Reading Kindleberger in Washington and Berlin
Ideas and Leadership in a Time of Crisis

Matthias Matthijs[1]
Johns Hopkins University – SAIS

matthijs@jhu.edu

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Abstract

Both the 2008-09 global financial crisis (GFC) and the 2010-13 euro crisis were 'systemic' crises with worldwide repercussions. Led by the United States, the global economy dealt with the GFC in a relatively swift and decisive manner: the acute phase of the crisis wound down by the spring of 2009, about seven months after Lehman Brothers' fall. By contrast, it took almost three years before financial markets stopped fearing a disorderly Eurozone breakup. In the absence of a decisive intervention by Germany or the EU, the crisis – though contained by early 2013 after the ECB's pledge to do 'whatever it takes' – was still simmering on four years after its eruption. Why did policymakers respond so differently? This paper will explain the different outcomes as caused by conflicting crisis narratives and distinct ideas about leadership in Washington and Berlin. In the wake of the GFC, the U.S. acted as a responsible hegemon for the world economy, showing 'benign' leadership, while Germany failed to play a similar role within Europe's regional context, instead practicing a form of rule-based 'coercive' leadership. By reviving and extending Charles Kindleberger's original version of hegemonic stability theory (HST), the paper clarifies why the U.S. *did* and Germany *did not* define its interest as providing the necessary public goods for the system to recover and sustain itself, including a market for distress goods, countercyclical long-term lending, lending of last resort facilities, and macroeconomic policy coordination. The crucial role of ideas – though constrained by structural factors and domestic institutions – in defining the interests of leading states during crises will be included as a key independent variable in the analysis. The paper will thus breathe new life into the HST literature, expand its explanatory reach into the regional context, and causally infer the consequences of the type of leadership for understanding the effectiveness of crisis responses.

Key words: hegemonic stability, leadership, regimes, ideas, public goods, Germany, United States, institutions, global financial crisis, euro crisis.

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In these circumstances, the international economic and monetary system needs leadership, a country which is prepared, consciously or unconsciously [...] to take on an undue share of the burdens of the system, and in particular take on its support in adversity by accepting redundant commodities, maintaining a flow of investment capital and discounting its paper.

Charles P. Kindleberger[2]

The global financial crisis, with its origins in the United States' housing market, and the Eurozone debt crisis, with its roots in the euro's institutional design and missing financial union, took the financial world by surprise and led to the worst real contractions of the advanced economies post-war. While similar in magnitude and potential for international conflagration, the outcomes to both crises were nevertheless quite different: the global financial crisis shored up relatively quickly in 2009, while the Eurozone crisis sputtered on for much longer and would come to a questionable halt without clear resolution in 2013. What explains the different policy responses and outcomes? Why was the more complex and less institutionally equipped global system capable of coming to terms with its crisis so fast, while the more highly institutionalized and integrated Eurozone was not?

1. The Puzzle: A Tale of Two Systemic Crises, Public Goods, and Leadership

The global financial crisis of 2007-8 resulted in the world's "Second Great Contraction," in the words of Reinhart and Rogoff, and has been widely recognized as the most serious economic and financial crisis since the Great Depression of the 1930s.[3] While the depth, scale, and strength of the global financial crisis (GFC) was without postwar precedent, the international policy response to it was remarkably swift and decisive. The acute phase of the crisis – from a global point of view – did not last all that long, especially if one compares the response and timeline of the 'Great Recession' with that of the Great Depression.[4]

The U.S. quickly responded with a wide-ranging financial bailout worth $700 billion in October 2008, aggressive monetary easing by the Federal Reserve, and a fiscal stimulus bill worth $787 billion in early 2009.[5] The U.S. also kept its markets open to world trade, arranged emergency currency swaps with the world's major central banks, and took it upon itself to coordinate the crisis response by launching the G-20 as the main body dealing with international economic issues. The U.S. economy bottomed out in the second quarter of 2009 and started growing again in the third quarter. The world economy as a whole bounced back in 2010 and 2011 with annual growth rates of 5.2 percent and 3.9 percent respectively.[6] Even though the world economy's recovery was

[2] Kindleberger (1973, [2013]), p. 28
[3] Reinhart and Rogoff (2009), p. 208. For an excellent review of the causes of the financial crisis, see Lo (2012). For an excellent analysis of the consequences of the crisis see Helleiner (2014)
[4] For a more direct comparison of the Great Recession with the Great Depression, see Eichengreen and O'Rourke (2012)
[5] For more detail, see Chinn and Frieden (2011), chapters 4 and 5
[6] IMF (2014), p. 180

uneven, with emerging market economies growing much faster than the advanced economies and all kinds of fault lines in the international economy remaining unresolved, another Great Depression had clearly been avoided.[7]

In Europe, however, the real crisis would only begin in 2010, one year after the ten-year anniversary of the introduction of the single currency had led ECB President Jean-Claude Trichet to praise the euro as “a large, solid, and steady ship.”[8] International relations scholars saw the euro crisis as the most significant aftershock of the global financial crisis.[9] Others have analyzed it as the first ‘real’ crisis of European integration.[10] Either way, what soon became known as the European ‘sovereign debt’ crisis shook the very foundations of the postwar European project.[11] Over twenty European crisis summits were convened over three years, often in haste, in search for a comprehensive solution. A myriad of ad hoc institutional innovations were adopted along the way, including a European Stability Mechanism (ESM), a macroeconomic imbalances procedure, a Fiscal Compact, and a banking union with single supervisory and resolution mechanisms.[12]

Though it had staged a timid recovery in 2010, growth slowed down in 2011, and the Eurozone slid back into recession in 2012 and 2013 with negative growth rates of –0.7 and –0.5 percent respectively.[13] These figures disguised the stark differences between the Eurozone’s core and periphery countries. While Germany recorded strong growth rates of 3.9 and 3.5 percent in 2010 and 2011, before slowing down in 2012 and 2013, Greece saw its GDP collapse by a cumulative 25 percent over six years (2008-2013) while its unemployment rate soared to close to 30 percent.[14] Most of peripheral Europe – including Greece, Ireland, Portugal, Spain, Italy, and Cyprus – experienced negative growth for successive years, very high and sustained levels of unemployment, and a steep rise in overall public debt levels. Southern Europe suffered another great slump, with levels of financial havoc and social devastation redolent of the Great Depression.[15]

This discrepancy – between the post-crisis performance of the global economy on the one hand and the Eurozone economy on the other – informs the central puzzle of this paper. Why was the global financial crisis, the most serious crisis to threaten the world economy since the 1930s, resolved so quickly, while the euro crisis remained well short of a comprehensive solution?[16]

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[7] Drezner (2014b), pp. 15-19. See also Kirshner (2014a) for an excellent review and critique of Drezner’s book, as well as Kirshner (2014b) for a more critical analysis of America’s role during and after the GFC.
[8] Trichet (2009)
[9] See Kahler and Lake (eds.) (2013), p. 1
[10] See Parsons and Matthijs (2015)
[11] The popular term ‘European sovereign debt crisis’ is a misnomer, however. The euro crisis was mainly a banking crisis, which only morphed into a sovereign debt crisis after large public sector bailouts converted private into public debt. See Blyth (2013), chapter 3
[12] For an overview of the euro crisis, as well as its major causes, see Matthijs (2014a)
[13] IMF (2014), p. 180
[14] Ibid., p. 181
[15] Matthijs (2014b), pp. 101-115
[16] At the time of writing, in the summer of 2014, the acute phase of the euro crisis was over, but the Eurozone economy was far from fixed and the institutional infrastructure remained incomplete. See, for example, Spiegel (2014b)

The empirical puzzle is important from a theoretical point of view, since it clashes with the rational choice deductions of Mancur Olson's "logic of collective action."[17] Olson theorized that rational actors pursuing their own material self-interests would be incapable of providing public goods due to the constant incentive to free ride. He further added that group size was inversely related to successful collective action. While larger groups "would fail to provide themselves with any collective good at all," smaller groups would struggle to deliver the collective good anywhere near the optimal level.[18] In simple terms, the larger the group, the less likely the group would be to promote its common interests. During the past two systemic crises, the larger group – comprised of all the world's national economies – actually proved capable of providing the global public goods of financial stability and economic recovery much quicker than the smaller, and more cohesive, European group at the regional level less than two years later.

The puzzle is also salient from a basic institutionalist or international regime point of view.[19] The world economy as a whole lacks the dense networks, powered by regular consultation, and supranational infrastructure that the European Union has been building for itself since the early 1950s. While the world economy is institutionally integrated in the realm of international trade through the World Trade Organization, this is not the case for international financial flows, where the International Monetary Fund has a much more narrow mandate and no functioning dispute settlement mechanism. The G-20 only became prominent after the GFC hit, and is not an international organization that has any legal standing. The EU encompasses a truly integrated common market, complete with free flows of goods, services, capital, and labor, and is permanently managed by supranational institutions in Brussels. The Eurozone, with 18 member states in 2014, has a common central bank in Frankfurt and legal mechanisms for close fiscal coordination through the Stability and Growth Pact. For those reasons, institutionalists would expect a crisis in the EU to be much easier to resolve than any global crisis.

