Confronting the Impediments to International Economic Cooperation: Domestic Politics and International Monetary Relations in the G8

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Abstract

How can interdependent nations maintain fixed or managed exchange rates in open capital markets? Policymakers often find the answer in economic cooperation. Such a regime, however, did exist under the classical gold standard (1880-1914) without cooperation. This seeming paradox can be explained by a highly stable adjustment mechanism under the gold standard. While modern policymakers have relied on cooperation to make up for the lack of such a stable adjustment mechanism today, effective cooperation (i.e., substantive policies which address fundamental problems) and compliance have nonetheless been impeded by domestic political forces. These forces represent a myriad of domestic political actors (interest groups, the public, parties, technocrats) and processes (legislation, bureaucracy, elections) which elevate parochial economic interests over and above, and therefore often serve as roadblocks to, substantive diplomatic agreements that would address fundamental multilateral economic problems. Orchestrating viable schemes of cooperation and compliance will depend critically on the ability of policymakers to limit these domestic political distortions. The implications for G8 diplomacy are compelling. If negotiations are going to deliver the kinds of economic stability and performance desired, nations will have to increasingly infuse their diplomacy with a greater understanding of how domestic politics can condition international economic relations.

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I. In Search of International Monetary Stability in the 20th Century

Eichengreen calls the international monetary system the very "glue" that links national economies together, thereby assuming a pivotal role as the foundation of the international economy.[1] Yet in the face of that crucial role, international monetary relations have experienced a long period of instability. The past quarter century marks a period of perhaps greater uncertainty among policymakers regarding the appropriate course for the international monetary system than at any time in the 20th century. The breakdown of the Bretton Woods system in the 1970s introduced a free-for-all monetary system that ended a long period of consensus among major nations about

[1] Barry Eichengreen, Globalizing Capital: A History of the International Monetary System, Princeton: Princeton University Press, 1996, p. 3.

ideal regimes to organize their monetary relations. Sadly, even within this recent period, which Corden refers to as a "non-system," the confusion has only grown as there has been a divergence rather than convergence of practices regarding the management of exchange rates.[2] The years prior to the non-system, notwithstanding greater consensus, were hardly more pleasant in terms of international monetary stability. In fact, it would not be too great an exaggeration to say that the international monetary system in the 21st century *is still recovering from the First World War*.

The War set in motion an international monetary system that has continued to struggle over the rest of the century in an attempt to recapture the stability of the years prior to the War (i.e., the classical gold standard, 1880-1914). In terms of monetary relations, the four decades prior to the War produced some favorable outcomes among advanced nations.[3] Parities between the monetary core powers (U.S., Germany, U.K., and France) remained fixed, major financial crises were few and geographically restricted, few nations that were on the gold standard ever suspended convertibility (no suspensions among the U.S., Britain, France and Germany), balance-of-payments problems were few, the external adjustment mechanism functioned smoothly, nations experienced long-term price stability, long-term trends in income and industrial production were favorable, and unemployment remained fairly low. Interestingly, all of this took place in an environment of very large capital and trade flows; and even more astounding to modern monetary diplomats, there was no systematic monetary nor financial cooperation among nations (only occasional ad hoc lending arrangements between central banks).[4] The period achieved an extremely favorable set of monetary outcomes, in effect, under conditions of autarky (each nation tending to domestic priorities without much regard to financial interdependence) in the face of fixed exchange rates, and large and unimpeded capital and trade flows. [5] As a result of these

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[2] W. Max Corden, Economic Policy, Exchange Rates, and the International System, Chicago: University of Chicago Press, 1994.

[3] The stability of the classical gold standard (1880-1914) was primarily a characteristic of the first world. On the stability of the gold standard, see especially Giulio M. Gallarotti, The Anatomy of an International Monetary Regime: The Classical Gold Standard, 1880-1914, New York: Oxford University Press, 1995.

[4] The three largest net-capital exporters of the period (France, Britain, Germany) saw extraordinary increases in this category from 1880 to 1913: from 55 to 1,960 million francs, 35.6 to 224.3 million pounds and 332 to 2,234 million marks respectively. With respect to trade growth, the same nations saw the following increases in commodity imports: from 5,033 to 8,421 million francs, 411 to 769 million pounds and 2,814 to 10, 751 million marks respectively. See Gallarotti, The Anatomy of an International Monetary Regime, p. 194.

[5] This is not to convey some blind veneration for the "good old days" of the classical gold standard (1880-1914), or for fixed exchange rates more generally. Indeed, recent scholarship has significantly reduced the "glitter" of the period in terms of economic performance. Under the gold standard, nations experienced somewhat greater real and financial volatility than in

outcomes, the years of the late 19th century have cast a very large shadow over international monetary policy for the rest of the 20th century, as monetary reconstruction never deviated significantly from the rules and norms of the gold standard until the breakdown of Bretton Woods.[6] But even in our present period, the idea of a rules-based monetary regime (i.e., fixed or managed exchange rates) still holds a widespread appeal. It is a testament to the psychological hold of the gold standard regime on monetary diplomats and national leaders, that reconstruction for the rest of the century was tied to a model that was impossible to sustain: i.e., fixed exchange rates among independent currencies under conditions of extensive domestic autonomy over macroeconomic targets and limited impediments to the flow of capital.

The pattern over the century has been unmistakable. Efforts have gravitated around reviving many or at least some of the practices of the classical gold standard. These efforts have manifested themselves in attempts to find some arrangements that could sustain fixed or managed exchange rates.[7] But the legacy of failure in these efforts underscores the conditions under which

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the period after World War II. While long-term prices were stable, short-term prices were anything but. Nations experienced an especially sharp deflation in the 1870s, which of course owed much to the maintenance of convertibility. The period did experience several financial crises, and nations did not have to face the same supply shocks which they have faced under flexible exchange rates. However, the period did produce some outcomes that present day leaders would find desirable. Leading nations were able to maintain their parities for more than three decades without seriously restricting the flow of foreign investment or trade. In fact, both trade and foreign investment grew at prodigious rates across this period. All of this occurred under generally favorable macroeconomic outcomes: growth, industrial production and employment were favorably sustained without inflation. Moreover, while financial crises did occur in this period, they were far less severe and prolonged relative to crises before and after the period. Hence, while the gold standard was hardly the model regime to which nations should aspire, it nonetheless produced some commendable results. On economic performance under the gold standard and other regimes, see Gallarotti, The Anatomy of an International Monetary Regime and “The Advent of the Prosperous Society: The Rise of the Guardian State and Structural Change in the World Economy,” Review of International Political Economy, vol. 7, no. 1, Spring 2000.

[6] Indeed the big difference between the Bretton Woods period and the gold standard at the level of policy was the fact that decision makers were far less willing to follow the appropriate monetary rules when capital flows increased under the former (in trying to peg exchange rates and liberalize capital markets, but exercise significant autonomy over monetary policy). Under the gold standard, prevailing monetary orthodoxy was much more consistent with pegging and liberalized capital markets (see below).

[7] Attish R. Ghosh, Anne-Marie Gulde, and Holger C. Wolf, Exchange Rate Regimes: Choices and Consequences, Cambridge: MIT Press, 2002 provides an excellent and useful taxonomy of exchange rate regimes, which features three types: pegged, intermediate, float. Pegged regimes include both hard (currency boards, monetary union, or dollarization) and traditional (single currency peg and basket peg). Intermediate regimes, or soft pegs, include cooperative regimes, crawling pegs, target zones and bands, as well as managed floats. The final regime type is a float which is characterized by exchange rates that float freely with minor or no

such a regime is possible. The historical track record demonstrates that these arrangements were most fragile when 1) macroeconomic policy was directed toward internal rather than external economic objectives, 2) there was little international cooperation or hegemonic intervention to address external crises, 3) capital flows were greatest, and 4) capital controls were minimal. Indeed, the newer schemes to address international monetary stability in an interdependent world (monetary union, dollarization, currency boards, target zones) emanate from some acknowledgement of these lessons. The stark truth is that the world of the late 19th century and its propitious conditions for a stable rules-based regime in the face of open markets for goods and capital is no more. The 20th century has introduced new conditions far less favorable for sustaining such a regime. Yet even today the appeal of the gold standard dies hard, as a large number of nations try to fix or manage their exchange rates. Monetary authorities over the past century have tried to compensate for the less favorable conditions by trying to achieve their exchange rate targets through cooperation. Indeed, the track record of the 20th century demonstrates that fixed or managed rates in the face of well-functioning capital markets absolutely require a high level of international economic cooperation: i.e., explicit macroeconomic coordination and/or international management (intervention, lending).[8]

But even the quest for stable structures of domestic macroeconomic outcomes which is founded on the conviction that the exchange rate is a "second-order problem" (i.e., that the real foundations for stable economies are sound macroeconomic policies and institutional reforms, rather than the appropriate exchange rate regimes) will be increasingly frustrated without international economic cooperation. Present day economies, whether large or small, will be unable to deliver and maintain domestic macroeconomic outcomes unilaterally in a globalized world. Indeed, economic interdependence has tied the economic fates of nations together even when they pursue strictly domestic objectives. In short, "island economies" are a thing of the past. Hence, the importance of cooperation will not diminish irrespective of the ranking of policy

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intervention. The term fixed in this paper comprises hard, traditional, as well as soft pegs. The term managed will refer to a managed float, which is categorized in Ghosh et al. as an intermediate regime because nations more vigorously attempt to achieve and maintain desired levels and paths in their exchange rates through intervention. This is distinguished, of course, from a free float in which authorities undertake very limited or no intervention.

[8] Present day proponents of fixed exchange rates and target zones see international cooperation as the lynchpin to sustaining such arrangements. See C. Fred Bergsten, "Managing the World Economy of the Future" in Peter B. Kenen ed., Managing the World Economy Fifty Years After Bretton Woods, Washington, D.C.: Institute for International Economics, 1994; Bergsten and C. Randall Henning, Global Economic Leadership and the Group of Seven, Washington, D.C.: Institute for International Economics, 1996; and John Williamson and Henning, "Managing the Monetary System," in Kenen, Managing the World Economy.

objectives across internal and external targets. Notwithstanding, international cooperation cannot serve as a substitute for sound domestic economic policy. In fact, cooperation will be most effective if it encourages sound policy. If it discourages such policy, it will be worse than ineffective, it will be counter-productive.[9]

At present, effective cooperation (i.e., substantive policies which address fundamental problems: both what is promised and what is delivered) will be a necessary condition for any viable regime founded on fixed or managed exchange rates, as well as regimes where a collectivity of nations are pursuing economic stability and desired macroeconomic outcomes by multilaterally orchestrating some structure of domestic economic policies (i.e., the exchange rate as a second-order problem). This paper is an analysis of such cooperation: it explains why such cooperation has become necessary in our present day, how such cooperation can be impeded by domestic politics, and what strategies national leaders and diplomats can employ to confront these impediments. The implications for G8 diplomacy are compelling. If negotiations are going to deliver the kinds of economic stability and performance intended, leaders and diplomats will have to increasingly infuse their diplomacy with a greater understanding of how domestic politics can condition international economic relations.[10]

The paper is organized as follows. Section II accounts for the political transformation of the international economy over the past century. Section III assesses the negative impact of domestic politics on economic cooperation. Section IV proposes some strategies for confronting such impediments to cooperation. Section V offers concluding remarks.

