U.S. DOLLAR POLICY AND MODERN CURRENCY CRISES:

HOW IS U.S. DOLLAR POLICY ASSOCIATED WITH RECURRENT FINANCIAL CRISES?

by

SUNG-HAE KIM

(Under the direction of Jeffrey D Berejikian)

ABSTRACT

The purpose of this thesis is to understand the role of international politics, in particular the impact of the United States, on the current spate of global financial crises. This thesis understands such crises as social in nature, and therefore that they are by definition the direct result of human action rather than a 'natural' consequence of markets. Specifically, the analysis here demonstrates that the international dollar policy of the United States supports a global economic structure that undermines the value of developing country currencies. The South Korean and Argentinean financial crises are examined in order to detail the relationship between U.S. dollar policy and developing country currency collapse. Furthermore, results from that analysis suggest that adopting a regional common currency will be an appropriate and effective strategy for the developing countries competing in under the modern floating currency regime. In conclusion, it is argued that hegemonic power should be balanced by regional cooperation among smaller countries in order to achieve global financial stability.

INDEX WORDS: The dollar policy, Global financial crisis, International monetary system, Hegemonic stability system, The power of news.

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DEDICATION

For

My mother-in-law YoungJa Kim,

My parents YongHo Kim & JeongSoo Kim,

My wife KyongWon Choi

&

Tongkyu and Yumin

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TABLE OF CONTENTS

CHAPTER I

INTRODUCTION

> "A strong dollar is the best interest for our nation, while enhancing the international buying power of Americans and helping to curb inflation. By limiting inflation, the stronger dollar also tends to reassure financial markets and hold down interest rates which can be helpful to boost domestic investment. In addition, a stronger dollar is also needed to insure that central banks continue to hold large sums of dollars as part of their foreign exchange reserves. Moreover, it also helps insure that the United States can continue to finance its budget deficits by selling bonds dominated by dollars. "
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> By Robert Rubin, the former Treasury Secretary of the United States, August 15, 1995

It is astonishing to watch over that the East Asian financial crisis that erupted in 1997 then spread easily over into Brazil in the following year, Russia in 1999, and soon reached to the whole Latin American continent. What began in Mexico in 1994-recent currency crises caused by capital exodus led primarily by international investors and domestic depositors who lost their confidence in the regional economies and currencies-seems to be an inevitable phenomenon of globalization and financial liberalization.[1] Correspondingly, to avoid future crises, it is recommended for virtually all the countries, except for the United States which has to provide international liquidity and credit via its trade deficit, to lessen their current account deficits and to stock up sufficient foreign

[1] It is assumed that modern currency crises started in the early 1970s when the Nixon administration abandoned gold –dollar exchange system by declaring gold inconvertibility into the United States dollar.

currency reserves by boosting exports and limiting imports.[2] It is exactly the same analogous to the situation in which a person has to save additional money by extra working in fear of unnecessarily increased job insecurity. What makes them further unhappier is the fact that building the United States dollar reserves is not without cost in real resources. The budget cost of paying higher interest rates for the domestic borrowings utilized to purchase lower yielding dollar assets is, in fact, a transfer of real resources to the previous holders of the dollars and ultimately the issuer of dollars-the United States. Furthermore, the dollar has not been backed by gold since 1971 nor by economic fundamentals for more than a decade. And there is hardly any assurance of the American government to guarantee the value of paper dollar. It implies that the world strives to accumulate the fiat money of a country whose current account deficits reaches to $435.0 billion up from $77 billion in 1990 and its foreign net indebtness is about $6 trillion against gross domestic products of $9.0 trillion.[3] Referring to the financial situation of the United States, Paul Vocker, the former chairman of the Federal Reserve Board, reiterates that "to finance both our current account deficit and our own export of capital, we need close to $3 billion of capital every working day to balance our accounts."[4]

[2] It is believed that there should be no need for foreign currency reserves to prevent foreign exchange turmoil within a freely floating exchange regime. However, because of the severity of the currency collapse and difficulty of adjusting domestic economic policy, virtually all of the countries, regardless of foreign exchange regime types such as a peg system or currency board or free exchange system, have to reserve sufficient level of foreign currencies, in particular, the United States dollar.

[3] In economic terms, current account deficit consists of trade account, income account, and foreign transfer. But, in most cases, trade deficits play a crucial role in current account balance. In historical evidences, growing current account deficits turned the United States, once the largest creditor in the world, into the biggest foreign debtor in the mid 1980s. (Above data come from the Federal Reserve Bank of New York)

[4] Paul Volcker, Testimony for Congress, July 25, 2001

Alan Greenspan, the chairman of the Federal Reserve Board of the United States, contends that the need for building U.S. dollar reserves, especially for a weaker currency country, will be a necessary choice in considering a currently unstable system. It is crucial to note though that the United States has been one of the biggest beneficiaries and the strongest proponents of the present market instability, which provides them with a unique opportunity to absorb huge amount of foreign savings. For example, it is reported that "capital inflows of close to $80 billion from the start of the Asian crisis in 1997 to the end of 1998, created a positive effect by financing a rise in U.S. spending, directly through increased financing for liquidity-constrained firms and consumers as well as indirectly through a drop in interest rates."[5] In comparison with the United States, ironically, the East Asian countries, for example, have been forced to defend further on the sponsorship of the International Monetary Fund, which has been played as one of the most influential organizations both of globalization and of such policies as the liberalization of capital markets, which make them particularly vulnerable to abrupt capital exodus. Another irony lies in the fact that, as shown in Argentine in 2001 and Brazil in 2002, despite their painful structural adjustments such as fiscal austerity policy, reduced government spending, and the sales of strategically important national corporations, there is rarely assurance of achieving financial stability represented by a stable foreign exchange rate and foreign capital inflows.

In economic principle, as many mainstream American economists believe, foreign exchange rates should be determined by demand and supply based on economic fundamentals. Yet it is interesting to know that the United States dollar has appreciated

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[5] Eric Van Wincoop & Kei yi Mui, "Asian crisis postmortem: where the money go and did the United States benefit," Economic Policy Review, September 2000,

and established the dollar hegemony, taking 68 percent of currency market share in 2000 from 50 percent in the early 1990s, while recording the largest current account deficits and accelerating its foreign indebtedness. Meanwhile South Korea, whose currency value depreciated to at least 75 percent compared to before the financial crisis in 1997, now accumulates more than $102 billion of foreign reserve currency as well as shifting its status from a net foreign debtor to a net creditor. As some economists argue, it is possible that the devaluated currency will be helpful to increase competitiveness and improve its balance of payment status. But, as seen the case of South Korea, steep depreciation of currency had played a more crucial role in lessening imports than boosting exports. In fact, after the financial crisis, the value of imports in Korea had been reduced to a little more than $21.0 billion in the following year and the level of exports of $24.6 billion, established already in 1995, was recovered three years after in 2000.[6] Joseph Stiglitz, a prominent economist at Columbia University, states that "this is the ultimate irony: the financial system allows the Untied States to live year and year beyond its means, buying abroad far more goods than it sells."[7]

1. The Purpose of This Paper

It is noteworthy to discern the difference between natural disasters such as typhoons or earthquakes and social crises like civil war or currency crisis. A crucial difference of the latter lies in its changeability insofar as we pay proper attention or take appropriate actions before it is realized in reality. The primary goal of this paper is not to test any hypothesis but to provide an alternative viewpoint to help understanding of recurrent

[6] Bank of Korea, Annual report, 2001,
[7] Joseph E. Stiglitz, "A fair deal for the world," The New York Review of Books, 05/23/02

global financial crises, in particular, in less developed or developing countries. Unlike the previous analyses of international financial/currency crises focused mainly on economic factors and domestic political factors of those impaired nations, this thesis attempts to shed lights on the likely role of international politics, especially the hegemonic strategy of the United States. Given the dominant status of the United States in the international political, military, and economic power hierarchy, it will be a valuable way of looking at the association of acting hegemon with transforming of the international economic system.

Even as the majority of research about modern currency crises, in particular the East Asian financial crisis, have shifted their focus from internal factors such as crony capitalism, corrupted politicians, inefficient banking system, and a relatively closed financial system to external factors such as financial panic, rapid financial liberalization, and increased short-term capital movement, a fatal deficiency of previous research lies in its insufficient attention to political factors.[8] In most cases, they failed to relate the international politics to recurrent financial crises, because they obviously assumed that those crises have been inevitable results of uncontrollable economic factors. Yet, considering Susan Strange's argument that "it was not invisible hands in market but political decisions regarding money and finance in the history of the world's monetary system that determined the distribution across states and class of gains and losses, risks and opportunities," it must be a necessary job to look forward the likely role of international politics on the development of the international monetary system and

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[8] Steven Radelet & Jeffrey D Sachs, "The East Asian financial crisis: Diagnosis, remedies, prospects," Brookings Papers on Economic Activity, 1998; Robert Chang, Robert Chang, "Understanding recent crises in emerging markets," Economic Review-Federal Reserve Bank of Atlanta, Second Quarter 1999

followed financial turmoil. Especially, it is crucial to ask who gets new opportunity and who is forced to run new risks from the systemic transformations.[9]

Even though quite a few scholars and experts such as Joseph Stiglitz and George Soros criticized systemic problems of the present monetary system, referred frequently to a U.S. dollar based freely floating foreign exchange regime, they pay considerable attention to the point that the main motivation of financial liberalization and capital market opening lies in ideology of the experts in Washington. For example, Stiglitz states that "the market fundamentalist, who believe that unfettered markets always and everywhere will, on their own, without government intervention, lead to efficient and socially desirable outcomes, argue that what went wrong with markets was too much government in the form of bailouts."[10] But, despite his reasonable argument against market fundamentalists, made up of the American mainstream economists and the Washington politicians, he fails to address a determining factor in constructing the market fundamental ideology. In other words, even though ideology seems to be stable, unchallengeable, and self-apparent, in many cases, there are hidden economic, political interests based on specific ideologies. In Susan Strange's term, "any ideological motivation is reinforced by an economic concern."[11]

Moreover, when those financial experts attempt to understand the motivation of the United States, which accelerated financial liberalization with the help of international organizations such as the International Monetary Fund, they focus primarily on the special interest of the financial sector represented by Wall Street financiers, which is

[9] Susan Strange, *Mad Money*, p 32
[10] Joseph Stiglitz, ibid, p 6
[11] Susan Strange, *Mad Money*, p 36

eager to maximize their profits rather than systemic stability. For example, Jagdish Bhagwati, an economic professor at Columbia University, asserts that "Wall Street's financial firms have obvious self-interest in a world of free capital mobility since it only enlarges the arena in which to make money."[12] However, it needs to be asked why the Wall Street-Treasury complex, a definite networking of like-minded luminaries among the powerful institutions-Wall Street, the Treasury Department, the State Department, the IMF, and the World Bank-has been able to agree with the ideology of the capital mobility and full financial liberalization. At least, pursuing special interest for Wall Street financiers need to be understood as a likely strategy to achieve national interests shared by the majority of the power elites within the nation system. Accordingly, given the unique opportunity of the United States due to recurrent financial crises and its role in implementing the present system, it is essential to look closer at the likely association of the United States with these on-going crises. This is far more urgent when we realize that most of the policies advised by the International Monetary Fund, supposed to work for achieving common goods in the name of financial market stability, are almost identical with the American foreign economic policies.

Robert Gilpin says that "political structure of power determines the basic framework of economic activity both in domestic realm and international level." He, as a realistic political scientist, stresses that "the pursuit of power and the pursuit of national wealth are inseparable."[13] Moreover it is unanimously shared among political scientists, whether realist or not, that the creation of money confers power as well as wealth on the creators. Defining economic hegemon as a state who has the ability and willingness to

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[12] Jagdish Bhagwati, "The Capital Myth," Foreign Affairs, May/June 1998,
[13] Andrew Walter, *World Power and World Money,* p 19

manage the international financial and trade system, Kindleberger contends that a high level of economic development and a considerable surplus of savings over domestic investment make it possible for the United States to provide the preconditions for the operation of an open or liberal world economic system.[14] According to Kindleberger, the Great Depression and the time that followed the Second World War were caused in part by a leadership vacuum. Then, the decline of US power as a hegemon has been easily employed to explain modern financial turmoil especially since the 1970s when the United States had allegedly lost her hegemonic power because of unbearable cost burdened on the shoulder of hegemon. Robert Gilpin even contends that "the United States would be well advised to divest itself of the role before, like Britain, it too damages its economy beyond repair."[15] But, disagreeing with Gilpin, Susan Strange points out the fact that "the international monetary system has been forced to loose its order because the United States had used its exorbitant privilege as the center country of a gold-exchange system to run a perpetual balance of payments deficit and to finance a distant and expensive war in Vietnam by inflationary credit expansion rather than by a transfer of resources from the American civilians to the military by means of taxation."[16] What needs to be particularly noted is that the decision to break the Bretton Woods system down has been made by the United States as a foreign economic strategy rather than granted by invisible hands in the market. Given the role of the United States in implanting the currently free floating exchange system and the resulting financial turmoil, in particular, since 1980s, it has been necessary for the author to speculate on the likely relationship between the United States

[14] Ibid, p 2
[15] Ibid, p 13
[16] Ibid, p 11

policies and recurrent financial crises around the globe. Overall, it is an inevitable step to ask who the biggest beneficiary from present market instability is and what its role in maintaining status quo or blocking to pursue required reforms is. One additional personal experience needs to be addressed before moving to research questions.

Edward Said states that “social knowledge is a social activity inextricably tied to the situation out of which it arose in the first place, which then either gives it the status of knowledge or rejects it as unsuitable for that status.”[17] One of the greatest frustrations for the author lies in that hardly any researcher attempts to examine a “strong dollar policy,” let alone relate U.S. dollar hegemony to recent currency crises. It may entirely be possible that the author’s idea is simply wrong and of little significance. Yet Susan Strange delivers an interesting viewpoint by arguing that “it will not be easy for U.S. trained economists, let alone political scientists, to question the dollar hegemony and its relation to current crises as they are trapped in the established system.”[18] To mainstream American economists, it can be ridiculous work to conjecture on the probability of U.S. intervention into recent financial crises because they simply believe that the impaired countries deserve the crises for their chronic problems such as irrational consumption or corrupted political leaders. It is also true of course that obviously the United States showed great leadership when the Korean government had to deal with private creditors such as the United States commercial banks in 1997. However, interestingly enough, the majority of research about financial crises has been produced primarily in the United States and has been supported generously by the International Monetary Funds, the United States Department of State, and public institutions such as Harvard University,

[17] Edward Said, *Covering Islam*, p156
[18] Susan Strange, *Mad Money*, p 17

Columbia University, and Brookings Institution. Edward Said stresses again that although the financial support in itself didn't dictate content and mechanically reflect a certain class or economic groups' interests, it is always possible that it set limits and maintained pressures.[19] With certainty, it will not be an easy task to figure out whether the experts residing in those impaired nations have been affected or not from the intellectual accomplishment of the United States. Yet, coincidently, just after the Korean financial crisis, many Korean scholars hurried in heralding the so-called "Mea Culpa" movement which laid primary blames on the Koreans' over-consumption, face-saving culture, and a rotten political system. At the onset of the Korean financial crisis, many Koreans students aggressively criticized the American conspiracy, but eventually they came to be complacent to the conventional wisdom that follows: 1) the Korean financial crisis was inevitable event, 2) Koreans deserve the crisis for its incapability to prepare for global change, 3) there might be external forces such as international hot money, but the U.S. has nothing to do with the Korean crisis, 4) it would be best to follow up the leadership of the United States financial institutions and the International Monetary Funds to overcome the crisis, 5) accordingly, the Koreans should not resist to sell nationalized corporations to Western corporations, to widen share of foreign capital ownership and to boost exports by suppressing currency value. Quite similar to those students, Korean government has been succumbed to follow the policy advice of the International Monetary Fund, and eventually focused its policy objective to accumulate additional U.S. dollar reserves by limiting imports and enlarging exports.[20] It should not be ignored though that both adopting a free floating exchange system and building up huge amount of dollar reserves

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[19] Edward Said, *Orientalism*, p 13
[20] The Bank of Korea, Annual Report in 2002.

will not go far enough to avert future currency collapse. Having something such as semiconductors or automobiles to sell for the American consumers has been the only opportunity for South Korea to take a different path from that of Argentina, which has nothing to sell except for her own national corporations and raw commodities.

The value of this research is its delving into the relationship between international politics and modern financial crises. On the one hand, by proposing the United States dollar policy, this paper will be helpful to grasp a comprehensive picture penetrating debt crisis in 1980s and financial crisis in 1990s. On the other hand, by looking into the likely strategies realized by the American government in managing the crises of South Korea and Argentina, it will be possible to understand the distinctiveness of social crisis presumably affected by the intervention of human beings, i.e., the intervention by an acting hegemon in the international system. In addition, in considering a lesser amount of research about the role of the United States, which acts as the only superpower in international politics and economics, this paper will be a useful attempt to look closer at the actual role of hegemony on maintaining status quo or preventing required reforms in the international financial system. Considerable attention will be paid to see whether the dominance by single hegemon is helpful or not in establishing monetary stability. Through examining the specific strategies performed by the acting hegemon-the United States- this paper can be positively employed to search for alternatives left open for the many weaker countries in terms of economic, political power. Lastly, by putting stress on the political implications of common currency, such as the euro, this study will be helpful to open additional debate over appropriate currency regimes for the global economic prosperity.

To put it together, this paper is organized with the following chapters: the United States dollar policy, literature review about the origins of the Latin American debt crisis and the East Asian financial crisis, case studies about the Korean financial crisis in 1997 and the Argentine currency crisis in 2001, and followed by discussion and conclusion. In the next chapter, the author argues that the United States dollar policy had been 1) initiated in the mid 1960s, when the United States found itself trapped in Triffin's dilemma—increased American foreign liabilities caused by the role of dollar as an international reserve currency makes the gold exchange standard increasingly vulnerable to breakdown, 2) realized as adopting a free floating exchange rate system in 1973, which provided the United States an efficient monetary tool for the Americans to avoid the adjustments that would otherwise have been required by America's news situation as a debtor, 3) challenged by confidence loss in the value of dollar as an international reserve currency because of the America's growing current account deficit and weakened financial soundness during the 1980s, and 4) ultimately, crystallized as 'a strong dollar policy,' in 1995 in order to maintain the role of dollar as an international key currency despite apparent weakness of economic fundamentals expressed by continuous current account deficits in the midst of gradual dollar depreciation and her new status as one of the largest foreign net debtor. For the purpose of theoretical justification of contending the existence of the dollar policy, following chapter reviews previous research about the origins of the Latin American debt crisis in the early 1980s and the East Asian financial crisis in the late 1990s. Considerable attention has been paid to find out common factors such as the role of the hegemon penetrating both of the crises. Then, in order to obtain better understanding of the exertion of the dollar policy, this paper, in brief, conducts a case study about the Korean and Argentina currency crises. In conclusion, after reviewing the historical evolution of the common currency, euro, this paper examines the role of politics on launching a common currency and likely impacts in the view of international balance of power. Considering the difficulty of many developing countries that have inferior currencies, the likely alternatives, for example, an Asian common currency will be suggested as well.

