

CHAPTER 5

WHEN GIANTS CLASH:

THE OECD FINANCIAL SUPPORT FUND AND THE IMF

Benjamin J. Cohen¹

What happens when one large multilateral organization threatens to encroach directly on the central and long-established role of another? This, in effect, was the question posed back in 1975 when, in the wake of the first oil shock, the 24 members of the Organization for Economic Cooperation and Development (OECD), a regional institution based largely in Europe, resolved to create a \$25 billion financial "safety net" for mutual balance-of-payments support. The goal of the initiative, dubbed the Financial Support Fund (FSF), was to help OECD countries in their efforts to cope with the impact of sharply higher energy prices -- under the circumstances, an entirely understandable ambition. The consequences for global institutional arrangements, however, could have been dramatic -- particularly for the International Monetary Fund (IMF), which had previously enjoyed universal recognition as the central source of payments financing for national governments. With \$25 billion at its disposal, the FSF threatened to eclipse the activities of the IMF, whose loanable resources at the time were nearing exhaustion. The IMF suddenly faced the prospect of a formidable regional rival.

In principle, OECD governments intended to "nest" the FSF firmly within the broader structure of international monetary relations first established at Bretton Woods -- a straightforward substantive linkage. In practice, however, the FSF was seen by many as a direct challenge to the authority of the Fund and wholly inconsistent with the unitary design of the postwar monetary regime. The stage was set, therefore, for a clash of giants -- two major organizations, the OECD and IMF, each with its own distinct interests and preferences and each with its own powerful allies and protagonists. Ultimately opponents of the FSF prevailed, despite vigorous lobbying by the OECD and support from many of its members. The critical battleground, ironically, turned out to be the United States, where in the end the FSF foundered when it failed to achieve formal legislative ratification. Washington had originally sponsored the initiative and had led the negotiations for its creation.

What caused the FSF to be stillborn? Why did the clash of giants end with total victory for one side, utter defeat for the other? Was the FSF a bad idea? A good idea badly conceived? Or simply an idea whose time came -- and then went? These questions form the central analytical focus of this chapter. Although structured as an historical study, the chapter's aim is prospective: to draw lessons from this now-forgotten episode² about conditions that may or may not favor a successful nesting of comparable institutions in the future. In short, what can we learn from the FSF experience about how to make regional organizations institutionally compatible with

broader global accords?

The discussion will examine the FSF story as a drama in three acts: an initial exploratory phase, which opened with the frantic search by Western nations for appropriate responses to the oil shock of 1973, culminating with the proposal for a Financial Support Fund at the OECD; the (successful) negotiation phase, which began in late 1974 and climaxed with the signing of the FSF agreement in April 1975; and the (unsuccessful) ratification phase, which closed anti-climactically a couple of years later when it became evident that the scheme had irrevocably lost the support of the United States.³ In reviewing each phase, use will be made of the consolidated analytical framework developed by Vinod Aggarwal (1997) for the study of institutional bargaining games that introduces this collection of essays. Drawing on a wide range of traditions in international relations theory, Aggarwal identifies several key factors that may be thought to drive the creation of regional organizations and their likely relationship with broader institutional arrangements. In the FSF drama, three elements highlighted by Aggarwal stand out as pivotal: cognitive considerations, structural factors and, within the United States, domestic politics. The influence of all three elements will be examined closely.

We begin with a brief synopsis of the FSF episode in Section I. The three acts of the play are then explored in more detail in Sections II-IV, followed by a review of analytical findings and implications in Section V. The chapter concludes, in Section

VI, with an outline of lessons for the challenge of institutional reform in the future.

I. Synopsis

The FSF drama began with the first oil shock in the fall of 1973. Following the outbreak of Arab-Israeli hostilities in early October, world energy prices soared, provoking widespread fears of impending economic calamity for oil importers. The Organization of Petroleum Exporting Countries (OPEC), with a near monopoly of oil exports and reserves, suddenly seemed in the driver's seat. Energy-dependent nations worried not only about where the money would come from to pay for more costly imports; even more acutely, they worried about their growing vulnerability to future shocks or shortages in what now appeared to be very much a sellers' market. Governments around the globe scrambled feverishly to line up financial resources and secure adequate access to oil supplies.

In this atmosphere of crisis, the United States Government -- guided by the strategic instincts of Secretary of State Henry Kissinger -- saw an opportunity for collective action that might counterbalance the emerging power of OPEC. For Kissinger the real problem was the threat posed to the unity of the Western anti-Soviet alliance, already frayed by growing commercial strains and the corrosive effects of the Vietnamese war. Efforts to reinforce trans-Atlantic solidarity earlier in 1973, which Kissinger had ambitiously designated the "Year of Europe," had ended

in division and acrimony over a wide range of economic and security issues. But here now was a new chance to mobilize and reinvigorate the industrial nations under firm American leadership. In December 1973, speaking in London, Kissinger called for comprehensive collaboration on all aspects of the energy problem. And in the ensuing Washington Energy Conference two months later, oil consumers were urged to match OPEC's cartel-like behavior with an effective coalition of their own.

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

Precisely for that reason, however, support for the IEA was not easy to muster. Several European nations, as well as Japan, were wary of a confrontational stance that might jeopardize access to OPEC production in the future. Some also resented what seemed a blatant attempt by Washington to reassert U.S. influence at a moment of relative weakness for its more import-dependent allies. For Kissinger, therefore, the challenge of the IEA negotiations was to offer supplementary incentives of sufficient allure to attain his desired response -- in effect to win support,

or at least buy off resistance, by adding reliable side-payments for the reluctant.