In this paper, I will explain the contrasting outcomes in terms of: (i) U.S. willingness to act as a 'responsible hegemon' for the world economy by providing 'benign' leadership; and (ii) Germany's refusal to play an equivalent leadership role within Europe's regional context, instead acting inadvertently as a 'coercive' hegemon. By adapting 'hegemonic stability theory' and Kindleberger's critique of U.S. actions during the Great Depression to include the role of ideas, I am able to explain the divergent outcomes and renew consideration of what it takes to solve a systemic crisis, including the 'right' kind of leadership and the provision of Kindleberger's public goods.[20] This paper will causally infer exactly why the U.S. *did* and Germany *did not* define its interest as providing the system with a market for distress goods, long-term countercyclical lending, lender of last

[17] Olsen (1965)
[18] Ibid., p. 28
[19] See Krasner (1983), Keohane (1984, [2005]), and Milner (1997)
[20] Kindleberger's original list included three public goods: a market for distress goods, lender of last resort facilities, and long-term countercyclical lending (see Kindleberger (1973, [2013])). In Kindleberger (1981), he would add two more: managing "in some degree, the structure of foreign-exchange rates" and "provide a degree of coordination of domestic monetary policies." In Kindleberger (1986a), he further expanded the latter good to become "coordination of macroeconomic policies," presumably also including fiscal policy.

resort facilities, and macroeconomic policy coordination.[21] My argument thereby counters Robert Keohane's claim that "although hegemony can facilitate cooperation, it is neither a necessary nor a sufficient condition for it."[22]

For Kindleberger the main lesson of the 1930s was that the world economy needed to have a stabilizer to be in balance, "one stabilizer."[23] Keohane argued that though the existence of a hegemon could be tremendously useful in establishing international regimes, a subsequent waning of hegemonic leadership would not necessarily threaten international cooperation.[24] According to Keohane, the conditions for maintaining existing regimes were much less burdensome than those required for setting up new regimes.[25] However, Keohane did not explicitly consider the essential role of a stabilizer in times of international economic crisis: is a stabilizer needed in times of crisis if international cooperative regimes already exist, or will the regime itself take care of the crisis? The goal of this paper is to show that while leadership by the system's most powerful state is a necessary but not a sufficient condition for the system to work, the *kind* of leadership that the leading state exercises will matter a great deal for the observed outcome of any systemic crisis.

While Kindleberger was absolutely right about the need for a hegemon during crisis periods, he did not really have a convincing explanation for why a hegemon would actually play the exact role he thought it 'needed' to play. It is difficult to argue that the U.S. was somehow more threatened by the global financial crisis than Germany was by the euro crisis. Germany is far more integrated with the rest of Europe than the U.S. is with the world economy. Also, the American economy is far less dependent on international trade than the German economy. Furthermore, the Eurozone economy was being dragged back into recession in 2012 partly due to Germany's relative inaction.[26]

So, to even begin to explain why dominant states fulfill the functional need assigned to them by hegemonic stability theory (HST), we must look beyond their structural positions and functional challenges, and consider their governments' ideas. In order to answer the question why any given hegemon chooses to play either a 'benign' or 'coercive' leadership role – or 'no' leadership role at all – we need an ideational approach within the context of a hegemon's domestic and structural constraints. In the cases of the U.S. and Germany during the GFC and euro crisis respectively, I will show that their governments did indeed perceive and define their leadership roles very differently, and held distinctive ideas that would inform their crisis responses in very different ways.

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[21] Kindleberger (1986a), chapter 14, pp. 288-303. I will omit 'stable exchange rates' from this list, since it makes less sense to include in a world economy with flexible exchange rates (post-Bretton Woods), and the Eurozone is by definition a fixed exchange rate regime, with one single currency.
[22] Robert O. Keohane (1984, [2005]), p. 12
[23] Kindleberger (1986a), p. 304
[24] Keohane (1984, [2005]), p. 50-51
[25] Ibid., p. 50
[26] Radoslaw Sikorski, Poland's foreign minister, even declared in 2012 that he feared Germany's power less than its inactivity. See Bulmer and Paterson (2013)

The paper proceeds in six sections. The next section analyzes the different crisis narratives that took hold over policy elites in the U.S. and Germany, and the ideas they held about systemic leadership that would inform their policy response. Section three gives a brief review of the HST and international regimes literature, while section four sets out the paper's theoretical framework, adapting Kindleberger's original insight on the importance of leadership in public goods provision to include economic ideas within the framework of the dominant state's structural and domestic constraints. Section five gives a theoretically informed empirical assessment of U.S. public good provision during the GFC, and section six does the same for Germany during the euro crisis. Section seven concludes.

2. Washington vs. Berlin: Different Narratives and Ideas about Leadership

Eric Hobsbawm summed up the U.S. government's management of the Great Depression during the 1930s as follows: "Never did a ship founder with a captain and a crew more ignorant of the reasons for its misfortune or more impotent to do anything about it."[27] Kindleberger observed that "[t]he World Economic conference of 1933 did not lack ideas […]. But the one country capable of leadership [the U.S.] was bemused by domestic concerns and stood aside."[28] One cannot help but think of Germany's behavior during the first three years of the euro crisis when reading these two quotes, while at the same time noticing that the United States in 2008 somehow managed to avoid the mistakes it had made during the late 1920s and early 1930s.[29] Why did both leading states – the U.S. during the GFC and Germany during the euro crisis – read the script so differently? What made them act in opposite ways in an otherwise similar situation of systemic crisis?

It would be fair to assume that economic policy elites in the U.S. and Germany do not have copies of Kindleberger's books lying around on their desks. But interestingly enough, some of the most powerful policymakers in both Washington and Berlin actually *did* read Kindleberger and stated publicly that his ideas were a major influence on their thinking.[30] Larry Summers, U.S. President Obama's chief economic adviser during the crisis, told Martin Wolf in an interview in 2011 that the most useful economics in dealing with the GFC was not to be found in the academic mainstream, but in the work of Walter Bagehot, Hyman Minsky, and "perhaps more still in Kindleberger."[31] Summers played a key role in crafting Obama's crisis response, including the fiscal stimulus of spring 2009.

Also Wolfgang Schäuble, Germany's finance minister from late 2009 onwards and one of the main architects of Europe's crisis response, read Kindleberger's *The World in Depression*, and strongly believed that its "central message [was] more important in 2010 than ever before."[32] In a speech at the Sorbonne in Paris in November 2010, he proclaimed: "A stable world economy does not materialize 'by itself.' It is a public good,

[27] Eric Hobsbawm (1968, [1999]), p. 190
[28] Kindleberger (1986a), p. 298
[29] See also Delong and Eichengreen (2013)
[30] See especially Kindleberger (1978, [2012])
[31] As quoted in Delong and Eichengreen (2013), p. 6. The interview at INET's Bretton Woods conference in 2011 can be viewed online at https://www.youtube.com/watch?v=Vgg5DoPkgYc
[32] Kundnani (2012)

that must be provided in the face of national self-interest. For the world economy to be stable, it requires a leading nation, a benign hegemon or 'stabilizer.'"[33] Schäuble continued to explain that he thought France and Germany once again needed to take up the leadership mantle in Europe, and "lead by example." By that, however, he did not mean actually provide the public goods Kindleberger had in mind. What he had in mind was for Germany and France to live by the letter of the EU's Stability and Growth Pact, abide by its rules, and implement their self-imposed (German) role model at home.[34]

Summers and Schäuble both studied Kindleberger's teachings, yet both men had internalized fundamentally different interpretations. Based on their actions during the GFC, most of America's economics and financial establishment – including Ben Bernanke, Timothy Geithner, and Christina Romer – had a completely different understanding of what the U.S. government should do during the GFC compared to the German establishment – including Angela Merkel, Axel Weber, and Jens Weidmann – during the euro crisis. The governing elites in both countries simply held different ideas about the proper conduct of economic policy during periods of financial crisis.

One can argue that the main reason for the discrepancy in policy responses between Washington and Berlin is that the GFC and the euro crisis were fundamentally different animals. There was never any doubt about the fact that the GFC was rooted in the U.S. housing market, hence it should be no surprise that the U.S. ended up shouldering a disproportionate share of the financial burden. Unlike the Eurozone, the United States also has substantial structural advantages. The U.S. is home to the world's international reserve currency, the dollar, and the rest of the world continued to hold dollar assets during the GFC. Indeed, the dollar strengthened during the crisis. The United States also has a very different political system than the Eurozone, having only one finance minister and one central bank governor with significant discretionary powers and a clear mandate to act as lender of last resort during a crisis. It the U.S. had not acted in the fall of 2008, the global financial system may well have collapsed.

The conventional narrative in Germany about the euro crisis was very different, with the 'sovereign debt crisis' caused by profligate spending in the Eurozone periphery, whose member states therefore needed to pay the price by implementing austerity policies and structural reforms. During the euro crisis, the rest of the world refused to hold certain euro denominated assets, especially the sovereign bonds of the periphery, initially weakening the euro. The Eurozone at the time had 17 finance ministers who needed to coordinate their actions, and a European Central Bank with no real legal lender of last resort powers and a president whose hands were tied by the Treaty of Maastricht. In other words: the U.S. and Germany were different hegemons in different systems. They simply responded to their incentives and did what was in their interest to do.