2. Research Questions and Data Analysis

1) Research Questions

As addressed above, this paper is motivated in part by recognizing the outstanding performance of the U.S. dollar and the United States economy in the midst of the East Asian financial crisis in 1997. To be sure, it is completely probable to contend that the economic prosperity of America has nothing to do with financial crises in developing countries. However given repeated capital inflow into the United States during those crises, it will be a valuable task to review the specific actions of the United States in handling the financial crises in the frame of the dollar policy. For instance, the question, why the United States rejected the idea of the Asian Monetary Fund before the full blown Asian financial crisis, is a question needs to be revisited. Even though there is a good deal of reasons to believe in the existence and operation of the dollar policy, figuring out the specific strategies associated with the U.S. dollar policy is far more difficult. The reason for a case study is to look more closely at the motivation of the United States which arguably pursued specific policies in order to achieve the dollar policy objectives. While hoping to understand the role of the acting hegemon, the following research questions will be examined through case studies:

Question 1: Has the United States had anything to do with the crises in South Korea and Argentina?

Question 2: If there were reliable reasons to believe the likely roles of the United States, how are the actions taken by the American government to be understood?

Question 3: Are those actions associated with the dollar policy?

2) Data Analysis

For the information of the dollar's market share and historical change of international reserve asset, the International Monetary Funds' annual survey data are employed as a main source. To check the balance of payment position of South Korea and Argentina, both countries' central bank databases are examined as well. To acquire financial data for the United States, the monthly publications of the Federal Reserve Bank at New York are included. In addition, in order to collect news articles related to the Korean and the Argentine financial crisis, this paper depends mainly on LexisNexis Academic Universe. Sample articles have been selected from the New York Times, the Washington Post, the Wall Street Journal, and the Financial Times. The search words include "financial crisis & South Korea," "debt crisis & Argentina," and "strong dollar."

CHAPTER II

THE DOLLAR POLICY OF THE UNITED STATES

Money serves, in principle, three key functions: it is a medium of exchange, a unit of account, and a store of value. Obviously, it is the United States dollar that has been enjoying the key currency status as the world's leading reserve and vehicle currency, and the most widely accepted standard of value. Yet, historical experiences tell that political involvement leads to economic involvement, and eventually, brings about a key currency status. Susan Stranges says "the political involvement clearly came first and the financial role followed." She set forth that "once in place, international economic involvement, in turn, increases the interest of the key currency in maintaining as much political dominance as well."[21] Referring to the political power related to the dollar, Robert Roosa, the former Undersecretary of the Treasury for Monetary Affairs of the United States, confesses "the use of the dollar as the major currency reserve gives it a role which naturally accompanies our leading economic and political position."[22] Accordingly, it needs to be addressed that the status of the dollar as a key currency has been achieved by a purposeful choice of the United States rather than granted for the Americans because of their superiority in technology and their incomparable amount of surpluses, in particular, since World War II. It is noteworthy to remember that the United Kingdom ran trade surpluses in only five years during the period from 1796 to 1913 when the sterling was

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[21] Susan Strange, *Sterling and British Policy*, p 15
[22] C. Fred. Bergsten, *Dilemma of the Dollar*, p 151

the leading world currency.[23] Even though the dollar, like the sterling before it, was originally elected as a key currency by market forces, Bergsten stresses that "a world political role was a necessary precedent for such election, and subsequently reinforced the market's choice."[24] Therefore, it will be a reasonable presumption to relate the present status of the United States dollar to the likely dollar policy subtly operated by the American government.

Before exploring the development of the dollar policy, it is desirable to clarify exactly what the dollar policy is. The dollar policy, in general, can be defined as the crucial part of the United States' monetary policy. To speak specifically, the dollar policy is represented by foreign exchange rate policy, supplemented by domestic monetary policies such as budget policy or interest rate policy and includes series of policies to achieve the objectives of the foreign economic policy. Moreover, since the dollar plays an international key currency especially as an international reserve asset, the dollar policy is considerably associated with the American foreign economic policy that contains two main objectives: national security and domestic economic health. Susan Stranges states that "where foreign and economic policies are concerned, only military security and monetary stability are universally sought and pursued by states above all other aims."[25] It is argued that the dollar policy consists of the following components: 1) well-disciplined policy makers who share common national interests and have the capability to pursue relatively independent policy objectives frequently affected by domestic politics, 2) the primary objectives of the dollar policy are, at first, to maintain or strengthen the reserve

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[23] C. Fred. Bergsten, ibid, p 170
[24] Ibid, p 420
[25] Susan Strange, *Sterling and British Policy*, p 334

currency role of the dollar, i.e., to buttress the United States to act as the world central bank, and, secondly, to serve for sustaining the status of the United States as a hegemon in the international system, and 3) to achieve the policy objectives, it is argued that there are generally three frontiers: to maintain stable dollar demand (demand frontier), to suppress the appearance of alternatives of the dollar as an international reserve currency (supply frontier), and to promote the role of news media in constructing confidence in the value of dollar and the present system (confidence frontier). The author contends that superior bargaining power of the United States established by increased foreign investment and aids since World War II made the United States pursue a unilateral dollar policy, and eventually contributed to develop the system in which the other nations should accept the growing deficits and influence of the United States which functions as the deficit of last resort.[26]

Clearly, there has been no officially proclaimed U.S. dollar policy except for “a strong dollar policy” publicized by the former Treasury Secretary Robert E. Rubin in 1995. What needs to be noted, though, is the fact that the primary objective of the dollar policy lies neither in evaluating dollar price which definitely has a negative effect on increasing trade deficits nor in devaluating dollar level that is potentially detrimental in maintaining the status of dollar as an international vehicle, intervention, and reserve currency. But, usually, it is considered that gradual depreciation of the dollar value may reflect the dwindling power of the United States as a financial hegemon. For instance, when the value of dollar against Japanese yen was devaluated from 357 in 1971 to 250 in 1985 and 81 in 1995, it was believed during the early 1990s that the dollar was finished as the currency of choice around the world and soon to be replaced by the European

[26] George Soros, *On Globalization*, p 5

common unit (ECU) and the yen.[27] Since the United States became sole hegemon only after the demise of the Britain, it was generally proclaimed at that time that Japan's huge trade surpluses and strength of yen would allow it to pile up wealth and grow strong at the expense of the United States.[28] Correspondingly, naturally enough, there should have been less favor with dollar devaluation rather than evaluation or at least maintaining stable value to buttress the role of a reserve currency. To put it simply, the repeated devaluation would likely force the dollar holders to be tempted to look for alternative assets such as gold or other hard currencies such as the Japanese yen or euro that probably have less risk in terms of price. What the Europeans and Japanese shared has been the notion that the fundamental causes of dollar's depreciation are the Americans' budget deficit and the unfavorable balance of payments that show no sign of improving. It is crucial to note the point that devaluating or evaluating the dollar level is a means rather than a final objective of the dollar policy. Therefore, it must be a mistake to consider that the United States gives up the dollar policy when the American government takes a benign neglect policy saying that market decides the value of dollar, not governmental intervention. As historical evidences show, the American government intervened into the foreign exchange market only when the dollar was caught in severe downward trend, for instance, in 1979, 1987, 1993, and 1995. The Plaza Accord in 1985 was the only exceptional case for the United States to intervene into the market to make the dollar devaluate. However, the decision to devaluate the dollar was soon reversed into the dollar appreciation at the Louvre Accord in 1987. In effect, while concerning about the ever-deteriorating trade deficit with the Japan in spite of about 30 percent of Japanese

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[27] Erdman, *Tug of War: Dollar Crisis or Yen Crisis,* p 81
[28] Ibid, p 132

yen appreciation in the early 1990s, the Clinton Administration intervened into the foreign exchange market repeatedly to boost dollar value during the first years of the Administration. Correspondingly, when the Mexican peso crisis in December 1994 affected negatively on the value of dollar, the Clinton Administration officially launched "a strong dollar policy," in the mid 1995.

Before exploring the likely policy makers, it is required to understand the backgrounds of launching a strong dollar policy in 1995. First of all, as shown in the following Figure 1, the Louvre Accord in 1987 failed to prevent further dollar depreciation as well as to improve trade and current account deficits. Figure 1 indicates that the total amount of trade and current account deficits had been sharply increasing since 1991 even as the value of dollar against the Japanese yen declined from 150 in 1991 to close to 80 in 1995. Furthermore, as Figure 2 shows, since the United States turn into a net foreign debt country in the mid 1980s, it can be inferred that the United States could not afford to accept further dollar devaluation. Simply speaking, a depreciated dollar implies that first, there will be growing pressure for the other central banks to look for alternatives hard currencies such as Japanese yen or German mark, second, it will become more difficult for the United States to finance its deficits by selling Treasury bonds, and lastly, the United States, as South Korea did during the financial crisis, will pay extra interests for its foreign borrowings to sustain foreign investments. In this context, the Clinton administration officially launched a strong dollar policy in 1995. Robert Rubin, the former Treasury Secretary, announced that

> "A strong dollar is in the best interest for our nation, while enhancing the international buying power of Americans and helping to curb inflation. By limiting inflation, the stronger dollar also tends to reassure financial markets and hold down interest rates, which can be helpful to boost domestic

investment. In addition, a stronger dollar is also needed to insure that central banks continue to hold large sums of dollars as part of their foreign exchange reserves. Moreover, it also helps insure that the United States can continue to finance its budget deficits by selling bonds dominated by dollars."[29]

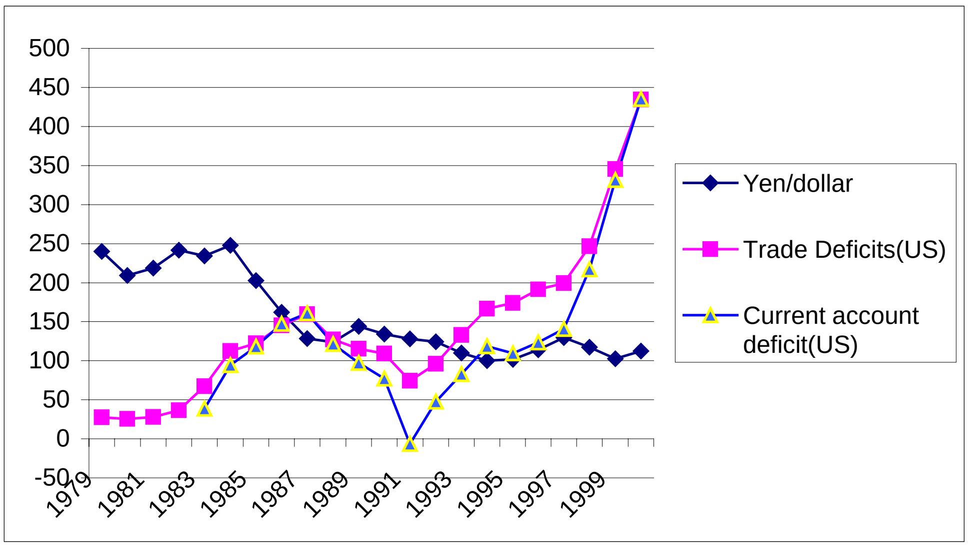

Figure 1: Historical trend of U.S. exchange rates, trade deficits ($ billion), and current account balance ($ billion)

(Note: A current account surplus in 1991 owed a vast amount to international transfer surplus of 10.8 billion from –26.7 billion in 1990)

[29] Robert Rubin, quoted from the New York Times, 08/15/95

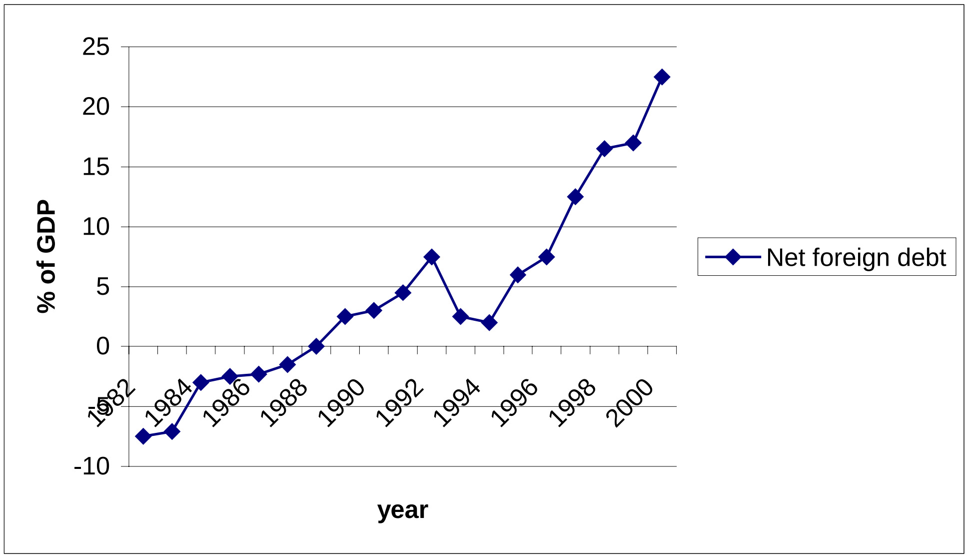

Figure 2: U.S. net foreign debt (Bureau of Economic Analysis)

(Note: A minus percentage indicates a net surplus of foreign debt)

Given the complexity surrounding foreign economic policies, in particular the dollar policy, the first task needs to be focused on the likely decision makers who actually initiated and executed the dollar policy. It is not sufficient to assume general state agents who are randomly assigned to deal with the dollar policy because it requires relatively coherent, well-disciplined, and independent experts groups. Since there has been very little amount of research about the dollar policy, it is unavoidable to make a hypothesis about the likely policy makers who launched and executed the dollar policy. In fact, while emphasizing the independence of the American foreign economic policy making, C. Goddard says that domestic interest groups along with lawmakers played very little part and remained relatively passive toward the entire international monetary policy issue area.[30] With certainty, it does not necessarily mean that domestic politics has nothing to

[30] C.Roe.Goddard, *U.S. Foreign Economic Policy and the Latin America Debt Issue*, p 84

do with it. Instead, it may imply that given the arcane and compound issues related to the dollar policy, those decision makers have been able to enjoy relatively independent decisions in accordance with their own jurisdictions. In effect, shared perception of national interests and relatively close human network among financial experts who are related to the Treasury department, the Federal Reserve Board and the Wall Street financiers may help them to pursue relatively consistent, well-designed and less visible policy objectives. It is also worthwhile to quote Ethman Kaptein's remark to understand states behaviors. He says that learning and the development of consensual knowledge may play a more crucial role in decision-making about international monetary issues.[31] Even though the British government scarcely researched their sterling policy, it is possible that American policy makers have learned precious lessons from the failure of the sterling - the former international key currency. One pivotal historical proof is that the Nixon administration declared gold inconvertibility into the dollar in 1971 and eventually floated the United States dollar in 1973 despite the historical experience that the British sterling never regained a truly global role after Britain suspended gold convertibility and floated its currency in 1931. The far superior bargaining power of the United States, since it enjoys the right to breakup the gold-dollar fixed exchange system after calculation costs and benefits, probably have helped the decision. It is valuable to note Susan Strange's remark that rarely decisions were inevitable as well as unavoidable especially in the international monetary issues. In addition, the fact that Paul O'Neill, who currently serves as a Treasury Secretary in the Bush administration, stands firmly with the strong dollar policy launched during the Clinton administration, possibly addresses the identification of national interests internalized among those agents who are in charge of

[31] Benjamin Cohen, *The International Political Economy of Monetary Relations*, p 17

crucial economic policy such as the dollar policy. In short, it is claimed in this thesis that professional expertise, relatively free from political pressure and shared national interests have been positively affected to initiate and pursue a coherent dollar policy since the mid 1960s. If an army of experts, who share common national interests, do exist and have the capability to pursue a relatively coherent policy, the next questions should be about the main purposes of launching the dollar policy and in what contexts it happens.

In following with Bejamin Cohen, there are two distinctive benefits for the country that has an international reserve currency. [32] On the one hand, the state is able to enjoy far greater flexibility of macroeconomic policy that is afforded by the privileges of being able to rely on domestic currency to help finance external deficits. It is helpful to look at most of the third world debt countries which do not have financial resources to finance their own deficits, and finally depend on the hand-outs provided by the International Monetary Fund with harsh conditionality. On the other hand, it will be possible for the key currency state to wield enormous political power that derives from the monetary dependence of others. Historical evidences indicate that the United State attempted to use this leverage against the Axis powers in World War II, against the Asian Communist countries in the early post-war period and then against the Arabs in the crisis of 1967.[33] While referring to 'seigniorage' as the command over real resources available to a

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[32] Benjamin J. Cohen, *Life at the Top: International Currencies in the 21st Century*, p 15
[33] C. Fred. Bergsten, ibid, p 339

sovereign state from his monopolistic privilege of coning money, Bergsten states that "seigniorage is available if a country appropriates real resources through the issue of non-interests bearing debt, through the suppression of interest rate or through the exercise of reserve requirement."[34] He goes on to add that "an elimination of the reserve currency role of the dollar would of course reduce one key aspect of the international monetary power of the United States."[35] Taking into account those American policy makers' philosophy that the hegemonic system has inherent inequality and exploitation even as other states may benefit from the order instituted by the hegemon, it can be inferred that those American policy makers might not likely to give up the privilege of the dollar. [36] Heretofore, the main purposes of the dollar policy should address the intention of the political and economic leadership by the United States. The author, in this context, argues that the primary objectives of the dollar policy lie in the following: On the one hand, maintaining or strengthening the reserve currency role of the dollar; buttressing the United States to act as the world central bank supposed to create international liquidity and credit, and on the other hand, helping the political leadership of the United States; serving for sustaining the status of the United States as a hegemon in the international system. Bergsten confesses that "total hegemony would be most compatible with global vehicle currency and reserve currency use."[37]According to Susan Strange, in effect, French administrations had strenuously attempted to reduce the role of reserve currencies that the exorbitant privilege afforded to the major Anglo-Saxon countries such as the

[34] C. Fred. Bergsten, ibid, p 210
[35] C. Fred. Bergsten, ibid, p 36
[36] Robert Gilpin, quoted from *World Power and World Money*, p 31
[37] C. Fred. Bergsten, ibid, p 112

Britain and the United States.[38] She asserts that "any monetary system is at once the servant and the partner of a political system."[39] It is safe to say that the lessons learned from the Britain's failure have been positively employed to achieve these goals. Bergsten set forth that "it also became apparent that potentially tragic parallels existed between the historical evolution of the roles of the sterling and the economic and political development of the United Kingdom, on the one hand, and the likely evolution of the dollar and the economic and political development of the United States, on the other hand."[40] Yet, without considering the historical contexts confronting the United States, it will be hard to grasp a whole picture why the United States projected the dollar policy especially in the mid-late 1960s. Bergsten suggests that only after the mid 1960s, the United States began to adopt active policies toward its balance of payments and toward the creation of a dollar area with as many members as could be cajoled into joining.[41] Of course, the actual time of launching the dollar policy should be more complicated. Susan Stranges, for instance, contends that the overriding purpose of the American government has been to defend the exchange value of the dollar against gold since the 1950s.[42] However, considering the sharply deteriorated U.S. balance of payment and increased pressures from the Gold block countries like France eventually doubted the dollar's convertibility, it may not unreasonable to assume that the dollar policy possibly began in the mid or late 1960s.