Along one track, this led the Secretary eventually to accede to European demands for a simultaneous -- and, in principle, more conciliatory -- strategy of dialogue between consumer and producer nations, later broadened into what came to be known as the North-South dialogue.⁴ Along a second track, this led to creation of the Financial Support Fund.

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

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

however, the answer was not so evident, since what was true for consumers as a group would not necessarily be true for each country individually. In fact, there was no reason at all to assume that OPEC reflows would match up neatly with the distribution of current deficits among oil importers. Quite the contrary, while some countries could look forward to healthy external accounts owing to their ability to attract OPEC investments, others were bound to face severe stresses. The challenge, therefore, was not to encourage a primary recycling of petrodollars from OPEC to oil importers; that would occur automatically. The problem was to ensure a satisfactory secondary recycling of petrodollars -- an appropriate allocation of loanable resources among consuming countries. How could nations with overall deficits be assured access to sufficient financing at reasonable terms?

Eventually, as we know, the problem was resolved -- more or less by default, and certainly not without difficulties -- by the private markets. In ensuing years Western banks and other financial intermediaries, mobilizing OPEC's surplus revenues, became the principal source of payments support for a diverse array of countries, in the process effectively "privatizing" the global regime for liquidity creation (Cohen, 1981). In 1974, however, all that still lay in the future. At the time, elite opinion was sharply divided. No one could yet be sure that the markets were up to the challenge; and policymakers were still accustomed to looking first to public, rather than private, sources for the bulk of their external finance. Attention therefore

focused on the feasibility of creating some new inter-governmental recycling mechanism -- in effect, a common-pool resource to help underwrite the deficits of oil importers. The climate was ripe for some attractive new balance-of-payments initiative.

The breakthrough finally came in another speech by Secretary Kissinger, this time in Chicago on November 14, just one day prior to formal creation of the IEA. Kissinger was well aware of lingering opposition to his consumer cartel strategy; of the OECD's 24 members, fully one-third -- including, most prominently, France -- refused initially to participate. To sweeten the pot, therefore, he now proposed to supplement the IEA with a new "safety net"⁵ to promote the "financial solidarity" of Western nations. As spelled out four days later by Treasury Secretary William Simon, the net would take the form of a joint loan and guarantee facility, with total funding amounting to some \$25 billion, to be administered by the OECD and available only to OECD members. Participation, Simon insisted, "should be linked with a commitment to cooperate in reducing dependence on oil imports" -- obvious code for an obligation to join, or at least not oppose, the operations of the IEA.⁶

The linkage between the safety net and the IEA was obviously tactical. In practice, however, Washington never did insist on a formal oil commitment of any kind. Instead, the proposal quickly took on a life of its own, quite independent of Kissinger's broader geo-political designs, owing to the pressing need many

governments (including the French) felt for assured access to payments support. Once the proposal was placed on the table, it in fact became linked to a quite different set of questions involving the broad structure of international monetary relations -- a linkage that was truly substantive rather than tactical.

Negotiation of the FSF was remarkably swift. Within a week, a working group, chaired by Jacques Van Ypersele of the Belgian Finance Ministry, was established by the Group of Ten industrial nations (G-10) to study Washington's initiative.⁷ Within two months preliminary agreement was reached on the broad outlines of a plan embodying most of what Secretaries Kissinger and Simon had proposed, including quotas for the commitments of individual governments. And by the end of March final details were hammered out by the Van Ypersele group, now reconstituted as an ad hoc working party of the OECD. On April 9, 1975, the "Agreement Establishing a Financial Support Fund of the Organization for Economic Cooperation and Development" (OECD, 1975) was duly signed by all 24 member governments -- including those, like the French, that were still resistant to full participation in the IEA.⁸ In diplomatic terms this was an extraordinary achievement, given the highly politicized and sensitive issues involved. As one source observed, "Rarely has a negotiation of such complexity and importance been conducted with such speed" (Louis, 1975, p. 368).⁹

Implementation, on the other hand, ultimately proved impossible, despite

rapid ratification by 21 of the OECD's 24 members.¹⁰ The critical battleground, as indicated, was the United States, where the necessary enabling legislation was first postponed and then, in the summer of 1977, finally withdrawn by the new Carter administration. On August 29, 1977, the OECD was formally informed by letter that "the Administration does not intend to seek ratification of the OECD Financial Support Fund.... Our embassies in OECD countries are informing their host governments of this position." Without the support of the project's biggest and most influential member, there seemed little point to going on. The FSF was allowed to pass quietly into history.¹¹

II. Act One

How could a proposal like the FSF be negotiated so quickly only to be later rejected so decisively? In an effort to answer that question, we begin with the initial exploratory phase in 1973-74, as OECD nations hastened to respond effectively to the dramatic acceleration of energy costs. The essential elements of the bargaining game during this phase are highlighted in Figures 1A and 1B. Two issues at the time were paramount. The first was uncertainty: at the level of elite beliefs, a lack of consensus over the financial consequences to be expected