While this observation is fair to some extent, it fundamentally misses the point of leadership during systemic crises. The main point is not that Germany did not provide any leadership during the euro crisis. By all means, it did. There was no doubt in

[33] Schäuble (2010), translated from German.
[34] Ibid.

anyone's mind that Germany was the Eurozone's indispensable member state, just as much as the U.S. held that position in the world economy in 2008. Yet, the kind of leadership it provided in Europe, steeped in ordoliberal thinking and based on following financially orthodox rules, was qualitatively the opposite of the leadership the United States offered the world economy two years earlier, which was characterized by Keynesian discretion rather than any fixation on rules. Different ideas held by national elites and different levels of pragmatism and policy flexibility in both countries explain the variation in outcomes of otherwise relatively similar systemic crises.[35]

Larry Summers was an early advocate of "spurring demand around the world" to fight the Great Recession.[36] Ben Bernanke, chairman of the federal reserve, declared in August 2009 that "[u]nlike in the 1930s, when policy was largely passive and political divisions made international economic and financial cooperation difficult, during the past year monetary, fiscal and financial policies around the world have been aggressive and complementary."[37] Bernanke went on to stress that without the Fed's "speedy and forceful actions … the entire global financial system would have been at serious risk."[38] Finally, Christina Romer, chairman of Obama's Council of Economic Advisers in 2009 and 2010, underlined her Keynesian credentials by stating that the lessons from the Great Depression for the U.S. were to increase the domestic money supply in order to "lower world interest rates and benefit other countries, rather than to just shift expansion from one country to another."[39] Romer argued in March 2009 that "[t]he more countries throughout the world can move toward monetary and fiscal expansion, the better off we all will be."[40]

The United States' response to the GFC was to reverse a global downturn through a combination of a large fiscal stimulus, monetary easing, countercyclical lending, and the full use of the Federal Reserve's powers as a global lender of last resort. While it could have blamed a global savings glut and Chinese currency manipulation for causing the crisis, U.S. government officials realized that the rest of the world's lack of spending was equal to America's overspending, and excess savings abroad were balanced by excess investment in the U.S. housing market. Rather than trying to push the burden of adjustment onto the rest of the world, which it easily could have done, the U.S. government refused to play the blame game. Once the crisis hit in 2008, the U.S. kept its markets open, and agreed to bear a disproportionate share of the global adjustment cost. Through its discretionary actions, the U.S. established new norms for the world economy, based on freedom of action and flexibility, responding in a pragmatic Keynesian rather than dogmatic and orthodox way.

Germany's management of the euro crisis was almost the exact opposite. The German response to the pending Greek default in 2010, and to the contagion to other periphery

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[35] See, for example, Berman (1998), Blyth (2002), and Matthijs (2010)
[36] Summers (2009)
[37] Bernanke (2009)
[38] Ibid.
[39] Romer (2009)
[40] Ibid.

countries later that year and in 2011 was a moralizing one, dividing up the Eurozone in fiscal sinners and budgetary saints.[41] Rather than choosing to analyze the crisis as a doing damage to its future exports or stressing the risk of financial contagion, the German government preferred to warn against the risk of moral hazard if the Northern core countries were too generous in bailing out the Southern periphery countries.[42] It is more than ironic that German savings during the boom years made periphery overspending possible, and that periphery overspending fueled German growth, giving it the moral high ground during the crisis and put it in the position of Europe's most dominant state. Overspending, too little saving and too much borrowing by the Greeks was the flip side of the coin of under spending, too high savings, and too much lending on the part of the Germans. There is no truth in arguing that the 'sinful' periphery was solely at fault, while the 'virtuous' core was blameless.

German finance minister Schäuble, in a 2012 editorial in The Wall Street Journal, summed up his government's view: "Moral hazard is not benign. Setting the wrong incentives would mean stabbing reformist governments in the back. By suggesting that uncompetitive economic structures can endure, we would buoy the populists, scapegoat-seekers and illusion-peddlers who lurk at the fringes of our political landscapes. By discouraging reform, we would not solve Europe's imbalances but make them permanent."[43] Furthermore, Jens Weidmann, president of the Bundesbank, outright rejected the idea of using the ECB as lender of last resort to governments. In an interview with the Financial Times, he emphasized the importance of following the rules: "I cannot see how you can ensure the stability of a monetary union by violating its legal provisions."[44] Both German economists Axel Weber and Jürgen Stark resigned from the ECB Governing Board during the course of the euro crisis in protest against the Bank's unconventional policies they saw as violating Maastricht's 'no bailout clause.'

Over the course of the euro crisis, the German government emphasized the importance of rules and laws over the arbitrariness and dangers of political discretion. Institutional innovations at the EU level, like the Fiscal Pact and the European Semester, only further cemented the importance of fiscal and financial rules in the Eurozone. Yet the German response initially shifted the whole burden of adjustment onto the 'deficit' countries of Ireland and the Mediterranean, by imposing austerity measures and structural reforms onto the countries that needed to be rescued financially. Germany thus acted as some sort of 'anti-Keynesian' hegemon, furthering a pro-cyclical fiscal regime, and insisting that the crisis had mainly 'national' rather than 'systemic' and international solutions.

Both the U.S. as well as Germany acted within their perceived interests during the systemic crises they faced as most powerful country within the regimes they had built.[45]

[41] Fourcade (2013) and Matthijs and McNamara (forthcoming)
[42] See Newman (2015)
[43] Schäuble (2012)
[44] Atkins and Sandbu (2011)
[45] There is, of course, a qualitative difference. While the U.S. built the new liberal economic order at Bretton Woods in 1944 primarily out of its own initiative and largely by its own design, the Germans only reluctantly agreed to Economic and Monetary Union (EMU) at Maastricht in 1991. While EMU largely

The very different ideas held by American and German policymakers about what caused their respective crises, and how to deal with it, would prove crucial for their policy responses. U.S. policy elites pushed the U.S. in the direction of acting as a 'benign' hegemon in the world economy. During the acute phase of the GFC, they felt bound to follow the path set out in Kindleberger's blueprint, shouldering the brunt of the adjustment burden. Two years later, the euro crisis narrative and the ordoliberal ideas informing German policymakers resulted in a fundamentally different interpretation of Kindleberger's definition of leadership, and explained why Germany ended up acting as a 'coercive' hegemon, emphasizing the importance of rules and creating a culcture of stability, thereby pushing the burden of adjustment onto others.

In order to place this argument more fully within the theoretical literature of hegemonic stability theory and regimes, I will first briefly review that literature in the next section, while setting up my own theoretical framework in section four.

3. Explaining International Cooperation (and the Lack Thereof) through Hegemonic Stability or Regime Theory: Brief Review of the Literature

According to Benjamin Cohen, HST was the "first genuine theory" in the field of international political economy (IPE).[46] While Keohane invented the term 'HST,' Kindleberger put forward the original thesis.[47] In an effort to go beyond the great debate between John Maynard Keynes and Milton Friedman, Kindleberger posited that the Great Depression had been caused by an absence of international leadership: "the 1929 depression was so wide, so deep, and so long because the international economic system was rendered unstable by British inability and U.S. unwillingness to assume responsibility for stabilizing it."[48] Hegemony, for Kindleberger, meant 'leadership' provided by one single country in the system that could fulfill three functions during periods of stress, including: maintaining a market for distress goods, facilitating countercyclical and long-term lending, and acting as a lender of last resort by guaranteeing enough liquidity for the overall system.[49]

Robert Gilpin subsequently developed Kindleberger's theory in the field of international relations by adding the power and security dimension, claiming that America's global public goods provision would last only as long as the benefits for the U.S. outweighed the costs.[50] In Cohen's words: "Hegemonic stability will last only so long as there are no challengers waiting in the wings."[51] Both Gilpin and Stephen Krasner argued that a hegemon was necessary to guarantee an open and stable world economy: overwhelming power by one state was needed to discipline other countries, and to make sure they did

tailored to German preferences, Germany never fully accepted its 'leadership' role in EMU: fiscal and inflation rules would replace the need for leadership, was the logic in Germany at the time.

[46] Cohen (2008), p. 67

[47] Ibid., p. 68.; for a complete review of the evolution of HST as a theory, see pages 67-79

[48] Kindleberger (1973, [2013])

[49] Kindleberger would later add two more: 'stable exchange rates' and 'coordination of macroeconomic policies.' See Kindleberger (1986a), p. 289. See also footnote 21.

