

ESSAYS IN INTERNATIONAL FINANCE

No. 204, June 1997

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THE FINANCIAL SUPPORT FUND OF THE  
OECD: A FAILED INITIATIVE

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INTERNATIONAL FINANCE SECTION

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## ESSAYS IN INTERNATIONAL FINANCE

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## THE FINANCIAL SUPPORT FUND OF THE OECD: A FAILED INITIATIVE

During recent jubilee celebrations of the Bretton Woods Agreement, few observers paused to recall, let alone mourn, the silent stillbirth a generation ago of what was perhaps the gravest threat ever posed to the formal authority of the International Monetary Fund (IMF): the Financial Support Fund (FSF) of the Organization for Economic Cooperation and Development (OECD). Such neglect is unwarranted, for much can be learned from a critical reappraisal of the FSF episode.<sup>1</sup>

The story began back in 1973–74, in the turbulent wake of the first oil shock, when the twenty-four members of the OECD resolved to create a massive financial “safety net” for mutual payments support. The initial endowment was to be about \$25 billion,<sup>2</sup> and the goal of the initiative was to aid OECD countries in their efforts to cope with the impact of sharply higher energy prices. Although the initiative was entirely understandable under the circumstances, its consequences for global institutional arrangements might well have been dramatic, particularly for the IMF, which had until then enjoyed universal recognition as the central source of payments financing for national

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This essay is adapted from a longer study to be published as “When Giants Clash: The OECD Financial Support Fund and the IMF,” in *Crafting International Institutions*, edited by Vinod K. Aggarwal (Copyright © 1997 by Cornell University, forthcoming). It appears here by permission of the publisher, Cornell University Press. The content of the essay is based on verified historical documentation, some publicly available and some graciously provided from the archives of the OECD secretariat, as well as on interviews initiated while I was still personally involved in the events discussed as a consultant to the OECD in 1976–77. The OECD bears no responsibility for any of the views expressed in these pages, however. All opinions are mine alone. I am grateful to Paul Boeker and Emile Van Lennep, two principal participants in the FSF episode; to Vinod Aggarwal, Beverly Crawford, Cedric Dupont, and Steven Weber, my colleagues in the project on crafting international institutions; and to an anonymous referee for helpful comments and suggestions on earlier versions of this manuscript. The able assistance of Lynne Bernier is also gratefully acknowledged.

<sup>1</sup> Little has been written about the Financial Support Fund. The only serious full-length study I have been able to locate is an early analysis, in French, by Belgian economist Jean-Victor Louis (1975). More cursory comments can be found in Camps (1975), De Vries (1985), and James (1996).

<sup>2</sup> Here and throughout, billion equals a thousand million.

governments. The proposed FSF was, in effect, a private club available to members only. With so much money at its disposal, it threatened to eclipse the activities of the IMF, the loanable resources of which were then nearing exhaustion. The IMF suddenly faced the prospect of a highly formidable rival.

In principle, the OECD governments intended to nest the FSF firmly within the broader structure of the monetary relationships established at Bretton Woods. Their club, though exclusive, was not meant to undermine the central role of the IMF. In practice, however, the FSF could be seen as wholly inconsistent with the unitary design of the payments regime and as a direct challenge to IMF primacy. The stage was set, therefore, for an institutional bargaining game of historic proportions. The OECD and IMF each had its own distinct interests and preferences and its own powerful allies and protagonists. Ultimately, the opponents of the FSF prevailed, despite vigorous lobbying by the OECD and support from many of its member governments. In the end, the critical battleground turned out to be the United States, where the FSF foundered when it failed to achieve formal legislative ratification. Ironically, it was Washington that had originally sponsored the initiative and had led the negotiations for its creation.

Why did an initiative that began with such promise fail so utterly? Was the FSF a bad idea, a good idea badly conceived, or simply an idea whose time came and then moved on? These are the questions addressed in this essay. Although the essay is structured as a historical study, its aim is to draw inferences about conditions that may or may not favor a successful nesting of comparable institutions in the future. In short, what can we learn from this now-forgotten episode about the ways in which similar clublike initiatives can be made to be institutionally compatible with existing global accords? The FSF experience remains instructive as a cautionary tale. It is as relevant to other issue areas, such as the relationship between new regional trade groupings and the World Trade Organization (WTO), as it is to the arena of international finance.

The story of the FSF is a drama in three acts: the initial exploratory phase, which opened with the frantic search by Western nations for appropriate responses to the oil shock of 1973 and culminated with the proposal for an FSF at the OECD; the negotiation phase, which began in late 1974 and climaxed with the signing of the FSF agreement in April 1975; and the (unsuccessful) ratification phase, which closed anticlimactically in 1977, when it became clear that the FSF had irrevocably lost the support of the United States. Section 1 of the essay



gives a synopsis of the FSF episode. Sections 2 through 4 review the three stages of its development, emphasizing cognitive considerations, structural factors, and (within the United States) domestic politics, three analytical elements that may be regarded as critical in bargaining games of this sort.<sup>3</sup> The respective contributions of these elements are reviewed in Section 5. Inferences for the present day are outlined in Section 6.

## 1 Synopsis

Following the outbreak of Arab-Israeli hostilities in early October, world energy prices soared, provoking widespread fears of impending economic calamity for oil importers. The Organization of Petroleum Exporting Countries (OPEC), which had a near monopoly of oil exports and reserves, suddenly seemed to be in control. Energy-dependent nations worried not only about where the money would come from to pay for more costly imports; they worried even more acutely about their growing vulnerability to future shocks or shortages in what now appeared to be very much a sellers' market. Governments around the globe scrambled feverishly to line up financial resources and to secure adequate access to oil supplies.

In this atmosphere of crisis, the U.S. government—guided by the strategic instincts of Secretary of State Henry Kissinger—saw an opportunity for a collective action that might counterbalance the emerging power of OPEC. For Kissinger, the real problem was the threat posed to the unity of the Western anti-Soviet alliance, an alliance already frayed by growing commercial strains and the corrosive effects of the Vietnam War. Efforts to reinforce trans-Atlantic solidarity earlier in 1973, which Kissinger ambitiously designated the “Year of Europe,” had ended in division and acrimony over a wide range of economic and security issues. The oil crisis now presented a new chance to mobilize the industrial nations under firm American leadership. Kissinger, speaking in London in December 1973, called for comprehensive collaboration on all aspects of the energy problem. In the ensuing Washington Energy Conference two months later, he urged oil consumers to match OPEC's cartel-like behavior with an effective

<sup>3</sup> These three elements, drawn from standard theories of international relations, are familiar to students of political science. For a consolidated analytical framework for the study of institutional bargaining games, formally incorporating all three of these elements, see Aggarwal (forthcoming 1997).

coalition of their own. Ultimately, under U.S. prodding, negotiations led to the creation, in November 1974, of the International Energy Agency (IEA), which was linked to the OECD. The goals of the IEA, which were ostensibly economic, were to include an emergency oil-sharing scheme and an energy information system as well as development of a long-term cooperative plan to reduce oil dependency. In fact, the *raison d'être* of the IEA was plainly political; its purpose was, in the words of one commentator, “to erode the political and economic power of the oil cartel” (Scheinman, 1976, p. 11).