FIGURE 1A: RESPONDING TO THE 1973-74 OIL SHOCK

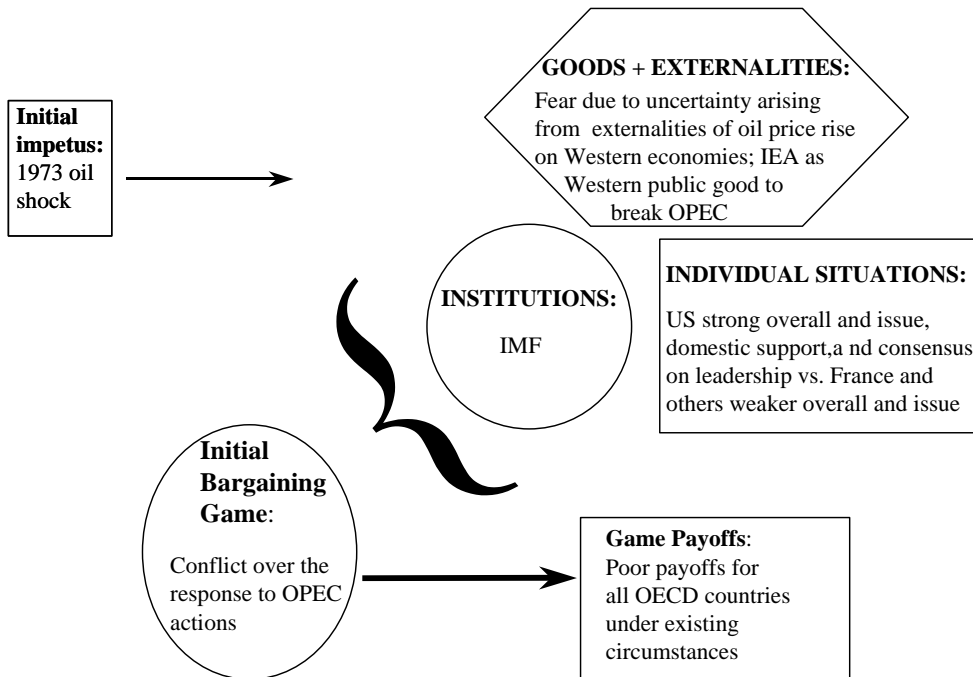
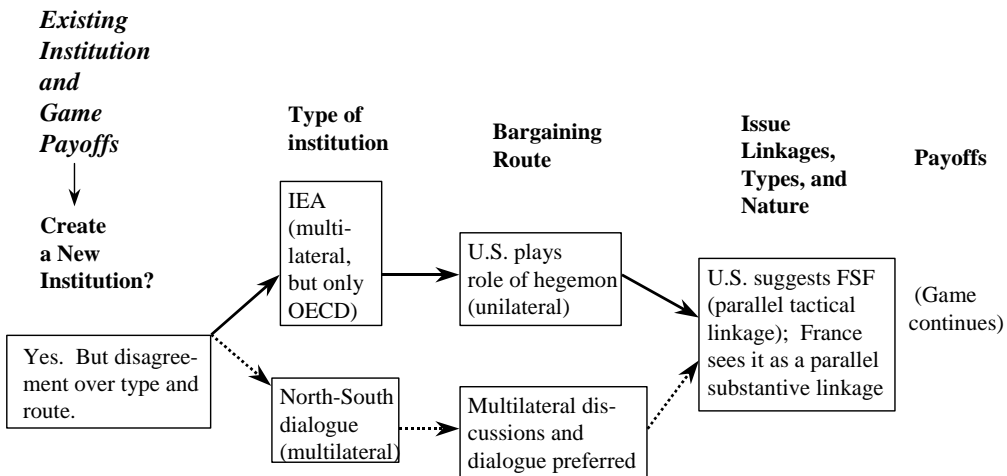


FIGURE 1B: DISPUTE OVER INSTITUTIONAL RESPONSES TO THE OIL SHOCK



from higher oil prices, compounded by parallel fears generated by the abandonment of pegged exchange rates earlier in 1973 and by the worldwide recession that set in during 1974. In the circumstances, it was not surprising that governments would feel impelled to do something -- anything -- to help protect themselves against the unknown. The second issue was power politics: at the level of inter-state relations, heightened tensions manifested through political conflict and bargaining. At the time two dimensions of conflict ultimately proved critical -- one between newly assertive OPEC and energy-hungry OECD nations, the other among OECD members themselves.

The impact of uncertainty

In the wake of one of the most unprecedented events in economic history -- the oil shock of 1973 -- uncertainty reigned in financial circles. Would oil-importing nations be bankrupted by OPEC greediness? Or were fears of a lasting collapse overblown? Could the private markets and IMF be relied upon to successfully recycle petrodollars to where they were most needed? Or would additional support be required to prevent desperate governments from resorting to mutually destructive "beggar-thy-neighbor" currency or trade practices? In retrospect, the answers are clear. Financing needs, while serious, turned out for the most part to be manageable. The markets and IMF did prove to be more or less up to the job; and governments

did resist the illusory temptations of competitive depreciation or import restraint. At the time, however, there was no convergence of views at all about either the magnitude or duration of the financial challenge at hand. Specialists differed wildly in both diagnoses and prescriptions. As one observer commented: "There is argument rather than agreement among the experts... [T]his absence of a guiding 'concept' is not a trivial problem" (Camps, 1975, p. 19). The attractiveness of some new balance-of-payments initiative, therefore, was understandable. The FSF could be viewed as a kind of mutual insurance policy in an atmosphere of emergency and incalculable risk.