[50] Gilpin (1981), p. 9

[51] Cohen (2008), p. 73

not resort to 'beggar-thy-neighbor' policies. Unsurprisingly, Gilpin and Krasner associated hegemonic decline with systemic instability and the potential reassertion of rival regional blocs.[52]

By the mid-1980s, the United States became obsessed with relative decline, but the global economic turmoil triggered by the OPEC oil shocks of the mid-1970s had not caused a collapse in the world economy, at least not anywhere near the chaos of the 1930s. Despite declining U.S. hegemonic power, the global "embedded liberal" system it had created proved to be robust and enduring.[53] It was thus not obvious that hegemony was a necessary or even sufficient condition for global stability. Hence, HST began its own decline, especially after being challenged head on by Robert Keohane, who was quickly joined by Duncan Snidal and Barry Eichengreen.[54] For Keohane, HST ignored the central role that international institutions play in providing information to states about each other's behavior, reducing the cost of negotiating agreements, and exposing (sometimes even punishing) violations of prior agreements by states.[55] Once international regimes are in place, they tend to take on a life of their own. Cooperation continues to take place without hegemony through a coalition of important states. For Keohane, "there [was] little reason to believe that hegemony [was] either a necessary or sufficient condition for the emergence of cooperative relationships."[56]

Snidal extended Keohane's critique of HST, and asserted that collective action could substitute for hegemony in the quest for international cooperation. Snidal identified two strands of HST: the "benevolent strand" where all participants in the international system were made better off by the benign actions of the dominant power, and the "coercive strand" where the benefits of stability accumulate disproportionately or even exclusively to the hegemon, either because systemic equilibrium is not a purely public good or because its costs are thrust upon the smaller states.[57] Like Snidal, David Lake also thought it valuable to divide HST into two distinct theories, classifying them as "leadership theory" and "hegemony theory."[58] Lake thought that HST, despite its prominence in the field of international relations during the 1970s and 1980s, had yet to "put its best possible 'model' into the competition."[59]

By 1998, Helen Milner called for the field of IPE to "move beyond" HST.[60] In addition to Keohane's role for international institutions, she stressed the power of values and the social construction of state identity, and how those can constrain state choices and propel states towards certain behaviors.[61] Milner also emphasized the impact of domestic

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[52] Gilpin (1975), Gilpin (1981), Krasner (1976), and Milner (1998)
[53] Ruggie (1982)
[54] Snidal (1985), Eichengreen (1989)
[55] Keohane (1984, [2005]), chapter 6, pp. 85-109. For a response, see Kindleberger (1986b).
[56] Ibid., p. 31. One dissenting voice during the 1980s was that of Susan Strange, who argued that it was nothing more than a myth that the U.S. had lost its hegemonic power over the system. See Strange (1987)
[57] Snidal (1985), pp. 585-590
[58] Lake (1993), pp. 459-460
[59] Ibid., p. 462
[60] Milner (1998), pp. 112
[61] See Goldstein and Keohane (eds.) (1993)

politics and domestic political processes in defining a state's purpose, and the renewed interest in the process of globalization and its impact on state power.[62] In his 2008 intellectual history of the field of IPE, Cohen somberly observed that David Lake's 1993 ISQ article had de facto ended the debate over HST.[63] But the advent of the global financial crisis and subsequent world recession in 2008-9, as well as the precipitous rise of China, would revive the HST literature.

Michael Mastanduno in 2009 emphasized that the ability of the U.S. to be both "system maker" and "privilege taker" had required the active collaboration of other major powers. While the U.S. maintained relative openness of its domestic market and provided security benefits to its supporters, the latter absorbed and held U.S. dollars, allowing the U.S. the luxury of maintaining its preferred policy mix of guns and butter. But Mastanduno noted that, after the Cold War, the U.S. quickly became the victim of its own success: the EU felt confident enough to challenge the role of the U.S. dollar, and China and other Asian states rose quickly by taking advantage of the liberal open economic system. He doubted whether the current situation could be stable.[64] Also for Harold James, the Great Recession of 2009 had caused a structural break in the international economic and political order, and meant a transformation of power away from the U.S. towards China.[65] James noted that China had actually started to behave more like a Kindleberger hegemon, in that it had a countercyclical strategy in response to the crash, making it an engine for world economic recovery; but also in that Beijing had acted to stabilize financial markets by continuing to hold dollars and by supporting the euro.[66]

G. John Ikenberry responded that the U.S.-based global liberal order would continue after the global financial crisis.[67] The key for America's success in maintaining that liberal order was that the U.S. as a hegemon had accepted some significant constraints through its membership in various international institutions. Ikenberry claimed that the preservation and expansion of the liberal rule-based order was in the interests of the rising states and would therefore simply endure. Charles Kupchan disagreed, instead predicting the emergence of what he referred to as "no one's world." For him, the global financial crisis had caused a fundamental shift of power away from the West towards "the Rest."[68] Kupchan saw "paternal autocracy" in Russia, "tribal autocracy" in the Persian Gulf and "communal autocracy" in China emerge as alternative forms of governance.[69] The outcome would be a world in which no single state is powerful enough to establish global norms, and no coalition of states can reach a sufficient degree of consensus on the rules of the game. Miles Kahler, countering Kupchan, concluded that the rising powers had proven they were "conservatives" rather than rebels during and after the GFC. They ended up defending the status quo, driven by domestic stakeholders and based on their

[62] Simmons (1994), Milner (1997)
[63] Cohen (2008), p. 78
[64] Mastanduno (2009), pp. 153-154
[65] James (2011)
[66] Ibid., p. 536-37
[67] Ikenberry (2011)
[68] Kupchan (2012)
[69] Ibid., chapter 5

national economic interests. Kahler did, however, warn that another large shock in the future could make regional options more attractive.[70]

Daniel Drezner, in his analysis of the global response to the Great Recession and the surprising resilience of global governance thereafter, argued that the system had worked.[71] While the initial shocks were more severe than the Great Depression, both national policy elites and multilateral economic institutions responded with remarkable speed and vigor.[72] However, while Drezner argued that Kindleberger's global public goods were all provided during the Great Recession, he stopped short of explicitly giving credit to the U.S. for providing them, or for it having been a necessary condition for the system to work. Eric Helleiner also argued that the strange result of the GFC was not radical change but the 'status quo' of the system, generated mainly by the structural power and active policy choices of the United States.[73] Finally, Jonathan Kirshner saw the GFC as a much bigger failure of the system compared to Drezner, while also observing much more dramatic change than Helleiner. For Kirshner, the GFC brought an end to the "second postwar American order" as it undermined the legitimacy of that order's economic ideas, and also meant an acceleration of U.S. relative decline and other non-Western powers' rise.[74]

What so far remains missing in the literature, however, is a comprehensive assessment or persuasive theoretical explanation of the differing leadership styles and policy choices of any given dominant state or hegemon during periods of systemic crisis, both at the global and regional level. I try to fill this gap in the next section.

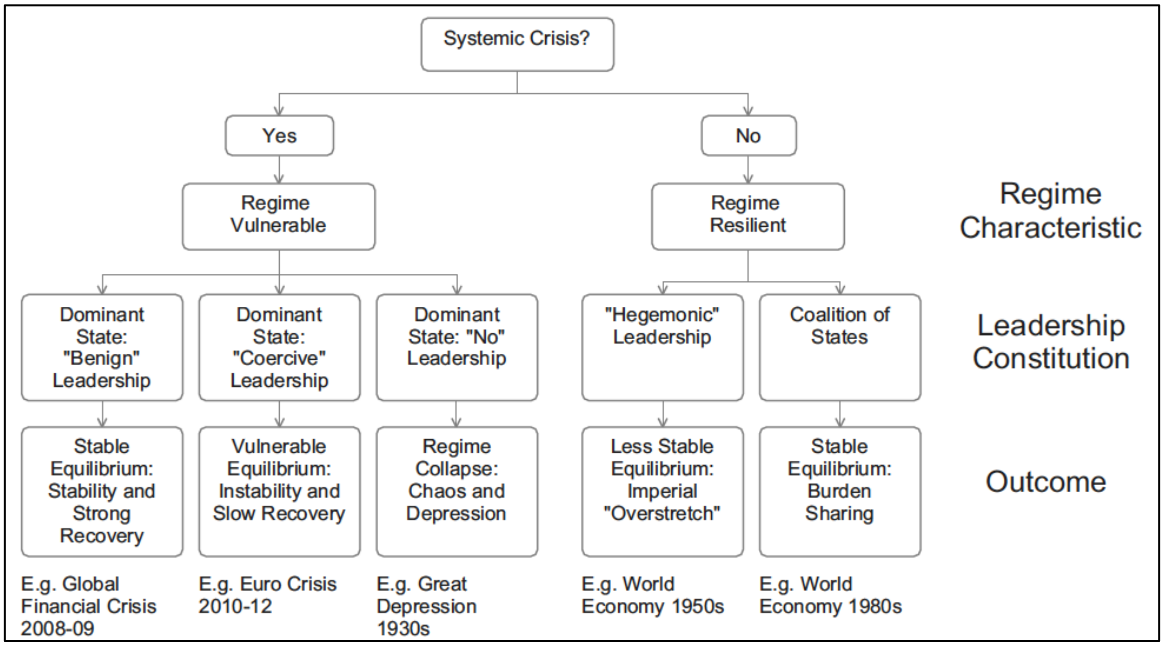
4. Theoretical Framework: Hegemonic Stability, Leadership, and Ideas

Leadership Theory: 'Benign' Public Goods Provision vs. 'Coercive' Rule Assertion

The main theoretical argument that follows modifies the 'leadership' tradition or 'public goods' version of HST to allow for the role of ideas in explaining what kind of leadership leads to different outcomes, and is schematically summarized in figure 1. The starting point is that over the natural life course of different international economic systems or regimes – be it the postwar economic system built by the U.S. at Bretton Woods, or regional international regimes such as the EU, the Eurozone, or ASEAN – there are two possible situations within which a regime can find itself. Either the regime is grappling with a systemic crisis rife with uncertainty over the potential outcome, or alternatively, and most of the time, it will only have to cope with day-to-day and mostly calculable risks and challenges. In the first case (figure 1, left arrow) the regime will be vulnerable and may be teetering on the brink of collapse, while in the second case (figure 1, right arrow) the regime will be resilient and can therefore rely on standard operating procedures and existing rules to continue its smooth functioning.