II. Then and Now: The Political Transformation of the International Economy

Why did the 19th century produce outcomes which are impossible today? Indeed, the answer to this question centers around the adjustment mechanism. That a stable adjustment mechanism was responsible for sustaining a system of fixed exchange rates under full convertibility is trivial. In

[9] Sally laments that much international cooperation today has the potential to err in this manner when he states that, “Most arguments for global governance are in fact bad economics and even worse political economy.” See Razeen Sally, “Looking Askance at Global Governance” in John J. Kirton, Joseph P. Daniels and Andreas Freytag, eds., Guiding Global Order: G8 Governance in the Twenty-First Century, Aldershot: Ashgate, 2001, p. 55.

[10] This paper does not propose fixed or managed exchange rates as necessarily optimal regimes nor superior to floating regimes. It merely seeks to propose political strategies that would facilitate the creation and maintenance of fixed or managed rates, if nations indeed decide to take that such routes. But even nations that select to float may still find these strategies to be helpful in aspiring to domestic macroeconomic targets, given the level of economic interdependence in our globalized world system.

fact, no such system void of multilateral intervention or large-scale balance-of-payments financing could be so sustained over such a long period without a stable adjustment mechanism. The more substantive question is then, What made the adjustment mechanism function so well under the gold standard, but so poorly afterward?

Economic historians such as Haberler and Gallarotti find the proximate cause in an altered international economic environment. Such historians hail the “soundness” of the late 19th century international economy. Conversely, above and beyond the economic and political dislocation caused by legacies of wars and severe depression in the 20th century, the current international economy has been touted as far more “fragile” than its predecessor of the late 19th century.[11] Indeed, the adjustment mechanism in the modern period has been thrown asunder by the rise of protectionism and capital controls. The 19th century saw limited protectionism in the form of tariffs and limited capital controls, while the modern economy has been pervaded by highly distortionary non-tariff barriers and extensive capital controls.[12] The problems which this has caused for the adjustment mechanism have been compounded by the growth of regionalism and globalization. The latter has increased the speed and magnitude in the flows of goods and capital, thereby making the potential external shocks to national economies that much greater. Regionalism in the form of trading blocs, along with the growth of protectionism, have given nations fewer avenues to compensate for problems in adjustment. Nations in the late 19th century faced fewer regional impediments. Furthermore those that had colonies could revert to the guaranteed markets of their colonial possessions when trade relations with other nations moved in an adverse direction. Indeed, the empire provided a substitute for adjustment, a substitute which modern nations no longer possess.[13] Moreover, with decolonization and globalization in the

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[11] On the structural differences between the late 19th century and the modern international economy, contrast Gilpin’s analysis of the structure of the modern “fragile” economy with Gallarotti and Haberler’s analyses of the “sound” 19th century structure. See Robert Gilpin, The Challenge of Global Capitalism: The World Economy in the 21st Century, Princeton: Princeton University Press, 2000, Introduction; Gottfried Haberler, "Integration and Growth of the World Economy in Historical Perspective," American Economic Review, vol. 54, no. 2, March 1964; and Gallarotti, The Anatomy of An International Monetary Regime. The comparison of the two periods below draws heavily from these analyses. For an excellent analysis on managing the problems of the modern fragile economy, see Kenen, Managing the World Economy.

[12] Although tariffs on manufactured goods have declined under GATT/WTO.

[13] The role of empire also explains why trade barriers were moderate under the gold standard. Guaranteed markets gave leaders confidence that they could resolve problems in external balances. Interestingly, colonies were also instrumental in the adjustment of nations other than mother countries, as they filled key positions in multilateral clearing networks under the gold standard. While developed nations in the modern period do enjoy preferential trading

modern period, the number of state and non-state actors in the international political economy has grown significantly. This has impacted on the adjustment mechanism in a variety of ways: more actors have created more possibilities for regional impediments to trade, the costs of adjustment have increased as the number of deals or compromises on trade have increased, adjustment has become ever more precarious as the increased number of nations have also increased the number of sources for potential trade/monetary shocks, and the increase in actors has also led to smaller immediate benefits from adjustment (both the greater costs and smaller benefits have led a more globally interested public to become increasingly cautious about such deals or compromises, which in turn has made mutually beneficial cooperation to manage collective adjustment all the more difficult to realize).[14]

Finally, the gold standard embodied a well-functioning regime where the rules and norms of monetary relations were well understood and honored. Regimes in the 20th century have been neither as orderly nor resilient: failed regimes were the rule and the Bretton Woods regime experienced a short and turbulent effective (i.e., after exchange controls were relaxed in the late 1950s) life. Simply stated, the difficulty of adjustment in this new modern international economic structure has made it hard to institute rules-based regimes (like the gold standard) that thrive on robust and fluid adjustment. But while changes in the structural conditions appear diverse, there has been a fundamental transformation which undergirds and in fact accounts for the structural transformation of the international economy over the last century. This transformation is a political one. It essentially embodies the transformation from a laissez faire economic culture under the gold standard to a politicized economic culture in the 20th century.

It can be said of economies before World War I that, unlike their successors in the 20th century, they occupied an environment which was far less influenced by politics: i.e., a much more laissez faire society.[15] This was crucial to the development of a favorable set of

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arrangements with former colonies, economic access is more encumbered vis-à-vis the 19th century. On the role of the colonies and the politics of empire, see Gallarotti, The Anatomy of an International Monetary Regime, pp. 189-91 and S. B. Saul, Studies in British Overseas Trade 1870-1914, Liverpool: Liverpool University Press, 1960.

[14] As it became clear in the WTO negotiations in Seattle (1999), the days of a restricted number of nations imposing a trading regime on the rest of the world may be a thing of the past, as both developing nations and civil society brought great pressure to bear on those proceedings.

[15] While there was indeed some variation among nations in the extent to which laissez faire principles prevailed in state-economy relations in this period (late developers such as Japan and Germany featured more mercantilistic domestic political economies than nations such as the U.S., Britain, France, and the Netherlands), it is certainly the case that across all these nations the state was less of a regulator and economic guarantor in the late 19th century than it would become in the 20th century. Hence, already mercantilistic nations saw a rise in the

circumstances under which monetary orthodoxy (and consequently adjustment) could take place: i.e., orthodoxy and adjustment had fewer political impediments. Convertibility and parities were fairly well insulated from political imperatives: in effect, money in the 19th century was not a political hostage. This independence emanated from the roles of central bankers and the prevailing underdeveloped state of macroeconomic policy. Indeed, the macroeconomy had no real guardian in the 19th century, as no major governmental institutions in the period had the mandate to monitor and stabilize the macroeconomy. These were inventions of the 20th century. The business cycle was not the responsibility of governments. That politicians had no firm macroeconomic mandates relieved central bankers of innumerable pressures to deviate from their orthodoxy under a variety of conditions. The lack of such distortions allowed the bankers to behave in a predictable and consistent manner with respect to monetary orthodoxy (preserve convertibility and thus preserve parities), and this in turn maintained the high level of investor confidence upon which a fluid adjustment mechanism was founded.

The 20th century ushered in a new age in the relations between economics and politics: unlike practices in the 19th century, the two would become inextricably connected. The fundamental change in the relationship between politics and the economy was born in the Progressive consensus that desirable social outcomes could be engineered by government. This growing ideology was given great impetus by the major crises of the 20th century: World War I and the Great Depression. Furthermore, political sensitivity to the macroeconomy became more pervasive, in good times as well as bad, with the expansion of suffrage. As political power was distributed to classes that bore a disproportionate cost of economic downturns, the "economic imperative" became a mainstay of modern politics. Leaders would be all the more rewarded for domestic prosperity, but all the more punished for inferior economic performance. The new imperative cast a strong shadow on the economic landscape in the 20th century. With the emergence of the new "guardian state," national prosperity became the first political priority, even at the expense of international economic targets.[16] Consequently, the latter took a back seat to the former. Laissez faire society gave way to a new political economy in which it became a

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state's economic role, while much more liberal nations saw the emergence of a strong state role in the economy.

[16] Indeed, while governments before World War I were not indifferent to domestic economic outcomes, they neither targeted nor intervened to encourage macroeconomic performance nearly to the extent that their successors did after the War. Macroeconomic policy was essentially an invention of the post-War world.

political imperative to maintain a "prosperous society." [17] Macroeconomies and international economic relations would now become the targets of politicians seeking to preserve domestic economic growth and employment. While 19th century leaders had fewer struggles accommodating the micro and macro management of their economies, 20th century leaders would be far more perplexed. The advent of the guardian state introduced a plethora of domestic political distortions, which essentially transformed the international economy. It was a crucial factor in the rise of protectionism and capital controls. It also pushed nations to solve their trade problems in a regional context. Moreover, it was the principal factor in undermining attempts to reconstruct viable international monetary regimes that might replace the gold standard.[18] The new structure of the international economy created by the guardian state has undermined the investor confidence necessary for a stable adjustment mechanism akin to that which existed under the gold standard. International monetary history throughout the century has demonstrated that institutions inspired by the gold standard have never been able to co-exist with the new domestic imperatives of the guardian state.[19]

III. The Limits of International Economic Cooperation

A century of failed attempts at resuscitating an orderly regime founded on fixed or managed exchange rates have provided much historical validation for Eichengreen's conclusion that nations which have traditionally pegged their currencies will have to choose between floating exchange rates on one extreme and monetary unification on the other.[20] While Eichengreen's corners hypothesis has garnered much attention in academic and practical circles, it is evident that policymakers are far from convinced about such restrictions. A glance at current exchange-rate practices published in IMF Financial Statistics suggests that a large number of nations still either

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[17] On the rise of the guardian state, and the political distortions which this created for international economic relations, see Gallarotti, "The Advent of the Prosperous Society."

[18] The failures at Genoa and Brussels in the 1920s, the limited success of the Tripartite Agreement and the failure of the World Economic Conference in the 1930s, the turbulent life of Bretton Woods after World War II, and the inability to build a new Bretton Woods afterward can all be attributed in large part to the mercantilist diplomatic posture created by the guardian state. The primacy of domestic imperatives has greatly politicized the process of building international monetary regimes, thus rendering such regimes difficult to construct and sustain. On the history of monetary regimes, see Eichengreen, Globalizing Capital.

