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Theorizing the Financial Statecraft of Emerging Powers

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‘Financial statecraft’, or the intentional use of credit, investment and currency levers by the incumbent governments of creditor – and sometimes debtor – states for both international economic and political advantage, has a long history, ranging from money doctors to currency wars. A neorealist, zero-sum framing of international monetary relations is not inevitable, yet casts a persistent shadow especially during periods of prospective interstate power transitions when previously peripheral countries find themselves with unexpected new capabilities. This article seeks to understand and theorise the financial statecraft of emerging economies, moving beyond the traditional understanding that closely identifies the concept with financial sanctions imposed by a strong state on a weaker state. We propose that the aims of financial statecraft may be either ‘defensive’ or ‘offensive’. Financial statecraft may be targeted either ‘bilaterally’ or ‘systemically’. Finally such statecraft may employ instruments that are either ‘financial’ or ‘monetary’. As emerging market economies have moved up in the ranks in the interstate distribution of capabilities, they have also expanded their financial statecraft strategies from narrowly defensive and bilateral to those involving offensive tactics and targeted at the global and systemic level. Historical and contemporary examples illustrate the analysis.

Keywords: financial statecraft, emerging economies, currency, capital controls, exchange rate policy, international debt

During the late twentieth century, the emerging economies in Latin America and Asia struggled to fend off imported financial crises. These governments adopted largely defensive strategies to protect their economies at the same time they faced pressure to implement market-oriented economic reforms. Meanwhile, the global interstate distribution of capabilities gradually shifted, and the new international configuration has had a substantial influence on the national and regional financial statecraft of these rising powers and regions. Governments in emerging

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economies have recently begun to hold more systemic and global concerns and have become increasingly assertive in voicing their views. We ask in this study how these emerging economies protect themselves from the pressures of globalised finance and strive to transform existing modes of global financial governance in order to provide themselves with a more secure position within it. Ultimately, such global rebalancing and more active use of financial statecraft by rising powers will have fundamental, although perhaps incremental, implications for the global financial architecture.

We define 'financial statecraft' as the intentional use, by national governments, of domestic or international monetary or financial capabilities for the purpose of achieving ongoing foreign policy goals, whether political, economic or financial. The study addresses two gaps in the existing literature. First we complement the large body of work on economic sanctions, which primarily has focused on asymmetric economic relationships through which the strong impose conditions and sanctions on the weak. This article instead explores the use of financial statecraft by rising powers. Second we expand the definition of international financial statecraft beyond its narrow use as a synonym for financial policies intended to alter the behaviour of a specific foreign state, often one viewed by the sanctioner as an outlaw or rogue nation. Here we analyse a variety of monetary and financial statecraft strategies, including those aimed at altering systemic conditions, the institutions and governance of global finance.

The article first discusses the emergence of new powers in Asia and Latin America. We suggest that the governments of many emerging powers have taken this power shift as their cue to engage in more active financial statecraft. Section 2 theorises the concept of financial statecraft focusing on three dichotomous dimensions. The aims of financial statecraft may be primarily 'defensive' or 'offensive', its targets 'bilateral' or 'systemic' and its instruments 'financial' or 'monetary'. The empirical portion of the article, in Sections 3–6, maps broad variations in the first two dimensions (financial statecraft's aims and targets), drawing on examples from Latin America and Asia. We suggest that states may be drawn to certain types of financial statecraft according to their position in the global interstate distribution of material capabilities. We conclude with brief comments on the implications of the analysis for future global financial governance. We infer that due to their nascent offensive financial statecraft capabilities as well as their own outward-oriented economic interests, it is unlikely for these emerging powers to pose aggressive challenges to the existing global governance structure in the near future.

1. The twenty-first century's shifting interstate distribution of capabilities

The use of international financial statecraft by new global and regional players rests on the assumption that an underlying shift of capabilities, and thus eventually of global influence, is indeed in process. Hence, we examine whether the emerging market economies are really 'emerging' with higher relative capabilities and potential to influence others and the global system.

Measuring shifting power is not simple. The field of international relations splits between strict 'realists' (Waltz 1979; Mearsheimer 2001), who conceptualise power principally in terms of the distribution of material capabilities (power potentials) among like units in an ungoverned ('anarchic') interstate system, and those, including liberal institutionalists, who understand power as inevitably relational and thus inhering only in situations in which one state is able to persuade or dissuade another away from the target state's default path (Barnett and Duvall 2005). Our theoretical stance is closer to that of the 'neoclassical realists', who ground their analyses in the material balance of power potentials among states. Yet we also would explicitly allow for the possibility of foreign policy choices being shaped, in addition, by policymakers' responses to domestic or transnational institutions, interests and ideas (Rose 1998; Kitchen 2010). Nonetheless, the classical balance of interstate material capabilities sets limits on plausible state choices, and thus matters, particularly when the balance is in flux.

