Transcript of Interview with Harold James

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Interviewed by
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Verbatim Transcript of Interview Between Jeffrey E. Garten and Harold James
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Garten: Harold, thank you very much for agreeing to do this interview. As you know, I am talking to a lot of people around the world about the future of the global financial system. I think it was Winston Churchill who said, "The further back you look, the further ahead you can understand." And what I always thought he meant by that was the greater your historical perspective, the more you can actually get a sense of what's really important now, and what's just passing phenomenon.

So you are one of the preeminent economic historians and I'm just delighted to have this opportunity.

James: Well, I'm very pleased to be with you,

Garten: So, what I want to start with really is very quick tour of the key milestone in international monetary and financial cooperation since the II World War. In other words, the events that one might want to identify in order to understand how financial cooperation in its broadest sense has or has not developed.

James: When people think about financial cooperation, I think they always look back to the spectacular conference in July 1944 in New Hampshire at the Mount Washington Hotel in Bretton Woods, the conference of the United Nations. And it's really from my
perspective its really quite an exceptional event. I think you can
never quite repeat that success because it was conducted under
enormous time pressure, and it just happened after the Normandy
landings, and it wasn't clear that it would take almost another year
to defeat Nazi Germany, and longer than a year to defeat Japan.

And so there was the feeling that the war might come to an end
very, very soon, and that you needed some kind of plan to be there
when the post-war reality hit you, and that's the pressure that the
people who were meeting in Bretton Woods faced. And the other
thing is that although there were 44 or 45 countries in Bretton
Woods represented, they weren't all equal; there were only two
countries that mattered, the United States and the United Kingdom.
And, actually, it was only one country that really mattered; it was
the United States. And so most of the Bretton Woods agreement
reflects the very farsighted US agenda at that time point.

_Garten:_ Would I be right, also, in saying that also absent were what would
today be the power brokers in the private financial arena? In other
words, private capital was not moving around the world at
anywhere near the way it does today, so that governments had a
lock on the system.
James: Absolutely. The consensus of Bretton Woods, and the key to the intellectual basis of Bretton Woods, was the idea that private capital flows were very, very dangerous and destabilizing, and that they would be restricted for the foreseeable future, and that there was an idea that trade was good. And the trade area should be liberalized, but that financial flows should be restricted and capital flows would be something for official agencies, and that's why the World Bank was created as part of the architecture of the Bretton Woods settlement.

Garten: So that's obviously one big milestone. Give us a few others.

James: Well, then I think the problem was that the Bretton Woods vision was grand, but it really couldn't be implemented, and so the next milestone for me would be in 1956, when there was an immense political crisis. It's the political crisis that France and Britain's set off when they invaded and took over the Suez Canal and alienated the United States. It was a big division between the United States, on one hand, and the UK and France, on the other.

And so in 1956, it's a diplomatic crisis. It is basically the end of Britain as a great power. And they're pushed into the Bretton Woods order, so it's kind of the realization of Bretton Woods.
Garten: So would you say that 1956 was an example of what happened in 1956 when the US made a demand on Britain to leave Suez or else face a dumping of their currency, at that moment really it was the US and not the US and the UK that were basically in charge of the financial system.

James: Absolutely. I mean in that sense it seems to me that this was a bilateral story from 1944 to the 1950s and 1960s, but it was always the US that called the shots in that relationship.

Garten: Okay. And what would be the next one?

James: So my next milestone is in the early 1970s, and I guess if I had to take one date, it's the August 15, 1971 closing of the gold window, the very dramatic announcement by President Nixon that essentially the United States was giving up on the Bretton Woods idea.

Garten: Okay. And the US –

James: And that's the moment also -- to go back to this discussion of public versus private capital movements -- that’s the moment when
the private capital moments really started moving ahead and private capital flows are going to be the thing that really drives the world economy for the next 30-40 years.

_Garten:_ So at that moment, the US said that the dollar was no longer backed by gold, and so was it capital flows that really were beginning to determine the currency relationships?

_James:_ Well, there was a realization I think that even in this beautifully conceived world in Bretton Woods where the short-term flows would be controlled, it was actually hard to do that because there were banks that were offshore. After all, a lot of American banks in the 1960s were moving and setting up London branches in particular, but branches elsewhere as well. The whole business of trade invoicing lent itself to short-term capital movements. You could delay the invoicing or you could advance the payments over these leads and lags so-called, and the payment system.

And so even in the control system you had short-term capital movements and people were really beginning to see by the 1970s that that attempt to control things just wouldn't work very well.
Garten: So in August of 1971, or let's say afterwards, how would you describe the political power configuration? Who were the major players after 1971?