[19] See especially Eichengreen, Globalizing Capital and Gallarotti, "The Advent of the Prosperous Society."

[20] This has become known as the corners hypothesis. Interestingly, Frankel cites arguments by Friedman which predate Eichengreen's argument. See Jeffrey Frankel, "Experiences of and Lessons from Exchange Rate Regimes in Emerging Economies" Harvard University, John F. Kennedy School of Government, Faculty Research Working Papers Series, February 2003. On Eichengreen's articulation, see International Monetary Arrangements, p. 5.

fix or try to manage their exchange rates. Evidently, the idea that one cannot have it all (prosperity, fixed exchange rates, and macroeconomic independence) resists even the most poignant lessons of history.

Trends regarding the selection of exchange rate regimes from the fall of Bretton Woods to the present are revealing. While the number of pegged regimes (traditional pegs) has shown a declining trend from 1973 to the present and the number of floaters has tended to be upward (as we might have expected), the trend in the number of intermediate regimes, or soft pegs, has shown some growth over that same period. This growth was most pronounced in the 1990s, a decade which also witnessed a decline in the number of floaters.[21] Of course the growth of pegged regimes is a manifestation of the specific characteristics of emerging market economies as small open economies: trade is not well diversified geographically, and the size of investment and trade are large in relation to the size of their economies. Their currencies need to shadow the currencies of principal trading partners, and investor perceptions of "price discipline" rendered by pegged regimes are seen as a means of keeping their relatively underdeveloped capital markets from experiencing destabilizing speculative flows. Over the past decade, with the monetary and financial experiences in Asia and South America, harder pegs (currency boards and dollarization) have become more compelling as viable solutions. Especially troubled emerging markets have attempted to impose harder rules onto monetary authorities so as to impose stricter policy commitments and condition investor perceptions even stronger in a positive direction. Most recently, with problems experienced under hard pegs, even emerging economies have thought about targeting inflation and allowing the exchange rate to float. Structural characteristics of these economies, however, have made benign neglect impossible. A stable exchange rate is crucial for supporting monetary discipline as well as promoting stable trade and investment. Moreover, they lack the deep foreign exchange markets to sustain free floats.

But even among developed economies, there are no nations that regard their exchange rates with indifference or impunity. The days of benign neglect appear to have had a very short life, being principally restricted to one nation in one period (the U.S. in the 1970s and early 1980s).[22]

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[21] On the various categories of exchange rate regimes and trends in their selection, see especially Ghosh, Gulde and Wolf's Exchange Rate Regimes, p. 47.

[22] Conventional wisdom suggests that developed economies make better candidates for more flexible exchange rates because of the size of their economies relative to trade and investment flows, the size and depth of their financial markets, and the level of diversification in their structures of trade. Simply put, the impact of external shocks will be insufficiently large to warrant the domestic adjustment costs necessitated by fixing the exchange rate. See Frankel "Experiences of and Lessons from Exchange Rate Regimes" and Ghosh, Gulde and Wolf, Exchange Rate Regimes.

Europe of course recoiled from the advent of the "non-system" by closing ranks and pursuing exchange rate stability in a regional context founded on trade interdependence: efforts which culminated in the present monetary union. The other major players in the world monetary system, the U.S., Britain, and Japan, can hardly be characterized as having been indifferent. After a short bout with benign neglect before the mid-1980s, the U.S. paid far greater attention to the level and path of the dollar. Life at both extremes, the appreciated dollar of the mid-1980s and the depreciated dollar of today, has been especially painful for the U.S. (on reactions to the overvalued dollar in the mid-1980s, see below). Similarly Japan has had much reason to care about the yen, and this has been a pervasive theme in Japanese diplomacy throughout the age of economic negotiations among the G8. The quest against the "high yen" (endaka) has under girded Japanese economic diplomacy over the past two decades. Although Britain has traditionally proved somewhat aloof from Continental monetary arrangements in its "island" orientation, one can hardly say it has been indifferent to Continental practices, as the fate of the British economy has always depended on outcomes on the Continent. While the U.S., Britain, and Japan hardly qualify as small open economies, they have not been immune to the effects of significant swings in their currencies. The impacts of the exchange rate on trade and foreign investment have carried crucial importance for their national economies, as the value of their currencies has influenced growth, employment and inflation both directly in terms of external shocks as well as indirectly through influencing macroeconomic policy trajectories (e.g., monetary discipline). The concern of these nations with the macroeconomic consequences of international economic interdependence is strongly evident in the track record of modern economic diplomacy (see below). And while some might argue that external shocks may be relatively small for these economies relative to emerging market economies, the politics of trade and foreign investment have become relatively "large" in industrialized democracies with the rise of the guardian state. Hence, leaders care even if conventional textbooks may tell them not to. Moreover, with respect to the exchange rate as a "public good," it is very apparent both in the G8 as well in the industrializing world that other countries have a critical stake in the value of key currencies as well, and they have been quite vocal about this dependence in diplomatic circles. Finally, the "prestige" of having a stable and strong currency is hardly unimportant to national leaders. Hence, even though elite-G nations such as the U.S., U.K., Canada, the ECB countries and Japan have continued to float and have intervened infrequently (principally to smooth market adjustments at that), these nations have nonetheless been quite animated about promoting or discouraging certain levels and paths in their exchange rates. This would make managing

exchange rates a priority for even large economies that are relatively shielded from external shocks.[23]

Hopes for fixing and managing exchange rates presently rest on the idea of cooperation between nations in setting their economic targets (i.e., macroeconomic coordination). Indeed, this principle is compelling both among academics and policymakers. Bergsten and Henning state that international cooperation is the key to solving our major international monetary problems; Timmins and Timmins call coordination "essential" and see the OECD as an important venue; Eichengreen and Kenen call for enhanced cooperation through the resurrection of the Bretton Woods institutions. This advocacy has not fallen on deaf ears as coordination has become a central issue in international modern economic diplomacy since the mid-1980s.[24]

Can nations avert this need for cooperation and the general problems caused by exchange rates if they make exchange rates a secondary priority? Greater attention has recently emerged on the priority of sound macroeconomic policies and institutions for economic stability and performance. In this vein, the exchange rate is often the symptom rather than the cause of economic instability and poor performance. Hence, the exchange rate is really a second-order problem.[25] While this argument has been more visible in the context of desirable economic policies for emerging markets, the logic rings nonetheless true for developed nations.[26] Misalignments and undesirable paths in exchange rates are often the *results* of excessive fiscal or

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[23] On problems of exchange rate fluctuations in major currencies, see Benoit Coeure and Jean Pisani-Ferry, "The Case Against Benign Neglect of Exchange Rate Stability" Finance and Development, vol. 36, no. 3, September, 1999.

[24] David B. Timmins and William M. Timmins, The International Economic Policy Coordination Instrument, Lanham: University Press of America, 1985, p. 109; Bergsten and Henning, Global Economic Leadership, p. 7; and Barry Eichengreen and Peter B. Kenen, "Managing the World Economy Under the Bretton Woods System: An Overview," in Kenen, Managing the World Economy, p. 54.

[25] Sally "Looking Askance" strongly avers that sound national economic policy is a necessary condition for stability in any international economic regime. Hence, the locus of economic problem solving must be at the domestic level. International cooperation can bolster such outcomes, but cannot substitute for them.

[26] See, for example, Guillermo Calvo and Frederic Mishkin, "The Mirage of Exchange Rate Regimes for Emerging Market Countries" NBER Working Paper, 9808, June, 2003 and Frankel, "Experiences of and Lessons from Exchange Rate Regimes." Interestingly, with respect to emerging market economies, this realization has the potential to set in motion policy orientations that reinforce Eichengreen's corners hypothesis regarding choice of an exchange rate regime. On one hand, monetary and financial turbulence in Asia and South America have established momentum for hard pegs such as currency boards and dollarization. Yet on the other hand, the conviction that the exchange rate is a second-order problem has led leaders to look more favorably upon strategies such as targeting inflation while allowing the exchange rate to float.

monetary policies rather than the *cause*s (of course, they may reinforce such policies). However, even if nations opt for macroeconomic policy as a first-order priority while allowing the exchange rate to float, neither the need for cooperation nor the problem of the exchange rate will disappear. As Cooper eloquently alerted us as far back as the 1960s with his *Economics of Interdependence*, and this holds true for developing as well as developed nations today: in a globalized-interdependent world economy, nations cannot assure domestic macroeconomic outcomes unilaterally.[27] This realization is perhaps the most compelling inspiration promoting modern economic diplomacy. The track record of G8 diplomacy resoundingly attests to the primacy of the conviction among leaders and diplomats that: domestic economic objectives require some "help from your friends" (see below). There is no more glaring manifestation of this need for cooperation to deliver domestic macroeconomic goals in G8 diplomacy than the tendency on the part of the U.S., which has been the most adamant floater after 1973, to impose a "locomotive" role onto other G8 members in order to attained its macroeconomic targets (see below). So in the final analysis, irrespective of the ranking (i.e., whether domestic targets or exchange rates are first-order priorities or not), the need for cooperation will remain compelling, especially in a politicized international economy.

Theoretically, the quest for economic cooperation is justified and very much consistent with political realities. In a world in which domestic political incentives have generated an unstable structure of macroeconomic outcomes (i.e., making international monetary arrangements more difficult to sustain), it is necessary to conceive of macroeconomic targets in a multilateral framework. The theoretical soundness is based on the premise that the cooperation is founded on neutralizing domestic political distortions on macroeconomic and international economic policies. But what if the cooperation itself, even when cooperation is achieved (i.e., multilateral agreements are forged), were strongly influenced by such domestic politics, thus making cooperation a venue for compounding these distortions? While the track record of cooperation over the past several decades shows many positive traits in neutralizing distortions, history also shows that cooperation exhibits a dark side (i.e., allowing the domestic distortions to structure diplomacy) as well, and it is this dark side that limits the effectiveness of cooperation as a solution to international economic problems.

Modern economic diplomacy has shown that cooperation can be contaminated by domestic political distortions in three ways: by shifting burdens of adjustment, by generating moral hazard, and by creating mistiming in schemes of multilateral coordination. All three outcomes have often

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[27] Richard N. Cooper, The Economics of Interdependence, New York: McGraw Hill, 1968.

times made international economic problems worse. The Plaza (1985) and Louvre (1987) negotiations, for example, generated agreements that compounded international problems through burden shifting and moral hazard.