It is generally agreed that currently the USA disposes of more 'power' resources (that is, material capabilities that might be translated into global influence) than any other single country. Ikenberry *et al.* (2009) find that today's interstate system is not hegemonic, but is certainly unipolar. Yet other states are increasing their presence. One quantitative snapshot comes from the Composite Index of National Capabilities (CINC) developed by the 'Correlates of War' project and calculated continuously for an evolving set of major and intermediate powers since 1820 (Singer *et al.* 1972). The index averages national shares of world totals of six objective capabilities particularly relevant to the ability to wage war: population, urban population, iron and steel production, energy consumption, military personnel and military spending. Table 1 (left half) shows the results for 1955, 1990 and 2007, the most recent year available. According to this index, the USA alone accounted for about 23 per cent of all international 'hard power' capabilities in 1955. Its share shrunk to about 14 per cent by 1990, then held steady through 2007. The decline in the share of capabilities controlled by the remaining major advanced industrial countries (G7 minus the USA) – Canada, France, Germany, Italy, Japan and the UK (G6) – was smaller and more gradual, falling from 18 per cent in 1955 to 13.5 per cent in 2007. Between 1955

TABLE 1. Relative material capabilities of states (percent of world)

	CINC			CCI	
	1955	1990	2007	1990	2007–9
G7	44.6	29.8	27.7	47.3	36.3
BIC	14.7	17.5	29.7	10.4	22.2
ROW	40.7	51.3	42.6	42.3	41.5
Memo: USA	26.6	13.9	14.2	21.4	17.0
Memo: China	9.1	10.6	19.9	5.1	14.1

Notes: G7 = Canada, France, Germany, Italy, Japan, USA and UK; BIC = Brazil, India and China; ROW = Rest of World.
Sources: CINC: Singer *et al.* 1972, as updated by CINC dataset Version 4, at: www.correlatesofwar.org; CCI.

and 1990, the relative shares of countries not included by name in the table (the rest of the world, ROW) expanded by about 10 percentage points, from around 41 to 51 per cent of world capabilities – but then fell back to less than 43 per cent in 2007. The share of China, India and Brazil (BIC) grew slowly from about 15 to 17.5 per cent from 1955 to 1990, then exploded to nearly 30 per cent of the world total in 2007 mainly due to the growth of China. Yet these results are questionable, as they suggest that today China has greater material capabilities than even the USA.

One might instead construct an alternative Contemporary Capabilities Index (CCI) more appropriate to measuring relative capability in our own era (Armijo *et al.* 2013). In contrast to the CINC, the CCI incorporates the total size of the economy, two proxies for technology and a measure of financial capability, but no longer assigns positive valence to high energy consumption or urbanisation per se. The CCI is calculated as the mean of national shares in global totals of: national income (gross domestic product, GDP, calculated at purchasing power parity, PPP), population, telephone subscriptions (both fixed and mobile), industrial value-added, foreign exchange reserves and military spending. As shown on the right side of Table 1, the CCI indicates that the USA had 21 per cent of global capabilities as recently as 1990 before it shrunk to 17 per cent by 2007–9. The share of the remaining six major advanced industrial countries (G6) meanwhile fell from about 26 to 19 per cent. Most of the expansion occurred in India, Brazil and particularly in China, whose global capabilities rose from 5 to 14 per cent.

Table 1 demonstrates that the trends in the CINC and CCI are broadly similar, although the CINC's arguably anachronistic indicators show the advanced industrial democracies declining sooner and farther. Both indices surely overstate the current international influence of emerging powers, as neither includes such 'soft power' (Nye 1990, 2004) dimensions as reputation, cultural influence or political stability. They also omit more esoteric or hard-to-measure dimensions of material power such as number of patents applied for or granted and share of global engineers graduated. Yet if we take them as indicators of the direction (but not necessarily the level) of change, they offer compelling support of a relative rise in capabilities by newly emerging powers. This is how trends are being interpreted in state houses, news media and universities worldwide.

2. Theorising financial statecraft

States often have deployed economic and financial instruments to achieve their foreign policy goals. The notion of economic and financial interests enlisted or involved in foreign policy goes back to the early years of the globalising economy and modern nation-state. The peace preference of the *haute finance,* argues Polanyi (1944), contributed significantly to the 100-year relative peace in Europe under the rapidly globalising market economy of the late 1800s through the First World War. Adopting a more *realpolitik* tone, Hirschman (1945: xv) examines how 'quotas, exchange controls, capital investment, and other instruments' can be used to engage in economic warfare, especially through establishing a country's potential for economic sanctions.

The term 'economic statecraft' has traditionally been defined as the employment by the state of economic levers as a means to achieve foreign policy ends. For instance, trade sanctions may be imposed on a foreign country with the aims of pressuring its government to end human rights violations against its citizens or cease construction of nuclear weapons. Conversely, military or diplomatic allies may receive subsidised loans or trade preferences. Baldwin's (1985) seminal work on economic statecraft highlights the way in which economic instruments, particularly trade and other economic sanctions, can be deployed in support of state security objectives. In the last 20 years, a cottage industry on economic sanctions has investigated both the domestic political foundations and the effectiveness of such sanctions.[1] Consistent with this usage, 'financial statecraft' (FS) would refer to a national government's use of monetary or financial regulations or policies to achieve foreign policy ends.

This body of work has a strong large country bias, however. These studies most often focus on the wealthy democracies, particularly the USA, the state which imposes most contemporary sanctions. Moreover, their focus on targeted sanctions has led researchers to underestimate the intentional political content of broad international financial and monetary policies. For example, only recently have scholars begun to consider the provision by the USA of the world's dominant transaction and reserve currency for decades as an 'exorbitant privilege' enabling the issuer to further a range of non-financial international policy goals (Eichengreen 2011). We suggest moving beyond both the large-country bias and the narrow focus on sanctions of much of the existing literature.