It was precisely for this reason, however, that support for the IEA was difficult to muster. Several European nations, as well as Japan, were wary of adopting a confrontational stance that might jeopardize their future access to OPEC production. Some also resented what seemed a blatant attempt by Washington to reassert U.S. influence at a moment when its more import-dependent allies were relatively weak. A key challenge for Kissinger, therefore, was to offer supplementary incentives of sufficient allure to win support for the IEA, or at least to buy off resistance to it by adding reliable side-payments for the reluctant. This led Kissinger eventually to accede to European demands for a simultaneous, and in principle more conciliatory, strategy of dialogue between consumer and producer nations—a strategy that later broadened into what came to be known as the North-South dialogue.<sup>4</sup> It also led to creation of the Financial Support Fund.

The case for some sort of financial initiative was clear. Most OECD nations, being oil importers, were hard hit by OPEC's higher prices and quickly found themselves facing sizable external deficits. In time, of course, it might be possible to make adjustments to close the gap in the balance of payments, even faced with an inelastic energy demand. Other imports could be squeezed or exports promoted. In the short term, however, governments had little choice. The current deficits had to be financed, either from a country's own monetary reserves or by borrowing. For nations with limited liquidity, the question was from whom to borrow.

<sup>4</sup> Kissinger's concession was, in fact, less conciliatory than it seemed to the Europeans, who hoped that a dialogue might ease tensions between oil producers and consumers. According to one highly placed State Department source, Kissinger saw the dialogue as providing one more opportunity to erode OPEC's power, much of which derived from its solidarity with other Third World governments. By highlighting the adverse effects of higher oil prices for non-oil-developing economies, Kissinger hoped to drive a wedge between OPEC and the other countries of the South.

In the aggregate, the answer was evident. Borrowing would be from OPEC itself, from the oil exporters' profits. To the extent that burgeoning "petrodollar" revenues were not immediately spent on imported goods and services, they had to be invested in foreign assets or otherwise lent back to oil consumers as a group. The combined surpluses of OPEC had, by definition, to be offset by an equivalent capital transfer to the rest of the world.

For individual countries, however, the answer was not so clear, for what was true for consumers as a group would not necessarily be true for each country. There was no reason at all, in fact, to assume that the distribution of OPEC investments would match up neatly with the distribution of oil importers' current deficits. Quite the contrary, for although countries that had the ability to attract OPEC investments could look forward to healthy external accounts, others that did not were bound to face severe stresses. The challenge, therefore, was not to encourage a *primary* recycling of petrodollars from OPEC to oil importers; that would occur automatically. The challenge was to ensure a satisfactory *secondary* recycling of petrodollars—an appropriate allocation of loanable resources among consuming countries. How could nations with overall deficits be assured access to sufficient financing at reasonable terms?

Eventually, the problem was resolved by the private markets—more or less by default and certainly not without difficulties. In ensuing years, Western banks and other financial intermediaries, mobilizing OPEC's surplus revenues, became the principal source of payments support for a diverse array of countries, thus privatizing the global regime for liquidity creation (Cohen, 1981). In 1974, however, all that still lay in the future. Elite opinion at the time was sharply divided. No one could yet be sure that the markets were up to the challenge, and policymakers were still accustomed to looking first to public, rather than private, sources for the bulk of their external finance. Attention therefore focused on the feasibility of creating some new intergovernmental recycling mechanism, a common pool of resources to help underwrite the deficits of oil importers. The climate was ripe for an attractive new payments initiative.

The breakthrough finally came in another speech by Secretary Kissinger, this time in Chicago on November 14, just one day prior to formal creation of the IEA. Kissinger was well aware of lingering opposition to his consumer-cartel strategy. Of the OECD's twenty-four members, fully one-third—including, most prominently, France—refused initially to participate. To sweeten the pot, Kissinger therefore

proposed to supplement the IEA with a new “safety net” to promote the “financial solidarity” of Western nations. As spelled out four days later by Treasury Secretary William Simon, the net would take the form of a joint loan and guarantee facility, with total funding of about \$25 billion. It would be administered by the OECD and available only to OECD members. Participation, Simon insisted, “should be linked with a commitment to cooperate in reducing dependence on oil imports”—obvious code for an obligation to join, or at least not oppose, the operations of the IEA.

Linking the safety net to the IEA was clearly a tactical maneuver, although Washington never actually insisted on a commitment to reduce oil imports. The safety net took on a life of its own, however (quite independent of Kissinger’s broader geopolitical designs), because many governments, including the French, felt a pressing need for assured access to payments support. Once the proposal was placed on the table, it became linked to a quite different set of questions involving the broader structure of international monetary relations—a connection that was substantive rather than tactical.

Negotiation of the FSF was remarkably swift. Within a week, a working group, chaired by Jacques Van Ypersele of the Belgian finance ministry, was established by the Group of Ten (G-10) industrial nations to study Washington’s initiative. Within two months, preliminary agreement was reached on the broad outlines of a plan embodying most of what Secretaries Kissinger and Simon had proposed, including quotas for the financial commitments of individual governments. By the end of March, final details were hammered out by the Van Ypersele group, now reconstituted as an *ad hoc* working party of the OECD. On April 9, 1975, the “Agreement Establishing a Financial Support Fund of the Organization for Economic Cooperation and Development” (OECD, 1975) was duly signed by all twenty-four member governments—including those that, like the French, were still resistant to full participation in the IEA. Given the highly politicized and sensitive issues involved, this was an extraordinary diplomatic achievement. As one source observed: “Rarely has a negotiation of such complexity and importance been conducted with such speed” (Louis, 1975, p. 368).

Implementation, however, ultimately proved impossible, despite rapid ratification by twenty-one of the OECD’s twenty-four members. The critical battleground was the United States, where the necessary enabling legislation was first postponed and then, in the summer of 1977, finally withdrawn by the new Carter administration. On August 29, 1977, the OECD was formally notified by letter that “the Adminis-

tration does not intend to seek ratification of the OECD Financial Support Fund. . . . Our embassies in OECD countries are informing their host governments of this position.” Without the support of the project’s biggest and most influential member, there seemed little point to continuing. The FSF was allowed to pass quietly into history.<sup>5</sup> How could a proposal like the FSF be negotiated so quickly only to be later rejected so decisively? Let us look first at the exploratory phase in 1973–74, when OECD nations hastened to respond to the dramatic acceleration of energy costs.

## **2 Act One: Exploring the Options**

Two factors were paramount in 1973–74. The first was cognitive. A debilitating lack of consensus regarding the financial consequences to be expected from higher oil prices was compounded by fears generated by the abandonment of pegged exchange rates earlier in 1973 and by the worldwide recession that set in during 1974. The second factor was structural. At the level of interstate relations, heightened tensions triggered by shifting power balances were manifested through political conflict and bargaining. Two dimensions of the conflict ultimately proved critical, one between the newly assertive OPEC and the energy-hungry OECD nations, the other among the OECD members themselves.

### *The Cognitive Factor*

The 1973 oil shock created a great deal of uncertainty in financial circles. Would oil-importing nations be bankrupted by OPEC greediness, or were fears of a lasting collapse overblown? Could the private markets and the IMF be relied upon to recycle petrodollars to where they were most needed, or would additional support be required to prevent desperate governments from resorting to mutually destructive “beggar-thy-neighbor” currency or trade practices? In retrospect, the answers are clear. Financing needs, though serious, proved for the most part to be manageable; the markets and the IMF were more or less up to the job; and governments resisted the illusory temptations of competitive depreciation or import restraint. At the time, however, there was no convergence of views about either the magnitude or the duration of the financial challenge at hand. Specialists differed wildly in both diagnoses and

<sup>5</sup> Parallels with the International Trade Organization (ITO), a post-World War II American initiative that was also ultimately dropped for lack of U.S. ratification, are striking. For more on the ITO experience, see Gardner (1969), especially chap. 17.

prescriptions. As one observer commented: “There is argument rather than agreement among the experts. . . . this absence of a guiding ‘concept’ is not a trivial problem” (Camps, 1975, p. 19). The attractiveness of some new payments initiative was therefore understandable. The FSF could be viewed as a kind of mutual insurance policy in an atmosphere of emergency and incalculable risk.