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[38] Susan Strange, ibid, p 172
[39] Susan Strange, "The politics of the international currencies," quoted from *The International Political Economy of Monetary Relations*, Benjamin Cohen (ed.), p 89
[40] C. Fred. Bergsten, ibid, p xiii
[41] C. Fred. Bergsten, ibid, p xiii
[42] Susan Strange, ibid, p 56

Ironically enough, the need for a dollar policy has been strongly associated with the growing political power of the United States. In Bergsten's words, "there emerged a sharp contrast between the political power position of the United States and the international role of the dollar in the early 1970s."[43] Susan Strange says that "both sharply increased American private investment insured by the United States government in case of many economic, political risks and the proceeding government programs contributed, in turn, to the American balance-of-payment deficits, which required external financing, and hence to the development of reserve currency role of the dollar."[44] One of the reliable ways of understanding specific policy is to consider both the external and internal challenges. Therefore, the first step should be to trace the historical backgrounds of those challenges strongly associated with the status of dollar as a key currency. To assess the dollar status before 1973 when the international monetary system finally had been shifted from a fixed gold-dollar system to a free floating foreign exchange regime, Bergsten recommends to divide the Bretton Woods system from 1944 to 1971 into three distinctive phases.[45] According to him, the first phase of the so-called 'dollar shortage' period, started just after World War II and lasted until 1958. Since the sterling lost its status as an internationally acceptable currency due to war damages and repeated devaluations the dollar was considered the only internationally reliable currency that could provide international liquidity and credit. It is even said that during most of the 1950s the American private capital outflow was regarded as a blessing and the accumulation of foreign dollar balances, together with some redistribution of the United

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[43] C. Fred. Bergsten, ibid, p 115
[44] C. Fred. Bergsten, ibid, p 81 & p 134
[45] C. Fred. Bergsten, ibid, xi

States gold stock, was considered as vital to the restoration of international currency convertibility and the removal of barriers to world trade.[46] The second phase from 1958 to 1967 or 1968 is distinguished by the return of the European currencies as the European countries, in particular West German, were able to significantly improve their current account balance as well as threatening the competitiveness of the United States in the international markets. Throughout the second period, the role of the dollar as a reserve currency came to be questioned and the balance of payment of the United Stated has gradually deteriorated. Such attempts as charging extra tax on bonds and stocks purchased by Americans from foreigners in 1963 and adopting a voluntary limitation policy on direct investment by American firms in developed countries in 1965, all proved to be less effective to mitigate the growing concern about the sustainability of the dollar. In addition, during the 1960s, the large amount of American capital outflows gradually force the Europeans to support the idea that the privilege conferred on the United States by the key currency status of the dollar allowed it to exchange paper dollar assets for control over European resources. Still the United States has successfully controlled the behaviors of the surplus countries such as West Germany and Japan during the second phase. For instance, with the intention of relieving the burden of the Americans and avoiding the risk of the United States troop's withdrawals, West Germany formally renounced its right to convert dollars into American gold in 1967. However, sharply increased United States current account deficits in 1969, the outbreak of the Vietnam war, and growing pressures from the gold block countries which have developed strong suspicion on the American foreign policy and its further commitment to converting dollars into gold, made augmenting the pressure to convert dollars into gold.

[46] Raymond F. Mikesell, *The U.S. balance of payments and the international role of the dollar*, p 4

To clarify the external factors in the development of the dollar policy, it is vital to look at the concerns to which the United States government paid considerable attention, especially since the mid to late 1960s. Asserting the need for an international central bank or at least an international reserve currency,[47] not the American dollar, Robert Triffins set forth that "while the world requires continuous the United States deficits to provide an expansion of the total volume of international liquidity, the growing volume of liquid dollar liabilities to foreigners has made the gold exchange standard increasingly vulnerable to breakdown."[48] Since the American balance-of-payment deficits eventually resulted in either a loss of gold stock or an accumulation of liquid dollar liabilities to foreigners, there was a growing concern to sustain the exchange value of the dollar against gold at the price of $35. For most of European central bankers, the largest concern was the vulnerability of the international payment system and their obligation to accept dollars in one form or another to preserve the system. The solutions in the view of those European bankers, therefore, were the deflation of the United States (i.e. less importing and more saving) and a reduction in United States economic and military aid to the developing countries. However, because the United States possesses leverage through its ability to finance balance of payment deficits and to break up the so-called gold-dollar exchange system, any suggestions of establishing an international central bank or creating international reserve assets rather than relying on American dollar as a reserve currency has been treated unfavorably. The American government, instead, took actions to strengthen capital export controls and pushed foreign central banks to hold their dollars in

[47] Much debate after the recent financial crises is essentially the same as those proposals recommended by Robert Triffins and John R. Keynes.
[48] Paul Crugman, *Currencies and Crises*, p 11

those forms such as non-marketable, nonconvertible, and medium-term United States Treasury Bonds, known as Roosa bonds. In other words, the primary aim of these actions was to limit abrupt capital exodus from the United States rather than to give up the advantage of the dollar as an international key currency. Andrew Walter asserts that "as the importance of the dollar in the international monetary and financial system steadily grew in the late 1960s and into the 1970s, the incentive for the U.S. in particular to accept a collectively managed system correspondingly declines."[49] While the United States and the American economists attempt to move to a full-dollar standard, discarding gold entirely, many European economists including Robert Triffin ardently contend that "there is little guarantee that the United States will be able to manage the system beyond private interests such as the profits or seigniorage it gains from its international banking service, oversea activities, and asset acquisition it can finance due to the role of its currency."[50] Heretofore, it is not impossible to suppose that one of the primary goals of the dollar policy must be to maintain and eventually strengthen the status of the dollar as an international reserve currency in spite of the shrinking gold stock, the deteriorating balance of payment position and the diminishing confidence in the value of dollar. In this context, while being funded by the Council on Foreign Relations, Bergsten, who worked as an assistant for International Economic Affairs to the National Security Council, came to propose an alternative monetary regime saying that his objective lies in proposing an approach to international monetary policy for the United States that will maximize the benefits.[51] Whether coincidental or not, the following transformation of the international

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[49] Andrew Walter, ibid, p 174
[50] Andrew Walter, ibid, p 74
[51] C. Fred. Bergsten, ibid, p xi

monetary system shows a clear identification with Bergsten's final proposal in 1968. To accomplish the aim at crowning the dollar, he suggests taking advantage of market forces rather than guaranteeing the value of foreign-held dollars against any United States devaluation, which devastated the British economy until the sterling finally stopped its function as an international reserve currency. He asserts that there are two likely conditions to achieve a pure dollar standard in an unorganized system relying on the interplay of market forces. On the one hand, if the dollar were again to meet the necessary criteria of key currency such as having an outstanding size of its economy, a well-developed financial market, and strong confidence in the political system along side the value of dollar. On the other hand, if there were not appropriate substitutes as an international reserve assets.[52] It is important to remember that in a pure dollar standard, with the world fully reliant on the dollar and no other reserve or vehicle assets in existence, the United States will need neither to back its outstanding liabilities nor to finance its current deficits.[53] Burgi and Golub confirm the view by stating that "the floating exchange rate system, taken unilaterally by the United States in 1973, provided a flexible and efficient monetary tool that enabled them (the Americans) to avoid the adjustments that would otherwise have been required by America's news situation as a debtor."[54] They continue that "in a system of fixed exchange rates and gold convertibility, the United Stated would have been obliged, like every third-world country today, to pay for its indebtedness with a relative loss of sovereignty and highly unpopular domestic austerity measures." As a result, it is believed that the United States appeared to

[52] C. Fred. Bergsten, ibid, p 420
[53] C. Fred. Bergsten, ibid, p 115
[54] Noelle Burgi & Philip S. Golub, "Has globalization really made nations redundant?" Le Monde Diplomatique, April, 2000, http://mondediplo.com/2000/04/07golub.

achieve monetary utopia: unlimited financing via the dollar for its deficit and adjustment initiated by others when they are unwilling to accept the dollar any more.[55]

To speculate on the likely strategies to achieve the objectives of the dollar policy is not an easy task. Yet, it is rational to suppose that the United States is less likely to repeat the same mistakes done by the British government when it tried to restore the power of the sterling as a key currency. For example, to guard the sterling against a resulting loss of confidence in the market, the British government had to keep an extremely high level of interest rates[56] as well as subsidize sterling holders with a cheap insurance against devaluation.[57] What needs to be noted is that the needs for additional cost of insurance on the sterling had been increased by the existence of alternative assets such as the dollar and gold. If the sterling were the only international reserve currency and the other nations had no option but to accept the pure sterling monetary system, the British would not have had to spend huge amount of financial resources, which, in turn, contributed to the demise of the British as a hegemon. Coincidence or not, the United Stated actually set forth a policy aiming at mitigating the role of gold as an international asset in the early 1960s. In mentioning the "Despres Plan" of 1965-66, which rescinds the United States government's commitment to buy from foreign monetary authorities any gold that they acquired after the announcement of the new policy, Bersten suggests to consider the plan as an elaborate proposal to crown the dollar by cutting down gold. He says that "this would supposedly make clear that gold derived its value primarily from its

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[55] C. Fred. Bersten, ibid, p 399
[56] In economic principle, it is believed that the higher interest rates the stronger the currency will be. In this connection, the primary prescription of the International Monetary Fund is focused on hiking interest rates to prevent further capital exodus and currency depreciation.
[57] Susan Strange, "The Politics of International Currencies," quoted from *The International Political Economy of Monetary Relations,* p 77

assured convertibility into dollars at a fixed price, and eliminate it as a serious contender to the dollar as a result."[58] In addition, even as the United States finally agreed to the creation of Special Drawing Rights (SDRs) as an international reserve assets in 1969 primarily to avoid the criticism come from the Europeans, its probability to replace reserve currencies and in particular the dollar is not at all clear because the American government has the ability to block any reform through a veto power in the International Monetary Fund.[59] Andrew Walter emphasizes that "the United States retain the ability to determine (at least in a negative sense) the pace of international monetary reform, in particular concerning any future role for the SDR or a reform of the exchange rate system."[60] Whether achieved by the dollar policy or led by the invisible hand supposed to be at work in the market, Figure 3 shows quite well the sharply dwindled role of gold since 1971 and less impressive role of SDRs and the IMF credits. Figure 3 also indicates that the share of currencies, particularly dominated by the United States dollar, remains above 80 per cent of total international reserve assets since 1980. Meanwhile, the value of gold as an international reserve came to be questioned since the early 1970s, when the Nixon Administration officially prohibited gold convertibility into dollars. In addition, most of the IMF reserves and SDRs are currently used for the less developed countries which suffered chronic foreign indebtedness since the early 1980s. The far increased power of the United States can be anticipated because of its strengthened status as a key currency in creating and managing international liquidity. Historical evidences repeatedly

[58] C. Fred. Bersten, ibid, p 425.
[59] Even though the United Stated has about 18 % of voting power in 2002 standard, the United States is able to veto any decision considered to be harmful to the American national interest since the approval rate should be above 85 % of major decisions.
[60] Andrew Walter, ibid, p 227

show that the monetary policy of the United States plays a pivotal role in international economic development.

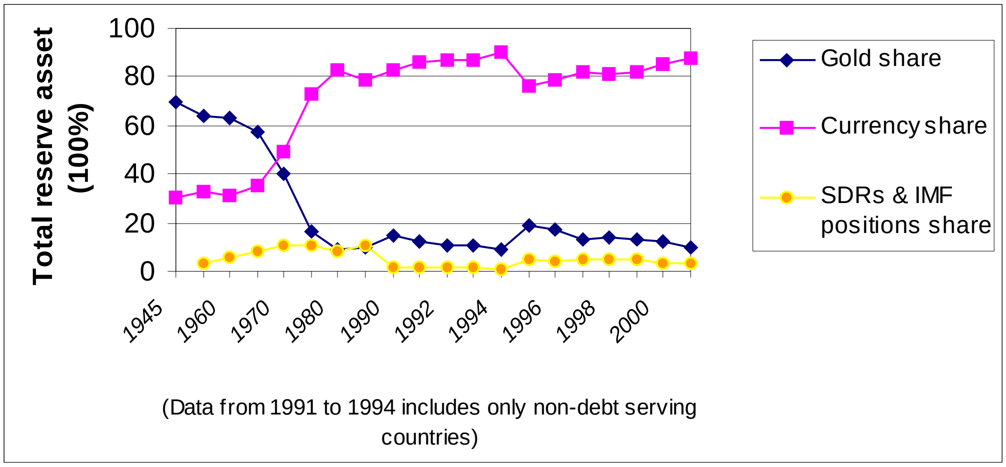

Figure 3: Shift of international reserve components (Source: IMF)

In order to obtain a better understanding of the probable strategies of the dollar policy, the author proposes to consider three frontiers related to the dollar policy - demand aspect, supply aspect, and confidence aspect. First, as with general commodities it is necessary to recognize that the value of the dollar and confidence in the dollar should depend on supply and demand. The artificial demand on the dollar has been helped, on the one hand, by the fact that growing number of countries have to pile up extra U.S. dollars to prepare for market volatility, and on the other hand, by market preference to purchase American bonds and stocks because the United States dollar was considered the most safest currency in the market. Therefore, it is natural to claim that insofar as the crises are helpful to augment artificial demand on the dollar and bring about far more favorable conditions for international borrowings, there will be less concern in the view of the United States. In fact, it is reported that the capital inflows, cause by the Asian crisis, created a positive effect by financing a rise in U.S. spending, directly through increased financing for liquidity-constrained firms and consumers as well as indirectly through a drop in interest rates.[61] Secondly, since the price of dollar, in economic principle, must be affected by the total amount of the dollar supply, whether held by foreign governments or private banks, it will be reasonable to suppose that those American dollar policy makers need to pay considerable attention to control the total supply of dollar. But, given the sharply dwindled influence of gold and SDRs as an international reserve asset, as shown in Figure 3, it is expected that to squeeze the dollar supply may not be free from cost in the international economy. Unless total world liquidity is rising, increases in one country's reserves can take place only if there is a corresponding decline in another's. It indicates that the sharp increase of the dollar reserves in the East Asian countries after the financial crisis in 1997 inevitably resulted in the same amount of deduction in other countries' dollar reserves if the United States does not increase the supply of dollars. Yet, as suggested above, since the total amount of the dollar must be limited to sustain the value of the dollar as an international reserve currency, the increased reserve holding of those countries such as South Korea and China, will eventually lead to further economic recession. In other words, it can be equal to the same situation as consumers restricting their spending in the midst of economic uncertainty. Finally, in remembering that the sterling had been considerably affected more by confidence loss rather than current account balances, it is anticipated that substantial considerations have been given to maintain international confidence in the

[61] Eric van Wincoop & Kei-Mu Yi, "Asia Crisis Postmortem," Economic Policy Review, September/2000, p 51

value of dollar as a key currency. In this context, what matters less to the American policy makers is the widening trade deficit than its likely negative effects on confidence in the value of dollar and not vice versa. Accordingly, insofar as the international society lacks of alternative international reserve assets and the United States is able to hold reliable confidence in the value of dollar through either an official statement like "a strong dollar policy" or an attempt to reduce budget deficit, there will be less concerns about the ever growing trade and current account deficits in the view of the United States. Yet, economically, the growing current account balance deficits should raise serious fears regarding the financial soundness of the economies since they imply growing indebtedness. On a related note, it is not unreasonable to ask how it is possible for other states or private banks to hold a similar or even higher level of confidence in the dollar in spite of the obviously deteriorating United States economic fundamentals. It is probable to contend, as the Secretary of the Treasury Paul O'Neill says, that the current-account deficit and foreign indebtedness are meaningless concepts.[62] However what should not be ignored is the lesson that the decision of the International Monetary Fund on severing already scheduled financial aids to Argentina was justified by relatively high amount of current account deficits and foreign indebtedness of Argentina. With regard to the fact that the United States achieved the dollar hegemony in the midst of the worst financial soundness of the United States, it is recommended to take into account the role of the American news media. For example, reminding of the fact that Britain had been able to play as an international reserve currency in spite of relatively small size of GDP, Susan Strange asserts that "though Britain has no newspapers as good as Le Monde or the Neue

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[62] Eric Pfanner, "Weak data give dollar investors the shivers," The International Herald Tribune, May 4, 2002.

Zeitung, the foreign circulation of these journals is limited. On the other hand, the jeremiads of the Economist or the Financial Times reverberate throughout the length and breathe of Europe."[63] Taking into consideration the dominance of the U.S. news media circulating not only in Europe but also in the world, proposing the likely role of U.S. based media in augmenting the confidence in the value of dollar and present international financial system will not be irrational. In fact, Figure 4 below reveals a clear divergence between the dollar performance and the financial soundness of the United States. Especially, since 1995 when the United Stated launched a strong dollar policy, there emerged a sharp contrast between the growing dominance of the dollar and the increasing foreign indebtedness of the United States. According Figure 4, the total foreign indebtedness of the United States as of Gross Domestic Products (GDP) is equal to 25 percent in 2001 base. Paying attention to 4.1 percent of current account deficit as of GDP, Paul Volcker, the former Chairman of the Federal Reserve Board, states that "the amount of $3 billion of capital import per day is simply too large to count on maintaining year after year, much less enlarging."[64] In this context, it is likely to contend that both a strong dollar policy followed by the United States economic prosperity and the potential role of the American press all contributed to bring about the present dollar hegemony. As economic experiences show, since the strength of currency has been strongly associated with the successful performance of domestic economy, as addressed by Robert Rubin in "a strong dollar policy," there is indeed a considerable stake to be tempted to employ the power of the United States based news media.

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[63] Susan Strange, ibid. p 331

[64] Paul A. Volcker, Prepared Testimony for Congress Hearing, August, 2001, quoted from http://www.unsustainable.org/view_art_un.asp?AID=120

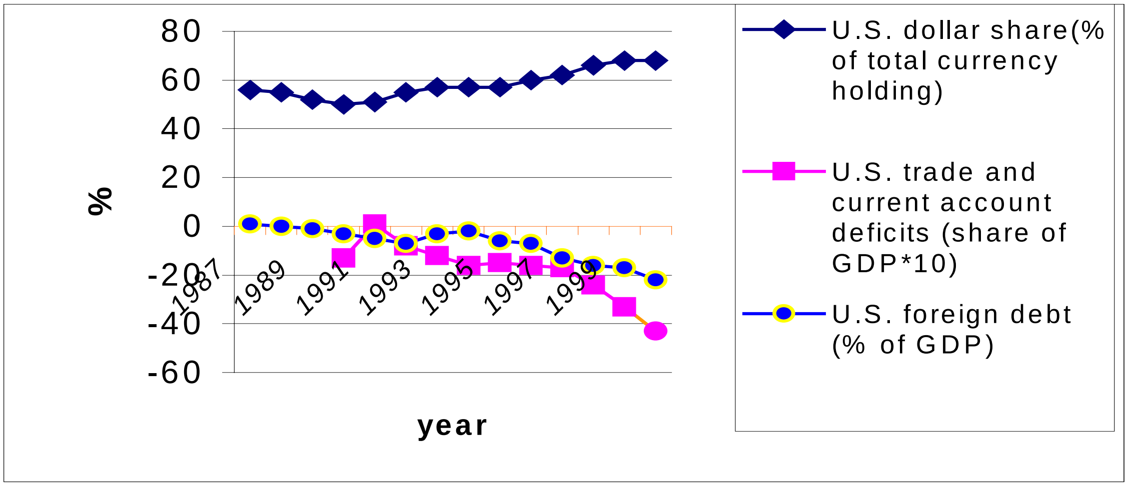

Figure 4: Comparison among the dollar performance, U.S. current account deficit and U.S. foreign debt (Source: Bureau of Economic Analysis)

In summary, the following arguments are proposed in this paper: First, the dollar policy is adopted as a crucial part of the U.S. monetary policy. Yet, since the dollar serves as an international reserve currency, it is more strongly associated with the American foreign economic policy. Second, there will be a number of well-disciplined, politically independent experts who are supposed to take in charge of initiating and operating a relatively coherent dollar policy. Third, the primary objectives of the dollar policy lie in, on the one hand, maintaining or strengthening the reserve currency role of the dollar, and on the other hand, serving for sustaining the status of the America as a hegemon in the international system. Fourth, sharply grown political power may provide the United States with the opportunity to pursue the dollar policy in spite of the dollar's declining confidence and deteriorating economic fundamentals of the United States. And finally, it is advised to divide the dollar policy into three frontiers: demand aspect, supply aspect, and confidence aspect. Keeping in mind the potential strategies related to the dollar policy, the author looks at the behaviors of the United States and the International Monetary Fund during the Korean and Argentina crisis. It will be definitely possible to conclude that if the United States abolished the role of gold as an international reserve currency, the next targets should be other hard currencies like the Japanese yen or the German mark. By pointing out the fact that Japanese yen was restricted in all sorts of ways by regulations and capital controls, Alan Walter asserts, "the triumph of the dollar was largely due to the restriction policies imposed on alternative currencies."[65]

[65] Alan A. Walter, "The coming of the euro: international money and global politics,"

CHAPTER III

LITERATURE ON THE FINANCIAL CRISES IN SOUTH KOREA AND ARGENTINA

Modern currency crises include a debt crisis in Latin America in the early 1980s, the European currency crisis in the early 1990s, and the East Asian financial crisis in the late 1990s. Yet, since the main purpose of this paper is to understand the dollar policy and its association with recent currency crises which brought about less desirable circumstances in many developing countries, it is expected that to review both the debt crisis and the Asian crisis will be sufficient to achieve this goal. Considering the recurrent financial crises in Brazil and Argentina even after a decade of painful reforms as proscribed by international organizations, in particular, the International Monetary Fund and the World Bank, reviewing the origins and development of Third world debt crisis and supposing an alternative viewpoint based on the exertion of the United States dollar policy will be very a valuable attempt. Additional review of the East Asian financial crisis, known as a global contagion effect, will be another good source to understand the contextual and historical factors surrounding the ongoing crises. Given the unique position of Japan as a potential rivalry to the dollar hegemony, literature on the East Asian crisis can be positively utilized to understand the likely existence and operation of the dollar policy.