A measure of the degree of uncertainty prevailing in 1974-75 can be found in the wide divergence among projections of OPEC earnings that were in circulation at the time (Cohen, 1976). In 1974, the combined surpluses of OPEC's members approached \$70 billion, up from a mere \$7 billion in 1973. Authoritative estimates of future transfers varied enormously, from an early World Bank suggestion of some \$650 billion (current dollars) through 1980 to later calculations running as low as \$165-190 billion. And comparable discord marked debate over other related issues as well, such as how OPEC's investable surplus might be distributed among alternative investments and which economies were most likely to benefit from the primary recycling of petrodollars. Facing future imbalances, few governments were prepared to put themselves entirely in the hands of the private markets, which at the

time were still largely untested as a secure source of balance-of-payments support; and the loanable resources of the IMF were known to be limited relative to potential need, amounting to less than \$12 billion.¹² The risk of a disorderly scramble of deficit-reduction measures, therefore, was real. The only real certainty, it seemed, was that some new way had to be found to ensure adequate financing when needed.

Over the course of 1974, proposals for new recycling mechanisms thus sprouted like mushrooms. As early as January, IMF Managing Director Johannes Witteveen initiated discussions leading in June to creation of a special oil facility at the Fund, open to all IMF members and funded mostly by loans from oil producers (De Vries, 1985, ch. 17). However, with total resources of only some \$3 1/2 billion, the facility clearly amounted to not much more than a drop in the proverbial bucket. During the summer, therefore, OECD Secretary General Emile Van Lennep began campaigning for an additional arrangement to be funded by borrowing from the private markets -- though, like Washington's later proposal, to be managed by the OECD rather than the IMF and to function solely for OECD members.¹³ And in September, at the IMF-World Bank annual meeting, Witteveen called for another and larger Fund oil facility for 1975, modeled along the lines of the 1974 arrangement -- an initiative enthusiastically backed by a number of national leaders, including especially Britain's Chancellor of the Exchequer Denis Healey, who not only proposed to greatly increase the facility's scale of lending, to as much as \$25 billion

annually, but also to make it permanent. All these plans were already the subject of public discussion when Secretary Kissinger introduced his own idea for a supplementary safety net in November.

Ironically, some of the stiffest resistance to extensive new official support schemes had come initially from the U.S. Treasury, led by Secretary Simon, who as late as October still seemed rather sanguine about the capacity of the private markets to effectively recycle petrodollars to needy governments (De Vries, 1985, pp. 335-336). It was only when Simon, in tandem with Kissinger, changed his tune in November that serious inter-governmental negotiations were able to get under way. However, even then it was clear that no one was quite sure just how serious the problem was or what approach might offer the best solution.

The impact of power politics

Given all this uncertainty, which was quite understandable under the circumstances, how did the Kissinger safety net manage so quickly to become the main focus of institutional bargaining? The answer, clearly, has to do with structural factors reflecting state capabilities and international political relationships. Though its conception could well have been justified solely on technical grounds -- particularly as a means of averting "beggar-thy-neighbor responses to emerging oil deficits"¹⁴ -- the FSF was first and foremost a by-product of power politics. Without

the sponsorship of the United States, still plainly the most powerful actor in the interstate system, it might never have prevailed in the proliferation of contending proposals.

In fact, strategic considerations dominated from the start. Led by Secretary Kissinger, who was determined to organize an effective Western response to OPEC's producer cartel, the U.S. Government began early to press for some kind of counterpart cartel of consumers, eventually resulting in creation of the International Energy Agency. The safety-net initiative, as indicated, was an integral part of Kissinger's grand strategy -- a side-payment offered to overcome the reluctance of key OECD members, many of whom viewed the Secretary's anti-OPEC stance as risky and overly provocative. In effect, Washington was obliged to fight two battles at once, one with OPEC and the other with its own allies.

That Kissinger's motivations were confrontational was never in question. For him, preservation of the anti-Soviet alliance was paramount. From the outset, therefore, he made clear his determination to neutralize any threat from OPEC to the unity or self-confidence of the West. The vulnerability of OECD nations to energy shocks or shortages simply had to be contained. The immediate price increases should be moderated or even rolled back. Oil dependency should be reduced. And effective defenses should be established to alleviate any risk of political manipulation of oil supplies in the future. The key was to reaffirm the solidarity of the industrial

world, preferably in some institutional form, in order to maximize diplomatic leverage. For Kissinger, there was no alternative to a policy of collective resistance to OPEC's new assertiveness.

For some of Washington's allies, on the other hand, there was an alternative -- not confrontation but, rather, dialogue and conciliation designed to appeal to OPEC's own long-term economic interests. Why risk needless antagonism, it was argued. Why not seek instead to cultivate harmonious trade and financial relationships that, over time, would deepen the stake of oil producers in the stability and prosperity of the West? OPEC members, after all, had their own vulnerabilities to worry about, which might be alleviated by offers of assured access to markets for their energy exports, financial outlets for their surplus revenues, or advanced technologies for their industrial development. A foundation existed for building a mutually beneficial "positive interdependence." Why use vinegar when more flies could be attracted with honey?