A measure of the degree of uncertainty prevailing in 1974–75 can be found in the wide divergence among projections of OPEC earnings that were circulating at the time (Cohen, 1976). In 1974, the combined surpluses of OPEC’s members approached \$70 billion, up from a mere \$7 billion in 1973. Authoritative estimates of future transfers varied enormously, from an early World Bank suggestion of some \$650 billion (current dollars) through 1980 to later calculations running as low as \$165 billion to \$190 billion. Comparable discord marked debate over other, related issues as well, such as how OPEC’s investable surplus might be distributed among alternative investments and which economies were most likely to benefit from the primary recycling of petrodollars. Facing future imbalances, few governments were prepared to put themselves entirely in the hands of the private markets, which had not yet proved themselves to be a secure source of payments support. The loanable resources of the IMF, moreover, which amounted to less than \$12 billion, were known to be limited relative to potential need. The risk of a disorderly scramble for deficit-reduction measures was therefore substantial. The only real certainty, it seemed, was that some new way had to be found to ensure adequate financing when needed.

Over the course of 1974, proposals for new recycling mechanisms sprouted like mushrooms. As early as January, IMF Managing Director Johannes Witteveen initiated the discussions that led, in June, to the creation of a special oil facility at the IMF, open to all IMF members and funded mostly by loans from oil producers (De Vries, 1985, chap. 17). With total resources of about \$3.5 billion, however, the facility was clearly inadequate. During the summer, therefore, OECD Secretary General Emile Van Lennep began campaigning for an additional arrangement to be funded by borrowing from the private markets. Like the later U.S. proposal, it was to be managed by the OECD, rather than the IMF, and to function solely for the benefit of OECD members. In September, at the IMF-World Bank annual meeting, Witteveen called for another and larger IMF oil facility for 1975, modeled along the lines of the 1974 arrangement. The proposal was enthusiastically backed by a number of national leaders, including, especially, Britain’s Chancellor of the Exchequer Denis Healey, who not only suggested greatly increasing the

facility's scale of lending, to as much as \$25 billion annually, but also proposed making it permanent. All of these plans were being publicly discussed when Secretary Kissinger introduced his own idea for a supplementary safety net in November.

Ironically, some of the stiffest resistance to extensive new official support schemes had come initially from the U.S. Treasury. As late as October, Secretary Simon still seemed sanguine about the capacity of the private markets to recycle petrodollars effectively to needy governments (De Vries, 1985, pp. 335–336). It was only when Simon yielded to Kissinger in November that serious intergovernmental negotiations could get under way. Even then, however, it was clear that no one was quite sure just how serious the problem was or what approach might offer the best solution.

### *Structural Factors*

Given all this uncertainty, how did the Kissinger safety net manage so quickly to become the main focus of institutional bargaining? The answer, clearly, has to do with structural factors relating to state capabilities and international political relationships. Without the sponsorship of the United States, still plainly the most powerful actor in the system, the FSF might never have prevailed amidst the proliferation of contending proposals.

To be sure, an OECD safety net could well have been justified solely on technical grounds, particularly as a means of averting beggar-thy-neighbor responses to emerging oil deficits. Earlier, in a formal declaration adopted in May 1974 (the so-called "Trade Pledge"), OECD members had unanimously promised to refrain from introducing or intensifying trade restrictions in response to the oil shock. By the fall, however, some governments were privately threatening to rescind their pledge unless they were promised additional financial assistance in some form. For this reason alone, the FSF would have been a welcome measure.

Strategic considerations, however, dominated from the start. The FSF was first and foremost a byproduct of global power politics, incidental to an opportunity, as Secretary Kissinger saw it, to prevent further erosion of the fraying Western alliance. An effective collective response to OPEC's producer cartel, Kissinger calculated, might help reinvigorate trans-Atlantic solidarity in the great cold-war confrontation with the Soviet Union. The safety-net initiative was, thus, an integral part of Kissinger's broader geopolitical strategy, a side-payment offered to overcome the reluctance of key OECD members, many of whom

viewed the secretary's anti-OPEC stance and the IEA as risky and overly provocative.

That Kissinger's motivations were confrontational was never in question. For Kissinger, the preservation of the anti-Soviet alliance was paramount. From the outset, therefore, he made clear his determination to neutralize any threat from OPEC to the unity or self-confidence of the West. The vulnerability of OECD nations to energy shocks or shortages simply had to be contained. The immediate price increases should be moderated or even rolled back; oil dependency should be reduced; and effective defenses should be established to alleviate the risk of any future political manipulation of oil supplies. The key was to reaffirm the cohesion of the industrial world, preferably in some institutional form, in order to maximize diplomatic leverage. For Kissinger, there was no alternative to a policy of collective resistance to OPEC's new assertiveness.

For some of Washington's allies, however, there was an alternative. They favored dialogue over confrontation and supported conciliation designed to appeal to OPEC's own long-term economic interests. Why risk needless antagonism, they argued, when they could cultivate harmonious trade and financial relationships that, over time, would deepen the stake of oil producers in the stability and prosperity of the West? OPEC members, after all, had their own vulnerabilities, and these might be alleviated by offers of assured access to markets for their energy exports, financial outlets for their surplus revenues, or advanced technologies for their industrial development. A foundation was in place for building a mutually beneficial "positive interdependence." Why use vinegar when honey would attract more flies?

Most resistant to Kissinger's lead was France, which had long pursued its own unilateral policies of friendship and cooperation with key OPEC governments. The French did not want to jeopardize the "special relationships" they had so laboriously constructed in the Arab world, relationships intended at least partly to ensure privileged access to scarce energy supplies. They were also deeply suspicious of any scheme that might help revive America's postwar dominance of Europe. Paris was acutely conscious of the divergence of state capabilities in this arena. As a major oil producer, which had, in addition, massive reserves of coal and natural gas, the United States was far less vulnerable to OPEC pressures than most of its allies in Europe or Japan. A consumer cartel, therefore, might simply consolidate America's influence over its more energy-starved partners. To the French, the Kissinger strategy seemed to point to "a new Atlantic structure designed to link French



and European economic security to the United States, thus opening the way for renewed American hegemony over the Continent” (Kohl, 1976, p. 248). Accordingly, throughout 1974, France (along with several smaller OECD nations) made clear its persistent opposition to the initiatives that eventually became the IEA. Not even Kissinger’s safety-net proposal in November could persuade the French to join the IEA (although it did help ensure that Paris would do nothing to thwart its operation).

Initial responses to the FSF initiative were, in fact, very much like those to the IEA. The proposal was thought to be too confrontational and, potentially, too hegemonic. Because the safety net would work exclusively through a secondary recycling of petrodollars by oil consumers, bypassing OPEC altogether, it “directly snubbed the oil producers” (Hager, 1976, p. 44). Less provocative, many thought, would be something like the Van Lennep or Healey plans, which by calling for more reliance on primary recycling of revenues implied greater cooperation with OPEC nations. Similarly, because a direct pooling of resources would naturally give weight to potential creditors—and, in particular, to the United States, which was one of the countries best placed to attract surplus oil revenues—it threatened to add to Washington’s influence over its allies, thus reinforcing fears of renascent American hegemony as well. More reassuring would be something like the first oil facility, which was managed through the less politicized procedures of the IMF.