1. The Origins and Development of Latin American Debt Crisis

It is worthwhile to note that the critical difference between Latin America debt crisis and the Asian crisis lies in whether it is a liquidity crisis or a solvency crisis. Jeffrey Sachs, an economist of Harvard University, explains that “an insolvent borrower lacks of the net worth to repay outstanding debts out of future earnings, meanwhile, an illiquid borrower lacks of the ready cash to repay current debt-serving obligations, even though this borrower has the net worth to repay the debts in the long term.”[66] Keeping in mind the distinctiveness between a liquidity and solvency crisis, Paul Krugman, an international political economy professor at Massachusetts Institute of Technology, argues that “even though, initially, the Latin American countries were not considered as having an insolvency problem given their enormous raw resources, eventually, their debt problem came to change its essence from an illiquid one into an insolvency one due to their over-hang debt which has absorbed a vast amount of their export earnings since the early 1980s.”[67]

The primary benefits of this review lie in, on the one hand, the helpful insights it give to comprehend the present crisis of Argentine in 2001, which is still suffering from over-hang debt problem inherited since the early 1980s. On the other hand, by obtaining the opportunity of looking into the role of the United States in originating and developing the debt crisis, it may be useful to apply the dollar policy to the on-going crises particularly in developing nations. Before looking back at the causes of the Latin debt crisis, it is recommended to remind the fact that the United States has been able to avoid

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[66] Steven Radelet & Jeffrey D Sachs, “The East Asian financial crisis: Diagnosis, remedies, prospects,” Brookings Papers on Economic Activity, 1998,

any obligation to pay for its indebtedness with a relative loss of sovereignty and highly unpopular domestic austerity measures owed good deal to the free floating foreign exchange system adopted unilaterally by the American government in 1973. Differently speaking, by financing its deficit via printing the dollar, the United States efficiently could export the burden of adjustments to the other countries, especially to the developing countries. Explaining deficiencies of this system, Bird and Killick assert that "it has given rise to an asymmetrical pattern of adjustment, with most of the burden falling upon the deficit countries, particularly, whose currencies are not reserve currencies and which have low commercial bank credit ratings."[68] A pivotal common factor between the Latin America debt crisis and the Asian crisis is that both the Latin Americans and the East Asians have had to adjust their current account deficits currently by deflating domestic spending and imports rather than to finance their deficits like the Americans. [69] Consequently, repeated adjustments via devaluating foreign exchange rate and via adopting fiscal austerity eventually drove most of the developing countries into a further economic recession and enlarged financial dependence on the International Monetary Fund and in particular the United States.

Even as the origins of the debt crisis can be traced apparently back to the quadrupling of oil prices in 1973-74 and the doubling of prices in 1979-80 which forced

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[67] Paul Krugman, *Currencies and Crises*, p 142

[68] Graham Bird & Tony Killick, "Balance of payment management: The IMF and the Third World," quoted from *The Political Economy of International Money*, Loukas Tsoukalis (ed.), p 233

[69] In general, current account deficits come primarily from trade deficit and aggravated by capital account deficits or mitigated by capital account surplus. For example, vast parts of U.S. current account deficits caused mainly by trade deficits. It is noteworthy that continuous current account deficits consequently lead to foreign indebtedness. Hence, the present foreign indebtedness of the United States equal to almost 25% as of Gross Domestic Products was the fruits of ongoing trade deficits by the Americans.

most of oil-importing countries to meet current account deficits, it is valuable to divide the causes of Latin debt crisis into the following three perspectives: a traditional viewpoint focused mainly on internal/domestic factors, a revised point of view widened to emphasize the role of external factors such as global economic recession or abnormally mounted interest rate, and an alternative approach based on international politics, especially, the United States dollar policy. While admitting the difficulty in attributing the origins of the debt crisis to a single cause, Goddard presents the following five factors as the main internal (national) causes of the debt crisis: 1) the contracting of international loans in order to maintain high growth levels, 2) import-substitution development strategies, 3) opposition to direct foreign investment, 4) the pursuit of monetary policies conductive to capital flight, and 5) a general unwillingness to impose austerity measures on their population. [70] Explaining the preference for international borrowing (financing) rather than immediate adjustment by slowing domestic growth, he states that “as credit flowed mainly from the surpluses of the oil-exporting countries was widely available and inexpensive, the Latin American governments less inclined to immediate adjustment rather than to depend on external indebtedness as the source of capital for continued deficit spending.”[71] Pointing out the fact that the vast majority of their total trade deficit came from the oil trade balance rather than structural lacks of competitiveness, Bird and Killick also state that since they believed that global developments, exogenous to individual countries, have had a great deal to do with the worsening current account

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[70] C. Roe Goddard, *U.S. Foreign Economic Policy and the Latin American Debt Issue*, p 4
[71] Ibid, p 5

balance of the Latin countries, the immediate needs of adjustment failed to get strong support at that time.[72] But, by noting relatively unpaired economies of the Asian countries since the early 1980s, Jeffrey Sachs criticizes that "internal fiscal and monetary management (adopted by the Latin governments) is most important in separating those countries that did and did not experience the need to renegotiate foreign debt."[73] In an attempt to compare development strategies between the East Asian countries and the Latin American states, Goddard stresses that "although the East Asian adopted the usual protectionist policies, including import-licensing, tariffs, overvalued exchange rates, and artificially low interest rates, their application was more flexible, less severe, and of a shorter duration than in the Latin American countries."[74] By mentioning the role of overvalued exchange rates and artificial low interest rates in augmenting the pressure of capital flight, Goddard states, "highly evaluated foreign exchange rates not only decreased the competitiveness of Less Developed Countries exports and worsened the trade deficit but also encouraged local residents to borrow abroad."[75] While introducing, Hayek's concept of competition among currencies: Under a floating exchange rate, the 'losers' in this competition depreciate, while under a fixed exchange rate the central banks of the 'losing' currencies provide the private sector a vehicle of escape into foreign assets, Jeffrey Sachs and Rudiger Dornbusch also emphasize the problem of over-evaluated local currencies, which, in turn, solicited the Latin Americans to purchase foreign assets, in particular, the United States dollar, to avoid further devaluation.[76]

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[72] Bird & Killick, ibid, p 236
[73] Jeffrey Sachs, quoted from *International Debt*, Graham Bird & P. Nicholas Snowden (ed.), p 301
[74] Ibid, p 7
[75] Ibid, p 9
[76] Jeffrey Sachs & Rudiger Donbusch, quoted from *International Debt*, Graham Bird & P. Nicholas Snowden (ed.), p 215 & p 307

Lastly, Goddard stresses the lack of political wills of most of Latin American governments. In taking an example of Brazil, he says that "reportedly government-initiated projects were taken in order to improve the ruling party's track record before elections."[77] In sum, Goddard's analysis can be categorized into the following sets: 1) managerial problem of the Latin American governments, 2) the problem of developmental strategies, 3) two types of moral hazard, committed by the Latin Americans and their politicians and 4) technical problems such as over-evaluated currency or low interest rates. However, as Goddard confesses, it needs to be addressed that given the relatively abundant credit facilitated by oil-surpluses, trade imbalance caused mainly by oil-trade deficit and stable Gross Domestic Products growth rates, it can be inferred that the problems of mismanagement such as depending on external borrowing rather than adopting adjustment policy immediately by squeezing domestic investment were not significant at all. In effect, Figure 5 below indicates that there was a considerable reason to defer adjustment at that time. It clearly shows that the average current account deficit as of GDP of the Latin American countries follows very closely with that of the Asian states during from the early 1970s through the 1980s. Yet, the figure implies that the subsequent steep rising of deficits in the Latin countries after 1986 owe considerable amount to the forced adjustment with the direction of the International Monetary Fund.

[77] Ibid, p 9

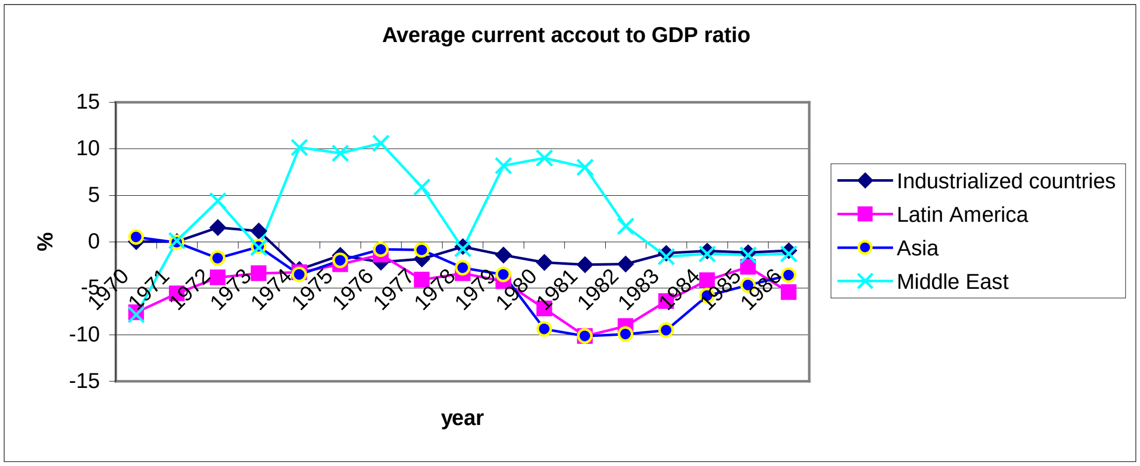

Figure 5: Comparison of average current account deficits (Source: Adjusted data from World Bank)

Admittedly, technical problems such as over-evaluated currency and low interest rates were hardly notable before the crisis. There is a reasonable argument, of course, that those policies adopted by Latin American governments were not efficient to cope with the challenges. Yet what needs to be asked is how much of responsibility should they take?

As a revised point of view, Goddard presents the following three categories of external factors: 1) the Western banking system, 2) the economic policies of the industrialized countries, and 3) the structure and functioning of the international economic system. [78] At first, by setting forth the high dependency on the private banks, Goddard says that "although it is true that the region did borrow considerable sums from the private market, this borrowing was in part a function of the slow growth in official

[78] Ibid, p 10

lending during that same period."[79] In accordance to his statement, Levitt recommends to focus on the special treatment with South Korea in terms of official lending as of total external debt. In mentioning on the South Korea's privileged position in the geopolitical priorities of the United States and relatively closed nature of economy, he emphasizes, "in 1983, 40 per cent of Korea's external debt of $21.5 billion was owed to official development agencies meanwhile only 12 per cent of the external debt of Brazil was official."[80] In indicating the problem of private creditors and economic policies of the industrialized countries, Goddard adds, "since a large number of these short-term loans were contracted at variable interest rates, the burden of interest rates was unbearable when the United States and Great Britain were both pursuing restrictive monetary, anti-inflationary policies."[81] Figure 6, in the next page, clearly shows the striking increase of interest payment cost since 1979, when the United States adopted a strong anti-inflationary policy by hiking interest rates. It indicates that the burdensome of debt payment came to a climax when the Mexico finally declared debt default in 1982. Levitt reiterates that "the interest/export ratio in 1983 was about 37 percent for Brazil, 37 % for Mexico, 42% for Argentine and 25% for Venezuela respectively."[82]

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[79] Ibid, p 10
[80] Kari Polanyi Levitt, "Linkage and vulnerability: the debt crisis in Latin America and Africa," quoted from *Political Dimensions of the International Debt Crisis*, Bonnie K. Campbell (ed.), p 24
[81] C. Roe Goddard, ibid, p 12
[82] Kari Polanyi Levitt, ibid, p 28

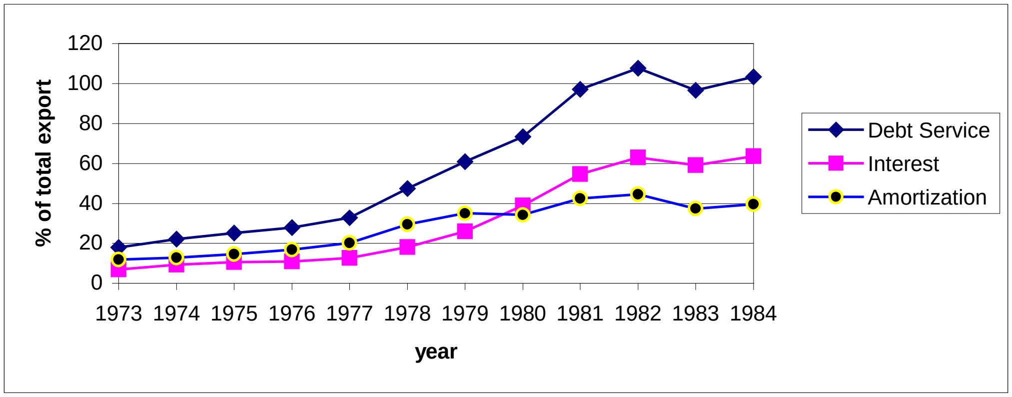

Figure 6: Debt service in non-oiling developing countries (1973-84)

(Source: IMF world economic outlook, 1983, 1984)

To make things worse, due to nose-diving commodity price from 236.3 in November 1980 to 143.0 in October 1982, Latin America's ability to generate foreign exchange earnings was dramatically declined. Meanwhile, the ratio of payment for interest and amortization as of the export earnings was skyrocketed.[83] Ironically, because both most of crucial commodities, especially oil, and majority of Latin American debts are priced as the United States dollar, the appreciation of the dollar value has been resulted in lowering commodities prices and in increasing debt burden for the Latin Americans. Lastly, Goddard put forward two-fold set of international factors contributed to the debt crisis. He asserts that "long-term structural changes in the industrial economies that reduced the debt-serving capacity of developing countries and the imbalance in world industrial development that precluded orderly recycling of OPEC surpluses and set the stage for the massive debt burden under which the developing countries are currently suffering."[84] In short, Goddard emphasizes that the sharply increased payment burden, in particular, interest payment, mounting inflation caused by oil-price hike and repeated currency

[83] C. Roe Goddard, ibid, p 14
[84] Ibid, p 15

devaluation- the so-called exchange rate inflation and followed international economic recession, all played a crucial role in originating the debt crisis. The significance of the external factors is also supported by Krugman and Diaz, who address the followings: 1) the economic management of at least some of the problem debtors was not that bad, 2) the external shocks were of overwhelming magnitude and 3) the fact that countries with very different pre-1982 policies all found themselves in similar straits shows the predominance of external factors.[85] Krugman, in particular, asserts that “if irresponsible behavior by debtors did not bring on the crisis, we need not worry about creating incentives for future irresponsibility by attempting to manage the crisis.” Yet, interestingly enough, the followed debt policy adopted by the United States and the International Monetary Fund fully reflect the idea that the responsibilities should be taken totally by the indebted states. Goddard put in stress that “it-the Reagan administration resisted a redefinition of the debt problem away from a strictly private debtor-creditor issue and refused to take any steps that might appear as if the administration would be willing to ‘bail out’ the banks or support the internationalization of the problem.”[86]

Lastly, while admitting the exertion of such external factors as a sudden hike of interest rate, oil-price rise and strong protectionism in the industrialized countries, have played determining roles in originating the debt crisis, an alternative approach suggested in this thesis pays considerable attention to the questions that follow. First, as Susan Strange asks, why it was that the United States could not or would not adjust higher oil prices by non-inflationary means. Second, if the sharply increase oil-price were a major

[85] Paul R. Krugman & Carlos F. Diaz-Alejandro, quoted from *International Debt*, Graham Bird & P. Nicholas Snowden (ed.), p 293
[86] C. Roe Goddard, ibid, p 17

culprit of the debt crisis, why the oil-exporting countries increased oil price so unexpectedly. And finally what considerations drove the industrialize states to adopt a strong protective policy, which, in turn, resulted in global economic recession. The main benefit of the above questions is to get an opportunity to shed a light on the role of the United States which has a significant impact on the other states' monetary policy decisions. In his proposal the impact of the international economic disorder on originating the debt crisis, Levitt contends that "the key date is 1971, when the United States opted out of the Bretton Woods system and the discipline which gold convertibility imposed on the United States fiscal and monetary policy."[87] He goes on to add that "when the U.S. dollar came under pressure in the late 1960s, the United States de-linked its national currency from gold, thus avoiding the need for politically painful domestic adjustment."[88] By directing the impact of the expanded fiscal deficit of the United States on boosting commodities price in the late 1960s, he also contends that "the oil price rise of 1979 was but the last phase of a general commodity boom, just as the fall of oil prices in the mid-1980s is the last phase of the subsequent decline of commodities price."[89] Admitting that the oil price rises of 1973-74 and 1978-80 had important adverse effects on real demand, both directly and by strengthening inflation, so leading to restrictive actions by industrial states, Susan Strange delivers this interesting viewpoint: "Having achieved that power through the Tehran Agreement of 1971, they (the OPEC members) then found that the extra dollars they had managed to writing out of the oil companies were being rather quickly depreciated as a result of U.S. inflation and American

[87] Kari Polanyi Levitt, ibid, p 25
[88] Ibid, p 26
[89] Ibid, p 26

domination of the international monetary system."[90] It can be said, at least, that the initiation by the United States to adopt a free floating exchange system had a good deal to do with the oil-price hike as well as followed worldwide inflation. Robert Triffin, a well-known economic professor of Harvard University, asserts that "it was the irresponsibility of the United States in first allowing the over-lavish creation of credit and then bringing about its drastic contraction at the end of the 1970s that lay at the root of other troubles."[91] In her address the legacy of the United States in augmenting inflationary pressure, Susan Strange also stands with Triffin's stance by stating that "the United States had used its exorbitant privilege as the center country of a gold-exchange system to run a perpetual balance of payment deficit and to finance a distant and expensive war in Vietnam by inflationary credit creation rather than by a transfer of resources from the civilians to the military by means of taxation."[92] Moreover, as Andrew Walter says, since impulses from the United States tend to have a much greater effect on the rest of the world, a dramatic shift in the American monetary policy in 1979, which instigated a rapid process of disinflation and sent real interest rates to record highs, directly bring about the intolerable burden of debt payment for most of the Latin American states.[93] One unsolved question is, as Susan Strange asks, why the United Stated relied on anti-inflationary policy by boosting interest rates up to almost 20 percent in 1979 rather than by imposing small amounts of tax on purchasing gas. In an attempt to reply to this question, George Tarlas says that while being confronted with double-digit inflation at home and flooded dollar markets throughout the world forcing foreign financial institutions to begin to

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[90] Susan Strange, quoted from *The Political Economy of International Money*, Tsoukalls (ed.), p 14
[91] Robert Triffin, quoted from ibid, p 16
[92] Susan Strange, ibid, p 11
[93] Andrew Walter, ibid, p 215

liquidate their dollar holding by 1978, the rate boost-to suppress inflation was considered the best strategy to bring a halt to the credit expansion and to save the dollar standard.[94] Noting the primary task of the Federal Reserve is to preserve the integrity of the dollar by holding down the rate of inflation, Erdman delivers a similar conclusion that "during the first half of the 1980s, extremely high American interest rates had attracted money from all over the world, a process that pushed up the exchange value of dollar."[95] Mentioning the impact of hiked interest rates, Sachs and Radelet asserts that "in the 1982 debt crisis in Mexico, the most important shifts were the steep rise in interest rates in the United States and the accompanying steep appreciation of the U.S. dollar." [96] Whether the determination of the Federal Reserve Board to boost interest rates has been driven by the intention of saving the dollar or not, it is clear in historical evidence that the United States had been able to enjoy renewed capital inflow as well as a consequential stable dollar value. Therefore, it can be concluded that even as the Latin American countries have had internal problems such as import-substitution policy or relatively high depending on private creditors, the United States was considerably associated with the Latin debt crisis in the early 1980s in various ways.