Most resistant was France, which had long pursued its own unilateral policies of friendship and cooperation with key OPEC governments. The French had no desire to jeopardize the "special relationships" they had so laboriously constructed in the Arab World, intended at least in part to ensure privileged access to scarce energy supplies. They were also deeply suspicious of any scheme that might help revive America's postwar dominance of Europe. Paris was acutely conscious of the

divergence of state capabilities in this arena. As a major oil producer with, in addition, massive reserves of coal and natural gas, the United States was far less vulnerable to OPEC pressures than most of its allies in Europe or Japan. A consumer cartel, therefore, might simply consolidate America's influence over its more energy-starved partners. In French eyes, the Kissinger strategy seemed to point to "a new Atlantic structure designed to link French and European economic security to the United States, thus opening the way for renewed American hegemony over the Continent" (Kohl, 1976, p. 248). Throughout 1974, accordingly, France (along with several smaller OECD nations) made clear its persistent opposition to what eventually became the IEA. Not even Kissinger's safety-net proposal in November would suffice to persuade the French to join (though it did help ensure that Paris would do nothing to thwart the operations of the IEA).

In fact, initial responses to the FSF initiative were very much the same as to the IEA: too confrontational and, potentially, too hegemonic. Since the safety net would work exclusively through a secondary recycling of petrodollars by oil consumers, by-passing OPEC altogether, it in effect "directly snubbed the oil producers" (Hager, 1976, p. 44).¹⁵ Less provocative, many thought, would be something like the Van Lennep or Healey plans, which by calling for more reliance on primary recycling implied greater cooperation with OPEC nations. Likewise, since a direct pooling of resources would naturally give weight to potential creditors -

- and, in particular, to the United States, which was one of the countries best placed to attract surplus oil revenues -- it threatened to add to Washington's influence over its allies, thus reinforcing fears of renascent American hegemony as well.¹⁶ More reassuring would be something like the first oil facility, which was managed through the less politicized procedures of the IMF.

Yet despite such objections the FSF proposal quickly moved to stage center, reflecting America's continuing predominance in the Western alliance. Overall superpower status as well as specific advantages as an energy producer and potential creditor gave the United States more than enough leverage to set the agenda for financial negotiations. The Europeans and Japanese may have had their doubts, but none -- not even France -- was prepared to openly defy the wishes of the U.S. Government on an issue of such vital importance. Once Washington made its preferences clear, and stated them unequivocally, others felt they had little choice but to accept the idea as a focal point for subsequent bargaining.

III. Act Two

The brief negotiation phase, which climaxed with the signing of the FSF agreement in April 1975, was dominated overwhelmingly by structural factors: the direct distribution of state capabilities in the bargaining game. Figures 2A and 2B outline the key elements of this act of the drama. Most critical to the outcome now

was the evident determination of the United States to do whatever was needed to gain the agreement of its allies.

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

On the U.S. side, by contrast, there was rising skepticism about the reliability of OPEC's surplus earners. Could they always be counted upon to lend to such schemes in the magnitudes likely to be required, particularly if better investment returns might be expected elsewhere? Washington was evidently concerned that oil producers would demand special interest rates or exchange guarantees for