Despite such objections, however, the FSF proposal quickly moved to center stage, reflecting America’s continuing predominance in the Western alliance. Overall superpower status, as well as specific advantages as an energy producer and potential creditor, gave the United States more than enough leverage to set the agenda for financial negotiations. The Europeans and Japanese may have had their doubts, but none—not even France—was prepared to openly defy Washington’s wishes on an issue of such vital importance.

### **3 Act Two: Negotiating an Agreement**

The brief negotiation phase, which climaxed with the signing of the FSF agreement in April 1975, was dominated overwhelmingly by structural factors, that is, the direct distribution of state capabilities in the bargaining game. Most critical to the outcome was the evident determination of the United States to do whatever seemed necessary to gain the concurrence of its allies. Washington not only had the power

to set the agenda, it also, alone among Western countries, had the capacity to offer tactical concessions when required, without sacrificing its more fundamental strategic objectives.

Initial reactions to the Kissinger proposal were generally cool—not least because of lingering doubts about the need for such massive intervention in the recycling process. In Europe, most opinion favored the approach embodied in the Van Lennep and Healey proposals and in the IMF’s 1974 oil facility, which involved borrowing from either oil producers or the private markets, backed if necessary by official guarantees, to raise funds for deficit countries. The West German government, in particular, was critical of Washington’s alternative strategy for a direct pooling of resources by oil consumers, a strategy that would have obliged Germany, as a leading creditor country, to make one of the biggest commitments.

On the U.S. side, by contrast, there was rising skepticism about the reliability of OPEC financing. Could the OPEC countries always be counted on to lend to such schemes in the amounts likely to be required, particularly if better investment returns might be expected elsewhere? Washington had already quietly agreed to an interest-rate concession for Saudi Arabia. American policymakers were evidently concerned that oil producers would make additional demands for special interest rates or currency guarantees in exchange for their cooperation in any primary recycling scheme. Washington also feared that OPEC might attach political conditions to its cooperation, thus converting any arrangements made into a sort of “money weapon” to reinforce its “oil weapon.” U.S. officials argued, moreover, that it would be imprudent to count on private markets to fill any remaining gap, no matter what guarantees might be available. Only a jointly funded intergovernmental program could manage to produce the needed financing quickly and with appropriate terms and certainty.

In that case, why lodge a new recycling mechanism with the OECD rather than with the IMF? For the United States, two considerations dominated. First, given the safety net’s origins as an adjunct of the IEA, a home in the OECD seemed natural—all part of Henry Kissinger’s broad strategy of unified Western opposition to the OPEC cartel. Second, Washington had little interest in sharing either decisionmaking or financial resources with the multitudes of oil-hungry developing countries, all of whom would have had a voice in the governance of any IMF initiative. The issue that mattered most to U.S. policymakers was the fate of the anti-Soviet alliance, not the financial health of the Third World.

After much bargaining, the two sides agreed essentially to split the difference. Following a meeting in Washington on January 16, the G-10 finance ministers formally endorsed both approaches, the Witteveen proposal for a second oil facility as well as the Kissinger safety net, in effect opting for two insurance policies instead of one. The oil facility, along with the IMF's other loanable resources, would in principle function as a first line of defense; the FSF, ostensibly, would be a supplementary last-resort source of help for deficit countries. America's goal was thus achieved and at remarkably little cost in terms of U.S. priorities. When finally approved by the IMF executive board three months later, five days before formal signing of the FSF agreement, the 1975 oil facility was limited to a temporary status and to a ceiling of just \$6 billion, considerably less than the \$7 billion to \$10 billion first suggested by the IMF secretariat and far below the \$25 billion advocated by Chancellor Healey. These were Washington's conditions for accepting the oil facility along with the FSF.

With a touch of hyperbole worthy of Richard Nixon (who had described the 1971 Smithsonian Accord as "the greatest monetary agreement in the history of the world"), Chancellor Healey declared the January negotiation to be the "most successful meeting ever held" to reform the international monetary system—this, despite the decisive rejection of his own more ambitious suggestions. More prosaically, the result could be described as an old-fashioned horse-trade. Washington got what it wanted by giving the Europeans a limited version of what they wanted.<sup>6</sup>

Other objections to the FSF were similarly resolved quickly through artful negotiating compromises. Fears about the risks of confrontation with OPEC had already been allayed by a deal announced at a summit meeting between President Gerald Ford (who had taken office following the resignation of Richard Nixon in mid-1974) and President Valéry Giscard d'Estaing on the French island of Martinique in December. The United States promised to take part in an early conference of oil-consuming and producing nations, a conference later expanded to become the so-called "North-South dialogue," on a broad range of development issues. Formally labeled the "Conference on International Economic Cooperation," the North-South dialogue continued intermittently for the next three years before ending inconclusively. In return for this parallel, and ostensibly more conciliatory, approach, Paris agreed to

<sup>6</sup> Chancellor Healey credits himself with personally persuading the Americans to accept the two-sided bargain (Healey, 1989, pp. 425–426).

drop its formal opposition to the IEA, with which it would now maintain a form of liaison, and to support the FSF actively. France's about-face persuaded others, in turn, to come on board as well.

Concerns about potential U.S. dominance of the FSF were similarly eased once Washington agreed to a limited share of no more than 28 percent of total voting power, well below the level required to dictate lending policy unilaterally (OECD, 1975, Article XVI). Additional safeguards for smaller countries were provided by a stipulation that no decisions would be adopted without at least half the member countries participating in a majority vote (OECD, 1975, Article XVI).

Compromise also succeeded in surmounting some more particularistic obstacles to accord. London's early reaction to the Kissinger initiative had been distinctly negative, in large part because it threatened to overshadow Healey's earlier suggestions. Britain was won over in January, however, by the G-10 decision to endorse Witteveen's proposed second oil facility along with the FSF. With Washington agreeing to split the difference, the Chancellor was able to declare victory for what he continued to call the "Healey Plan," even while surrendering to U.S. preferences. West German resistance was overcome later by a U.S. concession on the form of funding for the FSF. West Germany had been concerned about the potentially high budgetary cost of a direct pooling of resources; it had, as Jacques Van Ypersele told an interviewer, been "fearful of becoming the insurance company of the rest of the Western world." German worries were allayed once Washington agreed to an optional alternative method of FSF financing that would permit members to make commitments in the form of a loan guarantee (for borrowing by the FSF) rather than by cash contribution (OECD, 1975, Article VII).

Agreement on the FSF was thus made possible by a series of critical concessions by the United States. Why was the United States so accommodating on so many issues? Quite clearly, the battle with OPEC took precedence for the United States, and disagreements among friends could not be allowed to distract attention from the real enemy, the oil cartel. In the end, Washington was able to attain both of its strategic objectives, the IEA as well as the financial safety net, and to do so without seriously undermining any of its more basic preferences or interests. The FSF accord was a direct reflection of the foreign-policy priorities then prevailing in the United States. The rare speed with which the agreement was negotiated reflected America's unsurpassed capacity to grease the wheels of diplomacy with effective institutional compromises.