In marshaling its arguments, the rest of the paper will draw on cases of international economic diplomacy among the G8: principally from the G8 summits (i.e., among national leaders), as well as negotiations among G8 finance ministers. Since a full articulation of the context and details of negotiations in each of the summits and negotiations mentioned would be impossible in the limited space of an article, it is recommended that for such background, interested readers refer to more thorough historical accounts of the summits and negotiations.[28]

Essentially, both negotiations were oriented around problems of the misalignment in the dollar-yen exchange rate. Plaza was instrumental in abating the appreciation of the dollar, whose sharp rise in the early 1980s led to the advent of a large trade imbalance for the U.S. President Reagan's own domestic political priorities of cutting taxes and increasing military spending precluded the U.S. from unilaterally addressing the problem through fiscal policy, but just such a solution promised to be the most effective remedy to the overvalued dollar. Instead, the U.S. was able to shift the burden of dollar depreciation onto other nations in the form of a scheme oriented around multilateral intervention in financial markets.[29] Moreover, Reagan was able to shift the burden of reducing the U.S. trade deficit onto Japan and Germany through an indicator system: i.e., Japan and Germany would stimulate their economies so as to increase the demand for U.S. exports. Funabashi in fact calls the Plaza Accord "an instrument by which the deficit country…would be able to push the adjustment burden on the surplus countries." The burden of excessive economic stimulus in Japan and Germany ended up being a source of domestic economic problems in each nation and a source of instability for external relations among the G7.[30]

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[28] Nicholas Bayne, Hanging In There: The G7 and G8 Summit in Maturity and Renewal, Aldershot: Ashgate, 2000; Bergsten and Henning, Global Economic Leadership; Yoichi Funabashi, Managing the Dollar: From the Plaza to the Louvre, Washington: Institute for International Economics, 1988; Peter I. Hajnal, The G7/G8 System: Evolution, Role and Documentation, Aldershot: Ashgate, 2000; and Robert D. Putnam and Bayne, Hanging Together: Cooperation and Conflict in the Seven-Power Summits, Cambridge, MA: Harvard University Press, 1987. See also the various excellent analyses of G8 diplomacy at www.g8.utoronto.ca.

[29] Sally "Looking Askance," p. 55, might refer to such an outcome as the U.S. "grafting government failure onto the international system."

[30] Funabashi, Managing the Dollar, pp. 5,6. In fact, attempts to redistribute burdens of adjustment have been a pervasive characteristic of economic diplomacy from the time of the summit at Puerto Rico in 1976. See Putnam and Bayne, Hanging Together, p. 43.

At Louvre, exchange rate targets (this time centered around preserving current levels in exchange rates rather than promoting dollar depreciation), once more called for substantive accommodations in national macroeconomic policies, and once again domestic priorities injected impediments which pushed solutions toward intervention rather than a viable scheme of macroeconomic accommodation among the G7. Successful macroeconomic coordination at both Louvre and Plaza was inhibited because of its "subordination to national policy making".[31] The ongoing pressure within the G7 (especially the U.S.) on Japan and Germany to stimulate their economies as engines of growth for the world economy (which has called for a variety of domestic adjustments such as eliminating structural impediments, fiscal stimulus, and loose monetary policy) has reflected a preference for multilateralizing domestic and international economic targets over undertaking painful (but often necessary) domestic solutions to the problems. For Japan, however, maintaining lower interest rates for the purpose of avoiding a free fall for the dollar placed it in too inflationary a trajectory, the result of which was the need to raise interest rates to excessive levels afterward, thus casting its economy into a greater recession. This imposition of the burden of adjustment on Japan placed her on a more tumultuous macroeconomic trajectory than would have been the case if Japan were able to institute a higher discount rate in the mid-1980s.[32]

While the Japanese have not been as aggressive diplomatically toward other G8 governments, they have exhibited a very long trail of resentment against such attempts to redistribute adjustment costs. The latest iteration of this trend, at Genoa (2001), provoked (to no one's surprise) a strong and hostile reaction from the Japanese delegation which responded to calls for Japan to "once more contribute to global output" with "we are not here to hector each other." Similarly, at a G7 ministerial meeting in Rome (2001), American references to European economies as "locomotives" had European leaders reeling.[33]

Pushing the burden of adjustment onto both Japan and German has also led to domestic macroeconomic conditions within each nation that have contributed to problems of macroeconomic coordination and instability in exchange rates within the G3 (U.S., Germany, Japan) over the past two decades. Moreover, the domestic political backlashes from the size of

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[31] Funabashi, Managing the Dollar, p. 223.
[32] Funabashi, Managing the Dollar, p. 33.
[33] Japanese and European vituperation in recent diplomatic encounters should not cloud the fact that these nations have remained consistently generous in accommodating the will of the U.S. on international economic policy. See Christopher Rhoads, "Finance Chiefs See a Rebound in the Making," Wall Street Journal, July 9, 2001, pp. A21, A23 and Rhoads, Jim VandeHei, Geoff Winestock, and John J. Fialka, "G-8 Feeling Pinch, Turns to Developing World," Wall Street Journal, July 20, 2001, p. A8.

the macroeconomic burdens (excessive deficits and inflation) have also made each nation much more reluctant to consider even prudent collective trajectories in macroeconomic targets, thus seriously limiting the effectiveness of coordination.[34]

Moral hazard contributed equally to the destabilizing outcomes under Plaza and Louvre. In both coordination schemes it was generally acknowledged that the problem of misaligned exchange rates was best solved by orchestrating more fundamental changes in domestic policies. Domestic political impediments (political mobilization for accommodating changes in fiscal policies was weak in Germany, Japan, and the U.S.; Reagan was especially averse to raising taxes) made nations reluctant to bear the burden of domestically painful adjustments, so they fixed upon solutions centered around multilateral intervention to keep exchange rates within desired targets. To the extent that coordination can eliminate the adverse consequences of inappropriate macroeconomic policies, it reduces the incentives to restructure policy in a more internationally stabilizing direction. Such was precisely the case at Plaza and Louvre in that multilateral agreements mitigated some of the adverse consequences (misaligned and unstable exchange rates) of fiscal policy, thus giving nations greater incentives to maintain those domestic economic policies that were causing the original international problems in current accounts and exchange rates.

In this case, the moral hazard was pervasive among the G3 as none of the G3 had to make major concessions on fiscal policy, and this led to a destabilizing collective defection, with intervention allowing all three nations to indulge in looser fiscal policy. But this meant that the dollar-yen targets were being buttressed on an unstable macroeconomic trajectory, an ongoing problem which plagued economic diplomacy through the 1980s.[35] Although vigorous intervention proved moderately effective in achieving and maintaining exchange-rate targets, the poorly coordinated fiscal policies among the G3 served to undermine the target zones established under Louvre, as the indicator system was never effectively linked to the target zones.[36]

Compliance with the spirit of Plaza-Louvre solutions to exchange-rate misalignments was terribly flawed. G7 nations were unwilling to bear the adjustment costs of alignment as evidenced by their sterilized interventions, with reserve holdings absorbing the burden of adjustment rather than monetary policies. Moreover, successfully reaching some guidelines on alignment probably did more to discourage than encourage the desired paths and levels in exchange rates. This brings up the problem of moral hazard and compliance. Poorly structured agreements are often counter-

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[34] Bergsten and Henning, Global Economic Leadership, p. 73.
[35] Funabashi, Managing the Dollar, p. 44.
[36] Funabashi, Managing the Dollar, p. 193.

productive because more substantive reformist initiatives are muted by the false promise of the actual agreements. Hence, problem solving stops without the advent of viable solutions. To a large extent, this process was characteristic of the Plaza-Louvre cycle.[37] The actual accomplishments in terms of policymaking were largely overstated by both leaders and diplomats, as they fell well short of the rhetoric that surrounded the negotiations. The promises for and enthusiasm about cooperation as a vehicle for exchange-rate adjustment in this diplomatic process were hardly vindicated.[38]

But even when nations have been able to cooperate in ways that avoided deleterious outcomes in terms of moral hazard and burden shifting, it has proved the case that excessively reinforcing macroeconomic policies can lead to destabilizing outcomes as well (i.e., the problem of mistiming). It is generally the case that such excessive reinforcement is stimulated by overlapping domestic political priorities which push nations to overshoot on macroeconomic trajectories and/or maintain those trajectories longer than is optimal. The multiplier effects of such joint excessiveness in coordinating targets has often proved a source of instability throughout the history of economic diplomacy.[39] The G7 summit cycle from 1975 to 1982 exhibited a trail of exaggerated joint trajectories that resulted in collective macroeconomic overshooting. Rambouillet (1975) and Puerto Rico (1976) found nations faced with strong domestic political pressures to counter the inflationary impact of the oil crisis, which led to aggressive collective restraint, which in turn caused deflationary overshooting. This experience turned domestic policies in the opposite directions for Bonn I (1978) and Tokyo I (1979), which resulted in exaggerated collective stimulation, which in turn led to overshooting on inflation. Conversely, Ottawa (1981) and Versailles (1982) saw domestic pressures collectively encouraging

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[37] Gallarotti identifies a similar process at work with international conflict resolution. Often, UN initiatives to resolve regional and ethnic conflict have been counter-productive because the stop-gap solutions orchestrated discouraged more fundamental diplomacy on the part of warring factions. See Giulio M. Gallarotti, "The Limits of International Organization: Systematic Failure in the Management of International Relations" International Organization, vol. 45, no. 1, Spring, 1991.

[38] This is consistent with Kokotsis, Von Furstenberg, and Daniels findings that economic summits tend to over-promise and under-deliver. Moreover, their findings show that exchange-rate commitments engender lower levels of compliance relative to commitments on other issues. See George M. von Furstenberg and Joseph P. Daniels, Economic Summit Declarations, 1975-1989: Examining the Written Record of Cooperation, Princeton Studies in International Finance: Princeton University Press, 1992 ; Ella Kokotsis and Joseph P. Daniels, "G8 Summits and Compliance" in Michael R. Hodges, John J. Kirton, and Daniels., eds., The G8's Role in the New Millennium, Aldershot: Ashgate, 1999; and Kokotsis, Keeping International Commitments: Compliance, Credibility and the G7, 1988-1995, New York: Garland, 1999.