James: Well, it's an interesting question because in terms of the financial diplomacy, there's a lot of expectation in August 1971 that this is going to be the end of the US dollar and that the US dollar isn't going to play a big role in the international economy. It's at this time that people devise all kinds of really complicated mechanisms, the IMFs, SDRs, the special drawing rights, the substitution accounts to try to create substitutes for the dollar, but in fact, the dollar remains the world's leading currency, and from my point of view, it's likely to stay that way despite all kinds of big upheavals.

So the 1970s were full of upheavals, the oil shocks, the dramatic dollar depreciation, but the dollar remained the leading currency.

Garten: Okay. And then after that -- another milestone?

James: So I think my next milestone would be in the early 1980s, and in particular, again, I would choose an August date for that, August 1982, the outbreak of the Latin American debt crisis and the de
facto default of Mexico on its external debt. And I mean that showed that there was a problem in the way that international banks were operating. There was a problem about debt repayment, and it took a very, very long time to solve that, and in essence, we're still really wrestling with the same kinds of issues that policymakers had in that summer of 1982.

Garten: And those issues would at least in part relate to the whole issue of sovereign debt, right? I remember there was a lot of discussion that countries really couldn't default, which is, of course, odd, since historically, there had been many sovereign defaults. But somehow in the 1980s, it seems to me there was a feeling that something had changed, and then that debt bomb burst in Latin America. What are the lessons of that?

James: I think the lesson is there's no really very simple way out of a big sovereign debt crisis. If it had been tackled in the straightforward and obvious way that many economists wanted to propose in the summer of 1982, just by writing down debts, it would have triggered an enormous financial crisis that would have been similar to that of the Great Depression.

So it's a rather sad story. It's muddling through playing for time,
kicking the can down the road-- really for seven years. And so it's only right at the end of the 1980s that the Brady Plan gets implemented, but you couldn't have done that at the beginning. And so my lesson from that is that sovereign debt crises do not let themselves be resolved in a very neat and simple way.

It's always dealt with in a messy way. And people are always going to play for time and look for model solutions. And it seems to me, that this is exactly what the Europeans are doing at the moment that as with Mexico or Argentina, many people recognize that Greece is not really going to be able to ever repay its debt, but you can't explicitly recognize that in all its candor right at the moment.

_Garten:_ Right. On the Latin American debt crisis in the '80s, would you agree that here you had in a sense, the interaction -- on a massive scale -- of private capital and governments? In other words, this was an extreme swing of the pendulum from 1944 because all of this was private capital that had moved into countries in a way that was not tracked. It caught a lot of people by surprise. There was not even a common database to understand how much private money came into Latin America.
James: Right. Yes, it’s astonishing that the creditor governments didn’t realize how much their banks had lent. The debtor governments couldn't calculate how much debt they'd acquired because there were all kinds of subsidiary government institutions, para-state organizations that are borrowing as well on a kind of government security, and the whole thing was completely non-transparent. And since then, I think we’ve been wrestling with this problem of how do you get accurate data. It's still an issue.

Garten: Okay. So now we're up to the early '80s. Next milestone?

James: I think the next milestone I see really in the 1989-1990, it's the big geopolitical event of the collapse of communism, The world is clearly united. People talk about globalization and the big way globalization becomes the keyword of the 1990s. It's the way that everybody starts to understand what's happening. There's the Fukuyama book about the end of history. It's about the triumph of the market, and the triumph deregulation.

Garten: I imagine also you have now the – certainly by this time Japan has become a much bigger player so that the –

James: Right.
**Garten:** – global monetary system now has at least three poles, right? It has the US, it has Europe, and it has Japan.

**James:** That's right. For the 1980s, I think actually Europe doesn't play a very big role in the international monetary discussions. Everything takes place on the US/Japan basis, in the same way as we talk today about a US/China dialogue and the rest of the world is a bit peripheral to that discussion.

**Garten:** Okay. So now we've got the burst of globalization both intellectual and on the ground after the fall of communism, and we're into the late '90s. Next milestone?

**James:** Well, my next milestone is the 1997 to '98 Asia crisis, and I think this is really a critical one and it's the one where the Bretton Woods institutions and the Bretton Woods vision start to come under a really big challenge because the experience that the Asian countries went through in 1997-1998 really convinces them that they don't ever want to be subjected to IMF programs, and they see them as very politicized, very driven by a US agenda. They want to get independent of that, and so this is the motive that pushes them in the 2000s to the enormous reserve accumulation.
Garten: So this was a challenge to what was seen as sort of the essence of American philosophy of how economies are supposed to operate. Even if the US wasn't operating that way, it was espousing a free-market line that the Asians rejected.

James: Right. And then by the 2000s, the Asians looked as if they'd navigated an enormously successful way out of this, and I think by the time you get to our final milestone, as it were, the response to the 2007-2008 global financial crisis, you see Asia in a clearly dominant position.