#### 4 Act Three: The Failure to Ratify

Despite Washington's negotiating success, however, implementation of the FSF proved elusive—most importantly, because of a change of mood in the United States itself. After so swiftly shepherding its allies to agreement, the Ford administration chose subsequently to procrastinate, preferring to support other legislative priorities instead. For the next year, the ratification process remained stalled in Congress. By the start of the national election campaign in 1976, it was clear that the FSF no longer enjoyed active support in the U.S. government. Once the Carter administration came into office, formal endorsement gave way to determined hostility.

What explains the anticlimactic outcome of the ratification phase? As in the initial exploratory period, both cognitive and structural factors played a critical role. By the spring of 1975, a new consensus of elite opinion was beginning to replace the uncertainty of 1973–74, and it did not favor the FSF. Structurally, a competition between the OECD and the IMF now took center stage. Together, these two elements, mediated through domestic U.S. politics, ultimately determined the evolution and finally the denouement of the FSF initiative.

##### *A New Consensus*

In the atmosphere of crisis generated by the oil shock, it was understandable that governments might not thoroughly examine all the potential consequences of their decisions for existing institutions. Their main concern was to determine how much financing would be needed in the future. Their immediate objective was to avert the risk of illiquidity. In such circumstances, more seemed preferable to less. If one lending scheme was good, two would be better. Who had time to worry about the more distant implications for the structure of international monetary relations?

Even as the ink dried on the FSF agreement, however, it was becoming evident that the financial challenge was less dire than many had feared. OPEC surpluses declined throughout 1975 (although they rose again temporarily in 1976), whereas market financing increased. With the easing of the world recession, moreover, most oil consumers were finding their external payments a lot easier to manage than they had expected (De Vries, 1985, p. 357). The sense of urgency policymakers had, therefore, started to recede, and as it did, second thoughts began to emerge about the FSF. The problem lay in the expected conflict between the FSF and the IMF. The global monetary regime already had one center of decisionmaking in the IMF. Was a second

agency really needed, even if conceived solely as a lender of last resort? The advantages of a supplementary safety net were clear. But what about the possible disadvantages of divided authority in the management of monetary affairs?

To some extent, the issue had been anticipated by FSF proponents, who from the start proposed the initiative strictly as a backup to the IMF, not as an alternative. Later critics who characterized the initiative as “short-sighted” or “hastily conceived” were a bit unfair. The relationship was, in principle, to be strictly hierarchical: the FSF was clearly structured to nest snugly under the IMF’s wing. Kissinger himself, in his November 1974 speech, spoke of an initiative to “augment and buttress,” not displace or rival, existing financial arrangements. Secretary Simon, in his follow-up remarks four days later, also explicitly insisted that “what we are suggesting is in no way intended to replace the International Monetary Fund as the permanent institution providing the basic financial support for a well functioning world economy.” During the ensuing months, IMF representatives were involved as full participants in the deliberations of the Van Ypersele working group, and in the final agreement signed in April 1975, the FSF’s mandate was clearly limited to serving “to supplement, in exceptional cases, other sources of credit” (OECD, 1975, Article I). A government would be eligible to borrow only if it “has made the fullest appropriate use of other multilateral facilities” and would be subject to policy conditions comparable to those applied by the IMF (OECD, 1975, Article V).

Most important, the FSF would be temporary—a short-term expedient, not a long-term structural reform. Two years after its activation, the FSF would be liquidated unless extended by a 70 percent majority vote of its members (OECD, 1975, Article XIX). As Charles Cooper, Assistant Secretary of the Treasury, explained in congressional testimony a month after the agreement was signed:

There was a great deal of concern both in the United States and on the part of some other countries that we not be creating a new permanent institution. . . . We wanted to make it very clear that this was a transitional and a temporary institution, and for that reason we thought we should put a limitation on the period it could operate (U.S. Congress, House, 1975a, p. 12).

Notwithstanding Cooper’s statement, fears soon emerged about the future role of the IMF. No one could be sure how matters might work in actual practice. Even with the second oil facility, after all, the Fund’s loanable resources were nearing rock bottom. Larger OECD countries, confronted with serious payments problems, might have no

choice but to go first to the FSF, with its rich endowment of \$25 billion. Who was to determine, moreover, when a government “has made the fullest appropriate use of other multilateral facilities” or whether OECD conditionality was fully compatible with IMF practice? A hint of the kind of problems that might arise was suggested inadvertently by Jacques Van Ypersele in a 1977 interview. Even while insisting that “the IMF must have a say on establishing loan conditionality,” Van Ypersele admitted that “the OECD need not follow its advice one hundred percent” (private interview).

Who could predict, finally, how participants would feel about simply letting the FSF lapse after two years of operation? As Cooper admitted in the same congressional testimony: “At the end of two years, of course, circumstances may show that we have been too optimistic and the life of the Fund should be extended” (U.S. Congress, House, 1975a, p. 4).

Diplomatic language notwithstanding, the operation and duration of the FSF would ultimately be decided by OECD governments alone, not by anyone else. The IMF, observers began to worry, might be condemned to growing irrelevancy, at least with respect to countries eligible to borrow from the new FSF.

Typical of these concerns were the remarks of Fred Bergsten, testifying before the Senate Banking Committee in June 1976:

Today’s balance-of-payments problems within the OECD area derive from shortcomings in general economic policy rather than the price of oil. . . . Hence they should be handled through the normal international lending institutions, notably the IMF, rather than any new oil-related facility. . . . [B]y creating a new international financial mechanism, [the FSF] would weaken the International Monetary Fund, just at a time when the United States has a major interest in strengthening that institution (U.S. Congress, Senate, 1976a, pp. 26–27).

Gradually, fears about the FSF coalesced into a new mainstream consensus among specialists on both sides of the Atlantic. John Williamson’s statement that “analysis has not suggested that there is a compelling need for the creation of any new intermediation agency such as the \$25 billion OECD safety net” (Williamson, 1975, p. 220), was echoed by Milton Godfrey, a business consultant, who declared that “the proposed support fund has no real justification” (U.S. Congress, Senate, 1976a, p. 35). By mid-1976, even the FSF’s most ardent advocates were beginning to acknowledge the possible risks to the IMF’s central role and to search for new ways to nest the two institutions more securely. In July, for example, Illinois senator Adlai Stevenson, although a firm

FSF supporter, felt impelled to introduce an amendment “to insure that the Financial Support Fund is a lender of last resort by requiring that the IMF. . . first determine that the applicant is unable to obtain all or a part of any loan which it seeks from the IMF” (U.S. Congress, Senate, 1976b). Not even last-ditch efforts such as these, however, could turn the tide of opinion. In October, the *New York Times*, which less than two years earlier had hailed “the breadth of vision in this extraordinary project” (January 21, 1975), concluded that “the oil safety net is dead. . . . The scheme may just as well be given a quiet, respectful burial” (October 4, 1976).

By early 1977, when Bergsten and such like-minded colleagues as Anthony Solomon and Richard Cooper came to power with the new Carter administration, the handwriting was on the wall.<sup>7</sup> Little would be done to promote any initiative that threatened to dilute the pivotal authority of the IMF. Working-group chair Jacques Van Ypersele later attributed the loss of momentum for ratification directly to the “change of personalities” in the executive branch. More bluntly, and with a touch of bitterness, one high OECD official privately blamed the “one-world philosophy” of the new administration’s top officials—“proponents of a one-world concept in the financial sphere, who feel that the IMF can do no wrong” (private interview). Despite determined lobbying by the OECD, the FSF was put on hold; it was, in effect, allowed to linger in legislative purgatory until it simply faded into oblivion.