[70] Kahler (2013)
[71] Drezner (2014a) and Drezner (2014b)
[72] Ibid.
[73] Helleiner (2014)
[74] Kirshner (2014b)

Figure 1: International Economic Regimes: Systemic Crisis, Leadership, Outcomes



In the absence of any systemic crisis, for the regime to maintain its resilience, leadership of the system is still necessary. Keohane himself re-emphasized this point in 2012: "we know that in the absence of leadership, world politics suffers from collective action problems as each state tries to shift the burdens of adjustment to change onto others."[75] Of course, leadership can either be provided jointly, by a 'coalition of states' (e.g. the world economy during the 1980s, governed by a coalition of the U.S., the European Community, and Japan), or through 'hegemonic' leadership (e.g. the U.S. and the world economy in the 1950s).

Leadership by a coalition of states – à la Keohane – will prove less troublesome for the regime than hegemonic leadership, since the burden of public goods provision is shared more evenly among the main stakeholders of the regime, creating a relatively stable and balanced equilibrium. Hegemonic leadership – à la Gilpin – will sow the seeds and gradually create the conditions for the hegemon's own decline, since the hegemon will begin to suffer from continuing to bear an uneven and disproportionate burden of public goods provision while free riding by the other states increasing over time. This lack of burden sharing will undermine the hegemon's capacity to continue to provide hegemonic leadership, as it eventually falls into the trap of what Paul Kennedy described as "imperial overstretch."[76] In the case of hegemonic leadership, the regime will be broadly resilient initially but will be operating under a progressively less stable equilibrium, as there is no real balance between the regime's major stakeholders.[77]

[75] Keohane (2012)
[76] Kennedy (1987)
[77] See Kindleberger (1996), pp. 223-228 on whether one power's decline is followed by the rise of another.

In times of systemic crisis – the main focus of this paper – the regime will be vulnerable, and for it to survive and prosper, leadership by the dominant state is a necessary but not a sufficient condition. The pre-existence of a working international regime or supranational institution is not enough to guarantee that the system will continue to work: its most powerful state needs to step up during such a crisis, and save the system from itself.

My argument is based on the assumption that the regime will suffer from Olson's collective action problem due to the panic that tends to break out in the midst of systemic uncertainty, and will therefore underprovide the necessary public good of economic and financial stability. The leading state, which stands to gain the most from the regime's survival, will need to coordinate and deliver the system's public goods itself. Under this scenario of systemic crisis, the key question is whether the dominant state provides leadership that is 'benign' (in the liberal institutionalist tradition), 'coercive' (in the realist tradition), or 'non existent.'[78] In the words of David Lake: "When benevolent, the leader provides the international economic infrastructure unilaterally, or at least bears a disproportionate cost of providing the public good, and thereby gains relatively less than others. When coercive, the leader forces other, smaller states to contribute to the international economic infrastructure and, at an extreme, to bear the entire burden."[79] In the third possible scenario, where there is an absence of dominant state leadership, the regime will most likely collapse and die, as the international gold standard and liberal trading regime did over the course of the 1930s.

Under the first scenario where the dominant state chooses to practice 'benign leadership,' Kindleberger's original argument holds. Benign leadership manifests itself when the state in question can to some degree provide all Kindleberger's relevant public goods, including: keeping its domestic market open for the purchase of distress goods; facilitating countercyclical, stable, and long-term lending; acting as a lender of last resort by providing liquidity to countries and systemic financial institutions in need; and overseeing the coordination of macroeconomic policies.[80] This is the only realistic scenario in the event of a systemic crisis that will produce a stable equilibrium of the regime: stability will return relatively quickly and the recovery will be robust. As I will show in section five, this is the scenario that played out during the global financial crisis, with the United States providing benign leadership for the international system.

Under the second scenario where the hegemon chooses to practice 'coercive leadership,' the dominant state will try to push the main burden of adjustment onto the weaker states, and shirk its responsibilities as a stabilizer. The dominant state will refuse to coordinate macroeconomic policies in Kindleberger fashion, serve as a consumer of last resort, or provide countercyclical lending and lender of last resort facilities. Rather, it will use its position of power to dictate its own rules of adjustment to the other states of the regime,

[78] Yarbrough and Yarbrough (1992)
[79] Lake (1993), p. 467
[80] Kindleberger (1986a), p. 289. I will exclude 'stable exchange rates' from my analysis as it has less importance in a world dominated by floating exchange rates, while it is irrelevant within the Eurozone, which abolished exchange rates between member states by introducing one single currency, the euro.

which may serve its short-term interests, but will do much to weaken the regime over the longer term. This outcome will result in a much more vulnerable equilibrium: system instability will remain endemic and recovery will be anemic. I will show that this scenario occurred during the euro crisis of 2010-13, with ‘surplus’ Germany initially refusing to allow the ECB to act as a true lender of last resort. Furthermore, by imposing deflationary policies of austerity and structural reform on the countries that were hit most severely by the crisis, Germany ended up pushing the main burden of adjustment onto the ‘deficit’ countries, which prolonged the economic pain of the crisis.

In sum, while regimes and institutions enhance predictability, they occasionally fail. In that case, the regime needs leadership and freedom of action.[81] The rules of the game may need to be changed altogether. The existence of hegemonic leadership is necessary for the regime to survive a systemic crisis, but it needs to be practiced in a ‘benign’ rather than a ‘coercive’ way for the system to return to some sort of stable equilibrium. And exactly what kind of leadership the hegemon will practice is where the role of ideas during times of uncertainty comes in as our key explanatory variable.

It is no coincidence that Kindleberger, an economic historian in the Keynesian tradition of MIT, wanted the system’s leading state to provide certain *specific* public goods.[82] His three original 1973 public goods – serving as a *consumer* of last resort (“market for distress goods”), *investor* of last resort (“countercyclical” and “long-term lending”), and *lender* of last resort (“providing liquidity in financial crisis”) – are all three unmistakably “Keynesian:” their goal is to stimulate the system’s aggregate demand. The two other public goods he added in 1986 – policing a relatively stable system of exchange rates and managing the coordination of macroeconomic policies – still leave significant room for interpretation. A stable system of exchange rates is primarily aimed at avoiding competitive devaluations that resulted in the beggar-thy-neighbor policies of the 1930s, is less relevant for today’s world, and will therefore be omitted from the analysis. Coordinating macroeconomic policies can be interpreted either as joint stimulus, joint austerity, or stimulus for the ‘surplus’ countries and austerity for the ‘deficit’ countries.

The existing literature on HST has clarified the options for hegemonic stability and leadership very effectively. However, ultimately the literature does not really provide a convincing explanation – in general, or in specific cases – for why one of these scenarios actually ends up playing out. During a time of crisis, how do dominant states define their interests and how do they perceive and fulfill their leadership role? As I have illustrated in section two, and as I will further demonstrate in the next two sections, the kind of leadership provided by the most powerful state in the system – be it either ‘benign’ or ‘coercive’ – and the actions undertaken, will heavily depend on the economic ideas policymakers hold about the causes of the crisis and whether they define leadership as leading by example (by following existing rules), or use discretion to provide public goods (thereby paying a disproportionate share of the financial burden).

[81] Jones (2009), pp. 243-252

[82] Kindleberger would have flinched at being called a ‘Keynesian’ however. He thought the labels counterproductive and missing the overall agreements in economics. Nevertheless, his solutions to a systemic crisis today would fall under the broader Keynesian umbrella.

If the government of the dominant state is broadly pragmatic and Keynesian in its economic orientation, it will more than likely follow Kindleberger's recommendations, and act or continue to act as a consumer, investor, and lender of last resort. Coordinating macroeconomic policies in that case will mean coordinating fiscal and monetary stimulus in the short term to stop any further slide into recession (with the risk of inflation), and a rebalancing of demand between deficit and surplus countries in the medium term, when recovery is already well under way. If the government of the dominant state is more neoclassical, financially conservative and economically orthodox in its conduct of economic policy – in the tradition of former U.S. Treasury Secretary Andrew W. Mellon – it will largely act upon those economic ideas, and stress the need to balance budgets, cut spending, bring down overall debt burdens, maintain low inflation, and "purge the rottenness out of the system."[83] Coordinating macroeconomic policies in this case will mean exercising monetary and fiscal restraint, relying on market forces for prices to adjust, with the risk of deflation and stagnation in the short to medium term.

Two New Empirical Cases

As early as 1993, David Lake complained that both "leadership and hegemony theory remain poorly articulated."[84] He encouraged future scholarship to come up with more causal propositions, add missing variables, and conduct more empirical tests, but to avoid under specification and over extension.[85] The next two sections of this paper respond to Lake's call and are an effort to add more empirical flesh to the theoretical bones of the above framework. Both the GFC and the euro crisis have been analyzed extensively through various lenses.[86] However, the crises were too serious and the consequences too severe to remain within the narrow confines of discussions focused on technical fixes and political bargaining, or the broad parameters of general observation.

As I will show in the next section, the global financial crisis was a direct challenge to the decline of the leadership version of hegemonic stability in IPE. The global economy as a system has a relatively weak institutional framework, especially compared to the European Union. But with 22 percent of total world GDP in 2007, the United States was the only state in the world system that proved able and willing to provide global public goods, which had a positive transmission impact on the world's emerging markets. Because of its decisive actions, a second Great Depression could be avoided.[87] Almost as a *deus ex machina*, hegemonic stability theory saved the day.