Given the growing role of the International Monetary Fund in the development of the debt crisis, the next task should be focused on looking at the interactions among the United States, the International Monetary Fund and the American financial institutions. Above all, it is essential to ask why the situation is getting worse with the helps of the International Monetary Fund and the United States. In retrospect, it is still uncertain whether the problem of the Latin American countries was an illiquidity or insolvency at

[94] George S. Tarlas, "The international use of currencies: to U.S. dollar and the euro,"
[95] Erdman, ibid, p 26

that time. Though it is emphasized by Kari Levitt that "the only form of credit creation benefiting non-industrialized countries was IMF credits-increasingly carrying conditionality obligations, meanwhile international reserves have increased almost nine fold from $78 billion in 1969 to $688 billion in 1984, sustaining world inflation."[97] Given the above Figure 1, it is inferred that while the industrialized countries, especially, the United States are able to absorb massive international liquidity in form of currency reserve, the developing countries including the Latin Americans had to rely further on the handouts provided by the International Monetary Fund, which remains below 10 per cent as of the international reserve asset. Susan Stranges says that "if the surpluses (of Japan and other countries) had gone instead to the high-growth developing countries, whether in the form of loans or direct investment[98], who can doubt that Third World debtors would have been spared seven very lean, hard years."[99] What should not be ignored is the point that the United Stated efficiently prevented from increasing in the capital base in the IMF and World Bank. (Remember that the dollar policy aimed at mitigating the role of gold and SDRs & IMF credits) Although the American government agreed to increase the IMF quota, from time to time, there include additional, harsher conditionality, which, in turn, forced the recipients into further economic recession. To make things worse, according to Susan Strange, even using the surplus of Japan to debtors' nations was, in fact, blocked because of fear of the effect that might have on the dollar exchange rate.[100]

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[96] Steven Radelet & Jeffrey D Sachs, ibid, p 3
[97] Kari Levitt, ibid, p 26
[98] It may implies that what matters is political wills of the industrialized states in particular the United States rather than forms of money either private investment capitals or official loans. In effect, market decisions show strong dependency on the direction of the International Monetary Fund directly and the United States indirectly.
[99] Susan Strange, "Finance, Information, and Power," quoted from *The International Political Economy of Monetary Relations*, Benjamin Cohen (ed.), p 517
[100] Susan Strange, ibid, p 517

Describing the financial situation, she stresses that "instead of the chains to particular national creditors (like the United States) most developing countries who wanted foreign credit now found themselves chained to the decisions of the IMF, without whose seal of approval the commercial banks were unwilling to give them new credit."[101] As a consequence, it can be argued that the initial illiquidity problem of the Latin American states came to change its essence into an insolvency problem, which eventually resulted in further economic and political dependence on the International Monetary Fund and its virtual owner-the United States. Yet, in order to acquire a better understanding of the situation, it is helpful to revisit conventional wisdoms related to the behaviors of the American commercial banks and the International Monetary Fund, which virtually controls international liquidity. To be sure, there is a strong reason to believe that the drying up of private credits to the Latin American states totally based on the market decision and the government even the United States has only very limited influence on the decisions. Though, Benjamin Cohen put it differently by arguing that "since the bankers who run America's largest banks are subject to the forces of national feeling, in practice, political considerations are rarely absent, even if most instances they remain fairly subtle."[102] He goes on to state that "despite the extent of their overseas operations, the banks are still ultimately dependent on a domestic financial bases and subject to the influence of domestic monetary policy and prudential supervision."[103] Furthermore, it is important to remember that the United States, as the country with the largest share of votes in the International Monetary Fund, and as the source of the world's pre-eminent

[101] Susan Strange, ibid, p 508
[102] Benjamin Cohen, "International debt and linkage strategies," quoted from *The International Political Economy of Monetary Relations*, Benjamin Cohen (ed.), p 705
[103] Benjamin Cohen, ibid, p 707

international currency, still enjoys unparalleled influence over the IMF decision-making. Even though the voting power of the United States (see Figure 7) remains around 18 percent, it should be noted that the approval rate of main decisions in the IMF needs to be above 85 percent.

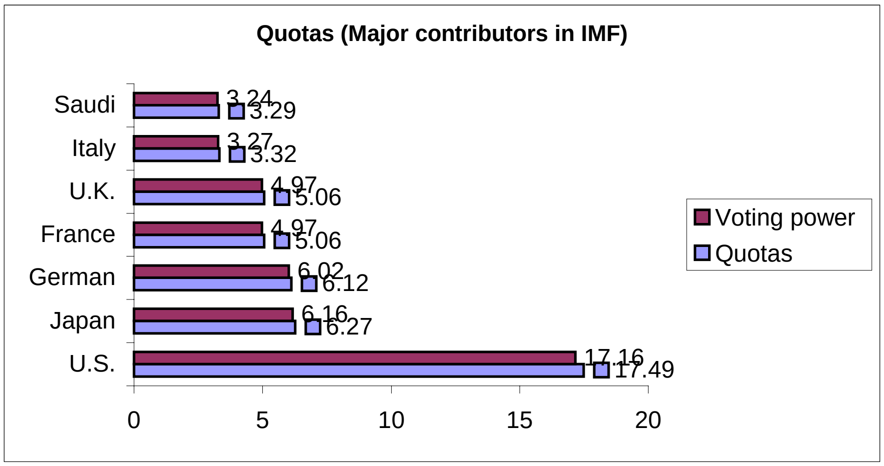

Figure 7: Voting power in the International Monetary Fund (Source: IMF 2002)

About the power exertion of the United States, Andrew Walter says, "the view put forward here is that U.S. power in international monetary relations has never been consisted of an ability to control outcomes by enforcing rules or policy-changes on the part of other sovereign states. Rather, it has consisted primarily in terms of its continuing ability to constrain the set of possible outcomes in the international monetary and financial area."[104] By pointing out the politicization of the International Monetary Fund by the United States, Cohen explains that some American administration officials came to believe "using the IMF might actually serve the American policy interests more

[104] Andrew Walter, ibid, p 219

efficiently than attempts to deal with debt problems on a direct, bilateral basis."[105] Eventually, it comes out that the United States has been able to manage the debt crisis efficiently by utilizing those international organizations, especially, the IMF supposed to have less ostensible interests other than the maintenance of the international monetary stability. However, such conditionality attached to the IMF credits as cuts in government spending, the elimination of price subsidies, a currency devaluation, higher taxes, and higher interest rates to keep money from fleeing made the situation of those indebted countries getting worse.

2. The Origins and Development of The Asian Financial Crisis

Interestingly enough, as the Latin American crisis came to shift its core from an illiquidity problem into an insolvency problem,[106] it is now widely recognized that the IMF's exclusive focus on fixing Asia, without addressing the root problems of international financial market instability, imposed excessive costs on the East Asian economies.[107] To put it differently, Hughes argues that the IMF's decision to regard the crises as originating in problems of insolvency, and then to tackle them by insisting on major structural reforms and the virtual dismantling of the Asian model, has instilled in many Asian policy makers the suspicion that the fund overstepped the mark and made the blunder of converting temporary currency crises (liquidity crises) into full-blown economic ones.[108] Coincidentally, the initial 'blaming-the-victim' analyses, led especially

[105] Benjamin Cohen, ibid, p 722
[106] Please refer to footnote #68
[107] Steven Radelet & Jeffrey Sachs, ibid, p 5
[108] Christopher W. Hughes, "Japanese policy and the East Asian currency crisis: abject defeat or quiet victory?" Review of International Political Economy, 7:2 Summer 2000, p 242

by the International Monetary Fund and the United States government, seem to be almost identical to those of the Latin American debt crisis. To grasp a comprehensive understanding of the Asian crisis, this paper divides the causes into three perspectives as with the case of the Latin debt crisis: initial perspective focused on internal (regional) factors, revised view including external (global) factors, and alternative approach associated with the United States dollar policy. Since the main objective of this review lies in looking at the likely roles of the United States, directly or indirectly, in originating and developing the Asian crisis, a good deal of consideration will be given to an alternative approach.

Robert Chang suggests two distinctive viewpoints in understanding the Asian crisis: a bad policy view and a financial panic view. He explains that a bad policy view focuses more on such internal factors of the East Asian countries as mismanagement of policy makers or relatively high dependence on short-term debt as opposed to external contexts such as the existence of international speculative hot money or rapid liberalization of financial markets. Meanwhile, a main focus of the financial panic view is that "international loan markets are prone to self-fulfilling crises, in which, although individual creditors may act rationally, market outcomes produce sharp, costly, and fundamentally unnecessary panicked reversals in capital flows."[109] According to Robert Chang, a bad policy view encompasses the following origins: 1) a weak banking system, controlled by government rather than business, resulting in over-capacity and inefficient investment on strategic industries like steel, ship-building and semi-conductors as well as a bubble in the real estate and stock market, 2) unsustainable corporation strategies such

[109] Steven Radelet & Jeffrey Sachs, ibid, p 4

as a high level of debt ratio to equity and a market-share oriented management than a profit-initiated one, 3) incompetence of the Asian model, known as a crony capitalism or Asian corporatism, in a globally integrated economic system since 1990s, and half-hearted liberalization of financial market including governmental intervention in the foreign exchange market, 4) a relatively high short-tem debt ratio to Gross Domestic Products and low level of foreign reserves rates, 5) the cultural shortcomings of the Asian nations such as collectivism, authoritarianism and Confucianism, 6) political uncertainty and incompetence of politicians, who are only concern about popularity, and finally 7) closed information access to government and private sectors.[110] But, it is crucial to note that the initial bad policy view is less persuasive by following economic collapses in Brazil in 1998 and Russia in 1999. Surya Sen asserts that conventional wisdom is shifting from a bad policy view into accusing the volatility of international capital flows and the wrong remedies from the IMF.[111] Sachs and Radelet criticize the idea that the Asian miracle was the result of strong authoritarian government, a close-knit relationship between governments and corporative leaders in fostering heavy industries. They assert that "such interpretations draw heavily on the distinctive experiences of Japan, Korea, and Taiwan, but, these kinds of interventionist policies clearly were not central to the successes of Hong Kong, Singapore, Thailand, China, Malaysia or Indonesia."[112] Supporting Krugman's theory that such weaknesses of the Asian countries cannot explain the depth and severity of the crisis, Radelet and Sachs present the following valuable regression test results: 1) a higher ratio of short-term debt to reserve is strongly associated

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[110] Robert Chang, "Understanding recent crises in emerging markets," Economic Review-Federal Reserve Bank of Atlanta, Second Quarter 1999, p 6
[111] Surya Sen, "Lessons for the next financial crisis," Chicago Red Letter, December, 1999, p 2
[112] Steven Radelet & Jeffrey Sachs, ibid, p 9

with the onset of the crisis, yet the ratio of total debt to reserves is not statistically related to the crisis (it is a liquidity crisis not a solvency one), 2) a larger current account deficit is only weakly associated with the onset of the crisis, 3) real exchange rate overvaluation does not seem to be associated with financial crisis and 4) the level of corruption is not significantly associated with the crises also.[113]

Throwing suspicion on a bad policy view, Bosworth also addresses the following facts. First, since current account deficits in Asian countries flowed into a capital accumulation as a means of investment rather than consumption as in Mexico in 1994, the level of deficits were usually regarded as tolerable. Second, given the fact that Asian current account deficits were caused mainly by capital inflow rather than by loosing competitiveness in their exports, the foreign exchange levels of the Asian states were not over-evaluated. Third, overall indebtedness was moderate relative to Gross Domestic Product and exports. And lastly, the International Monetary Fund's inappropriate structural reforms, such as closing banks and pushing austerity fiscal policy, resulted in a serious solvency problem like Latin American debt crisis instead of the desired results.[114] Given current account deficit ratio as of Gross Domestic Products (GDP), a widely recognized indicator of national current balance status, Figure 8 below shows that the pattern of South Korea was quite similar to those of Australia, Hong Kong, and New Zealand before the crisis in 1997. Moreover, the sharp rise in account surpluses of Korea and Hong Kong after 1998 implies that their situations were far from a solvency problem. It is quite interesting to note, for instance, that the balance of payment status of Korea

[113] Jason Furman & Joseph E. Stiglitz, "Economic crises: evidence and insights from East Asia," Brookings Papers on Economic Activity, 1998, p 10
[114] Barry Bosworth, quoted from Jason Furman & Joseph E. Stiglitz, "Economic crises: evidence and insights from East Asia," Brookings Papers on Economic Activity, 1998, p 31

was coming back from –4.5 percent in 1996 to –1.7 percent in mid 1997 even before South Korea's asking the International Monetary Fund for emergency loan. Nonetheless, it is true that the Asian governments failed to implement an appropriate regulatory regime when they opened the capital account, voluntarily or not. Yet, mentioning the pressure from the United States, Wade contends that "attention to building strong regulatory arrangements and linking capital opening to the strength of those arrangements on the ground was deliberately discouraged lest it provide countries with excuses to delay-contrary to U.S. objectives."[115]

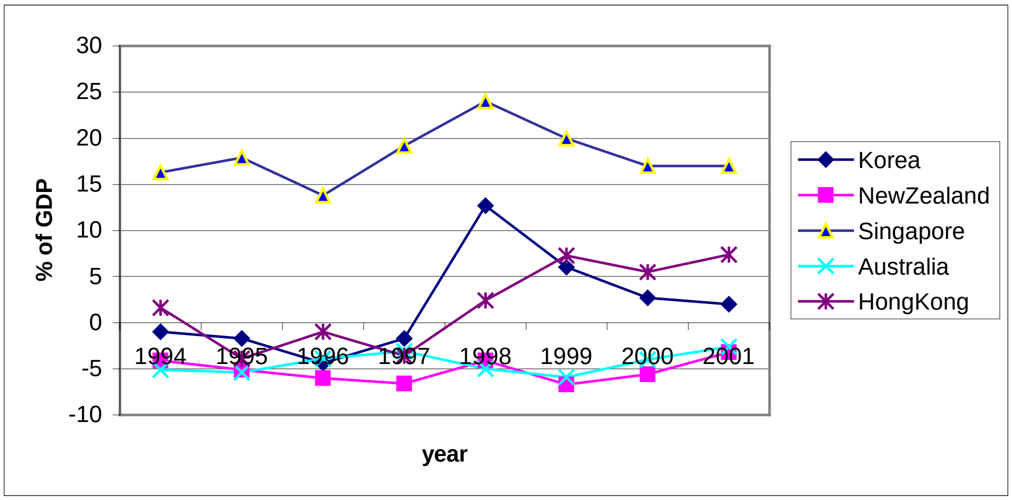

Figure 8: Current Account Deficit Ratio (IMF, 2002)

Broadly speaking, the panic view includes the following factors: 1) a rapid liberalization of financial market without appropriate government supervision facilities, 2) high volatility of international hot money and flexible currency regimes,

[115] Robert Wade, "The U.S. role in the long Asian crisis of 1990-2000," quoted from *The Political Economy of the East Asian Crisis and its Aftermath*, Arvid John Lukauskas & Francisco L. Rivera-Batiz (ed.), p 16

3) incompetence of international institutions such as the International Monetary Fund, and 4) financial market intrinsic instability that helped to create a self-fulfilling crisis.[116] Robert Chang contends that "even as the economic strength of the Asian countries was not satisfactory, the real cause was that international creditors and domestic depositors, fearing a crisis, suddenly refused to roll over credits or keep their funds in the impaired financial system."[117] According to Sachs and Radelet, it is even proclaimed that "unfortunately, financial crises in emerging markets are likely to be a recurring phenomenon in the coming years, the only questions being exactly where and when."[118] Yet a fatal drawback of a panic view is that it takes for granted the occurrence of the Asian crisis as well as future crises. The Asian financial crisis did not have to happen but for the United States blocking the establishment of the Asian Monetary Fund in September 1997. It needs to be remembered that there was a considerable consensus in establishing a firewall like the Asian Monetary Fund, which was to serve as the last resort during the Asian crisis as a central bank does in domestic banks run, but failed ultimately by the United States opposition. Surya Sen also argues that even though rapid financial liberalization without appropriate regulatory regime in the East Asian countries has played an important role, it did not have to be such a severe economic crisis unless the International Monetary Fund would pursue unreasonable policies such as closing domestic banks or urging to revise domestic labor law. In this connection, Feldstein reiterates that "the International Monetary Fund should eschew the temptation to use currency crises as an opportunity to force fundamental structural and institutional reforms

[116] Robert Chang, ibid, p11
[117] Robert Chang, ibid, p 6
[118] Steven Radelet & Jeffrey Sachs, "What have we learned, from the Asian financial crisis," A paper presented to Economic Reform Project, p 10

on countries, however useful they may be in the long term, unless they are absolutely necessary to revive access to international funds."[119] Coincidence or not, there is a significant similarity between the primary objectives of the fund's structural reforms and the goals of the American foreign economic policy. Krause states that "although, exaggerated, there is justice in the charge that the IMF has helped to achieve long-standing goals of the United States in opening markets in Asia."[120] Heretofore, it is necessary to ask the following questions. On the one hand, what are the backgrounds of the Asian countries to decide on liberalization of the capital account and financial sector in spite of their relatively high volume of domestic savings? On the other hand, how to interpret ultimate goals of the IMF policies implanted during the Asian crisis? In particular, to get plausible answers to the latter question, it is valuable to review such remedies as adopting a free floating foreign exchange regime and further liberalizing financial market recommended by the Fund.