Our analytical framework nonetheless builds on existing research. Paying close attention to monetary dynamics beyond the strongest states, Cohen (1966) was ahead of his time in suggesting that there are two different types of negative results from engaging in policy adjustment to reduce a persistent balance of payments deficit: continuing costs and transitional costs. Cohen (2006) later developed these concepts into 'the two hands of monetary power'; power to delay (that is, to postpone what would become the continuing cost of domestic macroeconomic adjustment to reduce a trade imbalance) and power to deflect (that is, to avoid the transitional cost of adjustment by passing it off to one's trading partner). Large countries with high levels of liquidity, borrowing capacity and diversified economies always have higher power to delay and deflect, while small countries typically lack both. Andrews (2006: 18–19) also analyses the use of monetary statecraft, and identifies both 'internal' and 'external' aims of key instruments or techniques. For example, he notes that manipulation of currency values has the internal objective of insulating domestic monetary policy, but also the external (international) goal of promoting exports or exacting concessions on other issues. Agreeing with Cohen (2006: 49–50), who argues that international monetary relations have tended to be hierarchical, our project pushes the envelope by considering the choices available to countries striving to ascend this hierarchy.

We propose three important dimensions of financial statecraft. The first and most important dimension concerns state leaders' policy objectives, which may be either 'defensive' or 'offensive', a judgment that we allocate to the researcher, although statements of senior policymakers serve as critical evidence. On the one hand, national leaders deploy financial statecraft *defensively*, as a 'shield'. Linking our usage to Andrews' (2006: 19) terminology, the goals of defensive statecraft are 'primarily internal'. Leaders' principal goal is to protect the status quo preserving their country's domestic economic and political autonomy. On the other hand, policymakers may deploy financial statecraft *offensively*, as a 'sword', with the aim of pressuring a recalcitrant smaller power, altering the international status quo, or even creating leverage with a close ally. Andrews (2006: 19) would term this FS whose orientation is 'primarily external'.

Table 2 shows the defensive/offensive dichotomy as its horizontal dimension. These two sets of goals are of course interrelated: an effective use of a shield makes one's swordplay more competitive, while a strong sword makes reliance on one's shield somewhat less critical. We acknowledge that the true, ultimate motivations of chief executives and senior ministers cannot be known with certainty. Moreover, and as we see in the phenomenon of international arms races, actions that are conceptualised as primarily defensive by one party easily may

TABLE 2. Forms of financial statecraft

	Defensive (State A uses shield)	Offensive (State A employs sword)
Bilateral (State A seeks to influence or defend against choices of State B)	*Financial* • Nationalise FDI • Default/reschedule foreign debt • Debtors' 'cartel' *Monetary* • Strategies to defend against the currency of a powerful neighbour (capital controls; dollarise)	*Financial* • Sanctions (freeze target's financial assets held abroad; withhold new loans) • Bribes (loans or aid to induce target to adopt policies such as trade liberalisation or UN votes) *Monetary* • Manipulate exchange rate to oblige target to adjust to payments imbalances ('power to deflect')
Systemic (State A aims to influence or defend against world markets or global governance regimes)	*Financial* • Diversify sources of foreign capital • Financial 'policy space' (public banks, capital controls) • Promote multilateral banks *Monetary* • Reserve accumulation • Promote regional monetary fund • Promote multiple reserve currencies *Both* • Seek greater voice in global financial and monetary governance	*Financial* • Promote home financial markets as a source of global influence *Monetary* • Promote one's currency as a global reserve or transactions currency (including as a means of avoiding BOP adjustment, aka 'power to delay') *Both* • Construct institutions of global governance, giving oneself ongoing hegemonic or disproportionate influence

appear hostile and aggressive to its neighbours or rivals (Jervis 1978). Still, in most empirical cases a consensus of informed observers would be able to identify particular financial statecraft choices as defensive, offensive or occasionally as mixed. Within the financial statecraft toolkit, currency intervention, the buildup of large foreign exchange reserves and even regional monetary cooperation all may possess this dual character.

A second dichotomous dimension distinguishes FS whose targets are 'bilateral' from statecraft targeted at the global 'system'. In *bilateral* financial statecraft, State A, the initiator, directs its efforts towards a specific sovereign target, State B, in the attempt to alter the target state's behaviour or protect itself against dangerous policies pursued by the target state. In *systemic* financial statecraft, State A employs its national financial capabilities in an attempt to alter conditions in the overall international system, that is, within the global political economy's processes, institutions or norms. Susan Strange (1998) termed a country's ability to shape international procedures, laws and organisations its 'structural' power; others have called it 'indirect' power, while we prefer 'systemic'. Thus systemic FS may seek to alter or protect against either international market conditions or the rules and institutions of international financial governance. In Table 2, *bilateral/systemic* is the vertical dimension.

The third analytical dimension is that between statecraft that is strictly speaking 'financial' and that which is 'monetary'. Following many of the authors already cited, we understand as *financial* all economic statecraft involving cross-border flows of credit and investment capital, ranging from foreign aid to the regulation of portfolio capital, sovereign borrowing or any other international investment or credit flows. The *monetary* dimension refers to economic statecraft involving currency values (exchange rate levels), currency regimes (fixed, floating or mixed) or the use of reserve currencies, each in the service of larger foreign policy goals. In Table 2, displayed in only two dimensions, each cell additionally is divided into financial and monetary dimensions. In some cases, a given modality of financial statecraft may display a dual character. This category we label 'both'.

The four empirical sections that follow discuss each broad type of FS, as determined by the intersection of the two most important analytical dimensions, shield as contrasted to sword (defence/offense), and oriented towards a specific partner or rival state versus towards the global environment for financial interactions (bilateral/systemic). We discuss the four cells in the order most convenient for our expository purposes, beginning with the upper left-hand cell.

3. Defensive and bilateral financial statecraft: shielding attempts by the weak

Comparatively weak and vulnerable states, often developing countries, have often resorted to defensive and bilateral financial statecraft to shield themselves against influence from strong and financially capable advanced industrial countries. This is the strategy in the upper left-hand cell of Table 2. Here State A, the active party, attempts to defend itself against what it perceives as dangerous or threatening behaviour by State B.