While the theory of hegemonic stability has traditionally been tested for the global system, there should be no reason why it could not apply to the European subsystem. First of all, the Eurozone is a regional economic regime with its own currency and

[83] As quoted in Eichengreen (1992), p. 251
[84] Lake (1993), p. 485
[85] Ibid.
[86] For the U.S. role during the GFC, see Drezner (2014b), Helleiner (2014) and Kirshner (2014b); for Germany's role during the euro crisis, see Bulmer and Paterson (2013), Matthijs (2014a) and Newman (2015)
[87] IMF (2014) and own calculations

monetary policy, but with different national fiscal policies, and no political union or supranational economic government. Because of the lack of any central government in Europe, the logic of collective action applies. Secondly, the Eurozone as a whole today is a relatively closed and self-sustaining economic regime, with only about 11 percent of its overall GDP accounting for extra-Eurozone imports in 2009, when it was also broadly in balance with the rest of the world. Thirdly, Germany, with close to 28 percent of overall Eurozone GDP, was the only country capable of providing effective leadership.[88] The 'coercive' leadership style and ordoliberal rules Germany adopted over the course of the euro crisis, as illustrated in section six, would prove decisive for the Eurozone's lackluster economic performance.

5. America's 'Benign' Leadership during the Global Financial Crisis (2008-09)

The actions of the U.S. government, both fiscal and monetary authorities, during the late 2000s stand in stark contrast to U.S. inaction in the late 1920s and early 1930s, when a 1929 stock market crash on Wall Street led to a global systemic collapse and the long slump of the 1930s. In order to assess U.S. actions, I will analyze America's record in providing four public goods: (1) market for distress goods, (2) countercyclical long-term lending, (3) lender of last resort, and (4) macroeconomic policy coordination.[89] The full extent of public goods provision by the United States during the Great Depression – when it was able but unwilling to lead – and the Great Recession – when it was able *and* willing to lead – are directly compared in table 1.

Table 1: United States Leadership: Great Depression (1930s) vs. Great Recession (2008-09)

Kindleberger's Public Goods	Great Depression, 1930s	Great Recession, 2008-09
U.S. Consumer of Last Resort (Distress Goods)?	✗ *(Smoot Hawley Tariff, 1930)*	✔ *(Resisted Protectionist Temptation)*
U.S. Countercyclical, Long-Term Lending?	✗ *(K Flow Reversal, Lower Lending)*	✔ *(K Flow Reversal + Fast Recovery)*
U.S. Lender of Last Resort (LoLR)?	✗ *(Fed only LoLR for U.S. economy)*	✔ *(Fed Swaps w/other Central Banks)*
U.S. Coordination of Macroeconomic Policies?	✗ *(London Economic Conference)*	✔ *(G-20 Summits in 2008 and 2009)*

First, while the United States responded to the Great Crash of 1929 by unilaterally imposing the 1930 Smoot-Hawley tariff on the rest of the world – increasing the price of all imported goods by an average of 40 percent – it managed to resist the many protectionist temptations after the credit crunch of 2008. Many analysts agree that the lack of any real upsurge in protectionist measures – least of all by the United States – was one of the more extraordinary aspects of the Great Recession. They give the WTO and the multilateral trading system, including its binding dispute settlement mechanism, much of the credit for it.[90]

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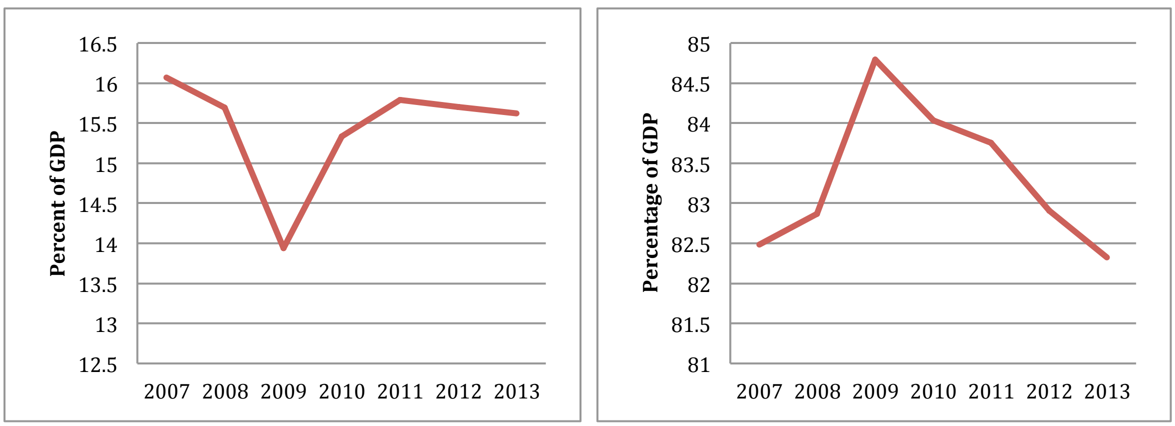
[88] Ibid.; European Commission (2014), *Ameco Database*.
[89] See footnotes 21 and 49.
[90] For an overview of those accounts, see Drezner (2014b), pp. 39-42

While this is undoubtedly correct, few have pointed out explicitly that the United States played a major role in this. It was the U.S. under President Bush after all that convened the inaugural G-20 summit for heads of state in Washington, DC in November 2008. In the communiqué of that summit, their joint commitment to free trade was stated in no uncertain terms: "We underscore the critical importance of rejecting protectionism and not turning inward in times of financial uncertainty. In this regard, within the next 12 months, we will refrain from raising new barriers to investment or to trade in goods and services, imposing new export restrictions, or implementing … (WTO) inconsistent measures to stimulate exports."[91] These pledges were repeated during the G-20 summits of London in April and Pittsburgh in November 2009.[92] Protectionism did not return.

Figure 2: U.S. Imports and Total Consumption, 2007-2013[93]

(a) Evolution U.S. Imports (% of GDP)

(b) Total Consumption (% of GDP)



While the share of U.S. imports to its GDP fell from 16 percent in 2007 to 14 percent in 2009, it surged back to 15.3 percent in 2010 and close to 16 percent in 2011. U.S. consumption increased from an already high percentage of 82.5 percent in 2007 to an absolute peak of 84.8 percent of its GDP in 2009, before gradually returning to around 82 percent by 2013 (figure 2). This last point underscores the United States' role as consumer of last resort: it delivered on public good #1 and, despite the deep recession it found itself in, and continued to serve as the world's market for distress goods. President Obama himself stressed the point in September 2009: "In Pittsburgh, we will work with the world's largest economies to chart a course for growth […] That means taking steps to rekindle demand so that global recovery can be sustained."[94]

Next, we look at public good #2 ("countercyclical long-term lending") together with #3 ("lender of last resort"), as they are closely related. The U.S. central bank, the Federal Reserve, played a major role in providing liquidity, but so did U.S. private investors, who took their money abroad in massive amounts in 2009 in search of higher yields. Also, the

[91] New York Times (2008)
[92] IMF (2009) and G-20 (2009)
[93] European Commission (2014*), Ameco Database*
[94] Obama (2009)

U.S. government used its voting power in the IMF and leadership role in the G-20 to advocate for a tripling of IMF lending capacity to $750 billion. Figure 3 neatly shows the evolution of U.S. financial flows during the crisis years. While U.S. private financial outflows (in blue) virtually come to an end in the third and fourth quarters of 2008, when one can observe massive private inflows into the U.S. from abroad as part of the 'flight to safety' into the U.S. dollar, these flows went into reverse during the first two quarters of 2009. But while private financial outflows suddenly stopped in the second half of 2008, they were replaced by U.S. government flows (in purple) during that time period, also known as Federal Reserve Swaps. By early 2009, the (purple) U.S. government flows already started going into reverse as foreign central banks honored their commitments to the Fed by paying back those loans.

Figure 3: U.S. Net Financial Flows (1991-2012)[95]