### *A Clash of Giants*

As critical as cognitive considerations may have seemed, however, they tell only part of the story. Washington’s change of heart can hardly be attributed solely to improving economic conditions or to the evolution of expert opinion. The increasingly effective opposition of the IMF also figured prominently in the minds of U.S. policymakers.

The IMF was, during this period, an institution in search of a new mission. Its role at the center of global monetary relations had been severely compromised by the shift to floating exchange rates in 1973 and by Richard Nixon’s earlier suspension of the dollar’s convertibility into gold. The subsequent failure of the Committee of Twenty (concluded in June 1974) to agree on any significant measure of systemic reform had only added to the IMF’s growing sense of impotence and frustration

<sup>7</sup> Bergsten was named Assistant Secretary of the Treasury for International Affairs. Solomon, an investment banker, became Treasury Under Secretary. Cooper became Under Secretary of State for Economic Affairs.



(Williamson, 1977). Even in the best of times, the IMF was bound to view with suspicion proposals for a new deep-pocketed rival such as the FSF, and these were clearly not the best of times for the IMF.

During 1973–74, institutional weakness within the IMF had made it difficult for Fund officials to counter the rush of ideas for new recycling facilities at the OECD or elsewhere. By 1975, however, international conditions were beginning to improve, and the deliberations of the Interim Committee (successor to the Committee of Twenty) were finally showing progress (which would ultimately lead to the Second Amendment to the Fund's Articles of Agreement in January 1976). Fund officials thus felt better positioned to reassert the IMF's pivotal authority at the peak of decisionmaking on monetary matters. The catalyst for this new energy was Witteveen, who took over as managing director of the IMF from a disappointing predecessor in September 1973. In the words of the Fund's official historian:

[Some initiative] was important for the Fund as the organization responsible for international monetary arrangements and for cooperation in the international monetary field . . . [and] it was essential that the Fund take some action. Already the Fund's influence and functions had been reduced by the collapse of the par value system and the introduction of floating rates earlier in 1973. By the middle of 1973, the Fund's image had also suffered by the failure of world officials to agree on a reformed system. Thus . . . Mr. Witteveen pushed the Fund into action (De Vries, 1985, p. 359).

The Fund's action did not, however, take the form of a frontal assault on the FSF. Although clearly unenthusiastic about the prospect of a new rival to his organization's primacy, Witteveen never directly challenged Washington's initiative. A skilled politician who had previously served as finance minister and deputy prime minister of the Netherlands, Witteveen knew better than to oppose publicly the IMF's largest and most powerful member. His strategy, instead, was to emphasize the acknowledged strengths of the IMF—its universality, experience, and proven expertise—as well as, more subtly, to underscore its essential neutrality in any confrontation between oil producers and consumers. Witteveen did not deny that the IMF had become less relevant, but the problem, he maintained, was financial, not institutional. The solution was to enhance the Fund's depleted usable resources by a significant increase in financing. Witteveen's public message was: The IMF still has a job to do. His subliminal message was: Give us the money to get the job done, and we won't need any sort of supplementary safety net in the OECD.

Beginning with the battle for a second oil facility, effectively won at the G-10 meeting in January 1975, the campaign moved into high gear over the course of the next two years. A proposed increase of IMF quotas was formally approved in March 1976, and a plan for a Supplementary Financing Facility (SFF), also known as the “Witteveen facility,” was implemented in 1977 (De Vries, 1985, chaps. 27–28). By focusing attention on replenishment of its own resources, the Fund deflected attention from the FSF, which was gradually relegated to a back burner in policy discussions. By mid-1977 it was the FSF, not the IMF, that appeared condemned to irrelevancy.

The FSF did not go down without a struggle. Behind the scenes, the OECD secretariat, led by Secretary General Van Lennep, continued to argue energetically for FSF ratification. Supporters focused increasingly on the unexpected emergence of second thoughts in the United States. Confidential briefs were prepared responding point by point to objections raised by U.S. critics; private meetings were arranged with legislators and policy officials on both sides of the Atlantic; and public backing was sought, whenever possible, from European governments and other interested organizations such as the Bank for International Settlements. As late as the spring of 1977, a majority of Washington’s allies were still promoting the FSF.

By this time, however, U.S. support for the FSF had dwindled to the vanishing point—to the immense relief of the IMF. “Witteveen’s success at repositioning the IMF at the center of the world economy has been a tonic for the morale of the Fund’s staff,” trumpeted a prominent business publication that summer (Ehrbar, 1977, p. 99). The risk of eclipse had been averted. Even in the cautious language of the Fund’s official historian, it is possible to detect some note of celebration and self-congratulation:

One result of the Fund’s supplementary financing facility was that the financial support fund in the OECD, extensively discussed in 1975 and 1976, never came into being. This was an understandable disappointment to Mr. Van Lennep, who had initiated the idea independently of U.S. officials, worked hard in developing the plan, and hoped that the OECD would, for the first time, have ample funds available to it (De Vries, 1985, p. 549).

The Witteveen facility was formally adopted by the Fund’s executive board on August 29—not coincidentally the very same day that Washington formally informed the OECD of its withdrawal of support for the FSF.

### *Domestic Politics*

Washington's reversal over the course of the FSF drama was striking. Although much can be explained by shifts in the cognitive and economic environment and by the opposition of the IMF, these variables were all external, influencing the attitudes and calculations of policymakers from the "outside in." To complete the picture, we must also consider the variables that influenced the outcome from the "inside out," through political conflict and bargaining within the country. External variables are unlikely, in practice, to exercise much impact except as they are mediated through the domestic political process.

During the exploratory and negotiation phases of the FSF drama, Secretary Kissinger's anti-OPEC strategy encountered little domestic resistance. Americans, shaken by the perceived threat to their energy security, required little urging to support a confrontational or even aggressive posture in relations with oil producers. Kissinger never felt the need even to consult with Congress before launching his safety-net initiative. The only serious bargaining sparked by his proposal apparently took place within the executive branch, between the Treasury and State Departments, soon after Secretary Simon was appointed to the Treasury in April 1974. Simon was too new to his post, however, and as yet too unsure of his place in Washington's power structure to offer much resistance to Kissinger's then-dominant voice within the administration. Although never fully persuaded that the markets were incapable of handling the recycling problem, Simon was nonetheless receptive to contingency planning within the government as well as at the OECD. By autumn, he was persuaded to agree, albeit with some reluctance, to give public support to a joint Treasury-State proposal. Whatever reservations Simon held in private about the safety net, no substantive differences could be detected between the rough idea sketched out by Kissinger on November 14 and the more detailed version that Simon himself elaborated four days later. As Simon's deputy, Assistant Secretary Cooper, insisted the following spring:

There are no differences of any significance at all between us and the State Department on this. This is something we worked very closely on and I am pleased to say this is an area where cooperation between State and Treasury is complete and full and there are no serious disagreements (U.S. Congress, House, 1975a, p. 15).

To all appearances, there were also no serious disagreements between the executive branch and Congress—at least, not at first. Testimony by

administration officials soon after the FSF agreement was signed encountered little criticism on Capitol Hill (U.S. Congress, House, 1975a), and no evidence suggests that ratification would have been unusually difficult had State and Treasury pushed for immediate action. In the event, however, beyond routine submission of draft legislation in June 1975 (U.S. Congress, House, 1975b), nothing was done to promote congressional consideration for over a year. The opposition thus had ample opportunity to emerge and mobilize. By the time formal hearings got under way in mid-1976, the FSF agreement was plainly in trouble (U.S. Congress, Senate, 1976a). Once the changeover of administrations occurred in early 1977, the FSF was essentially doomed.