Many Latin American countries, including Argentina, Brazil, Chile, Peru and Mexico, encountered their first post-independence financial crises as early as the 1820s, and then again in the 1880s, when they experienced the familiar pattern of high exposure to foreign debt, currency crisis and bank failures.[2] For a century thereafter, the principal financial shields available to weak states were debt default or sovereign expropriation of foreign direct investment (FDI), actions that not infrequently provoked a military response – so-called gunboat diplomacy – from the government of the injured creditor. The wave of financial crises in 1929–30, associated with the US stock market crash and subsequent drastic decline in demand for commodity exports, provoked coups and changes of government throughout Latin America. Then from the 1950s onwards, the governments of the larger countries in the region partially withdrew from international markets and turned to inward-looking industrialisation in part with the intent of shielding themselves from imported volatility. In the 1970s, cheap loans from global markets exposed the region to massive financial inflows. In the early 1980s, Latin America's debt crisis exploded, plunging many countries into a 'lost decade' of low or even negative per capita growth (Devlin 1989; Frieden 1991, 2007; Pastor 1992). In the 1980s, the International Monetary Fund (IMF) acted, at least in the view of peripheral governments, as the enforcer for creditor countries imposing drastic domestic policy change in exchange for new loans to make payment on crushing foreign debt. Although some Latin American governments attempted bilateral shielding strategies such as debt repudiation or the seizure of FDI assets, these proved unsuccessful. Although creditor country governments today are less likely to dispatch the Navy to invade defaulted sovereign debtors, they can effectively exclude debtor countries from global financial markets.

During this decade, Latin American governments occasionally sought to develop more sophisticated financial shields, but without much success. In 1984, the Colombian government attempted to rally its fellow Latin American debtors to negotiate collectively with foreign creditors. This embryonic effort of Latin American governments to negotiate jointly, derided in the dominant countries' press as a debtors' 'cartel', quickly died due to nimble US diplomacy and intra-Latin-American suspicion.[3] Major private bank creditors from the advanced industrial countries, in contrast, successfully enlisted their governments' diplomatic and intelligence support. They formed a joint creditor committee known as the London Club, and successively isolated each debtor government by negotiating bilaterally with it (Biersteker 1993).

Thereafter, debtor governments had few options but to turn to neoliberal reforms, accepting the international financial institutions' (IFIs) reform agenda targeting over-regulated and inward-looking economies, industrial sclerosis and fiscal profligacy. While many of these reforms proved useful and created the conditions for macroeconomic stability in countries with a recent history of hyperinflation, they were imposed from abroad and incurred significant social and political costs. The terms of the bailouts meant that virtually all of the new loans went to repay creditors, usually in the context of drastic cuts in both social and investment spending in debtor countries. Major US, European and Japanese banks, whose aggressive lending tactics in the 1970s encouraged often reluctant Latin American governments to borrow more than they could afford (Darity and Horn 1988), did not share the pain of adjustment.

Latin American governments still occasionally attempt dramatic bilateral shielding strategies. Argentina's default on $100 billion in sovereign bonds in late December 2001, then the largest sovereign default in history, is a case in point.[4] After enduring an enormous domestic economic and financial crisis, Argentina unilaterally swapped the defaulted debt for new bonds, forcing a substantial 'haircut' on its creditors. Most creditors accepted the new bonds, allowing Argentina fitfully and partially to return to international financial markets from 2005 on, assisted by bilateral sovereign lending from China and Venezuela (Labaqui, in press). However, as of September 2013, two US bond funds, holdout creditors from the 2001 default, continued to pursue legal judgments against Argentina in US courts, immensely complicating Argentine finances, while the government of President Cristina Fernandez was petitioning the US Supreme Court to hear the case (Andrade 2013).

Until recently, Asian developing economies had a somewhat different trajectory from that of Latin America. For many Asian polities under colonial rule through the Second World War, even such crude attempts to exercise defensive financial statecraft as sovereign defaults and nationalisations were of course impossible. Colonies' economic regulatory policies – including monetary, exchange and banking policies – were quite explicitly run to suit the needs of the colonial powers (De Cecco 1974). For example, Indian intellectuals from the 1880s through independence in 1947 repeatedly complained about the rupee-sterling exchange rate, administratively set in London and arguably responsible for heedlessly deepening financial crises in India prior to independence. By the 1960s and 1970s, Asian economies such as South Korea and Taiwan had integrated into the global economy as newly industrialising 'tigers' exporting increasingly sophisticated manufactured goods, while nonetheless retaining high barriers for imports, and in most cases also against foreign lenders and investors (Amsden 1992; Wade 2004). In order to direct the allocation of capital in the economy for industrialisation and export promotion, East Asian governments engaged in financial repression as governments imposed control over credit, entry and interest rates. Such financially repressed economies retained greater autonomy from foreign financial pressure, but the growth of domestic financial markets was stunted (Lukauskas 2002).

The Asian financial crisis (AFC) of 1997–8 cast doubt on the future prospects for this developmental model in the region (Haggard 2000; MacIntyre 2001; Armijo 2002; Sheng 2009). Although aggressive financial globalisation would share a part of the blame for the crisis, the so-called 'Washington Consensus' institutions convinced the world that it was the distorted domestic financial and economic structures of the debtor countries that had invited the crises (Wade 1998, Hall 2003). Hence, the crisis-ridden Asian governments that turned to the IFIs for emergency loan access and the seal of approval necessary for a return to international financial markets received the same neoliberal prescription for economic stabilisation and structural adjustment as had Latin American governments in the 1980s. Notably, these contractionary policies were even less relevant to the East Asian than the Latin American reality, as most affected Asian governments had

had neither hyperinflation nor extensive public sector debts prior to the onslaught of the crisis itself (Blustein 2001; Stiglitz 2002).

