence presented here are meant primarily to suggest ways in which further research and analysis can be pursued in order to understand better the interplay of politics and economics in the international movement of capital.

NOTES

1. The point is not so straightforward as it might seem. After all, capital only needs to be imported if national savings are smaller than domestic investment (and, *pari passu*, it can only be exported if national savings are larger than domestic investment). Changes in the savings or investment ratios would be enough to make it unnecessary or impossible to borrow or lend. If looked at from this perspective, the potential theoretical explanations of the correlation between per capita national income and the capital account are generally unconvincing: there is no evidence that the propensity to save, or to invest domestically, bears any clear and direct relationship with per capital income levels. Nonetheless, the argument developed here requires only acceptance of observed reality, not rigorous proof that this reality is theoretically possible. A raging debate on a closely related issue began with Feldstein and Horioka (1980); for more general surveys, see Genberg and Swoboda (1985) and Kindleberger (1987).
2. Because investment income is in the current account and overseas investment is in the capital acount, the two do not cancel each other out in normal balance of payments accounting procedures. It should also be noted that this brief sketch ignores capital inflows and the local earnings of foreigners; net and gross are assumed to be equal for the present purpose.

REFERENCES

Blaisdell, Donald C. (1967 reprint of 1929 original) *European Financial Control in the Ottoman Empire* New York: AMS Press.

Cain, P. J. and A. G. Hopkins (1980) The Political Economy of British Expansion Overseas, 1750–1914, *Economic History Review* Second Series 33, 4 (November).

Clarke, Stephen V. O. (1967) *Central Bank Cooperation 1924–1931* New York: Federal Reserve Bank of New York.

Clifton, Eric V. (1985) Real Exchange Rates, Import Penetration, and Protectionism in Industrial Countries, *IMF Staff Papers* 32, 3 (September), 513–536.

Costigliola, Frank (1972) The Other Side of Isolationism: The Establishment of the First World Bank, 1929–1930, *Journal of American History* 59, 3 (December).

Crawford, Vincent (1988) *International Lending, Long-Term Credit Relationships, and Dynamic Contract Theory* Princeton Studies in International Finance, 59. Princeton: International Finance Section, Department of Economics, Princeton University.

de Cecco, Marcello (1975) *Money and Empire.* Totowa, New Jersey: Rowman and Littlefield.

de Cecco, Marcello (1976) International Financial Markets and US Domestic Policy Since 1945, *International Affairs* 52, 3 (July), 381–399.

De Grauwe, Paul (1988) Exchange Rate Variability and the Slowdown in Growth of International Trade, *IMF Staff Papers* 35, 1 (March), 63–84.

De Vries, Jan (1976) *The Economy of Europe in an age of crisis, 1600–1750.* Cambridge: Cambridge University Press.

Dell, Sidney (1981) *On Being Grandmotherly: The Evolution of IMF Conditionality* Essays in International Finance No. 144. Princeton: International Finance Section, Department of Economics, Princeton University.

Eckes, Alfred E. Jr. (1975) *A Search for Solvency.* Austin: University of Texas Press.

Feigenbaum, Susan and Thomas D. Willett (1985) Domestic versus International Influences on Protectionist Pressures in the United States in Sven Arndt et al. (eds) *Exchange Rates, Trade, and the US Economy.* Lexington: Ballinger.

Feis, Herbert (1964 reprint of 1930 original) *Europe the World's Banker 1870–1914*. New York: Augustus Kelley.
Feldstein, M. and C. Horioka (1980) Domestic Savings and International Capital Flows, *The Economic Journal* 90, 358 (June), 314–329.
Frieden, Jeffry A. (1987) *Banking on the World: The Politics of American International Finance*. New York: Harper and Row.
Frieden, Jeffry A. (1988) Sectoral conflict and US Foreign Economic Policy, 1914–1940, *International Organization* 42, 1 (Winter), 59–90.
Genberg, Hans and Alexander K. Swoboda (1985) *The 'Stages in the Balance of Payments Hypothesis' Revisited* World Development Report Background Paper. Washington: World Bank.
Guitian, Manuel (1980) Fund Conditionality and the International Adjustment Process: The Early Period, 1950–1970, *Finance and Development* 17 (December), 23–27.
Helleiner, Gerald K. (1977) Transnational Corporations and the New Political Economy of US Trade Policy, *Oxford Economics Papers* 29, 1.
Kindleberger, Charles (1973) *The World in Depression 1929–1939*. Berkeley: University of California Press.
Kindleberger, Charles (1987) *International Capital Movements*. Cambridge: Cambridge University Press.
Krasner, Stephen (1976) State Power and the Structure of International Trade, *World Politics* 28, 3 (April), 317–343.
Lipson, Charles (1981) The international organization of Third World debt, *International Organization* 35, 4 (Autumn), 603–631.
Lipson, Charles (1985a) Bankers' Dilemmas: Private Cooperation in Rescheduling Sovereign Debts, *World Politics* 38, 1 (October), 200–225.
Lipson, Charles (1985b) *Standing Guard: Protecting Foreign Capital in the Nineteenth and Twentieth Centuries*. Berkeley: University of California Press.
Lomax, David F. and P. T. G. Gutmann (1981) *The Euromarkets and International Financial Policies*. New York: John Wiley and Sons.
Longstreth, Frank (1979) The City, Industry, and the State, in Colin Crouch (ed.) *State and Economy in Contemporary Capitalism* London: Croom Helm.
Magee, Stephen and Leslie Young (1987) Endogenous Protection in the United States, 1900–1984, in Robert M. Stern (ed.) *US Trade Policies in a Changing World Economy*. Cambridge: MIT Press.
McKeown, Timothy (1983) Hegemonic stability theory and 19th century tariff levels in Europe, *International Organization* 37, 1 (Winter), 73–92.
McKeown, Timothy (1986) The limitations of 'structural' theories of commercial policy, *International Organization* 40, 1 (Winter).
Mendelsohn, S. M. (1980) *Money on the Move: The Modern International Capital Market*. New York: McGraw-Hill.
Meyer, Richard H. (1978) *Banker's Diplomacy*. New York: Columbia University Press.
Milner, Helen (1987) Resisting the protectionist temptation: industry and the making of trade policy in France and the United States during the 1970s, *International Organization* 41, 4 (Autumn), 639–665.
Mundell, Robert (1957) International Trade and Factor Movements, *American Economic Review* 47, 3 (June), 321–335.
Nincic, Miroslav and Thomas Cusack (1979) The Political Economy of US Military Spending, *Journal of Peace Research* 16, 2, 101–115.
Platt, D. C. M. (1968) *Finance, Trade, and Politics in British Foreign Policy 1815–1914*. Oxford: Clarendon Press.
Sachs, Jeffrey (1984) *Theoretical Issues in International Borrowing* Princeton Studies in International Finance, 54. Princeton: International Finance Section, Department of Economics, Princeton University.
Strange, Susan (1986) *Casino Capitalism*. New York: Basil Blackwell.
Van Dormael, Armand (1978) *Bretton Woods: Birth of a Monetary System*. New York: Holmes and Meier
Versluysen, Eugene (1981) *The Political Economy of International Finance*. London: Gower.
Waltz, Kenneth N. (1979) *Theory of International Politics*. Reading: Addison-Wesley.
Wilson, Charles (1941) *Anglo-Dutch Commerce and Finance in the Eighteenth Century*. Cambridge: Cambridge University Press.