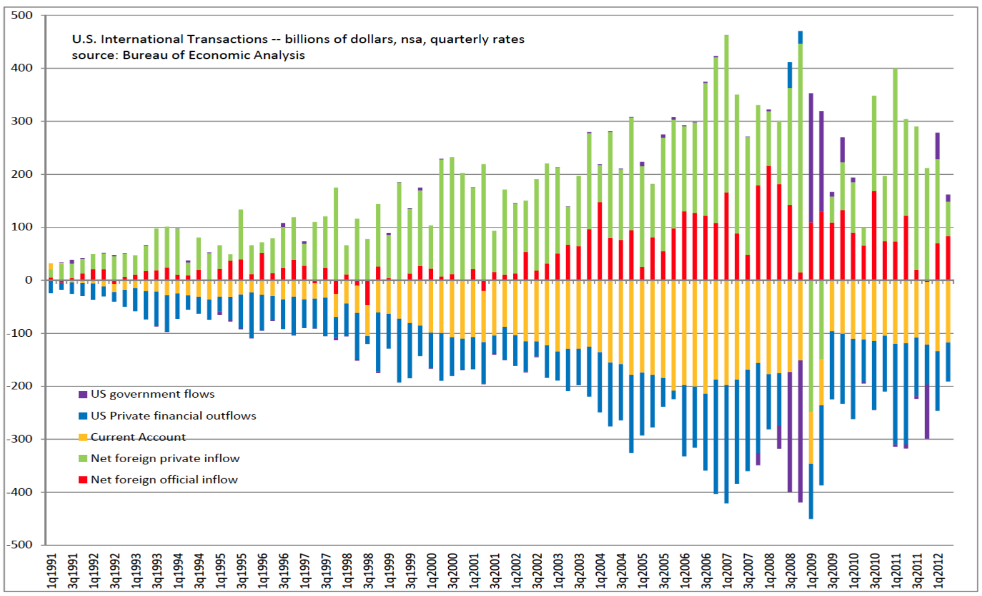


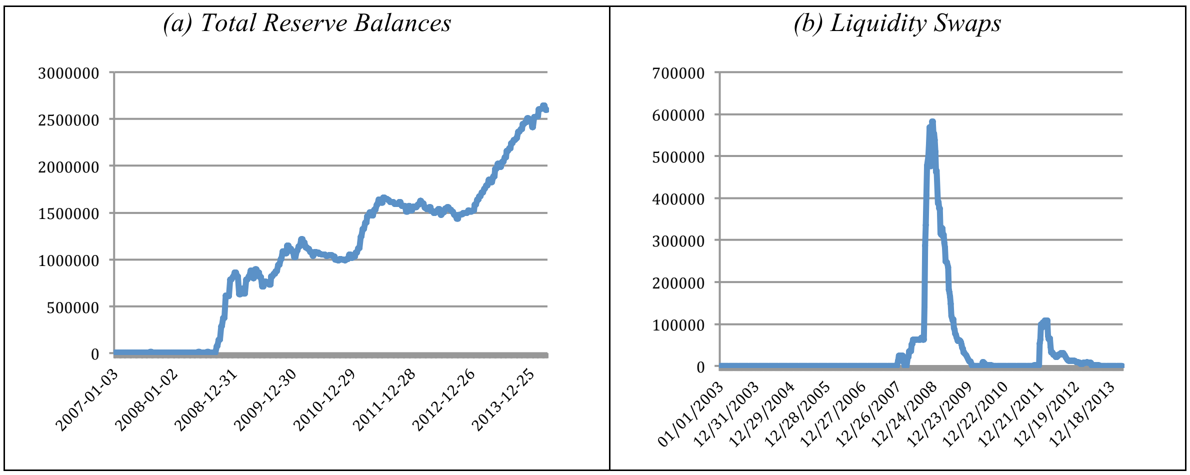
Figure four shows the liquidity activities of the Federal Reserve in a bit more detail. Not only did the Fed aggressively cut interest rates in response to the market panic that broke out after the bankruptcy of Lehman Brothers, it also expanded its balance sheet through multiple rounds of quantitative easing (QE), as illustrated on figure 4 (a). While the Fed's total liabilities were around $800 billion in early September 2008, those had grown to more than $2 trillion by the end of 2009. By buying up all kinds of agency debt and mortgage backed securities (MBS) from distressed financial institutions, many of which with substantial business and investments overseas, the Federal Reserve not only restored confidence in the global financial system, but also enabled its banks to start the painful process of deleveraging.

Furthermore, the Fed was literally the only institution in the world capable of functioning as a global lender of last resort. Between December 2007 and February 2010, the Fed made liquidity swap lines available to the European Central Bank, Bank of Canada, Bank

[95] Marquez (2014), data from *Bureau of Economic Analysis* (BEA), design from Charles Thomas.

of England, Bank of Japan, and the central banks of Australia, Brazil, Denmark, Korea, Mexico, New Zealand, Norway, Singapore, Sweden, and Switzerland.[96] By the end of November 2008, the total amount of outstanding Fed credit lines to the world amounted to a whopping $600 billion, almost as high as the Fed's own entire balance sheet prior to the crisis, as shown in figure 4 (b).[97] On top of the swaps, Helleiner added that "the Fed provided liquidity directly to troubled foreign financial institutions by allowing their US branches and subsidiaries access to its discount window and enormous emergency facilities during the crisis."[98] Bernanke commented in 2010 that the Fed "played a key role […] by providing backstop liquidity to a range of financial institutions as needed to stem the panic."[99]

Figure 4: Federal Reserve: Lender of Last Resort (2007-2009)[100]



Finally, public good #4, the coordination of macroeconomic policies globally, was most successful in 2008 and 2009 under the auspices of the G-20. As Dan Drezner has pointed out, "[t]he combined G20 stimulus in 2008 and 2009 amounted to approximately $2 trillion – or 1.4 percent of global economic output," which gave a substantial boost to global growth, estimated around 2 percent.[101] But again, the important point here is not so much that the system as a whole worked, but that the system could not have worked without the United States. Of the impressive $2 trillion in extra global fiscal spending, close to $800 billion was directly committed by the U.S. federal government, which adds up to almost 40 percent of the world's total stimulus. For an economy, which in nominal terms was just over 20 percent of the world's GDP at the time, the U.S. share of the stimulus was indispensable to the global regime's success. It is hard to imagine the world economy having recovered as fast without it. Also, as Helleiner has argued, most national stimulus plans were enacted because of domestic political reasons rather than any desire

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[96] For a more detailed analysis, see Helleiner (2014), pp. 38-45
[97] Federal Reserve Bank of New York (2014)
[98] Helleiner (2014), p. 41
[99] Bernanke (2010)
[100] Board of Governors of the Federal Reserve System (2014), "Total Reserve Balances Maintained" (a), and "Central Bank Liquidity Swaps held by the Federal Reserve: All Maturities" (b). Millions of dollars.
[101] Drezner (2014b), p. 45

to abide by the international regime of the G-20, making the large U.S. share all the more important for the speed of the recovery.[102] On the monetary side, the Federal Reserve had already done most of the coordinating of interest rate cuts before the G-20 had even met.

To sum up, the United States' response to the GFC could be characterized as benign leadership. Informed by Kindleberger's ideas of economic openness and pragmatic Keynesian demand management, U.S. policymakers' actions would help to bring about a relatively quick recovery of the world economy.

6. Germany's 'Coercive' Leadership during the Eurozone Crisis (2010-13)

The parallels between the United States' role during the GFC and Germany's role during the euro crisis are mostly striking because of their absence. If we assess whether Germany played a role in providing the equivalent 'regional' public goods for the Eurozone during its 2010-2013 crisis, we can only conclude that they were either underprovided or not provided at all, as summarized in table 2.[103]

Table 2: German Public Goods Provision during the Euro Crisis (2010-13)

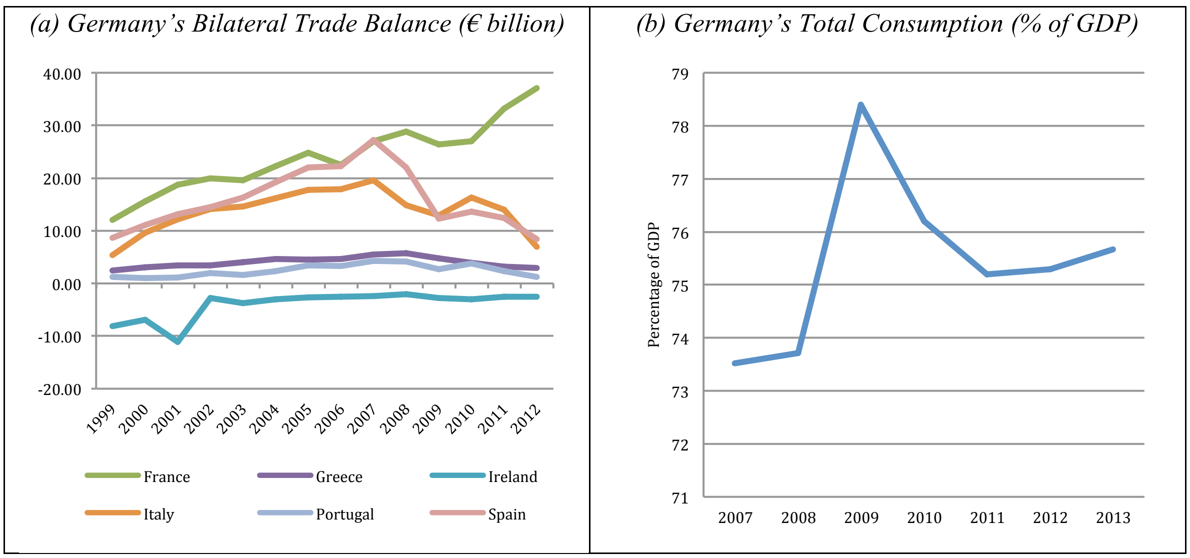
Kindleberger's Public Goods	Euro Crisis (2010-2013)
Germany: Consumer of Last Resort (Market for Distress Goods)?	✗ *(Persistent Current Account Surplus, High Savings)*
German Counter-Cyclical, Long-Term Lending?	✗ *(K Flow Reversal post Crisis, Pro-Cyclical Lending)*
Germany/ECB Lender of Last Resort, liquidity provision?	✗ then ✓ *(ECB Conditionality – even after OMT in Sept 2012)*
German Coordination of Macroeconomic Policies?	✗ *(No Stimulus, but Austerity for All)*

First, rather than providing the Eurozone's peripheral countries with a market for their distress goods, Germany continued to sell its manufactured goods to that periphery, a process which had started already in the late 1990s. According to Eurostat, while Germany's trade surplus with the rest of the EU was €46.4 billion in 2000, it had grown to €126.5 billion in 2007.[104] Looking at the evolution of Germany's bilateral trade surpluses with the Mediterranean countries, between 2000 and 2007 Greece's annual deficit with Germany grew from €3 billion to €5.5 billion, Spain's almost tripled from €11 billion to €27.2 billion, Italy's doubled from €9.6 billion to €19.6 billion, and Portugal's quadrupled from €1 billion to €4.2 billion. All those surpluses started falling after the crisis, but mainly due to a collapse in German exports to the periphery rather than a pick-up in German imports from the Mediterranean. All four countries remained in deficit with Germany in 2012. France's bilateral deficit with Germany steadily rose from €12 billion in 1999 to €37 billion in 2012 (figure 5a).