For me, that unofficial photograph released from the G20 summit in April 2009 is really a wonderful, wonderful moment where Hu Jintao is standing there absolutely in the middle of the picture, looking as if he's in control of the scene while President Obama and President Medvedev are embraced by this clownish prime minister of Italy in an absolutely silly gesture, and it's only China that looks as if it's concentrating.

Garten: So that was a really interesting identification of milestones. Can you just step back point to a few lessons of this financial and monetary history of really a half-century, a few lessons that go to the point of how far can the world go in terms of enhancing
financial and monetary cooperation? I mean you talked about
globalization, and I think most people would say since the ’90s, it
has only become more intense. We've had more trade. We've had
more finance. We've had more movement of people. We have
more movement of ideas.

So we have a more globalized system, but what do those
experiences say about the ability to construct – I don't wanna say
another Bretton Woods-- but to move in a direction of cooperation
that is somehow proportional to the amount of interaction that
occurs?

James: The distinction that you made between private and public aspects
of this process seems to me absolutely crucial because the 1990s
version of globalization was very much one that was driven by the
private sector, and it was private networks and private companies
and private markets that we're driving all these connections.

Already by the 2000s, I think the sentiment had begun to shift
there and it looked as if it was really big concentrations of political
power that mattered. And that’s the lesson that's really forced
home by the financial crisis that it's big countries that can be quite
resilient in the face of the financial crisis. So it's China. It's also
the United States. The United States is a big country, powerful
country.

But small economies, small countries-- the Irelands, the Icelands-- these were the poster boys of globalization in the 1990s. If you wanted to see where globalization was successful, you would have said Ireland or New Zealand or Chili. But these are on the whole losers in the 2000s, and small countries become really much more vulnerable, and we look more to big countries. And I think both China and the United States, the examples of that where there's a sense of being able to control parts of the financial process.

Garten: And so if someone were to say to you in the next decade, what do you think the prospects are for more global oversight of something like exchange rates or more global harmony of major regulations including capital requirements or listing derivatives on some kind of exchange? All these issues that are talked about now, but are still in their infancy. It seems every day you think there's progress and then the next day you see the national tensions pulling them apart.

So I'm asking you for some historical perspective. Is the financial system, broadly defined, becoming more integrated or is there a point where it is so integrated that it begins to de-conglomerate;
that is are we reaching the point of saturation in terms of international cooperation?

James: This is a kind of pendulum process and for long periods of time, the world moves to greater integration and then there's a shock. And in responding to the shock, there's a realization of the response has to be formulated in national terms, and so there's an attempt to limit all kinds of movement., I think we're in one of those moments I believe where the ability to coordinate in internationally has become much weaker.

For me, the kind of high point of cooperation was in the immediate aftermath of the collapse Lehman. When it looked as if the world economy was going into a freefall, there was a period between September 2008 and the spring of 2009 when world trade was declining at a faster rate of decline than it had even in the Great Depression. It was very, very alarming, and the financial sector was completely gummed up. And that's when there was a dramatic and really apparently quite successful policy response in April 2009 of the G20 summit.

And this is going to be I think remembered as the great success in dealing with the Great Recession, stopping it from becoming a Great Depression. The way it was coordinated, it was very
effective. But some of the advice that was given then, and some of
the policy decisions that were made then, look in retrospect as if
they're quite problematical. So it was problematical, for instance,
to try to push all of the European governments to do a coordinated
fiscal expansion.

Spain, in the spring of 2009, was being told that it needed to do
fiscal expansion, and nobody had calculated what the effect was of
the collapse of the housing bubble in Spain and how that would
damage the Spanish government's capacity to borrow. And so a
year later, policy makers were switching dramatically from putting
their foot down on the gas pedal, to putting their foot on the break.

_Garten:_ To what extent is this difficulty of intense coordination outside of
an immediate crisis is the difficulty of institutionalizing
coordination. Put another way, how much is Europe a an example
of the limits of a globalization? Are we watching something that is
actually a harbinger for the broader globe in how the Europeans
are trying to deal with their crisis?

_James:_ That's very much how I see it. The European experiment was in
many ways trying to do on a regional level what people have
thought of in terms of well coordination as well so that the
immediate precipitator of the European move to have a single currency. It was the failure in the middle of the 1980s to produce a global settlement between the Plaza and Louvre monetary agreements, or between 1985 and 1987, the finance ministers and central bank governors were talking about some kind of movement toward closer coordination of exchange rates. It didn't work on the global level, but there was a conviction that it could work on the European level.