In final, in the alternative view of the East Asian crisis, Robert Wade investigated first why many middle-income developing countries and some highly developed countries have had major financial crises during the period from 1980 to 2000, many more that in 1950-1970. He proposes to look at the role of the United States as one of the influential external factors. He addresses the following two specific roles: at first, the structural role of the United States in pumping out liquidity, and the instrumental role of the United States in effecting a quick financial opening and liberalization in Asia, making it easier for U.S. capital and financial services firms to enter Asia and reap higher Asian

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[119] Martin Feldstein, "Refocusing the IMF: overdoing it in East Asia," Foreign Affairs, March/April, 1998, p 30

[120] Krause, "Asia crisis: economic and political implications," The University of California-San Diego,

returns.[121] In the view of Wade, the first point needs to be noted is the end of the Bretton Woods regime and the United States role in ending the fixed foreign exchange system. He contends that "by breaking the link with gold in 1971, the United States could finance current account deficits by printing dollars and selling treasury bills, with much less of a limit than had existed earlier in the Bretton Woods system."[122] Consequently, this accumulating U.S. government debt, caused by huge current account deficits of the Americans, then became part of the central bank reserves of the source countries, which allowed for multiplied domestic credit creation at the same time as the United States continued to enjoy increasing central bank reserves, domestic credit expansion, and sustained excesses of imports over exports.[123] He concludes that "the surge of world liquidity (in the East Asia) manifested itself first in the major current account surplus country, Japan, in the form of the Japanese bubble of 1985 to 1990, and then in the fast growing Asian countries in the form of the bubble of 1992 to 1997."[124] Ironically, while the Latin American countries had to suffer from extremely limited liquidity owed a great deal to the United States policy that efficiently blocked the capital inflow from surpluses countries like Japan as well as limited the IMF credits expansion, the East Asian countries, voluntarily or not, had been induced to accept additional liquidity in the form of foreign currency reserves. Wade continues, explaining the institutional role of the United States, "financial opening and liberalization was an important enabling condition of the crisis, more important than the factors emphasized in the bulk of the literature, such as cronyistic or relationship-based economic structure, moral hazard, and opacity of

[121] Robert Wade, ibid, p 195
[122] Robert Wade, ibid, p 201
[123] Robert Wade, ibid, p 201
[124] Robert Wade, ibid, p 202

corporate and governmental accounts."[125] Even as he admits the domestic reasons for Asian countries undertaking capital liberalization, he pays more attention to the fact that the United States not only raised penalties against not undertaking rapid financial opening and liberalization but also persuaded Asians that capital account opening is in their own best national interest.[126] It is important to note, as Wade asserts, that "the East Asian countries enjoyed ample domestic savings and had no need to open themselves up to volatile capital flows; moreover, these flows threatened to undo the beneficial relationships that had evolved between firms, banks, and government policy makers."[127] Susan Strange, explaining the voluntary acceptance of financial liberalization, states that a hegemon such as Britain and the United States seems inclined to develop a strong political/economic ideology that assert, on the one hand, that the domestic and international interests are coincident if not identical, and on the other hand, that a prime aim of the state should be to persuade others that their national interests also coincide with the maximum development and extension of the international economy.[128] In order to encompass the objective of the United States in pursuing capital liberalization, Wade provides the following two interesting points. On the one hand, the United States has a strong national interest in being able to attract foreign savings, which, in turn, finance the large and growing external deficit. On the other hand, by promoting market access for American financial services firms which have great advantages over competitors in everything from securities placement, debt work-outs, privatizations, and mergers and acquisitions, the American government has a strong interest in lessening current account

[125] Robert Wade, ibid, p 202
[126] Robert Wade, ibid, p 203
[127] Robert Wade, ibid, p 16
[128] Susan Strange, ibid, p 89

deficit via the earnings of financial institutions.[129] Yet, the objectives of the United States in financial liberalization were able to be completed with the help of the International Monetary Fund which took full advantage of the Asian crisis to force the impaired nations to accept crucial structural reforms such as a freely floating foreign currency regime and allowing foreign ownership.

It is helpful to review the reluctant decision of adopting a freely floating currency regime by the Asian countries in order to understand the ultimate motives of the International Monetary Fund in fixing the Asia policy. Ironically enough, Malaysia and Hong Kong were less affected by the Asian crisis and they adopted capital control policy and a peg exchange system respectively at that time. Furthermore, it must be interesting to recognize that most of the countries in the East Asia except for Singapore were under a floating regime, specifically, fluctuated within a band, meanwhile the officials of the IMF argue the ultimate solution would be to adopt a totally free flexible foreign currency regime. The IMF wanted to was complete elimination of governmental intervention in the foreign exchange market, yet, as seen above, the United States and other industrial countries rarely gave up their intervention policies when they acknowledged certain needs. Reminiscent of Hayek's concept of competition among currencies, the remedy to adopt a fully floating exchange rate by relying on market forces means that the only option left for the inferior currency states is to devaluate their foreign exchange rates continuously or must build up additional foreign reserve to hold their currency levels until they will be able to stabilize the exchange rate in volatile market. Pointing out the fact that "no single currency regime is right for all countries," Frankel asserts that one "increasingly evident disadvantage of free floating is a strong tendency toward

[129] Robert Wade, ibid, p 219

volatility."[130] Susan Strange also criticizes the wisdom of a free floating currency regime by arguing that "even with fully flexible exchange rates, as shown by the experience of the period of 1931-39, national monetary authorities are seldom willing in practice to leave the decision on the exchange rate to the free play of market."[131] In addition, as Susan Strange mentioned before, many American economists have had additional ulterior motives in that they see more flexible exchange rates as another device to protect the United State dollar hegemony.[132] In spite of the theoretical assumption of a freely floating currency regime in which there is no need to accumulate foreign currency reserves, consequentially, the total amount of foreign reserve currency, especially the United States dollar, in the Asian countries has been boosted almost to 3 times than that of the before crisis period. For example, to hold up the present foreign exchange rate of 1,300 Korean won in 2002 from 800 won in 1996, South Korea had to increase its foreign currency asset from $39.0 billion in 1997 to $102.8 billion in 2002. (Note the opportunity cost by purchasing additional dollar by paying higher interest rates for the dollar holders)[133] It will be accurate to declare, as Henry Liu states, that this system robs the developing countries of the fruits of their exports and keeps their domestic economies starved for capital, as all surplus dollars must be invested in the United States treasuries to prevent the collapse of their own domestic currencies.[134]

Looking back at the American attitude toward the Asian Monetary Fund proposed and supported by the Asian countries gives a valuable opportunity to understand less

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[130] Jeffrey A. Frankel, "No single currency regime is right for all countries or at all times," p 5
[131] Susan Strange, ibid, p 333
[132] Susan Strange, ibid, p 333
[133] Please refer to page 2
[134] Henry C K Liu, "US dollar hegemony has got to go," The Asian Times, April 11, 2002

visible motives of the International Monetary Fund and the United States. At the onset of the Asian crisis, it seems to be quite clear to most of the Asian policy makers that a key problem lies in illiquidity, and not insolvency, like the Laitin American countries which had large budget deficits, high inflation, and massively indebted public sectors. In fact, eventually, it became clear that the IMF policies aimed at cutting demand and liquidity by credit ceiling have had the effect of causing bankruptcy and slashing the value of companies that were not only inefficient and unprofitable but also among those which were not so affected.[135] To make things worse, the currency devaluation and demand-restricting austerity measures of the IMF such as labor laws in South Korea, higher petrol prices in Indonesia, and new bankruptcy laws in Thailand have led to riots in all three countries. Initially, the proposal of an Asian Monetary Fund (AMF) was given impetus by the need to provide appropriate liquidity for Thailand and the United States refusal to participate in setting up a regional fund to avoid the spread of the crisis to other countries. Contrasting its support for Mexico in 1994, the United States not only refused to support the initial financial adjustment package but also opposed to calls to set an emergency fund to avoid what many leaders saw as the humiliation of the IMF telling them how to readjust to the new circumstance.[136] As an attempt to explain the motives of the United State stance against the Asian Monetary Fund and adjustment package, Higgot put forward that "U.S. policy toward an incipient Asian Monetary Fund reflects a private sector desire for continued financial liberalization on the one hand and a political/bureaucratic (both domestic and international) institutional desire not to cede the

[135] Richard Higgot, "The international relations of the Asian economic crisis," quoted from *Politics and Markets in the Wake of the Asian Crisis*, Richard Robinson, Mark Beeson, Kanishka Jayasuriya and Hyuk-Rae Kim (ed.), p 262
[136] Richard Higgot, ibid, p 269

power of the international financial institutions, in which the United States is dominant, to regional institutions over which it would certainly have less ideological/philosophical and practical control, on the other hand."[137] But, according to Higgot, what is more important is a successful Asian Monetary Fund would have reinforced the trend, following the strengthening of the yen from the time of the Plaza Accord through to the first half of the 1990s, and of the Japanese replacement of the United States as the major source of Foreign Direct Investment, the major force for production and principal aid donor in the region.[138] Eventually, as Figure 9 below indicates, there was a striking decline of foreign use of the yen in developing countries including neighboring Asian countries in which Japanese bank loans and other investments have been rolled back dramatically since the Asian crisis. Figure 9 also shows that the yen ratio in the international reserve currency market declined, firstly, when the United States launched a strong dollar policy in 1995, and then further slide due to the Asian crisis in 1997.

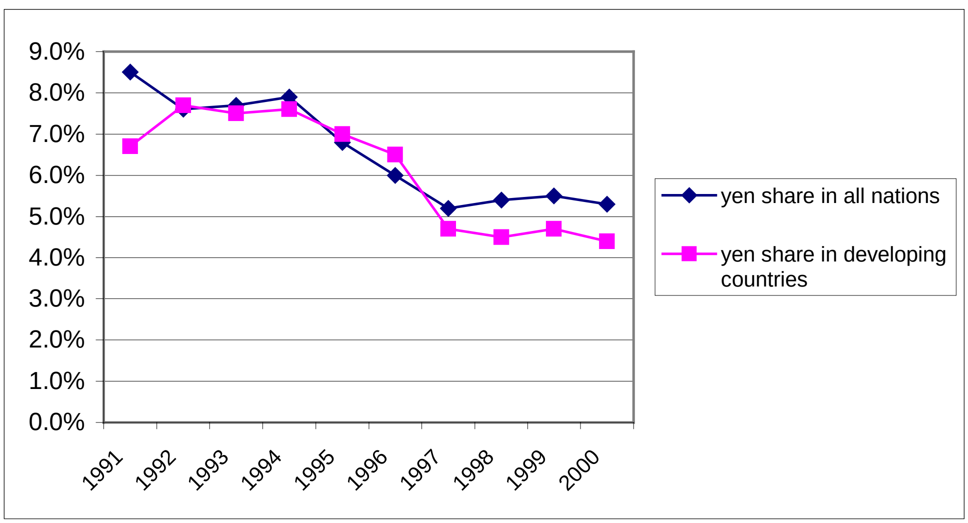

Figure 9: Yen ratio of total foreign reserve currency (Source: IMF annual report, 2001)

[137] Richard Higgot, ibid, p 272
[138] Richard Higgot, ibid, p 273

CHAPTER IV

CASE STUDY

1. The Financial Crisis in South Korea

George Soros states, "The origin of recent financial crises is to be found in the mechanism: the free, competitive capital markets that keep private capital moving unceasingly around the globe in a search for the highest profits and, supposedly, the most efficient allocation of the world's investment and savings."[139] It is reasonable, accordingly, to argue that with huge funds floating across global currency and stock markets, an individual country, in spite of doing everything right, may fail to stem the tide of financial turmoil. In the aftermath of the Mexican crisis in 1994-95, the International Monetary Fund, in fact, introduced 'new arrangements to borrow,' under which funds could be quickly raised to rescue countries facing a currency crisis. However, the IMF-led international interventions in the Asian crisis have not been encouraging at all. Instead of recovering market confidence, as Table 1 below shows, the approach to the International Monetary Fund was followed by a further decline of share prices and steep depreciation of currency prices against the United States dollar. For instance, the Korean stock price lost its value more than 40 percent and the Korean won

[139] George Soros, "Capitalism's last chance," Foreign Policy, winter/1998

depreciated about 63 percent since the Korean government solicited the IMF emergency loans.

Table 1: Impact of the IMF programs on currency and share prices

Country name	Share price and exchange rate on 12 December (1997)	Date of IMF approach	Share price and exchange rate on date of approach (change)
South Korea	359.82 1709.97	21 November, 1997	601.3 (-40.2%) 1051 (62.7%)
Thailand	368.39 45.05	29 July, 1997	679.5 (-45.8%) 31.7 (42.10%)
Indonesia	396.08 5120.19	8 October, 1997	518.9 (-23.7%) 3649.94(40.3%)

Interestingly, even though the Korean government has strong confidence in its economic fundamentals, much has been written about the inefficiency of the Korean conglomerates, the misallocation of credit due to directed credit programs and restrictions on trade, the consequent sickness of the financial sector, and hence, the need for the IMF structural programs since October in 1997.[140] Referring to South Korea's macroeconomic strengths before the Korean government finally submitted to the International Monetary Fund, Mihir Rakshit asserts that "with its accelerating export growth, fiscal surplus of about 3 percent, current account deficit hovered around 1 to 2 percent of gross domestic products (GDP), and high credit rating, Korea (unlike China and Hong Kong) did not feel the necessity of holding large international reserves."[141] Confidence in the Korean officials'

[140] Mihir Rakshit, *The East Asian Currency Crisis*, p 116
[141] Mihir Rakshit, ibid, p 118

view is also supported by the following data. Although a collapse of the market for semiconductors, a major Korean export, had caused Korea's current account deficit to up from 2.0 percent of GDP in 1995 to 4.7 percent of GDP, it was already back to a 2.5 percent annual rate by the mid 1997.[142]

Table 2: Key Macroeconomic Ratios of South Korea (Source: Asian Developing Bank, Asian Development Outlook; IMF, International Financial Statistics)

	1990	1991	1992	1993	1994	1995	1996	1997
GDP	9.5	9.1	5.1	5.8	8.6	8.9	7.1	5.5
External Debt Service	29.3	27.8	28.6	29.0	29.8	32.8		
Current account balance	-0.9	-3.0	-1.5	0.1	-1.2	-2.0	-4.7	-1.8
Net fiscal balance	1.5	1.7	0.6	0.6	0.3	0.6	0.5	-1.4
Official reserves/imports (in months)	2.5	2.0	2.5	2.9	3.0	2.9	2.6	1.6

Furthermore, even though the majority of the American economists argued that the Korean economy lost its competitiveness due to over-valued foreign exchange rate, it can be found, as shown Table 3 below, that the current account balance of South Korea has been less associated with foreign exchange rate. For instance, compared with 1989 and 1996, it simply indicates that the devaluated Korean won contributed to increase current account deficit rather than improve it. To be fair, it is hard to find any evidence of the

[142] John Burton, "South Korea expects drop in trade deficit," The Financial Times, September 30, 1997; Martin Feldstein, "Refocusing the IMF," Foreign Affairs, March/April 1998, p22

Korean won's over-evaluation in terms of current account balance.

Table 3: Foreign exchange rate and current account balance of South Korea (Source: Asian Development Bank)

	1989	1990	1991	1992	1993	1994	1995	1996
Won/dollar ratio	677	718	761	791	812	794	771	841
Current account balance (% of GNP)	2.44	-0.69	-2.84	-1.29	0.31	-1.00	-1.80	-4.90

It is true, however, that the very high debt-equity ratio of the Korean conglomerates, known as Chaebols in Korean, and relatively high scale of short-term borrowing in relation to low foreign exchange reserves, eventually resulted in soliciting the IMF support. Yet it is important to remember that Korea's external debt of about $110 billion, considered as a crucial factor of Korean insolvency, is negligible in relation to Korea's productive capacity and economic potential. Rakshit, correspondingly, contends that "in fact, Korea's was primarily a liquidity problem, which, thanks to domestic policies and the IMF intervention, may be transformed into an organic and long term one."[143] Martin Feldstein also asserts that "since Korea's total foreign debt was only about 30 percent of gross domestic products, among the lowest of all developing countries, this was clearly a case of temporary illiquidity rather than fundamental insolvency." [144] Interestingly enough, the International Monetary Fund persistently demanded a fundamental overhaul of the Korean economy and a deflationary macroeconomic policy of higher taxes, reduced spending, and higher interest rates. Citing

[143] Mihir Rakshit, ibid, p 118
[144] Martin Feldstein, ibid, p 25

a senior official in the Treasury Department, the New York Times writes that “the country’s (Korea) growth can no longer provide the cash to cover the debts of a banking system that is now in shambles after lending money to wildly over inflated real estate projects, pork-barrel construction, and well-connected businesses that in return paid the ruling party handsomely.”[145]

As stated before, the primary objectives of the Korean case study are to look at the role of the United States and its motivation in relation to the dollar policy. To look at the intervention of the acting hegemon, the Korean financial crisis, shifting its essence from an illiquidity problem to an insolvency problem in mid December in 1997, can not be understood properly without discerning the following three stages: 1) before approaching the International Monetary Fund, 2) during the negotiation between South Korea and the International Monetary Fund, and 3) after the New York meeting on December 24, 1997, when Robert Rubin, the Secretary of Treasury, organized the banks into a negotiating group.

[145] David E. Sanger, “Seoul will ask U.S. and Japan for assistance,” The New York Times, 11/20/1997

Historical Review of the South Korean financial crisis in 1997

Date	Event[146]
July 2, 1997	Bank of Thailand gives up foreign exchange market intervention
July 27, 1997	Thailand government asks for emergency loans from the IMF
September, 1997	Japan proposes to establish the Asian Monetary Fund to provide appropriate liquidity for the affected Asian countries
September 30, 1997	South Korea's finance ministry reports that "current account deficits will be declined from $23.7 billion in 1996 to $15.0 billion in 1997"
October 30, 1997	Indonesia asks for emergency loans from the IMF
November 18,1997 (The initial stage)	Bank of Korea ends its attempt to defend Korean won
November 19,1997	* South Korea announces its plan to ask U.S. and Japan to provide direct helps * Robert Rubin issues a statement urging Korea to move forward quickly to address the present challenges by seeking assistance from the IMF but not Washington
November 20, 1997	* Lim Chang Yuel, newly appointed finance minister, asks U.S and Japan for currency swap. * Robert Rubin, secretary of treasury, officially declines it. * The demise of Asian Monetary Fund proposal (by the IMF and U.S.) at the Asia Pacific Economic Cooperation meeting at Manila
Novemeber 21, 1997	Japan refuses to provide direct financial support to Korea (through currency swap)
November 22, 1997	South Korea asks for $60 billion emergency loans from the IMF
December 2, 1997 (The second stage)	The IMF announces $57 billion bailout plan ($21 billion, directly from the IMF and $25 billion from G11 countries)
December 10, 1997	* Lim Chang Yuel, Korean finance minister, asks for early injection of $15 billion from U.S. and Japan. (The total injected money, at that time, was only $5.6 billion come from the IMF) * Robert Rubin, the secretary of Treasury, refuses any loan before completing policy negotiation.
December 11, 1997	Moody's Investors Service downgrades credit rating on Korean bonds to closer to 'junk' status

[146] The information quoted above come from The New York Times, The Washington Post, and The Financial Times. Detailed information about the sources is included in Bibliography.