Turning to defensive and bilateral *monetary* statecraft, the shielding options available to weaker states historically are again limited. Louis W. Pauly (2006) contrasts the cases of Canada and Austria, both small countries vis-à-vis large neighbours. He argues that Canadian government elected to maintain domestic monetary policy autonomy through flexible exchange rate policy and regular imposition of capital controls, while Austria preferred to import Germany's stable and conservative macroeconomic policies by tightly fixing to the deutschmark. Through the AFC of the late 1990s, most developing countries in Latin America and Asia followed the Austrian path. Arguably, however, fixed exchange rate regimes played a major role in provoking or at least permitting the waves of financial crises that hit developing countries in the 1980s and 1990s.

In sum, although they have a long tradition of being used, the options available to countries forced to rely on bilateral financial shields against what looks to their leaders like the predatory financial statecraft of powerful neighbours have been relatively ineffective. As this has been the situation of most developing countries, their leaders have been eager to discover policy options that will allow them to escape this trap.

4. Offensive and bilateral financial statecraft: sanctions, bribes and currency coercion

The most traditional understanding of financial statecraft assumes that it is offensive in intent and directed bilaterally towards a specific target state, as shown in Table 2's upper right-hand corner. Bilateral and assertive actions include sanctions, bribes and currency coercion. Thus Steil and Litan (2006: 4) refer to financial statecraft as 'those aspects of economic statecraft that are directed at influencing [international] capital flows'. Their interest is in the use of these capital flows mainly for traditional security and foreign policy goals, and primarily against a specific foreign target state. Bilateral and offensive FS may involve both threats and rewards to the target. Its instruments include capital flow guarantees and restrictions, or financial sanctions on state and non-state actors – as well as government decisions to underwrite foreign debt in a currency crisis, or to aid weaker partners by creating currency unions or allowing them to opt for dollarisation.

Many authors have assumed that only major powers can exercise offensive bilateral financial statecraft. Thus work by Hufbauer *et al.* (2009) on economic sanctions imposed between 1914 and 2006 statistically analyses the characteristics of the home and target of the sanctions as well as the indicators of success. These scholars propose that the size differential between the home state (which imposes the sanction) and the target state (the sanction's recipient) has to be at least 10 to 1 for the sanctions to be minimally feasible, and that the sanction must amount to at least 1 per cent of the target's GNP for it to be effective. By setting the bar for potential real-world significance so high, most previous research has limited the studies of financial statecraft by emerging economies, even those possessed of substantial economic and financial capabilities. Examples of financial sanctions employed by emerging powers also are as yet hard to find, although India has quite aggressively used the threat of withdrawal of access to its enormous domestic market to 'bargain' for trade and political concessions from Nepal and its other smaller neighbours. As South–South lending and investment flows increase, however, direct financial sanctions by larger emerging powers also become more likely.

Several types of bilateral instruments potentially might be used by governments of emerging economies to support their foreign policy goals, including sovereign wealth funds (SWFs), bilateral credits and monetary pressure. Empirical examples of financial inducements, instead of sanctions, by emerging powers have recently increased. Initially defensive accumulation of foreign exchange reserves (a systemic measure discussed below) has led several emerging economies to become significant international creditors (Perroni and Whalley 2000). With their reserves standing at 10 to 100 per cent of their GDP by the mid-2000s and a significant portion invested in the advanced countries, East Asia's so-called 'savings glut' became a political issue in Washington, DC (Bernanke 2005). First some of these governments launched powerful SWFs[5] with the aim to employ some of their foreign exchange reserves in productive and remunerative investment projects, rather than simply holding US Treasury bills as the safest and most liquid asset. Due to the size and lack of transparency in their investments, the rise of the SWFs, particularly Chinese funds investing heavily in energy and utility firms worldwide, triggered concerns among the countries of the Organisation of Economic Co-operation and Development (OECD) (Truman 2007; Drezner 2008). More recently, and post-global financial crisis (post-GFC), some analysts instead have seen SWFs as a useful source of global financial liquidity and stability (Sun and Hesse 2009).[6]

Second, large emerging economies have begun to act as direct sovereign lenders. If they also extract a political *quid pro quo*, this fits our category of bilateral and offensive FS. The US and Latin American policy communities worry about the political leverage that China's increasing loans and investments may be buying in the Western Hemisphere (Gallagher *et al.* 2012), with similar concerns arising regarding Africa. Other emerging powers such as South Korea, Chile, Brazil and even India have in the last decade improved their financial capabilities, achieving overall financial depth (measured as the ratio of the value of total national financial assets to GDP) comparable to that in France or Germany.[7] China, Brazil and other emerging economy exporters provide extensive trade credits, often subsidised, to foreign purchasers of goods and services, while Brazil has extended substantial loans, grants and technical assistance to sub-Saharan Africa (Frayssinet 2013). There are instances of apparent political reciprocity associated with these loans. In the mid-2013 election for the new head of the World Trade Organization (WTO), African support for the winning Brazilian candidate, Roberto Azevêdo, was an important reason that he edged out a similarly qualified Mexican candidate backed by both the USA and all the countries of the European Union.