And the strains that you see in Europe at the moment are really indicative of the problems facing this interconnected world. When you're hit by a crisis, there's a tendency to go back, think of it in terms of protecting national interests, and so part of the story of the integrated market was that there were big cross-border banks that function in Europe and in the aftermath of the crisis, the national bank regulators say to, for instance, the German bit or the Austrian bit of an Italian bank that's active all over Europe, they say, "No, no. You mustn't take liquidity from Germany and put it back into Italy. We want to keep your resources in Germany, you mustn't move it around. And the Europeans are still really confronting this issue; they haven't produce a solution as yet to it of how to have a common banking system in a world in which there are 27 or 28 different states.
Garten: So I’m going to conclude with two questions. One of them is: what are the biggest underlying trends that you see that will affect global financial cooperation over the next decade. Obviously, one is how the Europeans deal with their crisis. You’ve mentioned that.

James: Yes.

Garten: I think the second that you have brought up is really the US/China relationship and how that is becoming so dominate. But are there other trends, for example, in the regulatory arena or in the attitudes that we have about international institutions? What else do you think is going to bear heavily on the nature and the depth of financial cooperation over the next decade? Europe and the US and China, for sure, but what else?

James: First of all, international institutions. The existing international institutions were very much the product of the immediate post-World Order of 1944-1945, conceived even before the end of the Second World War. They're clearly outdated, and the international monetary fund in particular is facing an enormous problem credibility problem. The Asian crisis in ‘97-98 was the first stage of that credibility problem. In Asia, people wanted to move away
from the fund. And the euro crisis has really been quite terrible for the fund because it got heavily involved in it. Emerging markets were asking themselves, "Why is this institution trying to channel so many resources from poor countries into relatively rich countries that are over indebted?"

And it really raised all those questions that were always around about this European/American dominance of an institution in a world in which the center of economic activities and moving somewhere else. And so this institution which played an enormously part in managing financial crises in the past looks terribly, terribly weakened by the aftermath of both the Asian crisis and the euro crisis.

The second story is the private sector institutions that manage these big flows, the big global banks, I think are also going to look more and more vulnerable and they're going to be subjected to increasing constraints by national regulators, and national regulators are not going to want to see them be so internationally active. You can see it much more clearly I think with small countries because for small countries, it's an existential threat when Irish or Swiss or British banks get too big, the potentially pose an enormous threat to the state budget, the fiscal capacity of the
parent country.

So those are going to be the first banks that are going to contract. But I think US banks are also going to face the challenge of becoming less international than they were in the past, so both the private sector and the public sector are less global I believe could be less global in the future than they were over the last 20 years.

_Garten:_ So finally, I'm going to give you a multiple-choice quiz, and just tell me which of these scenarios you think is the most likely. And I know for an historian this is a terrible thing for you to have to answer, but just to give us a sense of where your instinct is. So “A” would be that sometime in the next decade, there is actually going to be a scenario in which we see a real burst of international financial cooperation with, for example, a real tightening of international regulations, almost a high commissioner for global financial regulation, some more formal regime when it comes to currencies and a much deeper consensus about the balance between domestic and international adjustment policies. So that’s Scenario A.

Scenario “B” is based on the idea that most of history is based on improvisation. Bretton Woods was the high point. There simply is
too much diversity in the world, diversity of conditions, diversity of ideas, diversity of political power, and so actually the monetary and financial system of a decade from now might not look at all different than it does today. I mean they may be some new rules, but basically it's very messy. It has no real centralization, and there will be some countries that are doing well and some that aren't but basically it's improvisation and muddle through is the long-term status quo.

And the third, Scenario “C”, is we are on extremely dangerous territory. Economies are becoming much more linked, and as a result, everybody is quite vulnerable and we don’t and we won’t have the mechanisms to deal with the shocks that will naturally occur. And, therefore, if you look at financial crises over the last 30-40 years, actually, each one is successfully more global, more interconnected, more damaging, and so we are actually – we are in dangerous territory. In other words, improvisation alone won’t work.

Which of those three scenarios do you think is most likely? Or give me a fourth.
James: If I want to sleep quietly at night, I obviously hope for the first alternative, but I just don't believe that, so I see things very much, I'm afraid to say, in terms of the catastrophic scenario “C.” It's really striking how many people will say today that in previous crises, they could see a way out. You could see a way out of 1971 and the August declaration by President Nixon. You could see a way out of the Latin American debt crisis that was painful for Latin America, but there was some kind of way out.

But there's a real feeling of hopelessness in terms of the international ability to cooperate, so you've got an enormous web of potential cooperators, but you've got no fundamental idea that links them together that will show them a way out of the mess they're in.

Garten: Harold, thank you very much. That was one of the most interesting discussions I've been part of, and I really appreciate it. I wish you the very best.

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