December 12, 1997	* Thomson Financial Services Company, the world's largest bank credit rating agency downgrades South Korea's sovereign risk rating * Standard & Poor's, a major credit rating agency, downgrades the debt ratings of several the largest Korean corporations like the Pohang Iron and Steel corporation, the Korea Electronic Power corporation, SK telecom, Hyundai Motor, and Samsung Electronics
December 13, 1997	* Japan's initial agreement on earlier delivering $10 billion was called off by pressure from the Washington officials. It was said that "if they acquiesce to Korean requests for additional cash infusions, it just encourages the Koreans to avoid the tough decisions that they really should be making."
December 14, 1997	Three candidates in Korea's presidential election officially pledge to keep the IMF terms after Hubert Neiss, the IMF's chief negotiator, talking with David Lipton, a senior American Treasury official.
December 18, 1997	* Presidential election in Korea (Kim Dae Jung, elected as the new president) * The IMF votes to give South Korea $3.5 billion * The Bank of Japan provides $1.4 billion bridge loan
December 25, 1997 (The final stage)	* The United States agrees to rapid $10 billion infusion—including $3.3 billion from Japan, $2 billion from the IMF, and contributions from a variety of European nations. * Robert Rubin, the Secretary of Treasury, set up a negotiation meeting with six major American banks, officials of the United States, Japan, and South Korea at the Federal Reserve Bank of New York * Lawrence H.Summers, the Deputy Secretary of Tresury, reports that "South Korean president, Kim Dae Jung, agreed to a number of concessions such as allowing lay-off in return for the fast help."
December 30, 1997	Commercial banks agree to delay debt repayment of $15 billion

As shown the Chronicle Review, the first stage of the Korean financial crisis consisted primarily of the Korean government's attempts to avoid the structural reforms implemented later by the International Monetary Fund. The initial support of the Korean government for the Asian Monetary Fund, proposed by Japan, was officially demised by the opposition of Washington and the International Monetary Fund at the Asian Pacific Economic Council meeting at Manila on November 20, 1997. Later, Japan's former finance vice-minister, Eisuke Sakakibara, better known as "Mr. Yen," reiterates that "it is the politics, stupid, that often gets in the way and accounts for why sound ideas like the Asian Monetary Fund on global cooperation sometimes get lost as a result."[147] Next, the Korean officials repeatedly asked for direct help in the form of currency swap or bridge loans, but unlike the case of Mexico in 1994, it was not successful. The Washington Post reported that "the newly appointed finance minister, Lim Chang Yuel, openly pleaded for support from Japan, Korea's ancient rival, warning repeatedly that Tokyo stood to suffer significant losses from Korea's travails."[148] Yet, Robert Rubin, the Secretary of Treasury, publicly stated that "the International Monetary Fund, not Washington, would have to take the lead in any bailout of South Korea."[149] The second stage of the crisis started with lagged negotiation between South Korea and the International Monetary Fund about required reforms. According to Feldstein, the fund's program emphasized the following eight structural problems of the Korean economy: 1) foreign investors are not able to acquire Korean businesses by purchasing their shares or to own majority stakes in Korean businesses, 2) Korea's domestic financial markets are not fully open to foreign banks and insurance companies, 3) imports of some industrial products are still restricted, especially Japanese cars, 4) Korean banks do not apply good Western banking standards of credit evaluation but follow what might be called the Japanese development model, in which the government guides banks to lend to favored industries in exchange for an implicit guarantee of the loans, 5) the Bank of Korea is not independent and does not have price stability as its only goal, 6) the corporate structure involves large conglomerates (the

[147] Edward Tang, "Good ideas stymied by big-power politics," The Straits Times (Singapore), May 10, 2000
[148] Paul Blustein, "S. Korea changes stance, begins talks for IMF aid," The Washington Post, November 21, 1997
[149] Robert Rubin, cited from The New York Times, A1, 11/20/97

Chaebols) with an extremely wide range of activities and opaque financial accounts, 7) Korean corporations generally have very high debt-to-capital ratios that make them risky debtors for domestic and foreign lenders, and finally 8) Korean labor laws make layoffs very difficult and provide strong impediments to the flow of workers between firms.[150] Paying attention to the fact that several features of the IMF plan are replays of the policies that the United States and Japan had long been trying to get Korea to adopt, Feldstein said that “although greater competition from manufactured imports and more foreign ownership could in principle help the Korean economy, Koreans and others saw this aspect of the plan as an abuse of IMF power to force Korea at a time of weakness to accept trade and investment policies it had previously rejected.”[151] Considering the strong emphasis of the Fund on reforming financial system, protections for corporate shareholders, and liberalizing trade and capital flows, it was even argued that “the IMF’s Korean foray proves that the Fund has become an adjunct of American foreign policy.”[152] Furthermore, what made the Korean government hesitate to swallow the prescriptions, provided by the International Monetary Fund and the United States Treasury department, was that the structural reforms of the Fund such as hiking interest rates, closing inefficient banks, opening capital account in the time of crisis, and ceiling credit limit would result in wide spread bankruptcies and further capital exodus led by confidence lost of foreign investors. However, the delay of proposed money infusion from the Fund, unexpected credit downgrading by major American credit corporations such as Moody’s, Standard and Poors, and Thomson, and mounting criticisms come from Washington and

[150] Martin Feldstein, ibid, p 26
[151] Martin Fedlstein, ibid, p 32
[152] Anonymous, “New illness, same old medicine,” The Economist, 12/13/97

the Fund played a crucial roles in shifting the Korean illiquidity problem into the first insolvency crisis in the East Asia. In addition, the desperate efforts of the Korean government to get adequate cash to compensate for accelerated capital exodus was doomed to fail because of strong opposition of the United States. Robert Rubin, who has directed the American response to the series of Asian bailouts, stated that "the Koreans should implement the reforms that are needed to get Korea back on the right path." He went to add that "I think the overall structure of the IMF program is a strong one and the direct financial participation of the United States and other nations in aiding South Korea only comes later."[153] It is believed, in general, that the final stage of the Korean financial crisis came with Robert Rubin's announcement on December 24, 1997. By changing his stance from insisting on the role of the United States as the second line of defense, Robert Rubin issued that "the decision, to agree to lend $1.7 billion to Seoul for stabilizing the South Korean currency won, is overwhelmingly in our economic and national security interest."[154] The New York Times wrote that "six major American banks met today at the Federal Reserve Bank of New York and agreed to come up with a plan to help the Koreans, prodded along by the Administration and the Federal Reserve."[155] It is also reported that "Seoul, and especially the newly elected president, Kim Dae Jung, is agreed to lift the restrictions on foreign acquisition of Korean companies, and the ceilings on foreign investments in bonds issued by Korean companies."[156] On December 29, 1997, South Korean legislators passed major financial laws including interest rates deregulation

[153] Andrew Pollack, "Koreans pressing U.S. and Japanese for speedier aid," The New York Times, December 12, 1997
[154] David E. Sanger, "In a shift by U.S., aid will be sped to South Koreans," The New York Times, December 25, 1997
[155] David E. Sanger, ibid,
[156] David E. Sanger, ibid,

and capital market opening to foreign investors, forbidding subsidiaries of the country's giant conglomerates to finance one another's activities. Pointing out the failure of the United States and the International Monetary Fund in delivering bridge loans solicited by the Korean government, Martin Feldstein argued that "the situation in Korea might have been much better and the current deep crisis avoided had such negotiations, happened late December in 1997, begun much earlier."[157] As a result of the crisis in 1997, as anticipated by many economists such as Jeffrey Sachs, the Korean society had to suffer massive lay-offs, mounting bankruptcies, and severe economic recession. Figure 10 indicates that the unemployment rate jumped to 6.8 percent in 1998 from 2.0 percent during most of the 1990s, and the real growth rate of gross domestic products has declined to –6.7 percent in 1998 from average 8 percent during the period.

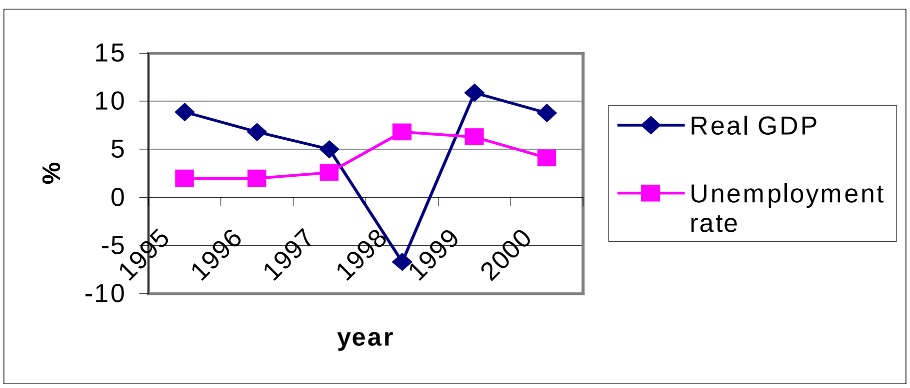

Figure 10: Korean Economic Indicators (Source: Bank of Korea, 2001)

To understand the association of the United States with the Korean financial crisis, it is crucial to note the following fact. Despite the claim that the Japanese attempt

[157] Martin Feldstein, ibid, p 32.

to take advantage of the Korean crisis by asking for lifting a ban on the imports of Japanese cars and other products through the International Monetary Fund's reform packages, it is fair to state that the Japanese government has been forced to be isolated and be focused on to solve its domestic economic problems. The New York Times reported that "the U.S. will probably have to play a dominant role in a Korean aid package because it is difficult to imagine Government in either Seoul or Tokyo accepting one which placed a major responsibility on Japan."[158] It is even claimed that the curtailing of credit lines on the Korean banks by the Japanese banks in the early December 1997 was motivated by the growing concern of the Japanese financial sector to respond to international criticism, especially from the Wall Street, on the Japanese banking system. In fact, the Japanese government was eager to prevent the Asian financial crisis as well as the Korean one from deepening, initially, by proposing the Asian Monetary Fund in mid September, then by offering currency swaps with the affected countries in October, and attempting to deliver bridge loans to stabilize Korean currency market in mid December 1997. But the repeated humiliation in the view of the Japanese government during the Korean crisis is a good example supporting Susan Strange's argument. She claims that "though Americans may be worrying about their possible vulnerability in future to Japanese investors' taste for, and confidence in dollar assets, the Japanese have already felt and recognized their vulnerability at the hands of American structural power."[159] In June of 1997, for example, confronting strong criticism by the Treasury Department, the initial suggestion of Ryutaro Hasimoto, the Prime

[158] David E Sanger, "Seoul will ask U.S. and Japan for assistance," The New York Times, 11/20/97
[159] Susan Strange, ibid, p 17

minister of Japan, that Japan might find it necessary to sell some of its large Treasury holdings to prevent further Japanese yen devaluation, had been muted immediately.

Accepting the role of the United States in managing the Korean financial crisis, the next questions need to be focused on which factors have been played for the policies of the United States and the Fund. To begin with, it is important to remember that the primary goal of the International Monetary Fund has been to help countries cope with temporary shortages of foreign exchange and with more sustained trade deficit. But, interestingly enough, the International Monetary Fund has played quite deviant functions in dealing with the Korean financial crisis. It can be said that the Fund has succeeded in achieving its primary function in terms of imposing fiscal austerity policies such as imposing higher taxes or lessening government spending to improve current account balance and credit tightening by hiking interest rates to prevent further foreign exchange rate devaluation. Yet several reforms proposed by the Fund have been considered for the Koreans and many Asians as attempts to address political objectives of the United States rather than helping the Koreans to resolve financial market instability. In fact, the bilateral agenda of the United States to lift off restriction on access to local funding sources, on introducing new products, and on access to the security market have been fully achieved through the negotiation between the Fund and South Korea. Furthermore, the main focus of the Fund on financial openness and capital account liberalization has been entirely identical with the American foreign policies projected to strengthen the American financial hegemony. As Benjamin Cohen asserted before, the role of the Fund in Korea shows clearly that the American administration officials used the International Monetary Fund to serve the American policy interests more efficiently than attempts to deal with financial crises on a direct and bilateral basis. [160] It is possible to argue that the reasons of the Treasury Department to attach additional conditions for the South Korean package have been motivated by domestic politics to assure the American public that the money used for bailing out the troubled countries will be fully compensated. However, Robert Wane contends that "the greatest blessing of financial opening for the United States economic policy agenda is that it has no domestic costs; In other words, to the extent that the United States deficits are financed by dollar accruals abroad, which are deposited in the U.S., the deficits would not even require offsetting monetary policy to avoid effects on domestic economy as well as have no contracting effect on the U.S. monetary supply."[161] Pointing out the fact that national banking systems especially in South Korea, Japan, and Germany came into existence to support mercantilist or national industrial policy goals free from the dictate of private institutional profitability, Henry Liu reiterates that "with financial globalization, these banking structure of national policy have been forced to transform themselves into components of a globalized private banking system that puts institutional creditworthiness and profitability as prerequisites, serving the needs of the global financial system to preserve the security and value of global private capital."[162] What needs to be focused is that initially the United States declined South Korea's plea for allowing currency swap as well as urging the Koreans to be under the guardianship led by the International Monetary Fund. And then, the Fund, coincidentally, played a crucial role in achieving the Americans' foreign policy objectives such as reforming the banking system and opening the financial market,

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[160] Please refer to Benjamin Cohen, reference #56
[161] Robert Wane, ibid, p 311
[162] Henry C K Liu, "The BIS vs national banks," The Asia Times, 05/14/02

supposed to be significantly associated with the dollar policy, rather than providing adequate funds to mitigate market panic. In fact, on the contrary to the Korean financial crisis, the United States provided $40 billion for Mexico in 1994 and allowed the Fund to increase its quota in order to provide bridge loans for Brazil in 1998. Moreover, it is still unclear why market participants and officials came to agree with the idea that South Korea has fundamental problems in its financial and corporate sector. Stanley Fischer, the chief economist of the International Monetary Fund, states that "given the widespread view in the market before the crisis broke out, that there were fundamental financial sector and corporate financing problems in the crisis countries, the program (the Fund's aid packages) had to attempt to deal with these difficulties if it was to succeed."[163]

Conscious or not, it is not unfair to argue that the United States has been able to augment the dollar demand both by market preference to safe haven and by strategic choice by the East Asian governments, which wish to stock up additional foreign currency, in particular the United States dollars to prepare for future market instability. Figure 11 shows that there has been steep increase of the dollar as a foreign reserve currency in Thailand, Indonesia, and South Korea since the crisis. For example, Korea's ratio of foreign reserve currency as of imports has jumped from an average 3.0 month in the early 1990s to 6.7 month in 1998. In short, it is possible to conclude that the objectives of the strong dollar policy, such as insuring central banks to hold large sums of dollars as part of their foreign exchange reserves and continuous selling Treasury bonds dominated by dollars, have been successfully achieved.

[163] Stanley Fischer, "The international financial system: crises and reforms," quoted from http://www.iie.com/fischer/sl.html

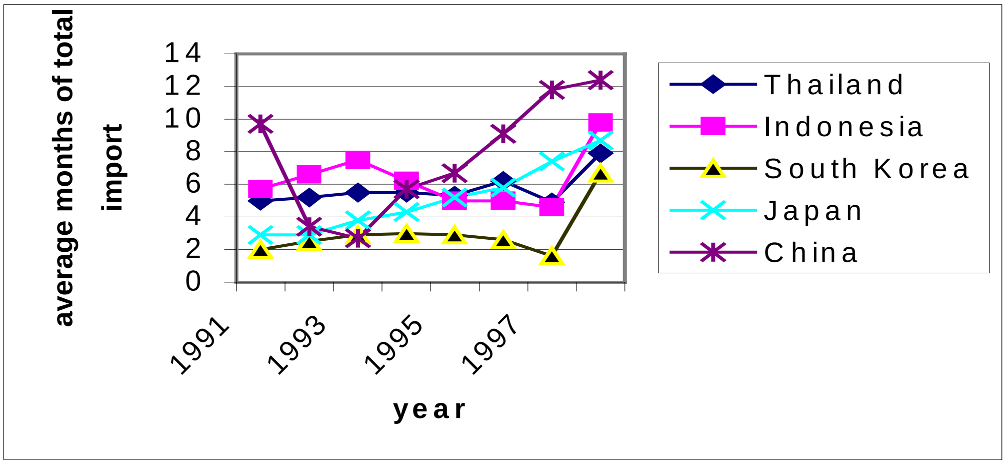

Figure 11: Official reserves/imports (in months)

Additionally, given the situation in which the Koreans needed to increase dollar reserves by trade surplus with the United States, it was difficult for South Korea to support the idea of the weak dollar, which will considerably reduce the purchasing power of the American consumers and possibly resulted in Korea's trade deficit with the United States. As Figure 12 indicates, even though the Koreans have been able to achieve sharply increased trade surplus with the United States, thanks mainly to 75 percent of foreign exchange depreciation since the crisis, the economic dependence of South Korea on the United States has been deepened since the United States provided the primary foreign reserve to buttress the financial stability and foreign exchange rate of the Korean won. Therefore, it is anticipated that in order to maintain the current amount of trade surplus with the United States, it is vital for the Koreans not to appreciate its international buying power (foreign exchange rate) to the extent, which it can be negatively affect on the trade balance with the United States. In other words, it is possible to argue that the

American government will be able to enjoy additional influence on the Korean economic decisions.

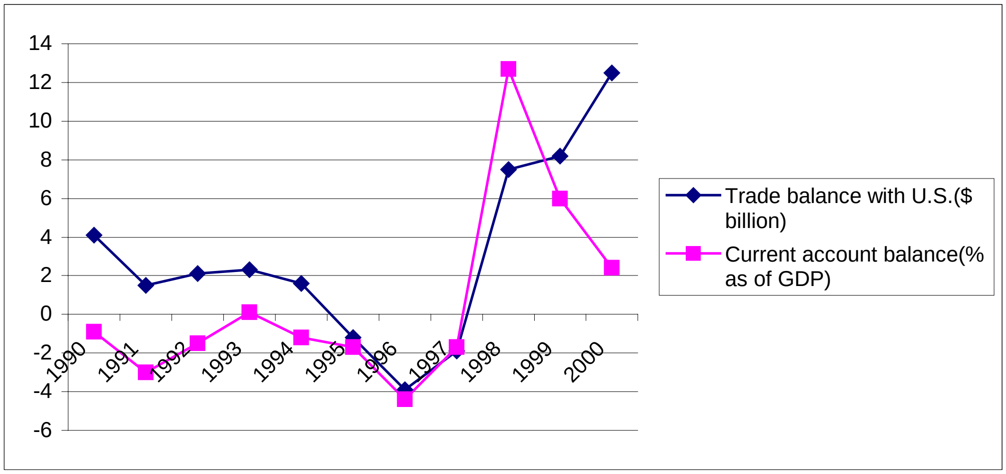

Figure 12: Trade and Current account balance of South Korea (Source: Bank of Korea, 2001)

With certainty, there is reasonable argument that the apparent achievement of dollar policy objectives in terms of demand and supply has been the byproducts of the East Asian financial crisis rather than well-calculated consequences. But, given both the capital exodus from Korean financial market owed a good deal to liberalized capital account established mainly by the pressure from the American government and such U.S. strategies as blocking of establishing Asian Monetary Fund, barring bridge loan from Japanese government, and delaying to infusion of IMF emergency loan, the dollar policy view provides a useful tool in understanding the behaviors of the Treasury Department and the International Monetary Fund during the Korean financial crisis.