[39] Putnam and Bayne, Hanging Together, p. 95.

macroeconomic restraint, with the same outcome as Rambouillet and Puerto Rico. Interestingly, this cycle of diplomacy showed a reactive character in which each set of diplomatic encounters were, at least to some extent, called upon to fixed problems generated by previous diplomacy.[40]

IV. Confronting the Domestic Political Impediments to Cooperation

While international economic cooperation could never be entirely purged of the distortionary influence of domestic politics, it would be useful to move toward a systematic understanding of how such impediments could be limited. The history of economic diplomacy over the past quarter-century strongly reveals that the success and failure of cooperation among the G8 hinge directly on minimizing such distortions. But the success in forging agreements must also be reinforced by compliance. Indeed the work on G8 compliance suggests that while the successful follow-through with the commitments generated at the summits has been "positive and sustained," the summits themselves tend to over-promise and under-produce.[41] Indeed, both the negotiations themselves and subsequent compliance are both strongly driven by domestic politics. Hence and strategies to confront domestic political impediments to economic cooperation would also have to be extended beyond the immediate diplomatic arena in which agreements are forged, and into the inner-sanctum of domestic policymaking.

Domestic political impediments that distort and contaminate cooperation, as well as discourage compliance, can be limited through six fundamental strategies. First, leaders can generate greater public support for their diplomatic initiatives by underscoring the domestic impact of international problems. Second, leaders can build important elite coalitions for their initiatives from the ranks of influential political interest groups and key bureaucratic players. Third, leaders can exploit strategic opportunities for cooperation and compliance by carefully timing international negotiations to accord with favorable political-economic outcomes. Fourth, the domestic political burdens of making costly international accommodations can be partially redistributed or rendered less transparent. Fifth, leaders can act strategically in a diplomatic context. Finally, domestic political pressures can be better resisted through the greater institutionalization of G8 diplomacy.

A. Public Support

The history of economic diplomacy has demonstrated that domestic political impediments to cooperation and compliance are strongest when the public perceives a clear wedge between

[40] Bayne, Hanging in There, p. 35 and Putnam and Bayne, Hanging Together, pp. 235,263.
[41] See Von Furstenberg and Daniels, Economic Summit Declarations; Kokotsis and Daniels, "G8 Summits and Compliance"; and Kokotsis, Keeping International Commitments."

international and domestic economic goals. Eliminating such a wedge would engender greater domestic political support for diplomatic initiatives and subsequent compliance. One can attribute the public support, and consequently the success in reaching agreements on intervention and target zones, which G5 (U.S., Germany, Japan, Britain, France) representatives carried with them to Plaza and Louvre, on precisely this ability to make international and domestic interests synonymous.[42] France's Chirac took advantage of loosely specified international objectives at Louvre by portraying it in a light most favorable to the French public (i.e., as a target-zone agreement). The emphasis on exchange-rate stability galvanized French agriculture and exporters in favor of the accord.[43] For the U.S., Reagan played on American concerns with the trade deficit by selling Plaza and Louvre as solutions to the large imbalances which America was running up in the mid-1980s. All G5 leaders, in fact, worked to engender public support for Plaza and Louvre by highlighting elements of the accords which impacted favorably on the most sensitive economic issues in each respective nation. Similarly, all five leaders minimized domestic opposition by downplaying the macroeconomic sacrifices called for by the target zones. Nakasone perpetrated the most impressive political coup of the five by agreeing to a "high yen" (endaka) policy at Plaza in the face of a domestic political culture averse to yen appreciation. He successfully sold the policy to the public by linking a higher yen to national prestige.[44]

At Bonn I, largely hailed as the most successful summit, the structure of macroeconomic coordination that best accorded with international priorities was easy to sell on the part of Carter, Fukuda and Schmidt; as the required targets for each nicely accorded with macroeconomic policies which were largely popular back home. This gave each leader enough popular support to strongly back a substantive solution. In an ongoing quest throughout the 1980s, Germany's Kohl was able to quell popular criticism of German diplomatic initiatives to raise interest rates in the face of domestic unemployment by citing unstable monetary policy as a cause of unemployment.[45]

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[42] While the Plaza and Louvre negotiations, as noted, produced some agreements that were flawed in many respects, the strategies that national leaders and diplomats employed to engender cooperation there were nonetheless impressive. It is clear from the arguments below that more aggressive and sustained efforts in this regard could have produced better agreements at Plaza and Louvre, as they have done at other negotiations.

[43] This political ploy by French leaders to gain popular support for exchange-rate adjustments runs as far back as the Tripartite Agreement of 1936 where a devaluation was sold to the French public as a solution to the problem of exchange-rate instability. See Charles P. Kindleberger, A Financial History of Western Europe, London: Allen and Unwin, 1984, p. 397.

[44] Funabashi, Managing the Dollar, pp. 91,92,208,214,215.

[45] Putnam and Bayne, Hanging Together, pp. 34,53,74.

At Denver (1997) leaders increased popular support for controversial macroeconomic policies at home (Japanese economic deregulation, inflation control in the U.S., and fiscal restraint in European nations) by framing them as solutions to pressing problems highlighted in the summit agenda. More generally, recent summits from Birmingham (1998) to the present have seen a greater inclusion of populist economic themes in summit agendas as well as a greater efforts to communicate with civil society in reaction to increased public scrutiny of the summit process. The present attention to problems of globalization, sustainable development, debt relief, health and employment has been directed at addressing the civil society agenda: in large part this has been a response to the growing protests which have accompanied economic negotiations among developed nations in recent years. Including non-governmental groups (trade unions, grass roots organizations, ENGOs, as well as other NGOs) in the conference processes, continuing G8-civil society dialogue and the establishment of Civil Society Centres at summit sites have been targeted at addressing popular concerns about the role of summits in the international political economy.[46] In a similar vein, the outreach initiatives visible at Kananaskis (2002) and Evian (2003), whereby developing nations have been invited into diplomacy with the G8 leaders, have been a manifestation of this quest for greater global legitimacy. As the summit cycle from Lyon (1996) to Evian has featured development as a major issue in the summit agenda, including developing nations has become a more compelling priority in the eyes of the global community.[47] While civil society can hardly be characterized as supporting G8 diplomacy at present, as the over one hundred thousand who protested in Switzerland over Evian would attest to, its support is nonetheless of crucial political importance to national leaders in framing effective agreements. As Hajnal puts it, "civil society and the G8 (and individual G8 governments) need each other."[48]

Since diplomatic communiqués and resolutions from high-profile economic diplomacy tend to reflect a "blue-sky" orientation (i.e., under-specified in objectives and commitments), international negotiations often present systematic opportunities for engendering public support

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[46] Nicholas Bayne, "Impressions of the Denver Summit," www.g8.utoronto.ca/evaluations/index.html, June 1997; Bayne, "Impressions of the Birmingham Summit," www.g8.utoronto.ca/evaluations/index.html, May 17-19, 1998; Bayne, "Impressions of the Genoa Summit," www.g8.utoronto.ca/evaluations/index.html, July 28, 2001; and John J. Kirton, "Generating Genuine Global Governance: Prospects for the Genoa G8 Summit," www.g8.utoronto.ca/evaluations/index.html, July 15, 2001.

[47] Nicholas Bayne, "Impressions of the Kananaskis Summit" www.g8.utoronto.ca/evaluations/index.html, June 26, 27, 2002, and Bayne, "Impressions of the Evian Summit," www.g8.utoronto.ca/evaluations/index.html, June 1-3, 2003.

[48] See especially Peter I. Hajnal, "Civil Society Encounters the G7/8" in Hajnal, ed., Civil Society in the Information Age, Aldershot: Ashgate, 2002 on civil society and the G8. The quote comes from p. 236.

because leaders enjoy wide latitude in interpreting the significance of cooperative schemes for their domestic constituents. In fact, internationalists have continued to see G8 diplomacy as a venue for educating populations on the merits of cooperation.[49]

With respect to compliance, public support is a crucial condition for successfully stewarding through diplomatic commitments. The findings on G8 compliance bear this out. Kokotsis and Daniels find that compliance increases when public opinion favors a particular agreement.[50] Riding popular support on the diplomatic follow-up will put pressure on leaders and diplomats to both move things along quickly over their own domestic political hurdles (as public opinion and support can be fickle) and to continue garnering public support well after the diplomacy has ended. For example, Canada launched strategies on both fronts in attempting to marshal through desired policies on climate change in the 1990s, as it followed up its diplomacy at the summits with aggressive outreach initiatives to sell its global warming policies to the Canadian public. The Canadian government consulted broadly and quickly with the public across the various provinces regarding environmental policy in summit follow-up. The public momentum for environmentalism was an important factor for conditioning the domestic political mood which brought forth into law a variety of summit agreements made by the Canadian government.[51]

B. Elite Support

Political leaders can attain three kinds of elite support in building domestic political support for their diplomacy and compliance: from key bureaucrats, from domestic interest groups, and through transnational linkages to foreign bureaucrats and interest groups.[52]

Economic diplomacy is quite amenable to the mobilization of key bureaucrats in the cause of substantive accommodation. The *ad hoc* nature of much diplomacy gives leaders much latitude in selecting diplomats and keeping decisions within a favorable circle of elite advisors. At Plaza, Darman and Baker's orchestration of a policy targeting dollar depreciation depended on deft strategies which were effective in gaining the backing of key bureaus (Commerce, Defense, U.S. Trade Representative, and financial elites in Treasury who resisted changes in fiscal policy) by playing on parochial interests, and averting the bureaucratic roadblocks created by financial elites (ideological floaters Schultz and Sprinkel) hostile to targeting the dollar. Darman and Baker

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[49] Putnam and Bayne, Hanging Together, pp. 34,53.
[50] Kokotsis and Daniels, "G8 Summits and Compliance," p. 87.
[51] Kokotsis, Keeping International Commitments, p. 49.
[52] This bears on the process of two-level diplomacy whereby leaders have to negotiate both at the international and then the national level (often with elite bureaucrats and legislators) to achieve desired policies. See Peter Evans, Robert Putnam, and Harold Jacobson, eds., Double-Edged Diplomacy, Berkeley: University of California Press, 1993.

limited the input of these ideological floaters through the strategic manipulation of communication. They hastily proceeded to negotiate, but gave floaters insufficient time to influence the American delegation by alerting them only in a late draft of the President's State of the Union Address. They also facilitated the passage of the initiative through a hostile bureaucracy by incremental and selective revelation: they used the term "targets" rather than the more controversial term "fixed exchange rates." Similarly, Nakasone was able to protect his diplomatic stance at Plaza from hostile bureaucrats and political elites by restricting involvement to select outsiders.[53]