A third type of offensive bilateral financial statecraft occurs when a state's leaders employ monetary instruments to alter the behaviour of its neighbour (Kirshner 1995, 2003; Andrews 2006; Cohen 2006). Here the underlying assumption is that a persistent bilateral international payment imbalance is problematic, particularly for the deficit country. However, adjustment is neither economically nor politically pleasant, as it implies lower domestic absorption for the deficit country, as well as a renegotiation of carefully crafted intersectoral domestic political deals. Hence countries with sufficient capabilities will push the necessary adjustment onto their trading partners. Henning (2006: 124) discusses numerous such episodes involving the USA using exchange rate coercion vis-à-vis Japan and Western Europe, observing that its incidence has coincided with periods of a large US trade deficit, when the incumbent US administration feared that Congress would turn protectionist if foreign partners did not adjust. Similarly, as the Eurozone struggles with its early twenty-first century sovereign debt crisis, the large surplus country (Germany, aided by the European regional institutions) pressures its weaker partners (Greece and other smaller Southern European trade deficit countries) to adjust by imposing drastic austerity.

Although examples of currency coercion by emerging economies have been rare, the potential for rising states to employ the sword of monetary statecraft clearly exists as regions such as East Asia, Southern Africa or South America and others become financially integrated. The new trend of invoicing trade in one another's home currencies provides an opportunity to free both parties from the tyranny of incurring future obligations (or receipts) in US dollars and saves on foreign exchange transaction costs. However, as can be seen in the RMB-swap between China and Argentina, the country that develops trade deficits may see a new type of bilateral currency coercion looming.

Thus, although often portrayed as an instrument usable only by major world powers, offensive and bilateral FS has become available to emerging market economies, particularly in the form of the use of sovereign credit and investment to promote 'friendly' policy support in international organisations and other contexts, as well as some forms of monetary statecraft. As the world becomes incrementally more multipolar, and as South–South economic integration proceeds, instances of such behaviour by rising powers will increase.

5. Defensive and systemic financial statecraft: contemporary strategies of rising powers

Unlike the bilateral forms of financial statecraft discussed above, the types detailed in Table 2's lower two cells are oriented towards dealing with the global environment(s) within which global financial and monetary relations occur. The left-hand cell belongs to defensive and systemic financial statecraft, with which states resist or defend against pernicious influences from global financial markets and also voice dissatisfaction with the contours of global financial and economic governance. Recently, with the increase in their financial capacities, the elites in many of the larger emerging and transitional economies have begun to believe in their capacity to fend off disruptive influences from the global financial system. Such FS strategies include three broad types.

The first set of defensive and systemic financial policies come in the form of consciously applying interventionist ('developmentalist') financial measures such as the buildup of foreign exchange reserves, capital controls and the use of public banks to implement counter-cyclical policies. These policies are aimed at resisting contagion from global markets due to sudden shifts in the availability international liquidity. Latin American governments in countries such as Mexico, Chile, Colombia and Peru have opted to maintain economically liberal policy frameworks since the 1990s. However, a number of governments of other large countries – including Brazil, Argentina and Venezuela – have since the beginning of the new millennium shifted their policies back towards greater state intervention in financial systems and markets, while nonetheless retaining substantial trade openness and a comparatively stable macroeconomic environment. A similar trend is observable in Asia, with relatively liberal South Korea, the Philippines and most recently Indonesia at one end of the continuum, and comparatively interventionist China, India and Malaysia at the other. The interventionist emerging powers of Brazil, China and India have made conscious and explicit efforts to rely to a greater extent on domestic rather than foreign financing.

Other 'developmentalist' choices aimed at resisting these sudden stops in global flows of credit and capital include inward capital controls, notably and (arguably) successfully employed by countries such as Malaysia and Chile in the 1990s, and public resources directed to state-owned banks charged with allocating investments for the 'public good' as defined by the incumbent government. In the aftermath of the GFC of 2008–9, governments in Brazil, China and India among others used public sector banks as a major conduit for counter-cyclical fiscal stimulus policies.

A second, and closely related, broad category of defensive and systemic FS is monetary statecraft aimed at resisting currency pressure from global markets. Emerging economies have long been vulnerable to currency pressure, as they have suffered under the 'original sin' of being unable to borrow abroad in their home currencies (Eichengreen and Hausmann 1999). In addition, governments and firms often could not access domestic sources of long-term financing. These two conditions have made their borrowing a 'double mismatch' (mismatch of both currencies and terms) and acutely crisis-prone. Hence, one of the important reasons behind the buildup of foreign exchange reserves in East Asian and other emerging economies including China, despite the high opportunity cost, has been the desire for self-insurance (Chin 2010; Hamilton-Hart, in press).

During the 2000s, some emerging economy policymakers also began to address the currency challenge by attempting multilateral (often regional) liquidity cooperation in attempts to replicate something like the IMF, yet controlled by themselves. Around the Pacific Rim, two such mainly South–South collaborative efforts have been notable (Dullien *et al.* 2013). In Latin America, the Latin American Reserve Fund (FLAR), whose principal members are small to mid-sized countries of the Northern Andes, successfully aided both Ecuador and Bolivia in the early twenty-first century, with total funds of only $2 billion at its disposal. Brazil, whose economy is too large to have recourse to such a limited mechanism, nonetheless has recently debated joining the FLAR, principally as a political gesture in support of its ambitions to lead in the larger project of enhancing South American regional political cooperation (Biancareli 2011). In East Asia, the Chiang Mai Initiative, a regional emergency funding mechanism established in the aftermath of the AFC among the member countries of the Association of Southeast Asian Nations, augmented by China, Japan, and Korea (ASEAN + 3), transformed its web of bilateral currency swap arrangements into a $240 billion regional reserve pooling arrangement, the Chiang Mai Initiative Multilaterization (CMIM) (Ciorciari 2011).