2. The Currency Crisis of Argentine in 2001

The Argentine financial crisis had started on December 5, 2001, when the International Monetary Fund refused to disburse a scheduled $1.3 billion loan by citing that "Argentine's inability to meet the targets under the zero deficit law."[164] In a response to the decision, many American economists hurried to claim that "the crisis would have been averted had Argentina followed the advice of the International Monetary Fund religiously, especially by cutting back on expenditures more ruthlessly."[165] The main purposes of this case study is to understand, as mentioned before, 1) the role of the United States plays as a hegemon, 2) the motivations of those policies pursued by the hegemon, and 3) the relation with the dollar policy. To clarify the influence of the United States government in initiating the recent financial crisis in Argentina, it is vital to evaluate whether the decision of severing additional funds by the International Monetary Fund has been justified in considering the macroeconomic performance of Argentine. The Fund claims that the decision was inevitable to build confidence among investors and lenders because the Argentine government could not accept a sufficient dose of the painful medicine of austerity. However, given Table 4 and 5, it is possible to cast serious doubt on the claim of the Fund. First of all, compared with Brazil, both the current account balance and the fiscal balance of Argentina was a better shape. Pointing out the relatively modest amount of fiscal deficit of 3.3 percent of Argentine, Joseph Stiglitz asserts that "when the United States was experiencing a far milder recession than the current Argentine one, the U.S. federal deficit was 4.9 percent of GDP."[166] Paul

[164] IMF spokesman Thomas Dawson, December 20, 2001, press briefing (at www.imf.org)
[165] Joseph E Stiglitz, "Argentina, shortchanged: why the nation that followed the rules fell to pieces," The Washington Post, 05/12/2002
[166] Joseph E. Stiglitz, ibid,

Krugman, an economist at MIT, reiterates that “Argentina’s budget deficit has ranged between 1 and 3 percent of GDP, not bad for a depressed economy, and its government debt is only about half of GDP, better than many European countries.”[167]

Table 4: Fiscal Balance (% GDP)

Year	USA	Japan	EMU	Argentina	Brazil	Average (Latin American countries)
2000	2.4	-9.5	-0.8	-2.5	-4.5	-2.6
2001	1.3	-8.0	-1.3	-3.3	-5.3	-2.9

Table 5: Current account balance (% GDP)

Year	USA	Japan	EMU	Argentina	Brazil	Average (Latin American countries)
2000	-4.5	2.1	-0.9	-3.1	-4.2	-2.3
2001	-4.1	1.8	-0.1	-1.6	-4.6	-2.5

It is true of course that the total budget balance, the numbers allegedly employed by the Fund in its decision, has deteriorated to a deficit of $6.8 billion in 2000 from $2.7 billion surplus in 1993.[168] But Mark Weisbrot and Dean Baker stresses that “all of deterioration occurred on the revenue side, as tax collections fell off during the recession rather than on government spending, excluding interest, remained flat over the period from 1993 to 2000.”[169] Table 6 indicates that government total revenue fails to meet the gap caused by steep growth of interest payment from 2,914 million in 1993 to 9,656 million in 2000. As Table 6 shows, it was increasing interest payments on the debt that drove the government’s budget from surplus to deficit.

[167] Paul Krugman, “A cross of dollars,” The New York Times, 11/07/2001.
[168] Mark Weisbrot and Dean Baker, “What happened to Argentina,” Center for Economic and Policy Research, Jan. 31, 2002

Table 6: Argentina, National government spending and revenues (1993-2000) in millions of current pesos

	1993	1994	1995	1996	1997	1998	1999	2000
Total Revenue	50,726	51,078	50,293	47,668	55,376	56,726	58,455	56,570
Interest Payment (% GDP)	2,914 (1.23)	3,150 (1.22)	4,083 (1.58)	4,607 (1.69)	5,745 (1.96)	6,660 (2.23)	8,223 (2.9)	9,656 (3.4)
Deficit or Surplus	2,730	-285	-1,373	-5,264	-4,276	-4,073	-4,768	-6,791

Weisbrot and Baker argues that "this by itself is a significant drain on the economy, since almost all of these payments are in foreign currency, and most of the money goes out of the country." [170] They continues, stating that in the context of Argentina's fixed exchange rate, "the government's attempts to eliminate the deficit, by cutting primary spending during a recession, worsens the economic situation: first by directly reducing demand, and also by causing political instability and uncertainty, which fed fears of devaluation and/or default."[171] Finding the primary problem with the fixed exchange rate system, obviously supported by the Fund, Joseph Stiglitz contends that "with the Argentine peso pegged to the dollar, an overvalued dollar means an overvalued peso. And while the United States has been able to sustain trade deficit, Argentine could not."[172] He reiterates that "given the exchange rate, given the economic depression which the IMF policies had already brought about, given the huge debt, given that the IMF did not provide any convincing economic strategy to get out of the mess, given that there were open capital markets so that anyone who wanted to could move their investments to safer havens

[169] Mark Weisbrot and Dean Baker, ibid,
[170] Mark Weisbrot and Dean Baker, ibid,
[171] Mark Weisbrot and Dean Baker, ibid,
[172] Joseph Stiglitz, ibid,

elsewhere in the world, it was highly unlikely that anyone—especially when the government signed an agreement on reduce its deficit further, predictably causing more unemployment and lower output—would start investing more."[173] But, paying attention to the external shocks such as the Mexican peso crisis, the Asian financial crisis, Russian, and Brazilian crisis, Weisbrot and Baker argue that "Argentine's experience—including the considerable amount of capital flight during the period—does raise questions about the functioning of international capital markets without control at the national level."[174] They put forth that "it raises the question of how much any country would want to put itself at the mercy of such volatile international markets."[175]

It is unclear whether the United States had anything to do with the decision of refusing to disburse a scheduled $1.3 billion loan for Argentina in 2001. Yet considering the fact that the American government has veto power in major decisions including loan approval, it can be said that the decision of discontinuation of additional funds was done with the agreement of the United States. In this context, Hector Maletta, a professor at University del Salvador, contends that "because the Bush administration has different philosophy, Argentina was the test case they chose for their new approach, hence the reluctance to come to the rescue when Argentina was titling towards national default."[176] However, given the limitation of the total amount of available quota of the Fund, determined mainly by the American government, it is not irrational to argue that the decision of severing additional aids may be constrained by the abnormal needs for the IMF credits owed a great deal to the global financial instability. In a situation of

[173] Joseph Stiglitz, ibid,
[174] Mark Weisbrot and Dean Baker, ibid,
[175] Mark Weisbrot and Dean Baker, ibid,
[176] Hector Maletta, "Argentina, IMF, and the U.S. taxpayer,"

increased demand and less hope of sufficient support for additional funding, it is inferred that the severance of scheduled loans for Argentine has been inevitable. In effect, focusing on the limited choice of the International Monetary Fund, the Financial Times already predicted in October 2001 that "Turkey, NATO's only Muslim member, is likely to receive help from the Fund, but Argentina's slide towards default looks hard to stop." [177] Curiously, despite close to 80 percent of net public debt, far bigger than that of Argentina, the Executive Board of the International Monetary Fund approved a three-year, $16 billion, stand-by credit for Turkey to support the government's economic program on February 24, 2002.[178] Meanwhile, it is reported that "after weeks of rioting and looting that had left 27 people dead, the Argentine government was officially in default on its international debt, the largest default of a national government in recent memory on December 2001."[179]

Interestingly enough, the prescriptions, such as additional exports and adopting a freely floating foreign exchange system, provided for Argentina were not much different from those for the Koreans. Joseph Stiglitz argues that "on an emergency basis, we-Americans should open our markets to Argentine goods. This is a form of assistance that would cost us nothing-Americans as consumers would be better off."[180] Pointing out this irony, Henry Liu states that "world trade is now a game in which the United States produces dollars and the rest of the world produces things that dollars can buy."[181] Furthermore, Paul Krugman argues that the natural answer for resolving the Argentine

[177] Alan Beattie, "Clinging on: Emerging markets are under stress," The Financial Times, October 17, 2001.
[178] The International Monetary Fund, Press Release No. 02/7, February 4, 2002 (www.imf.org)
[179] The New York Times, January, 10, 2002
[180] Joseph Stiglitz, ibid,
[181] Henry C K Liu, "US dollar hegemony has got to go," The Asia Times, 04/11/02

problem is to remove the straitjacket: let the peso float, and floating its currency will improve its economic position.[182] But, while emphasizing the benefit of the United States in adopting freely flexible rates, Susan Strange reiterates that " even in a more structural sense, the viability of this system relies wholly on the absence of alternatives to the dollar, both as a reserve asset and as a vehicle currency, and alternative adjustment mechanism."[183] As she says, it is fascinating to note that much of today's discussion of international monetary reform echoes the discussion that occurred around the time of the collapse of fixed rates in the early 1970s.[184] In conclusion, it will be possible to argue that the adamant demand of the International Monetary Fund and the United States on adopting a freely floating currency regime and structural adjustments, especially during the financial crisis, can not be properly understood without the frame of the dollar policy.

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[182] Paul Krugman, ibid,
[183] Susan Strange, *Sterling and British Policy*, p 400
[184] Susan Strange, ibid, p 562

CHAPTER V

DISCUSSION AND CONCLUSION

1. Summary

By taking the stance that a social crisis needs to be differentiated from a natural crisis, which denies human intervention in its development, this paper primarily attempts to look for the hidden forces of the modern currency crises since the breakdown of the Bretton Woods system. In particular, considering the growing dominance of the dollar as an international reserve currency despite growing deterioration of the United States' financial soundness, this paper examines the political role of the United States in the present international monetary system. After arguing the presence of the dollar policy to maintain and strengthen the status of the United States as a hegemon, this paper initially asks whether the United States had anything to do with the Latin American debt crisis in the early 1980s and the East Asian financial crisis in the late 1990s. And then, considerable attention was paid to relate the specific policies of the United States during the Korean and Argentina crises to the dollar policy. The strong focus on financial liberalization and capital account opening by the International Monetary Fund, criticized by its strong association with the United States and consequential results of the financial crises such as adopting freely floating foreign exchange regime and accumulating additional dollar reserves, are reviewed in terms of the specific strategies of achieving the dollar policy.

Given the fact that a world political role by the American government was a necessary precedent for the market election of the dollar as an international reserve currency, this paper argues a number of specific points. The dollar policy had been first initiated in the mid 1960s, when the United States found itself trapped in Triffin's dilemma—increased American foreign liabilities caused by the role of dollar as an international reserve currency made the gold exchange standard increasingly vulnerable to breakdown. Second, the dollar policy was realized as adopting a free floating exchange rate system in 1973, which provided the United States an efficient monetary tool to avoid the adjustments that would otherwise have been required by America's new situation as a debtor. Third, the dollar policy was challenged by confidence loss in the value of dollar as an international reserve currency because of the America's growing current account deficit and weakened financial soundness during the 1980s. Ultimately, the policy was crystallized as 'a strong dollar policy,' in 1995 in order to maintain the role of dollar as an international key currency despite apparent weakness of economic fundamentals expressed by continuous current account deficits despite gradual dollar depreciation and America's new status as one of the largest foreign net debtor. In addition, to achieve the objectives of dollar policy such as to maintain the reserve currency role of the dollar and to serve for sustaining of the United States as a hegemon in the international system, it is argued that the dollar policy includes at least three frontiers: to maintain stable dollar demand (demand frontier), to suppress the appearance of alternatives of the dollar as an international reserve asset, and to utilize the power of news media in the construction of international confidence in the value of dollar and the present system (confidence frontier). The official launch of a strong dollar policy in 1995 is also understood as a final version of the dollar policy in order to achieve the policy objectives such as to support the role of the United States as an international central bank in spite of its new status as one of the largest debtor in the world.

The main purpose of reviewing the Latin American debt crisis is to clarify the role of the United States in the development of the debt crisis in the early 1980s. Robert Triffin claims that “it was the irresponsibility of the United States in first allowing the over-lavish creation of credit and then bringing about its drastic contraction at the end of the 1970s that lay at the root of other problems.” Particularly, considering the severity of the hiked interest payment burden of the Latin American countries, this paper concludes that even though the Latin American countries have had internal problems such as import-substitution development policy or relatively high dependence on private creditors, the United States was considerably associated with the debt crisis, initially, by handing over the burden of adjustment to the deficit countries and then exporting domestic inflation to the other countries. Through the Asian financial crisis review, this paper attempts to examine whether the intervention by the United States and the International Monetary Fund played a crucial role in shifting the Asian crisis from an illiquidity problem into an insolvency problem. Robert Chang asserts that “even as the economic strength of the Asian countries was not satisfactory, the real cause was that international creditors and domestic depositors, fearing a crisis, suddenly refused to roll over credits or keep their funds in the impaired financial system.” Additionally, the reason for the United States’ blocking of the Asian Monetary Fund and the Fund’s extensive focus on fixing the Asian economies has been conceived as the American foreign economic policies aim to achieve its financial hegemony. For example, Robert

Wade contends that “on the one hand, the United States has a strong national interest in being able to attract foreign savings, which, in turn, finance the large and growing deficits, on the other hand, by promoting market access for American financial services firms which have great advantages over competitors in everything from securities placement, debt work-outs, privatizations, and mergers and acquisitions, the American government has an efficient tool in lessening current account deficit via the earning of the financial institutions.”

The Korean financial crisis is reviewed in detail, on the one hand, to understand the systemic problem of the present international monetary system. Referring to the Korean financial crisis, George Soros states that “with huge funds floating across global currency and stock market, an individual country, in spite of doing every thing right, may fail to stem the tide of financial turmoil.” On the other hand, the value of the Korean case study lies in getting the opportunity to look at the distinctiveness of a social crisis, which may shift its core by the intervention of human beings. Given the relatively deviant policies pursued by the International Monetary Fund and the United States, it is argued, as Martin Felstein says, that “although greater competition from manufactured imports and more foreign ownership could in principle help the Korean economy, Koreans and others saw this aspect of the plan as an abuse of IMF power to force Korea at a time of weakness to accept trade and investment policies it had previously rejected.” Furthermore, since the Fund focused mainly on financial openness and capital account liberalization identified completely with the American foreign economic policies to achieve the American financial hegemony, it is claimed that the IMF played an important role in achieving the dollar policy rather than providing adequate funds to mitigate market panic. By recognizing the Korean economy's further dependence on the United States and sharply increased dollar reserves to prevent the 75 percent devaluated foreign exchange rate of the Korean won, this paper argues that coincidentally, the objectives of the strong dollar, such as insuring central banks to hold large sums of dollars as part of their foreign exchange reserves and continuous selling bonds and stocks dominated by dollars, have been successfully achieved by the Korean financial crisis in 1997. The politicization of the International Monetary Fund and the influence of the United States in initiating the recent financial crisis of Argentina in 2001 are also reviewed to understand the likely association of the dollar policy with the ongoing financial crisis especially in the developing countries. After reviewing the status of Argentina in terms of financial soundness and the potent reason of deteriorating government budget deficit, it is claimed that Argentine's experience—including the considerable amount of capital flight during the period—does raise questions about the functioning of international capital markets and how much any country would want to put itself at the mercy of such volatile international markets. While admitting the likely ideological change of the American government, this paper contends that the decision of severing the already scheduled loans for Argentina can be properly understood only by considering the abnormally increased demands for the IMF credits and its blocked supply by the American government.

2. Implications

Primarily, this paper attempts to look for the likely relationship between the United States, playing as a hegemon in the present international system and the recurrent financial crises. Recognizing the potential influence of human intervention on the development of a social crisis, it is examined whether the ongoing financial crises from the Latin America in 1980s to the European countries in the early 1990s and to the East Asia in the late 1990s have anything to do with the grand strategy of the United States. While casting a doubt on the validity of the theory of hegemonic stability-hegemony provides the preconditions (or regimes) for the operation of an open or liberal world economic system-this paper especially strives to examine whether the United States, with the intention of maintaining the status of the dollar as an international reserve currency in spite of its growing deterioration of financial soundness, has played any role in the development of those crises. Given the result of the case study, it is inferred that the United States had paid more attention to take advantage of the financial crisis in Korea and to pursue its political agenda in Argentina in 2001 rather than to provide adequate liquidity, which might have prevented the temporary financial crisis from developing into social crisis. Hence, Andrew Walter argues that "the power of hegemon, which, artificially, abuse its accredited power to strengthen hegemonic status, should be constrained rather than restored as the theory of hegemonic stability assumes."[185]

Because the United States acted primarily for its self interests by taking advantage of the financial crisis rather than attempted to help market stability, the structural reforms, prescribed by the United States and its alleged political association, the International Monetary Fund, need to be re-examined. It is crucial to seriously ask if complying to the agenda of the International Monetary Fund such as a free floating exchange regime, financial liberalization and capital account opening, and reforming banking and industrial system will work for the benefit of the affected countries. Unfortunately, the case of Argentina clearly shows that preventing future financial

[185] Andrew Walter, ibid, p 53

turmoil depends less on domestic reforms than on the political wills of the hegemon. Susan Strange states that the solution for financial stability and economic security needs to be found not only in economic reforms but also in political actions.[186] Therefore, for the affected countries including South Korea and Argentina, the political underpinning of the common currency, euro, should not be dismissed. Immauel Willestein, a well-known political scientist, states that "for Europeans, or at least for western Europeans, it (common currency euro) marks a giant step in the direction of restoring Europe to a central role in geopolitical decision-making, a centrality it had lost in 1945."[187] Obviously, the objective of the promoters of the European Monetary Union is for Europe to challenge the hegemony of the dollar and of the United States leadership of the free world.[188] Yet, it is true that the existence of another international currency does not help the other developing countries to establish economic stability and a viable monetary system. This is the starting point of pondering the possibility of launching regional currency union such as the Asian Common Currency. Given the exertion of the dollar policy of the United States, the strategic response of the European countries to the American hegemony, and the increased burden of the developing countries, which have to accumulate additional foreign reserve currency, in particular the United States paper dollars, to prevent future financial turmoil, it is the very time for those affected countries to look for establishing a regional common currency.

[186] Susan Strange, *Mad Money*, p 14
[187] Immanuel Wallerstein, "The Euro," quoted from, http://fbc.binghamton.edu/commentr.htm
[188] Alan A. Walters, "The coming of the euro: international money and global politics," The Economist, October 22/1998

3. Limitations and Further Studies

Even as case studies about the Korean and Argentina financial crises provide a good opportunity to look closer at the specific behaviors of the present hegemon, it is less easy to apply it generally to other countries. It is also true that the relationship between those policies pursued by the United States and the dollar policy needs to be elaborated. Apparently, it is possible to argue that the American foreign economic policies including the dollar policy are the results of strategic choices of the American decision makers rather than played as specific guidelines for achieving certain political/economic objectives. To be a comprehensive theoretical framework, the dollar policy should be refined and needs additional analyses. For example, how the Treasury Department of the United States is able to restrain foreign capital outflow during the time of confidence loss from early 1990s to 1994 was not addressed in this paper. The reason of relative passivity of Japan and German in the international monetary system is another arena needs to be explored. In addition, the role of the United States based news media in constructing confidence on the dollar and the present international monetary system has to be analyzed as well. Yet it needs to be cautious not to over-evaluate the power of news media in influencing market decisions and confidence construction. Given the emergence of multinational corporations, choosing a nation state as a unit of analysis may have inherent limitations. In fact, it is unclear whether there is unanimously shared national interest in the current global society. As a related issue, the influence of international politics in the ongoing financial crises should not be exaggerated as well. It is obviously possible to argue that current financial crises are caused mainly by technical problems rather than the interaction between politics and economics. Data limitation should not be dismissed at this point. Even though the author strived to maintain an objective and neutral position in choosing news articles and related data, it is probable to be criticized that this thesis is not free from data bias and the author's personal opinion. In a simple example, since the author has been solicited to present persuasive arguments about the negative role of the United States- an acting hegemon on the recurrent financial crises, it failed to count sufficiently on the potential role of the internal factors prevailed in the impaired countries such as South Korea and Argentina as well as the positive aspect of the leadership shown by the United States during the crises. To be fair, in spite of the theoretical stance of the political economic approach based inevitably on collecting supportable data, it needs to be addressed that sample articles employed to justify the dollar policy and the hegemonic strategy of the United States are not free from the author's subjectivity.

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