Plaza also demonstrated how the building of coalitions among influential interest groups can buttress domestic political support. For the U.S., Darman and Baker sold the Plaza accord to a broad-based coalition of specialized interests: dollar depreciation attracted agriculture, unions, exporters, and manufactures. Especially important allies in selling Plaza to American industry were leading industrialists Lee Morgan of Caterpillar, David Hewlett of Hewlett Packard, and Lee Iacocca of Chrysler; all of whom were moved by Department of Commerce exhortations linking the success of American manufacturers to a weaker dollar. American finance was attracted by promises that intervention would help avoid excessive inflation, but also by Baker's suggestion that the G5 synchronize moderate reductions in interest rates (private banks welcomed the latter as a solution to the debt burden on their LDC borrowers). In the case of Japan, diplomats were able to obtain the necessary political support from Japanese manufacturing for appreciated yen-dollar targets at Plaza and Louvre (an otherwise detested outcome for Japanese business interests) by drawing on their links to financial experts in leading Japanese corporations who convinced their respective directors that exchange-rate stability would be more beneficial to them than yen depreciation. Nakasone, himself, courted export-oriented manufacturers by citing Plaza as a means of opening up the Japanese economy.[54]

More systematically, over several summits, Germany's Schmidt continued to overcome political opposition to diplomatically driven reflationary policies by getting the support of the Social Democratic Party and unions. Most recently, at Genoa, success at promoting an agreement which dictated a new round of WTO talks was engineered by keeping the language shielded from very specific prior agreements that had a sectoral impact. Such diplomatic perspicacity kept key

[53] Funabashi, Managing the Dollar, pp. 67-69,82,85,91.
[54] Funabashi, Managing the Dollar, pp. 70-72,88.

groups in favor of liberalizing initiatives, thus providing leaders with the requisite political capital to push for new trade negotiations.[55]

Transnational linkages to influential political interest groups have also served as a useful means of building strategic support in the history of summitry. Such alliances have been at the heart of cooperative initiatives across diverse issues in the summit cycle: in facilitating a trade agreement at London I (1977) and Bonn I, in mitigating American isolationist tendencies during the early- and mid-1980s, and in moving Japan toward liberalizing its economy in the 1980s. These linkages have exhibited both an aggressive (forced acquiescence in the case of Japan) and passive (natural acquiescence in trade and American policy) character. In all of these cases, domestic cleavages on the proposed policies existed, thus creating a sort of domestic deadlock on these diplomatic initiatives. The balance was tipped by the emergence of an international coalition reinforcing supportive domestic groups, thus pushing summit agreements in a liberal-internationalist direction. Hence, domestic free-trade groups were bolstered by international pressures and were consequently able to push through agreements promoting liberalization at London and Bonn. Similarly, domestic groups supporting American multilateralism and Japanese economic reforms found the requisite international allies to promote their desired policies. Putnam and Bayne, in fact, report a comment citing the Bonn I package as having been the outcome of an "international conspiracy."[56]

As with public opinion and support, maintaining elite support is crucial to compliance, as the track record of summitry reveals. One of the principal findings of the G8 compliance literature is that domestic institutional variables are important factors in determining the success of compliance. Nations with broader and more effective domestic institutional frameworks tend to produce a better track record in complying with G8 commitments in those specific issue-areas. Kokotsis and Daniels account for a myriad of patterns in compliance of G8 agreements based on such domestic institutional variables. At the root of this relationship lies the strategic importance of elite bureaucrats: where such bureaucrats are numerous and have effective institutional resources at their disposal, compliance will be greater; where bureaucrats are fewer and poorly endowed institutionally, compliance will be wanting. Such is the case because bureaucrats are the leading specialists in domestic government who consult legislators and leaders on developments in specific issue-areas, hence they play a crucial stewardship role in shaping the domestic agenda,

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[55] Putnam and Bayne, Hanging Together, p. 80 and Kirton, "Generating Genuine Global Governance".

[56] Putnam and Bayne, Hanging Together, pp. 90,266.

and consequently guide diplomatic initiatives into domestic law. [57] The Canadian government's follow-up to the Houston Summit (1990) on global warming policy showed an especially perspicacious strategy of shaping the domestic environmental bureaucracy. This specific case involved expanding the bureaucracy to facilitate compliance on diplomatic initiatives. After the Summit, a new Energy Advisor was appointed to consult with leading industries on conservation and carbon emissions. Canada's Green Plan generated a further institutional layer with the creation of the Greenhouse Emission Reporting and Assessment Office. The new institutions were envisioned as venues for informing, galvanizing and advocating a domestic environmental agenda consistent with Canada's international agreements.[58]

C. Strategic Timing

Diplomacy has always been shaped by crucial events in the international political economy: negotiations within the G8 are no exception. While events have spontaneously shaped diplomacy, driving it toward either failure or success, diplomats have continued to be perspicacious in seizing such opportunities to generate domestic political support for cooperation and compliance. The very first summit, Rambouillet, was a manifestation of such strategic timing, as G5 leaders took advantage of widespread stagflation to gain domestic political support for international agreements. Similarly, cooperation on collective expansion at London I relied on opportunistic diplomacy based upon a collective need among the G7 to reflate their domestic economies. At Bonn I, success in orchestrating asymmetrical expansion among the G3 (Germany and Japan expanding more than the U.S.) reflected an agreement grounded in complimentary domestic positions (U.S. fighting inflation more than Japan and Germany). Bonn I also benefited from diplomatically exploiting political overlap in the G7 (most of which were Centrist and Left-Center governments) and economic linkages to terrorism (economic diplomacy benefited from the resolve for cooperation created by G7 experiences with recent terrorist acts). More generally, success at addressing macroeconomic issues at the early summits in the 1970s owed much to a diplomatic reliance on ideological overlap among participants, most of whom were former finance ministers and internationalists.[59]

In the 1980s, America's mounting trade deficit was crucial in reviving substantive cooperation on monetary relations, as it dislodged America from a policy of benign neglect. In fact, the deficit moved Congress in a soft-money direction, and Darman and Baker used the deficit as a weapon

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[57] See Kokotsis and Daniels, "G8 Summits and Compliance" and Kokotsis, Keeping International Commitments.
[58] Kokotsis, Keeping International Commitments, pp. 49,50.
[59] Putnam and Bayne, Hanging Together, pp. 9,41,71,74,191,228.

against ideological floaters in the Reagan administration hostile to target zones. On a whole, successes in the diplomacy of the 1980s, especially at Williamsburg (1983), Plaza, and Louvre; owed much to cooperative opportunities created by a convergence of macroeconomic and foreign-policy orientations among the G7, a result of most governments moving to the political Right.[60]

An exception was London II (1984), which was a victim of poor timing: with upcoming national elections discouraging risky diplomatic commitments. At the crux of this political impediment was Reagan's upcoming election which caused the U.S. to resist pressure to alter fiscal policy in fear of the electoral consequences. In fact, it has been common for summits conducted just prior to elections to fail for just this reason. At Bonn II (1985) a similar concern caused Mitterrand to stonewall on a new date for GATT talks. So too did Japanese elections before Tokyo II (1986) cause the Japanese to be reluctant on easing macroeconomic policy. Toronto (1988) and Paris (1989) were victims of a different sort of adverse timing, as coordination efforts were hampered by a widespread turnover in finance ministers among the G7. New finance ministers, while they held the reigns on economic policy, were nonetheless still subject to the diplomatic transition costs (i.e., initially cautious about making substantive changes in policy) and at Paris found themselves often reviewing issues rather than marshaling new initiatives. Diplomacy in the fourth summit series from 1989 to 1993 (Paris, Houston, London III, Munich, Tokyo) was hampered by several developments. First, political turnover in Italy, Japan, the U.S., and Britain interrupted the personal continuity in leadership. Second, the new finance ministers, as noted, made a slow transition into substantive economic cooperation. Finally, recessions afflicting the G7, especially Japan, caused a general caution on pushing diplomatic initiatives that might impact further on growth.[61]

The more recent summits at Birmingham (1998) and Cologne (1999) enjoyed more favorable political timing, as there once more emerged a political convergence (on the Left) among the G7, and the diplomatic agenda featured issues on which political ideologies coincided (i.e., the impact of globalization on trade, money, and employment). Changes in circumstances from Birmingham to Genoa nicely demonstrate the importance of timing for trade negotiations at the summits. At Birmingham, events discouraged any substantive agreements on a new trade round under WTO because uncertainty in the U.S. Congress about granting fast-track powers to Clinton made the U.S. position on liberalization tentative at best for any upcoming round. At Genoa, however, fast-

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[60] Funabashi, Managing the Dollar, p. 72 and Wendy Dobson, Economic Policy Coordination: Requiem or Prologue?, Washington: Institute for International Economics, 1991, p. 33.
[61] Bayne, Hanging in There, pp. 32,59,60,73.

track issues were resolved and the business cycle provided a fortuitous factor for encouraging negotiations on trade. Slow growth in the OECD, and some able diplomacy from leaders who linked the slow growth to protectionism, produced a favorable ideological environment with respect to the willingness to consider trade liberalization.[62]

Specifically with respect to compliance, the track record of G8 summitry suggests that the chronological structuring of post-summit initiatives can also enhance follow-through on agreements. For example, ministerials that follow closely after summits tend to enhance compliance on summit agreements in a variety of issues.[63] And, of course, like the outcomes from the summits themselves, follow-up on the agreements can also take advantage of specific domestic and diplomatic developments that might enhance compliance. In the case of summit environmental agreements forged in the 1990s, American and Canadian compliance increased significantly after the Earth Summit in 1992. Kokotsis and Daniels identify a "Rio effect" which imparted a compelling diplomatic momentum onto follow-up environmental policies at the national levels in the U.S. and Canada. More generally, with respect to domestic factors, Kokotsis and Daniels' findings show that compliance increases when specific policies enjoy partisan and public approval. [64] As with diplomacy, such developments provide ample opportunities for strategic timing which enhances domestic follow-up on agreements.