Several factors seem to have contributed to the change of heart in Washington. Of considerable importance was the improving economic climate, as adjustments to the 1973 oil shock finally began to take hold. With the public's sense of urgency slowly receding, it became correspondingly more difficult to sustain domestic support for a seemingly radical and potentially expensive financial initiative—particularly as even more demanding emergencies, such as the looming bankruptcy of New York City, began to appear on the horizon. Of some salience as well were personal frictions generated by Kissinger's abrasive and muscular style of policymaking. On Capitol Hill, the Secretary of State was resented for neglecting the usual courtesies of prior consultation before formally announcing the U.S. plan. In the executive branch, Secretary Simon was reportedly piqued by Kissinger's heavy-handed dismissal of Simon's private reservations about the safety-net strategy. According to one highly placed State Department source, Simon was "regularly humiliated by Kissinger power plays" and "was never convinced the FSF was needed or that useful" (private interview).

Nothing was more critical, however, than the rival institutional ambitions of the State Department and Treasury. Whereas Treasury had always enjoyed authority over U.S. representation at the IMF, State was the lead agency for the OECD. Treasury officials, worried that a successful FSF would force them to share their traditional primacy in international financial policymaking with counterparts at the State Department, became the Fund's natural allies in its competition with the OECD. In terms of domestic U.S. politics, this was the real clash of giants, not the rivalry between the IMF and the OECD. One State Department official recalls a European minister saying: "We Europeans can only hope for peace between the world's two superpowers—the U.S. Treasury and the U.S. State Department" (private interview).

The State Department, of course, remained the natural ally of the OECD, but by 1976, with the OPEC threat fading, its influence over financial matters was clearly on the wane. Once Richard Cooper, a known skeptic concerning the FSF, arrived as Under Secretary for Economic Affairs in January 1977, the challenge to the Treasury effectively ended. Cooper was never swayed by staff arguments in favor of the OECD safety net. Instead, he worked closely with his Treasury colleagues Solomon and Bergsten to bring the bitter turf war between their respective departments to a quiet, albeit decisive, conclusion.

The federal electoral cycle also had a significant impact on the calculations not only of legislators, but of two successive administrations as well. Political weakness at home made President Ford increasingly hesitant to push for controversial legislation of any sort. Political frailty also encouraged him to pay more heed to the views of Secretary Simon, whose reservations about the FSF were well known inside the beltway and who carried considerable weight in the Republican party. In the words of one Washington source, “Ford, facing an election, needed Simon more than he needed Kissinger” (private interview). Ford’s subsequent defeat brought to power an opponent, Jimmy Carter, who naturally had little interest in sustaining or promoting key policies of his predecessor.

Washington’s change of heart made it easier, in turn, for the IMF to succeed in diverting attention from the FSF. In January 1975, following the review of IMF quotas begun in early 1974, Managing Director Witteveen engineered agreement in principle to increase the Fund’s quotas by nearly one-third (SDR 10 billion). Although final details were not worked out for another fourteen months, the prospect alone of an increased U.S. share, requiring congressional authorization, sufficed to justify delaying congressional consideration of the FSF. Treasury officials argued, with some reason, that legislators were unlikely to approve both financial initiatives simultaneously. In fact, Congress at the time exhibited little interest in even a single new program of costly foreign assistance, let alone two.

In early 1977, moreover, Witteveen proposed the Supplementary Financing Facility, which from the start was seen as a direct riposte to the FSF. The idea of a new arrangement at the IMF was warmly supported by the incoming Carter administration, partly because it would rely on financing from oil exporters as well as industrial nations (thus making the scheme more palatable to potential donors like Germany) and partly because its resources would be available to all governments, not just members of the OECD (thus making it attractive

to developing countries as well). In both respects, the SFF seemed more consistent with the new administration's "one-world philosophy" than did the FSF. The SFF would, in addition, restore the Treasury to primacy in international financial policymaking.

Officials in Washington now also began to argue that two schemes were in fact one too many. With oil deficits shrinking, they contended that activation of both initiatives might actually create too much liquidity. Given the demonstrated capabilities of the IMF as a lending institution, moreover, the SFF seemed preferable. Washington's new attitude was concisely summarized in a brief colloquy between Senator Stevenson and Treasury Under Secretary Solomon in August 1977 (U.S. Congress, Senate, 1977, p. 38):

SENATOR STEVENSON: With this addition [of the SFF], if the resources would be adequate, then it follows that the administration does not support an OECD support fund. Is that correct?

MR. SOLOMON: If the Congress gives approval to this and the facility is established, then we would not expect to return to the Congress for any contribution to the Financial Support Fund.

The executive branch, under two successive presidents, thus felt compelled to choose between the facilities proposed by the OECD and the IMF. In the end, it gave priority to the IMF.

## 5 Resolving the Bargaining Game

What can we learn from the FSF experience about the ways in which actors make their choices and the ways in which bargaining games are resolved? It is evident that cognitive considerations, structural factors, and domestic politics all played salient roles in the FSF drama. Much useful insight can be gained from a review of their respective contributions.

### *The Influence of Ideas*

Ideas may be understood as "shared beliefs" (Jacobsen, 1995) or as "consensual knowledge" (Rohrlich, 1987). Most relevant in the context of the FSF are ideas as causal beliefs, that is "beliefs about cause-effect relationships which derive authority from the shared consensus of recognized elites" (Goldstein and Keohane, 1993, p. 10). Causal beliefs guide individuals in achieving specified objectives. They serve both as "road maps" to help shape strategies for the attainment of goals and as "focal points" to help coordinate action and create effective coalitions.

Such ideas can be a powerful force for initiative and innovation, particularly in an emergency when actors feel least assured about the consequences of alternative actions. They can be a stubborn barrier to change as well, however, when they put cognitive blinders on decision-makers, limiting imagination and restricting the number of acceptable outcomes. A fading of a sense of urgency, for example, may lead to an uncompromising closing of minds. In the FSF drama, ideas as both stimulus and constraint were evident.

During the exploratory and negotiation phases of the financial initiative, when governments were struggling with the shock of sharply higher oil prices, as well as the earlier abandonment of pegged exchange rates, consensus about the management of international monetary relations broke down. No one could be sure that the multilateral structures established at Bretton Woods were capable of coping with the impending payments imbalances and prospective recycling needs. The perception of dramatically altered economic circumstances produced an intense demand for some kind of institutional reform. Among the proposals put forward in the ensuing confusion, the FSF proposal emerged as a viable strategy, in part because it seemed to offer both a clear road map at a time of uncertainty and a potentially effective focal point for collective action. Quite clearly, the initiative would never have received the attention it did, even apart from the power of its sponsor, the United States, had there not been a severe jolt to the prevailing cognitive order.