A more overtly assertive tactic in this area, which its users nonetheless clearly perceive as essentially defensive, has come in the form of verbal attacks by large emerging powers on the legitimacy of the dominance of the US dollar as the key currency for global economic exchanges. Emerging economies' preferences for a multiplicity of reserve currencies clearly challenge the 60-year dominance of the US dollar as the 'top' currency (Cohen 1998, 2009). The acute credit and dollar shortage imposed on the global economy in the months immediately following the September 2008 Lehman shock led emerging market governments to demand reforms of the global currency structure. In the spring of 2009, the Governor of the People's Bank of China argued in favour of international monetary reform and increased use of IMF special drawing rights (SDRs) to supplement or supplant the dominant role of the dollar as the international key currency (Zhou 2009). In terms of concrete actions, the Chinese government has signed several RMB currency swaps totalling the equivalent of $650 billion with countries that have had large trade payments to China.[8]

A third strategy of great importance has been the post-GFC efforts on the part of the larger emerging powers to expand their voice in global financial governance. Prior to late 2008, if their leaders and scholars spoke on the subject, they were seldom heard. Since the GFC, which began in the subprime mortgage markets of the USA, the tables have been turned. The advanced economies, which once had a monopoly over the institutions that have guided global financial governance, face continuing financial crises, while most emerging market economies bounced back rather quickly. The raising of the financial G20, created during the AFC as a multilateral consultative committee of finance ministers and central bankers, to the status of a group convening regular heads-of-state summits beginning in November 2008 was the institutional breakthrough. Major emerging market economies such as Brazil, Russia, India, China, Indonesia, Korea, Turkey and Mexico are now included in the global economic discussion. At the second G20 Summit in London in April 2009, the Financial Stability Forum in Basel, which had been the main technical coordinating body for international financial regulatory reforms, also extended membership to all G20 members, renaming itself the Financial Stability Board. Seoul became the site of the fifth G20 Summit in November 2011, and the country's President Lee Myung-bak was able to have the G20 leaders endorse the 'Seoul Development Consensus for Shared Growth', which explicitly incorporates the development agenda into global financial governance.

Similarly, four major emerging market economies also created a caucus-type group in the form of BRICs (Brazil, Russia, India and China) Summits beginning in 2009.[9] At the first BRICs Summit meeting in April 2009, the four governments agreed to make their support for an IMF quota increase (arguably needed to provide sufficient resources for the Fund to assist ailing Europe) dependent on an internal rebalancing of Fund voting rights. Emphasising the central role of the G20 in all of their joint statements, recent BRICs Summits have expanded their issue coverage from mostly finance and development to energy, environment, security and public health. Including South Africa since late 2010, the

BRICS have continued to make the goal of increasing their voice in global economic and financial governance a high priority for their cooperation (Armijo and Roberts, in press).

Through these recent efforts, the larger emerging market economies have attempted to employ their newfound political and financial capabilities to open space for their greater participation in shaping the conditions of international financial markets and global governance. Although participation is not consistent across all the emerging market economies, those with higher capabilities and influence are most likely to opt for such defensive but systemic financial statecraft.

6. Offensive and systemic financial statecraft: the strategy of the future?

Attempts made by any powers to reshape the major contours of the global political economy of money and finance should be considered 'offensive' and systemic financial statecraft. Despite the rise of emerging economies, the contemporary distribution of global and systemic financial influence still overwhelmingly favours the USA and the other traditional major powers in the G7, and thus much of the leverage to shape global economic governance resides with them. For example, the international economic institutions (today the IMF, World Bank and WTO) established as the result of the 1944 conference in Bretton Woods, New Hampshire, still give the USA disproportionate influence through its large share of official votes, along with policy and paradigmatic dominance (Block 1978; Wade 1996; Tabb 2004; Stone 2011). Since the breakdown of the multilateral fixed exchange rate regime of the 1970s, informal yet regular consultation of G7 (initially G5) finance ministers and central bank governors has guided global economic governance (Bergsten and Henning 1996). While the G20 partially has supplanted the G7, this transition remains far from assured.

Until quite recently, instruments of systemic FS were unavailable to emerging economies, and we judge their efforts at systemic influence thus far to have been more defensive, and aimed at participation for its own sake, than offensive, and intending significant institutional restructuring. Nonetheless the dividing line is fuzzy, and the prospects of the governments of some emerging economies for systemic influence are gradually improving. As already noted, there have been shifts in the global distribution of specifically financial capabilities (Armijo *et al*. 2013). The USA, still the world's largest market, has become the world's largest debtor country. Japan remains the world's largest international creditor overall, but China has displaced it as the largest foreign owner of US Treasury securities.[10] Emerging powers also aspire to be influential in the 'soft power' realm of ideas and economic-financial ideologies. The GFC was a blow to the credibility of advanced economies, and since then, uneasiness about the dominance of US dollars has persisted.[11] The US Federal Reserve's quantitative easing, particularly its second phase in 2010, raised concerns of excessive liquidity in the emerging markets (Volz 2012). Brazil's finance minister suggested that both East Asian mercantilist exchange rate policies and US monetary expansion should share the blame for what he called a growing 'currency war' (Wheatley 2010). In the not-so-far-off future, the G20 Summits may become a key forum where offensive financial statecraft at the systemic level will play out.

In sum, the emerging market economies have begun to show an interest in engaging in offensive and systemic FS in order to influence global monetary and financial governance. Acknowledging that the distinction between defensive and offensive is often blurred, their actions at this stage will more likely be construed (at least by themselves) as defensive rather than offensive. As their relative capabilities increase, these governments will demand changes in the workings of global financial markets and collective financial governance in order to protect their economies from systemically borne volatility and pressures.