FIGURE 2A: NEGOTIATING TO CREATE THE FSF

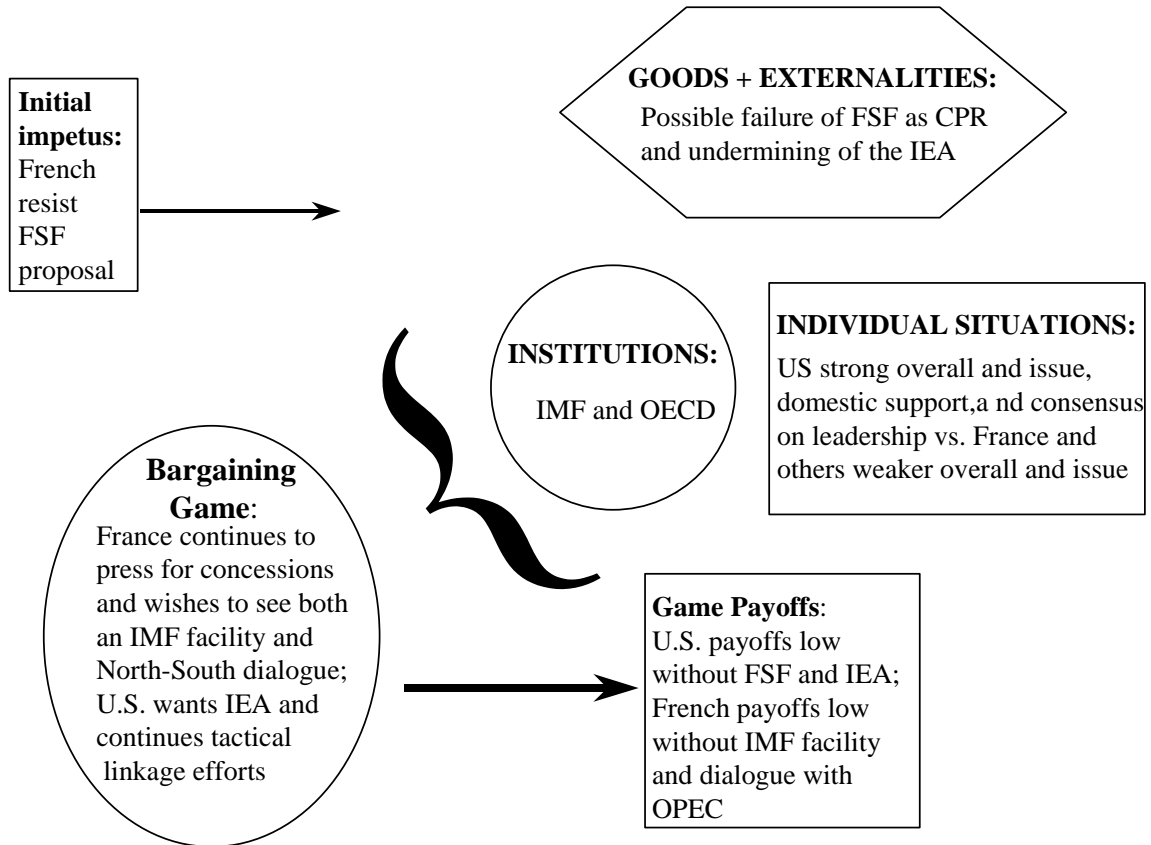
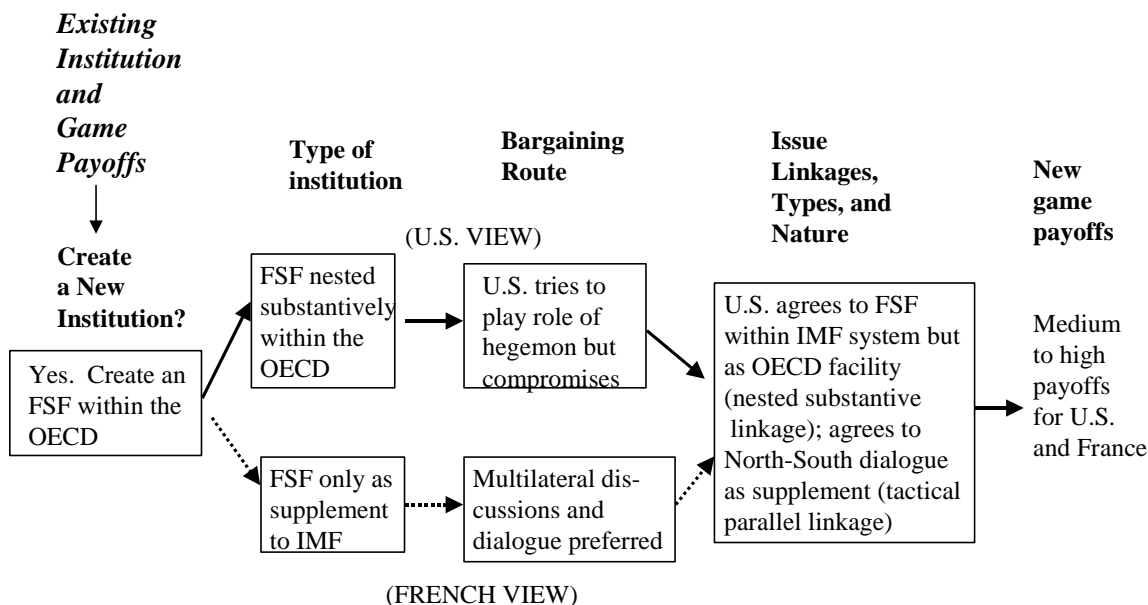


FIGURE 2B: NEGOTIATING THE NESTING OF THE FSF



their cooperation in any primary recycling scheme. There was also a fear that OPEC might attach political conditions to its cooperation, thus turning such arrangements into a sort of "money weapon" to reinforce its "oil weapon." Nor, U.S. officials argued, could the private markets necessarily be counted on to fill any remaining gap, no matter what guarantees might be available. Only a jointly funded inter-governmental arrangement could manage to produce the needed financing quickly and with appropriate terms and certainty (The Times, December 30, 1974; Financial Times, January 10, 1975).

In that case, why lodge a new recycling mechanism in the OECD rather than the IMF? For the United States, two considerations dominated. First, given the

safety net's origins as an adjunct of the IEA, a home in the OECD seemed natural -- all part of Henry Kissinger's grand strategy of unified Western opposition to the OPEC cartel. And second, Washington had little interest in sharing either decision-making or financial resources with the multitudes of oil-hungry developing countries, all of whom would have a voice in the governance of any initiative within the Fund. The issue that mattered most to U.S. policy-makers was the fate of the anti-Soviet alliance, not the financial health of the Third World.

Finally, after much bargaining, the two sides essentially agreed to split the difference. At a meeting in Washington on January 16, G-10 finance ministers formally endorsed both approaches -- the Witteveen proposal for a second oil facility as well as the Kissinger safety net (now to be blended with the Van Lennep proposal) -- in effect opting for two insurance policies instead of one (IMF Survey, January 20, 1975, p. 17). The oil facility, along with the IMF's other loanable resources, would be a first line of defense; the FSF, a supplementary last-resort source of help for deficit countries. With a touch of hyperbole worthy of Richard Nixon,¹⁷ Chancellor Healey declared this to be the "most successful meeting ever held" to reform the international monetary system (The Times, January 17, 1975), despite the fact that his own more ambitious suggestions had been decisively rejected. More prosaically, the result could be described as an old-fashioned horse-trade: Washington got what it wanted by giving the Europeans what they wanted.¹⁸ The 1975 oil facility, with

projected resources of some \$6 billion,¹⁹ was officially approved by the IMF Executive Board within three months, on April 4, five days before the formal signing of the FSF agreement (IMF Survey, April 14, 1975, p. 97; De Vries, 1985, ch. 18).