During the ratification phase, by contrast, as the general sense of urgency abated, more traditional notions began to reassert themselves—particularly with respect to the crucial issue of where institutional authority should properly reside in the global regime. Most recognized experts continued to maintain that monetary affairs are best managed in a unitary fashion, that just as national money systems are traditionally governed by a single central bank, the international system should have a single center of decisionmaking, the IMF. At the level of elite U.S. opinion, therefore, opposition began to build against the implementation of the FSF. The prevailing ideas were strengthened by the existence of an articulate and far-flung network of knowledgeable experts opposed to the FSF—an “epistemic community” sharing a comparatively uniform point of view.<sup>8</sup> Not only did this community have access to key policymakers, but some of its members became policymakers themselves,

<sup>8</sup> The term “epistemic community” is John Ruggie’s (1975) and has been popularized by Peter Haas (1992).

holding positions of real political authority in Washington while the issue of ratification was still pending.

### *Structural Change and Leadership*

Students of world politics have long emphasized the role of power in determining the shape of global institutional arrangements—most generally, in the well-known theory of hegemonic stability; more specifically, in that strand of the political-economy literature called “leadership theory” (Lake, 1993). Leadership theory highlights the impact of dominant powers (hegemons) on the production of an “international economic infrastructure.”

The patronage of the powerful is clearly critical for effective organizational reform. On the one hand, significant regime transformation is less likely to be attempted without the active support or sponsorship of one or more leading governments. On the other hand, major reform is more likely to be rejected if that support or sponsorship is withheld. Both kinds of influence are evident in the FSF episode.

The FSF represented a potentially dramatic change in global institutional arrangements. Looking back, it seems improbable that such a grave challenge to the IMF would even have been contemplated without the explicit intervention and forceful diplomacy of the United States. Few governments paid serious attention to Secretary General Van Lennep’s proposal when he first presented it in the summer of 1974. A financial facility at the OECD, with resources to rival the IMF’s, became a plausible possibility only when it was promoted by Washington. Plainly evident throughout the exploratory and negotiation phases was the phenomenon Scott James and David Lake (1989, p. 4) call the first “face” of hegemony, the overt “use of positive and negative sanctions aimed directly at foreign governments in an attempt to influence their choice of policies.” Some use was also made of hegemony’s third face, the projection of ideas, to legitimate the Kissinger proposal, when Washington took advantage of the uncertainty generated by the oil shock to promote its own conception of an appropriate solution.<sup>9</sup> Most vital to the rapid success of the FSF negotiation, however, was the U.S. government’s unabashed and open manipulation of power.

The power of the United States also proved decisive during the ratification phase—ironically, in this instance, by its lack of use—as the executive branch first procrastinated and then became actively hostile to

<sup>9</sup> The second face of hegemony, the influence of the hegemon’s international market power on incentives and interests in foreign countries, does not appear to have played a significant role in the FSF episode.



the FSF. Despite appeals from figures as prominent as the chairman of the Bank for International Settlements, no government was prepared to activate the safety net without participation by the OECD's richest member.<sup>10</sup> The IMF and OECD were two giants locked in combat, and neither could prevail without the support of the United States.

#### *Winning Support at Home*

As Robert Putnam (1988) reminds us, international diplomacy is a game played at two levels, within countries as well as among them. At the international level, negotiators seek accord through mutual accommodation and compromise. But agreements reached abroad must also be capable of winning political support at home, particularly when legislative ratification is required. No intergovernmental negotiation, however artfully conducted, can be considered truly "successful" if implementation is subsequently blocked by domestic discord.

In this sense, the FSF initiative was not a success. In the rush to win over governments in Europe and Japan, little was done to win support in the U.S. Congress or to mobilize public opinion in the United States. Legislative ratification was apparently not expected to be a problem, even despite an improving economic climate and Witteveen's subtle campaign on behalf of the IMF. Nothing was done, moreover, to mollify critics at the Treasury, from Secretary Simon on down. Instead of moving rapidly to organize a winning coalition when enthusiasm for the FSF was at its peak, supporters allowed the agreement to linger in the legislature while preferences gradually shifted toward the IMF alternative. In the end, the FSF failed because its sponsors neglected to tend their own back yard.

#### *The Dominance of Power*

Among the elements affecting the conclusion of the FSF episode, power stands out as the decisive factor. Although the proposals put forward in the wake of the oil shock may all have provided useful direction in the prevailing climate of uncertainty, the choice among those ideas depended directly on the relative strength of their respective sponsors. Opposition at the level of elite opinion may, similarly, have helped to defeat the FSF proposal, but the influence of the

<sup>10</sup> As noted, twenty-one of the twenty-four members of the OECD had ratified the FSF agreement by the spring of 1977, representing 71.3 percent of total voting power. This was more than enough for formal activation of the plan, which legally could have been accomplished by a decision of as few as fifteen members holding as little as 60 percent of total quotas (OECD, 1975, Article XXIII).

relevant epistemic community would have been far less had key members of the group not been appointed to positions of authority in Washington. The FSF might have taken a different shape had the distribution of state capabilities in the bargaining game been different. The OECD might have prevailed in its clash with the IMF had it retained the patronage of the United States. Ratification of the FSF by the U.S. Congress might have been possible had the requisite effort been made to capture the domestic political process. In every phase of the drama, power took center stage.

## 6 Inferences for Today

The FSF was not a bad idea. Given the atmosphere of crisis prevailing in 1974–75, it made perfectly good sense for governments to take precautionary action. The OECD safety net, moreover, was not poorly conceived. Its proponents were well aware of the need to ensure its institutional compatibility with the operations of the IMF. Despite careful crafting and the patronage of a powerful sponsor, however, the FSF foundered. The experience suggests important lessons for comparable future efforts to nest similar clublike initiatives within broader global structures, whether in the financial arena or in other dimensions of the global economy such as international trade.

One of the most contentious issues in international economic policy today stems from the spread of regional trading blocs: from the European Union and its widening web of commercial agreements in Europe to the North American Free Trade Agreement, Mercosur, and the future free-trade zones projected for the Western Hemisphere (Free Trade Area of the Americas) and the Pacific Basin (Asia-Pacific Economic Cooperation). Are these initiatives compatible with broader commitments to the multilateral trade regime centered on the WTO, or do they pose a threat comparable to what many saw in the FSF? Are they, in Robert Lawrence's (1991) famous phrase, "building blocks or stumbling blocks"? The answer, clearly, depends on the same combination of elements that determined the outcome of the FSF drama, in particular, on the element of power.

It is not enough that there may be a perceived need to retain compatibility with the rules and decisionmaking procedures of the WTO, or even that credible efforts are made to avoid overt institutional rivalries. Although ideas such as these matter, they are not by themselves decisive. In the case of the FSF, IMF representatives were invited to participate at the negotiation stage, IMF policy conditionality was incorporated

into the FSF's legal framework, and formal provision was made for regular consultations between OECD and IMF officials, all in hopes of satisfying the demands of the relevant epistemic community, especially in the United States. Yet none of these measures could bring the FSF to life. Ultimately, the FSF failed because the United States, the most powerful participant in the process, changed its course and withdrew its support.

The eventual impact of today's emerging trading blocs will also be determined, not by elite opinion, but by the priorities and preferences of the most powerful state actors involved. In order for the new trading clubs to become "building blocks," they must have as sponsors one or more governments with enough power to ensure that any agreements made will be nested firmly under the wing of the WTO. Individual state sponsors must, in turn, be able to ensure that their projects will be ratified, formally or informally, at home. They must actively cultivate and mobilize domestic political support.

In the end, power prevails. If the FSF episode teaches us anything, however, it is that power will ensure compatibility of new clubs with existing global accords only if it is effectively deployed at both levels of the institutional bargaining game, at home as well as internationally. By forgetting the lessons of the FSF experience, we risk repeating its failure.

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