7. The future of international financial relations

We have suggested that the increased overall material capabilities of the emerging powers, combined with their experiences of financial crises, have intensified their eagerness to employ financial levers of foreign policy. Particularly in the first two dozen years of the twenty-first century, the FS strategies employed by incumbent governments of emerging powers were transformed from purely bilateral and defensive actions to protect their economies to the utilisation of newly assertive strategies, both bilateral and against systemic targets such as the structure of global markets and global financial governance institutions. Three themes emerge.

First the redistribution of global financial capabilities away from the traditional post-Second World War industrial democracies and towards large emerging economies is real, and already has had non-trivial consequences in the way in which these governments apply financial statecraft. Now that China is the single largest foreign owner of US Treasury bonds, US policymakers feel vulnerable (Drezner 2009). Consequently, the pronouncements of Chinese officials on international currency matters are treated with great respect. Venezuelan loans to Argentina, and Chinese loans to Venezuela and Argentina, have enabled these countries – for the moment – to avoid the pain of being shut out of international commercial markets. Brazilian transnational banks plausibly intend to become the major foreign financial presence throughout Latin America. There has been incremental redistribution of IMF voting rights towards China, India, Brazil, Mexico and other emerging powers. Moreover, the World Bank's chief economist during and just following the height of the GFC, Justin Yifu Lin, was for the first time a Chinese national, who took steps to reorient the institution's research programme in a direction more consistent with East Asian perspectives.

Second the GFC arguably has given a chance for emerging market policymakers to become more active on the international stage. Until recently, the advanced industrial democracies had managed to offer a shining example of capitalist success, so that emerging economies' decisions to comply with a presumably universally valid 'global standard' presupposed the triumph of a neoliberal model of financial regulation and development. Most observers assumed that emerging market economies would have to meet the financial regulatory criteria best exemplified by the USA and UK in order to have truly developed economies (La Porta *et al.* 1997, Hansmann and Kraakman 2000, Oman 2004). However, the GFC undermined their legitimacy and credibility, and made many leaders in developing countries sceptical of such a one-way flow of influence. While many developing countries had employed capital controls to prevent crises and state banks to run counter-cyclical macroeconomic policies in the 1990s and early 2000s, it is only from 2008 that their leaders have felt sufficiently confident to lecture to policy-makers in the advanced economies. Many key emerging market governments are voicing their dissatisfaction with the global governance arrangements they have inherited, yet admittedly they have not agreed as to which new directions they would like to push global institutional reforms in (Borzel 2012).

Finally, we conclude by noting that we do not anticipate that the mostly liberal, mostly cooperative post-war international order faces danger in the near future. While it is important to highlight the emerging powers' increasing voice within the network of liberal international institutions established to govern the world political economy since the end of the Second World War, the emerging powers' systemic financial strategies to date remain primarily defensive, aiming at participation in rather than transformation of the existing international market and regulatory systems. We can also be comforted by the fact that many of these emerging powers are *democratic* (as with India, Brazil and South Africa, as well as most of Latin America and, more recently, East and Southeast Asia) and/or *outward-oriented* and clear beneficiaries of open global trade (as with China, all of East and Southeast Asia, most of Latin America and increasingly even India). Both democracy and outward-orientation lead governments to have large stakes in maintaining the liberal economic order and enhancing international cooperation (Leeds 1999; Mansfield *et al.* 2002; Mansfield and Solingen 2010, Ikenberry 2012). Hence although we expect increasing use of voice and other forms of assertive financial statecraft by the BRICS countries and other emerging powers, this change does not necessarily undercut nor threaten the existing liberal global economy.

Notes

1. Important works on economic statecraft include those by Mastanduno (1998), Drury (1998), Pape (1997), Drezner (1999, 2003), Hufbauer *et al.* (1990) and Cortright and Lopez (2002). Blanchard and Ripman (2008) critique this literature.
2. Reinhart and Rogoff (2011, 348–94, Appendix Table 4.1) provide a list of financial crises.
3. Interview, October 2010, Berlin, with Peruvian former senior debt negotiator.
4. We tentatively code this episode 'bilateral' in that it was directed at coercing specific foreign creditors, rather than systemic reform, but acknowledge there is some ambiguity.
5. The definition of SWF varies, but generally it is 'a government investment vehicle which is funded by foreign exchange assets, and which manages these assets separately from official reserves'. http://www.morganstanley.com/views/gef/archive/2007/20071026-Fri.html
6. In 2012, China's three largest SWFs managed $1142 billion worth of assets. Data source: Global Finance, 'Largest SWFs – 2012 ranking' http://www.gfmag.com/tools/global-database/economic-data/12146-largest-sovereign-wealth-funds.html#axzz2fZ20us2Q
7. In all four countries, the 2008 ratio of total domestic financial system assets (bank deposits plus stock and bond market capitalization) to GDP was between 3.0 and 3.6 per cent (Beck and Demirguc-Kunt 2009).
8. These swaps have been extended to Argentina, Belarus, Hong Kong, Indonesia, Malaysia and South Korea.
9. The First summit was held in Yekaterinburg, Russia in June 2009. Since then, the national leaders have met in Brasilia, Brazil (April 2010), Hainan, China (April 2011) and in New Delhi, India (29 March 2012).
10. As of December 2010, China and Japan combined held about one-third of the $4.5 trillion treasury securities held by foreigners (http://www.treasury.gov/resource-center/data-chart-center/tic/Documents/mfh.txt)
11. The irony was that during the crisis, risk capital still flocked to dollar-denominated assets.

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