Other objections, likewise, were rather quickly resolved through artful negotiating compromises. Fears about the risks of confrontation with OPEC had already been allayed by a deal announced at a summit meeting of President Gerald Ford (who had taken office following the resignation of Richard Nixon in mid-1974) and Valéry Giscard d'Estaing on the French island of Martinique in December, where the U.S. promised to take part in an early conference of oil consuming and producing nations (Kohl, 1976, pp. 250-252). In return for this parallel, and ostensibly more conciliatory, approach -- later broadened into a North-South dialogue on a broad range of development issues²⁰ -- Paris agreed to drop its formal opposition to the IEA, with which it would now maintain a form of liaison,²¹ and to actively support the FSF. France's volte-face, in turn, persuaded others to come on board as well. Likewise, concerns about potential U.S. dominance of the FSF were eased once Washington agreed to a limited share of no more than 28 percent of total voting power, well below what would be required to dictate lending policy (OECD, 1975, Article XVI).²² Additional safeguards for smaller countries were provided by a provision that no decisions would be adopted without at least half the member-countries participating in a majority vote (OECD, 1975, Article XVI).

Compromises were also successful in surmounting more particularistic obstacles to accord. In January, Britain was won over by the G-10 decision to endorse Johannes Witteveen's proposed second oil facility as well as the FSF. London's early reaction to the Kissinger initiative had been distinctly negative, in large part because it threatened to overshadow Denis Healey's own earlier suggestions. However, once Washington agreed to split the difference, the Chancellor was able to declare victory for what he continued to refer to as the "Healey Plan" (The Times, January 17, 1975) even while surrendering to U.S. preferences. And subsequent West German resistance was overcome by a U.S. concession on the form of funding for the FSF. Germany, as indicated, was concerned about the potentially high budgetary cost of a direct pooling of resources. In the words of Jacques Van Ypersele, the Germans were "fearful of becoming the insurance company of the rest of the Western world."²³ But those worries too were allayed once Washington agreed to an optional alternative method of FSF financing, permitting members to make commitments in the form of a loan guarantee (for borrowing by the FSF) rather than by cash contribution (OECD, 1975, Article VII).

In short, agreement on the FSF was quickly made possible by a series of critical concessions by the United States. Why was the U.S. so accommodating on so many issues? Quite clearly, the battle with OPEC took precedence. Disagreements among friends could not be allowed to distract attention from the real enemy, which

in this arena remained the oil cartel. Flexibility was therefore called for to maintain Western solidarity. In the end, Washington was able to attain both its strategic objectives: the IEA as well as the financial safety net. The rare speed with which the FSF agreement was negotiated was a direct reflection of foreign-policy priorities then prevailing in the United States.

IV. Act Three

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

What explains the anti-climactic outcome of the ratification phase? As in the initial exploratory phase, both cognitive considerations and structural factors once again played a critical role. At the intellectual level, in contrast to the earlier uncertainty of 1973-74, a new consensus of elite opinion was finally beginning to

develop by the spring of 1975 which, unfortunately for supporters of the Kissinger initiative, did not happen to be favorable to implementation of the FSF. At the structural level, a new dimension of conflict now took center stage: competition between the OECD and the IMF -- the clash of giants. Together these two elements, mediated through domestic U.S. politics, ultimately determined the evolution and finally the denouement of the FSF story, as can be seen in Figures 3A and 3B.

A new emerging consensus

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

FIGURE 3A: CLASH OF GIANTS: STRUGGLES OVER THE FSF

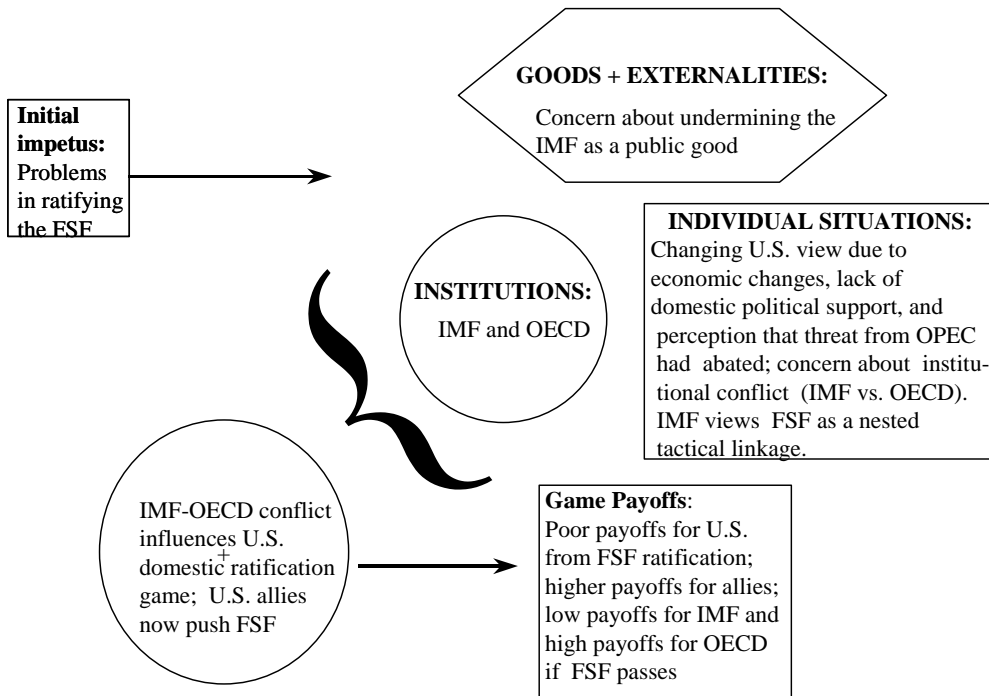
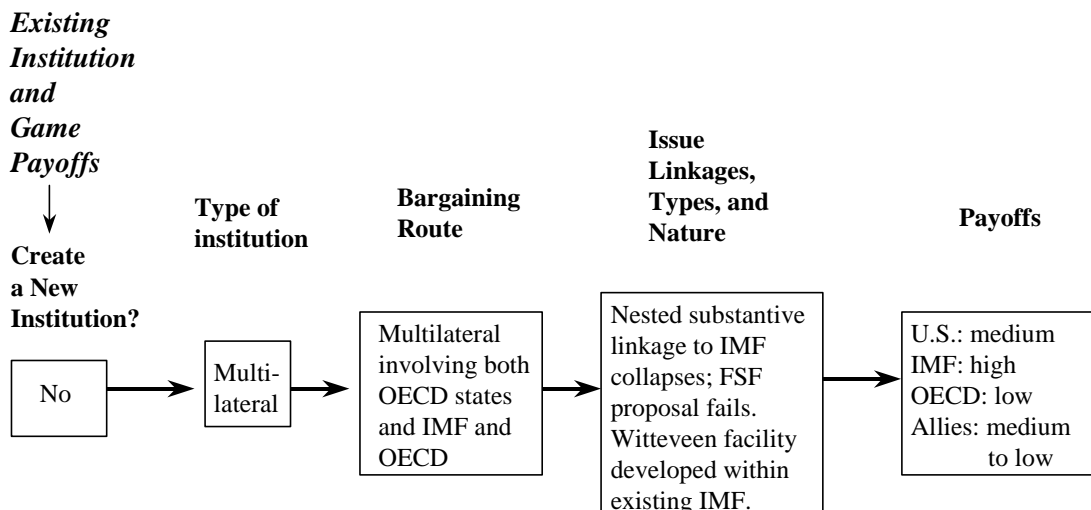