[102] Helleiner (2014), p. 30
[103] See also Matthijs and Blyth (2011)
[104] Eurostat (2010), p. 145

Germany saw its final consumption increase from 73.7 percent of GDP in 2007 to 78.4 percent in 2009 after the GFC. After 2009, however, consumption fell back to just above 75 percent in 2011, during the midst of the euro storm, and barely budged since then, staying somewhere in between 75 and 76 percent in 2012 an 2013 (figure 5b). Germany's gross savings rate increased from just above 20 percent of GDP in 2001 to almost 26.8% in 2007, after which it fell to a low of 22.5 percent during the fiscal stimulus year of 2009. But again, German savings started going up during the euro crisis, hovering around 24 percent between 2010 and 2012. Germany's current account deficit also persistently remained above 6 percent between 2007 and 2013, with the exception of 2009 when it stood at 5.9 percent. The German economy remained Europe's (and by some measures also the world's) export champion, with high savings and relatively low consumption: exactly the opposite of a consumer of last resort.

Figure 5: Germany's Trade Balance and Total Consumption[105]



Second, instead of providing the Eurozone with countercyclical long-term lending, German lending was largely pro-cyclical after the introduction of the euro. During the boom of 2003-2008, German banks extended credit on a massive scale to the periphery countries of the Eurozone, a trend that abruptly went into reverse as the euro crisis began to gather steam in late 2009. A 2010 IMF working paper on "European Financial Linkages" revealed Germany to be one of the two biggest net creditors within the Eurozone in 2008 (after France) with intra-Euro Zone net investment positions of +€735 (compared to France with +€764 billion), which was the exact mirror image of Portugal (–€136 billion), Greece (–€199 billion), Italy (–€334 billion) and Spain (–€794 billion).[106] Since the beginning of 2010, when the European periphery needed long-term loans and cheap credit more than ever, Germany's enthusiasm for credit extension – both from the private and the public sector – quickly faded away as German investors lost their appetite and started fluctuating between caution and active hostility. The credit that was extended

[105] European Commission (2014)
[106] Waysand, Ross, and de Guzman (2010)

through the ESM and the bailout programs for Greece, Ireland, and Portugal, limited Germany's share to its percentage of EU GDP, and were primarily aimed at directly helping governments finance their deficits, and were subject to strict conditionality.

Third, the public good where you could argue that Germany and the Eurozone did eventually deliver was with the lender of last resort function, though with a serious caveat. The ECB, which had been dominated by Germany and German ideas since its inception, was initially not allowed to act as a real lender of last resort by discounting or providing liquidity during financial crisis. Germany insisted on IMF conditionality for the bailout countries and severe austerity measures in 2010 and 2011. German policymakers initially opposed letting the ECB play the same "bazooka" role as the Federal Reserve. Jens Weidmann, the president of Germany's Bundesbank, rebuffed global demands for more decisive intervention in Europe's bond markets by the ECB. He rejected the idea of using the ECB as "lender of last resort" for governments, warning that such steps "would add to instability by violating European law."[107] Weidmann would never give up his opposition to the idea, but over the summer of 2012, Germany's Chancellor Angela Merkel would be forced to change her mind and let go of her objections.[108]

The change of heart started with the replacement of the monetary orthodox Frenchman Jean-Claude Trichet by MIT trained Italian economist Mario Draghi at the helm of the European Central Bank. While Draghi managed to temporarily calm down the markets in late 2011 and early 2012 by instituting Long-Term Refinancing Operations (LTROs) to put liquidity back into the currency union's ailing banks, the real turnaround for the Eurozone would come when he announced in the summer of 2012 that he would do "whatever it takes" within his mandate to save the euro. The follow up announcement of Outright Monetary Transactions (OMTs) in September 2012, opposed by Weidmann but quietly supported by Merkel, calmed down the markets. Even though the program has never been tested at the time of writing, it was not clear whether OMT would actually work as it still had a strong element of conditionality to it. But it seemed to be enough of an assurance to investors and financial market participants, and the tail risk of a euro break up disappeared over the course of 2013.

Fourth and finally, in the domain of coordinating macroeconomic policy, Germany advocated austerity in the European periphery without trying to offset the negative economic effects with either fiscal stimulus or inflationary policies at home.[109] The result was an increase in the debt-to-GDP ratios in the affected countries, thereby exacerbating the problem the deflationary medicine was trying to solve.[110] It was always going to be impossible for the rest of Europe to become more like Germany, as Berlin's elites prescribed. Germany extolled the virtues of austerity, while in effect benefiting prior to the crisis from the fact that others did *not* follow austerity. By the iron logic of the balance of payments, one country's exports are another country's imports, and one country's capital inflows are another's capital outflows. The Eurozone could never as a

107 As quoted in Matthijs and Blyth (2011)
108 Spiegel (2014a)
109 Farrell and Quiggin (2012)
110 Blyth (2013), chapter 3

whole become more like Germany, since Germany could only be Germany because the others were not.

Overall, when one looks at the German record in public goods provision during the euro crisis, it is clear that rather than a 'benign' hegemon – in the Kindleberger fashion – Germany used its power in a 'coercive' way by transferring the main burden of adjustment onto the smaller, periphery countries.[111]

In the short term, Germany gained in importance within the Eurozone. Its superior growth performance over the course of both crises, made it increase its share of nominal GDP within the Eurozone from 26.7 percent in 2007 to 28.5 percent in 2013. The United States' share in the world economy, on the other hand, fell from 22 percent of the world's nominal GDP in 2007 to 19.3 percent in 2013.[112] Germany gained more than the rest of the Eurozone due to its own actions in the short term, but it left the regime in the Eurozone vulnerable and instable in the longer term. The global economy gained relatively more from U.S. actions and leadership in the short term than the U.S. itself, but the system was saved and put back on a more solid footing, benefiting the Americans in the long term.

7. Conclusion: Deduced and Abandoned? Why the Global Financial Crisis and Euro Crisis Show HST Should Not be Left on the Shelf

Hegemonic stability is alive and well in the 21st century. It should be dusted off and taken off the shelf. This paper presented a new model of hegemonic stability theory, testing longstanding and opposing theories – that of Kindleberger and that of Keohane – with new empirics made possible by two recent cases, the Great Recession of the world economy in 2008-9 and the European debt crisis of 2010-13. The theoretical framework makes a crucial distinction in times of systemic crisis between different types of leadership. The dominant state can either act as a 'benign' or a 'coercive' hegemon, determined by whether or not the system's leader bore a disproportionate amount of the costs of stabilization by providing the public goods necessary for economic recovery.

This paper has shown empirically how the U.S., acting as a benign hegemon, was able to resolve the global financial crisis relatively quickly, while Germany, acting as a coercive hegemon, delayed the resolution of the euro crisis by refusing to provide the necessary public goods, thereby exacerbating the consequences of the crisis, especially in the European periphery. Moreover, this paper has added a critical variable to explain why a dominant state will provide benign or coercive leadership: the power of ideas, and in particular, the role economic ideas play in defining states' interests. The U.S. acted the way it did because of the Keynesian economic ideas it held, no doubt influenced by its catastrophic performance during the Great Depression. It took Kindleberger's lesson to heart. Germany also acted based on its ideas, advocating an ordoliberal approach of national fiscal rules and domestic structural reform in a crisis that instead demanded largely 'systemic' solutions.

[111] See also Fubini (2013)
[112] IMF (2014), World Economic Outlook Database.

In his presidential address delivered to the ninety-eighth meeting of the American Economic Association, Kindleberger ended his remarks as follows: “Let me conclude by emphasizing once again my concern that politicians, economists, and political scientists may come to believe that the system should be run at all times by rules, including regimes, not people. Rules are desirable on trend. In crisis the need is for decision.”[113]

It is the ultimate irony that Germany’s finance minister during the crisis expressed a belief in the importance of leadership and hegemonic stability, yet fundamentally misinterpreted Kindleberger’s vision, and acted almost in opposite fashion to what the MIT economist had in mind. Rather than providing the public goods necessary to resolve the crisis, Germany emphasized the importance of following rules and induced the hard-hit Eurozone countries to adopt German-style austerity policies. The different ideas held by national policymakers in the United States and Germany would lead to very different perceptions of their national interests and fundamentally opposing definitions of leadership during crises. This divergence of views explains why, in the beginning of the 21st century, Kindleberger’s leadership version of hegemonic stability theory was fully embraced in Washington, but largely ignored or misread in Berlin.

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[113] Kindleberger (1986c)

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