D. Reducing the Domestic Political Costs of International Cooperation and Compliance

The domestic political costs of cooperation and compliance can be reduced in a variety of ways. Historically, leaders have tried to shield themselves from criticism by increasing the role of technocrats in economic diplomacy, as the latter are better positioned to conclude agreements without generating as much domestic political fallout: meetings are less newsworthy, they can therefore meet more often, and can better exploit opportunities for continuity in that they meet in various *fora* (OECD, IMF, etc). In fact, the precursor of modern economic diplomacy within the G8 was the (White House) Library Group of G5 finance ministers in 1973, which met in relative secrecy.[65] At the summits, it is no coincidence that the most successful ones have also had the most extensive preparation by the sherpas. The success of Bonn I, for example, can largely be

[62] Bayne, "Impressions of the Denver Summit" and Kirton, "Generating Genuine Global Governance".
[63] Kokotsis and Daniels, "G8 Summits and Compliance," p. 85.
[64] Kokotsis and Daniels, "G8 Summits and Compliance," pp. 85,86.
[65] The subsequent rise of regular G5 meetings among finance ministers in the 1980s was, in part, an attempt to limit the adverse impact of media attention on economic diplomacy. They were also useful in isolating economic issues from foreign policy. See Bayne, Hanging in There, p. 34 and Putnam and Bayne, Hanging Together, pp. 29,233,259.

attributed to such technocratic preparation. The preparations, which lasted two years and were enhanced by close integration with negotiations in the OECD and IMF, forged a fairly rigid set of priorities which overcame even the most pressing national priorities. The follow-up phase was especially effective at resolving thorny issues with acceptable language. This was perhaps most important in forging an agreement on macroeconomic coordination, as G7 nations were being asked to make commitments on very sensitive economic policies on inflation and spending. The American and German sherpas were quite perspicacious in carving out an agreement on a German stimulus package and American policies on inflation and energy. In several cases, the extensive preparations were even able to overcome embittered relations among the leaders themselves.[66] Similarly, at Okinawa (2000), leaders found it politically safe to endorse fairly contentious agreements on reform in the international financial system because long standing preparation from the time of the Cologne Summit rendered a fairly rigid diplomatic initiative which was sold as a *fait accompli*. The leaders essentially endorsed the document drawn up by their finance ministers without much of their own modification or input. At the crux of the initiative was the rather touchy subject of reform of the IMF and regional development banks. Since the initiative was the result of ongoing preparation and was already agreed to at Cologne, the political costs of supporting any such bold reforms of the financial architecture were abated.[67]

Leaders have also limited domestic fallout by concealing the domestic economic sacrifices of cooperation and compliance through the use of less transparent policies, as well as by diversifying between macroeconomic policies according to political vulnerability. For example, making promises to alter monetary policies have been carried out, when possible, through changing reserve requirements rather than risking more visible and unpopular interest-rate changes (a preferred strategy of the German diplomats who have had to deal with a very rigid Bundesbank). The reliance on diversification among macroeconomic tools for the purpose of limiting domestic criticism was most visible at Tokyo II and the subsequent Louvre meeting. Controversy over the proposed indicator system was a manifestation of differing domestic political vulnerabilities leading to differing preferences on how to gauge macroeconomic coordination. In fact, Japan exhibited changing preferences for its macroeconomic accommodations in this period as changes in the political "heat" afflicting fiscal or monetary policies led Japan to choose accordingly.[68]

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[66] Putnam and Bayne, Hanging Together, pp. 85, 90.
[67] Nicholas Bayne, "First Thoughts on the Okinawa Summit" www.g8.utoronto.ca/evaluations/index.html, July 27, 2000.
[68] Funabashi, Managing the Dollar, pp. 6,46,55,136.

Diversification not only took place among policies within nations, but also across nations with respect to the structure of accommodations. A strong pattern in summitry has established itself in terms of bearing political costs: historically the economies doing best in terms of macroeconomic performance have shouldered the greatest sacrifices in multilateral agreements and subsequent compliance. In addition, national leaders have carefully crafted accommodations with an eye to their relative political standings: i.e., colluding for the purpose of shielding the most politically vulnerable members of the group (i.e., because of the timing of elections or prevailing popularity levels). For example, at Bonn I Jimmy Carter took on the burden of reducing oil imports as a solution to the problem of high oil prices, as he was still in the early part of his term as President.[69] At Genoa, Chrétien and Bush, safely behind the protective shield of recent electoral victories, took the lead in pushing agreements that more politically vulnerable leaders would have found difficult to orchestrate. Chrétien pushed for agreements on trade liberalization, financial transparency in IFIs, and poverty reduction. Bush pushed for strong statements about reform in the international financial system. Conversely, only one year prior to Genoa, Clinton's lame duck status at Okinawa effectively eliminated the U.S. as an active leader in promoting substantive agreements because future commitments on the part of the U.S. were in doubt.[70]

E. Strategic Diplomacy

Strategic diplomacy can be used to limit domestic political impediments in three ways. First, leaders and diplomats can rely on their individual perspicacity in maneuvering negotiations in ways that break down domestic political barriers. Impressive examples can be seen in Nakasone and James Baker at Plaza and Tokyo II. At Plaza, Nakasone used the national security establishment as a domestic platform from which to negotiate for a higher yen: an outcome which financial elites resisted vehemently. Baker broke down German and Japanese resistance to economic stimulus in 1986 by isolating each in a bilateral confrontation, and subsequently conflated the agreements into a G3 accord at Tokyo.71 Sometimes such perspicacity also involves temporal decomposition of issues so as to enhance the potential for agreement or reduce barriers to agreement. The latter was visible at Denver where the U.S. and Japanese delegations eliminated a contentious issue between them (the U.S. trade deficit with Japan), which promised

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69 Bayne, Hanging in There, p. 34 and Putnam and Bayne, Hanging Together, pp. 88,229.
70 Bayne, "First Thoughts on the Okinawa Summit" and Bayne, "Impressions of the Genoa Summit".
71 Putnam and Bayne, Hanging Together, pp. 213,217.

to unravel a greater diplomatic fabric at the Summit, by working out a prior agreement calling for deregulation of the Japanese economy.72

Second, negotiations can be diversified among various *fora* to either take advantage of favorable confluences of domestic politics (when the amalgamation of domestic politics among nations produces stable group preferences) or to avoid negative confluences of domestic politics (i.e., unstable preferences which inhibit cooperation). Once negotiated, such *faits accomplis* pressure other nations, which owing to domestic political constraints might have resisted at earlier stages, to go along. At Plaza, the U.S. and Japan were able to overcome German resistance to intervention by working out a G2 (U.S., Japan) agreement in advance. Germany was not given the chance to block such a plan. At Louvre, since the dollar-yen rate was the key problem addressed, and the G3 were the principal players in effecting the desired target zones (Germany was important in assuring a soft landing for the dollar), a G3 agreement was crucial. Essentially, the G5 rubber-stamped a G3 initiative. (A similar outcome with respect to exchange rates was engineered at Rambouillet by the U.S. and France.) But when the G3 decided to more aggressively pursue macroeconomic coordination as a support mechanism for the target zones at Tokyo II, it became necessary to include the entire G7: inclusion being a response to the need for more participants in a scheme involving broader coordination.[73] In addition, the members of the G8 have traditionally used the various *fora* of economic diplomacy (IMF, OECD, GATT) to diversify negotiation sets in order to revive and reinforce their multilateral initiatives. Bayne observes that summits were more successful when they were more closely integrated with OECD initiatives.[74]

Third, issues can be either decomposed so as to avoid unstable linkages or integrated to exploit favorable linkages. The Library Group (1973), for example, was designed with a limited agenda so that issues could be addressed in isolation. As summitry has evolved, diplomacy has spread to a greater diversity of issues, thus opening up possibilities for favorable and unfavorable linkages. As the agenda has become more complex, success has often depended on exploiting or avoiding linkages. In the 1980s, cooperation on target zones did best when instruments where considered separately. Moreover, the emergence of regular diplomacy among finance ministers in the 1980s was an attempt to keep economic negotiations on a separate track from a growing set of political issues which have served to complicate the summit process. In the new expanded summit format, success has depended on segmenting issues. At London I success on issues of coordinated

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[72] Bayne, “Impressions of the Denver Summit”.
[73] Funabashi, Managing the Dollar, pp. 129-36,169.
[74] Bayne, Hanging in There, p. 54.

expansion and trade emanated from French and Japanese resolve in resisting an expansion of the agenda to arms control and security which was marshaled by the U.S. The U.S. was ultimately placated by a meeting of the Four Powers (U.S., Germany, Japan, France) after principal negotiations on economic issues at the summit were concluded. At Kananaskis, Chrétien skillfully resisted the expansion and politicization of the agenda, thus keeping negotiations focused successfully on three items: terrorism, Africa and economic growth.[75] Similarly agreements at Birmingham and Cologne on debt and finance were enhanced by the extensive preparation which specialist groups undertook well in advanced on limited issues. Birmingham was preceded by the most intense preparation to date from the sherpas to the ministerials. As with London I, the summit agenda was also restricted and most of the major items generated agreements in advance. At Cologne, finance ministers undertook intensive preparations on a financial architecture that leaders later found compelling.[76]

In addition to considering the impact of linkages across issues and organizations, intertemporal linkage is another venue for facilitating diplomacy. Bayne underscores how Genoa to Kananaskis introduced a greater resolve on the part of the G8 to create continuity in the summit process (i.e., a more resolute follow-up initiative). The negotiations on the Africa Plan, the WTO, debt relief and global health at Kananaskis were all reinforcements of prior work done at Genoa. Similarly, two of Genoa's main achievements (the Global Health Fund and the DOT Force report) represented follow-up work done at Okinawa.[77] Such strategic commitment mechanisms across summits can serve as a means of deflecting domestic political pressures and facilitating effective diplomacy.

The recent push since Birmingham in 1998 to integrate non-governmental actors into the conference process at the summits has reflected an important strategic reaction to the rising tide of popular involvement in summitry. As such groups began to meet among themselves in "shadow fashion," and such engagement further galvanized popular scrutiny of summits, leaders have found it strategically useful to systematically include such elements in diplomacy. This serves two important purposes. First it breaks down post-diplomacy reaction which could adversely stir up domestic political opposition to summit outcomes. Second, agreements forged among the greater collective produce momentum which discourages recalcitrant elites from unraveling the extensive fabric of agreement, thus making diplomatic outcomes more compelling

[75] Bayne, "Impressions of the Kananaskis Summit."

[76] Bayne, Hanging in There, pp. 34,116,153, 154 and Putnam and Bayne, Hanging Together, p 29,71.

[77] Bayne, "Impressions of the Genoa Summit" and "Impressions of the Kananaskis Summit."

for each participant nation. Of course, on the down side, inclusion causes proliferation in the diplomatic fabric, thus making agreements more difficult to achieve. The current trend of inclusion, however, enhances the net benefits of inclusion as such groups are given consultative roles but are not as systematically integrated into the inner-sanctum of decision-making (which still resides among national leaders and diplomatic elites).[78]

In terms of compliance, strategic behavior will be equally crucial. The track record on G8 compliance bears this out. There is a tendency for compliance to increase when leaders take a more active role in stewarding specific policies. This proprietary effect is a testament to the opportunities for strategic action in the follow-up phase as well as at the diplomatic level. Consistent with this trend is the tendency for compliance to increase when timely and animated ministerial initiatives reinforce G8 agreements.[79] Strategic action should be all the more effective in the follow-up phases as the battleground for selected policies reverts back into domestic institutions which leaders and bureaucrats know well, hence they can more effectively shepherd agreements through the particular hurdles which confront them.

F. Institutionalizing the Summits

Some support has emerged for replacing the *ad hoc* summit process with a more formal regime: i.e., systematic institutionalization through a permanent secretariat, a systematic agenda, and more formal rules and procedures.[80] While meetings among various ministers have become more regular, and a bureaucracy of technicians (sherpas) has continued guiding diplomacy, the G8 diplomacy still lacks a rational institutional structure. Such a structure would be valuable as a means of deflecting domestic political pressure on national leaders who are making controversial, but necessary, concessions. The findings on G8 compliance bear this out. Kokotsis and Daniels' findings show that agreements in issues with more elaborate institutional frameworks at the international level (as well as at the national level, as noted above) tend to enjoy greater compliance than agreements in issues with thinner frameworks. Also consistent with this trend is the finding that U.S. and Canadian compliance on G8 agreements increased with the expansion of

[78] Bayne, Hanging in There, pp. 214,215; Bayne "Impressions of the Genoa Summit"; Hajnal, "Civil Society," and Kirton, "Generating Genuine Global Governance".
[79] See Kokotsis and Daniels, "G8 Summits and Compliance," pp. 85,86.
[80] On institutionalizing the summits, see Bayne, Hanging in There, pp. 212; Dobson, Economic Policy Coordination, p. 143; and G. John Ikenberry, "Salvaging the G-7," Foreign Affairs, vol. 72, no. 2, Spring 1993.

preparatory and follow-up phases of the summits.[81] Indeed, institutionalization promises not only to enhance substantive agreements, but also encourage subsequent compliance.

Institutionalization would have to be carefully orchestrated as the current trend toward greater bureaucratization, agenda expansion, and inclusion in the summit process promise to encourage an institutionalization consistent with a large and diversified organization. Indeed, the growth of working groups under the G8 umbrella (G8 African Group and various ministerials), as well as the growth of preparatory and follow-up activities surrounding the summits, suggests the presence of elements of a natural momentum toward greater bureaucratization.[82] Whether a grand institutional structure is superior to a smaller and more restricted international organization is problematic. Clearly, the grand model offers the advantages of diplomatic clout, greater possibilities for linkages, greater transparency, greater representation, and greater accountability and legitimacy.[83] However, the more restricted model avoids bureaucratic overload, discourages cosmic (i.e., insufficiently specified) agendas, and maximizes diplomatic flexibility.[84]

Hodges has marshaled a very compelling argument which underscores the negative consequences of grand institutionalization.[85] A systematic institutionalization founded on increasing the number of participants and the size of the bureaucracy could threaten the flexibility, informality and limited size that have facilitated effective and efficient negotiations among national leaders and finance ministers. Hodges avers that the G8 will more effectively promote economic stability in the world at large if it continues as a small and informal venue in a role which is subsidiary to larger international organizations. Indeed, the reforms at Birmingham to, as Bayne notes, “cut the heads [of state] loose from [the] bureaucratization” of summitry (i.e., leaders meeting separately with more limited agendas and limited political discussions) were a

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81 Kokotsis and Daniels, “G8 Summits and Compliance” and Kokotsis, Keeping International Commitments.

82 Bayne, “Impressions of the Evian Summit” and Kokotsis and Daniels, “G8 Summits and Compliance.”

83 Indeed, the growing anti-globalization movement has sent strong signals to developed nations that heretofore restricted venues such as the summits and IMF meetings will illicit increasing resentment from civil society. This will strongly increase the importance of promoting legitimacy and accountability in any G8 reforms. In fact, the Kananaskis and Evian Summits have introduced initiatives that suggest greater inclusion of developing nations in G8 diplomacy.

84 On the consequences of institutionalizing the summits, see Bayne, “Impressions of the Denver Summit”; “First Thoughts on the Okinawa Summit”; and “Impressions of the Genoa Summit”.

85 See Michael R. Hodges, “The G8 and the New Political Economy” in Hodges, John J. Kirton, and Joseph P. Daniels, eds., The G8’s Role in the New Millennium, Aldershot: Ashgate, 1999 and “More Efficiency, Less Dignity: British Perspectives on the Future Role and Working of the G7” The International Spectator, vol. 29, no. 2, April-June, 1994.

testament to the importance which simplicity and flexibility held for national leaders.[86] Such considerations may push reformers to think more in terms of a venue that can preserve some of the positive aspects of the traditional summit process in the newly institutionalized G8.[87] But it may in fact be the case that reformers can maintain some of these positive aspects and still reap the gains of broader institutionalization. The GATT/WTO is a case in point. This organization has enjoyed the wide representation, accountability and legitimacy which a large and formal organization can generate; but has maintained (through its rules and norms) a high level of flexibility, allowed negotiations to take place among smaller groups of participants, and has shown sufficient deference to relative stakes in the system. The rounds are not regular, the most favored nation principle makes it a fully represented and accountable body (thus enhancing legitimacy), and the "major interest" norm (i.e., major importers and exporters of specific products are central participants in determining generalized trade concessions on those products) allows for smaller and more intimate diplomacy among large stake holders in the trading system.

V. Conclusions

Unlike the period of the classical gold standard, stable monetary regimes based on fixed or managed exchange rates in the present day will require successful cooperation and compliance. Such cooperation and compliance can, in turn, be enhanced by the ability of diplomats and national leaders to limit domestic political impediments. The track record of international economic diplomacy has shown that when leaders and diplomats engage in such strategies, there are far greater possibilities for substantive and successful cooperation and compliance. The track record has also demonstrated the converse: when domestic political distortions remain unchecked by such strategies, cooperation and compliance suffer.[88] Unfortunately, diplomatic successes have

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[86] See Nicholas Bayne, "G8 Performance from Birmingham to Evian and Beyond" www.g8.utoronto.ca/conferences/2003, May 17, 2003,.

[87] The strategy of "keeping it simple and intimate" appears to have been a key contributor to the successes at Kananaskis. Chrétien fought hard to resist expanded and politicized agendas, and tailored the structure of negotiations to maximize intimacy and flexibility for the heads of state. Conversely, Evian went back to the more elaborate style of summitry, with perhaps less impressive results. Of course, the latter had to overcome the diplomatic schism created by the Iraq war. See Bayne, "Impressions of the Kananaskis Summit" and "Impressions of the Evian Summit."

[88] Contrasting the Bonn I (1978) and the Bonn II (1985) Summits is instructive in this respect. The first benefited from a widespread use of the strategies (there was a broad convergence of the strategies), consequently it proved highly successful in generating viable solutions to prevailing international economic problems. Conversely, Bonn II was plagued by a dearth in the use of such strategies, and unsurprisingly was widely considered to be a failure in

only emerged in piece-meal fashion because the use of such strategies has been all too selective and limited. Moreover, even after successful agreements have been forged, nations have tended to follow-though on fewer than half of their promises.[89] Successful cooperation and compliance will require policymakers to be more comprehensive in limiting domestic political distortions.

But lasting and stable rules-based international monetary regimes will require more than economic cooperation, they will also require a constellation of long-term domestic macroeconomic trajectories that are consistent with both internal and external balance. Such a system would invariably rely on a consensus grounded in the three pillars of responsible macroeconomic management at the domestic level: stable growth, low inflation, and fiscal balance.[90] In short, exchange rates and sound domestic macroeconomic policies and institutions are *both first-order problems*.[91] Domestic political forces in the 20th century have impeded such trajectories, and consequently have inhibited stable and lasting rules-based regimes at the national level as well as the international level. Hence, policymakers must also endeavor to limit the politicization of money within their national economies. Such an outcome would serve to deal with fundamental problems at the source. Combined with strategies to invigorate international cooperation and compliance, such initiatives might indeed expand the future monetary menu of nations to include regimes other than floating and union.

If these political forces indeed prove too difficult to keep at bay, then perhaps Eichengreen will prove correct in underscoring the shrinking menu of exchange rate regimes.[92] Large nations with small external sectors like the U.S. will then want to float, trade dependent regions like Europe may choose monetary union, and emerging market economies may continue experimenting with dollarization and currency boards. But the bifurcation of choice between floating and hard pegs

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economic diplomacy. On comparing and evaluating these two summits, see Putnam and Bayne, Hanging Together, pp. 73,74,87-92,204-08.

[89] The empirical findings on G8 summits and compliance suggest that nations tend to follow-through on fewer than a majority of their resolutions. See Von Furstenberg and Daniels, Economic Summit Declarations; Kokotsis and Daniels, “G8 Summits and Compliance”; and Kokotsis, Keeping International Commitments.”

[90] On this point, Sally’s (“Looking Askance”) diatribes against international cooperation that attempts to substitute for sound domestic economic policies should be seriously heeded. Sound macroeconomic trajectories have been widely acknowledged among diplomats and national leaders with strong endorsements coming frequently in G8 meetings. On the role of sound macroeconomic policy in sustaining rules-based monetary regimes, see Otmar Emminger, "Contribution" in Robert Mundell and Jacques Polak, eds., The New International Monetary System, New York: Columbia University Press, 1976 and Corden, Economic Policy.

[91] Ghosh, Gulde and Wolf, Exchange Rate Regimes, p. 174, aver that “no exchange rate regime can substitute for sound macroeconomic policy.”

[92] Eichengreen, International Monetary Arrangements, p. 5.

places nations between a rock and a hard place. If politics makes the maintenance of traditional and soft pegs difficult, they make hard pegs even more difficult because domestic politics resist such solutions all the more, as autonomy over macroeconomic policy would be given up to a far greater extent, given the greater difficulty of breaking the rules. Moreover, the recent difficulties experienced with hard pegs in Argentina suggest that solutions on the harder end of the continuum may be fraught with significant dangers as well. But floating, on the other extreme, is antithetical to stable trade and investment, as well as antithetical to monetary discipline. All of these, no doubt, impact on domestic growth and employment. It is therefore clear that fixed and managed exchange rates still serve important functions for the global economy. This importance makes the quest for invigorating such international monetary regimes an admirable goal.

As the G8 moves toward the Sea Island Summit (2004) these lessons appear all the more compelling, to both the summiteers and their ministers. The road to Sea Island has been largely paved with a concern for economic growth. The G7 finance ministers have cited the strengthening in global economic recovery, and that sound fiscal and monetary policies have been crucial to this outcome. They have also averred the central importance of exchange rates in the growth equation. In their words, “We reaffirm that exchange rates should reflect economic fundamentals. Excess volatility and disorderly movements in exchange rates are undesirable for economic growth.” Notwithstanding an overriding concern for domestic economic stability and performance, the G8 continues to be faced with the stark truth of interdependence: that no nation is an economic island in today’s globalized world. The lead-up to Sea Island suggests that the G8 members are well aware of the importance of cooperation for the kinds of goals they will pursue at this summit and beyond: stable growth, sound macroeconomic policies, and orderly exchange rates. They also realize that “much more remains to be done.”[93] Indeed it does.

[93] Statement of G7 Finance Ministers and Central Bank Governors, Boca Raton, Florida, February 7, 2004 www.g8.utoronto.ca/finance