FIGURE 5.3B: FAILURE OF THE FSF



Even as the ink dried on the FSF agreement, however, it was becoming evident that the financial challenge was less dire than many had feared. OPEC surpluses declined throughout 1975 (though rising again temporarily in 1976), while market financing increased; and with the easing of world recession, most oil consumers were finding their external payments a lot easier to manage than expected (De Vries, 1985, p. 357). Policy-makers' sense of urgency, therefore, started to recede -- and as it did, second thoughts began to emerge about the FSF. The problem lay in the expected linkage between the FSF and the IMF. The global monetary regime already had one center of decision-making in the Fund. Was a second agency really needed, even if conceived solely as a lender of last resort? The advantages of a supplementary safety net were clear. But what about the possible disadvantages of divided authority in the management of monetary affairs?

To some extent the issue had been anticipated by FSF proponents, who from the start posed the idea strictly as a back-up to the IMF rather than as an alternative. Later critics who characterized the initiative as "short-sighted" or "hastily conceived"²⁴ were a bit unfair. Linkage was, in principle, to be strictly hierarchical: the FSF was clearly structured to nest snugly under the Fund's wing. Kissinger himself, in his November 1974 speech, spoke of an initiative to "augment and buttress," not displace or rival, existing financial arrangements. And in his follow-up remarks four days later, Secretary Simon explicitly insisted that "What we are

suggesting is in no way intended to replace the International Monetary Fund as the permanent institution providing the basic financial support for a well functioning world economy." During the ensuing months IMF representatives were involved as full participants in the deliberations of the Van Ypersele working group, and in the final agreement signed in April 1975 the FSF's objective was clearly limited to serving "to supplement, in exceptional cases, other sources of credit" (OECD, 1975, Article I). A government would be eligible to borrow only if it "has made the fullest appropriate use of other multilateral facilities" and would be subject to policy conditions comparable to those applied by the IMF (OECD, 1975, Article V).

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

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

House of Representatives, 1975a, p. 12).²⁵

Nonetheless, fears were soon roused for the future role of the IMF. No one could be sure how matters might work out in actual practice. After all, even with the second oil facility, the Fund's loanable resources were nearing rock bottom. Larger OECD governments, confronted with serious payments problems, might have no choice but to go first to the FSF, with its rich endowment of \$25 billion. Moreover, who was to determine when a country "has made the fullest appropriate use of other multilateral facilities" or whether OECD conditionality was fully compatible with IMF practice?²⁶ And who could predict how participants, after two years of operation, would feel about simply letting the FSF lapse?²⁷ Ultimately -- diplomatic language notwithstanding -- the operation and duration of the FSF would in practice be decided by the OECD alone, not anyone else. The IMF, observers began to worry, might be condemned to growing irrelevancy, at least for countries eligible to borrow from the new FSF.

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

Today's balance-of-payments problems within the OECD area derive from shortcomings in general economic policy rather than the

price of oil.... Hence they should be handled through the normal international lending institutions, notably the IMF, rather than any new oil-related facility.... [B]y creating a new international financial mechanism, [the FSF] would weaken the International Monetary Fund, just at a time when the United States has a major interest in strengthening that institution (U.S. Senate, 1976, pp. 26-27).

Gradually, such fears coalesced into a new mainstream consensus among specialists on both sides of the Atlantic. Wrote British economist John Williamson, "analysis has not suggested that there is a compelling need for the creation of any new intermediation agency such as the \$25 billion OECD safety net" (Williamson, 1975, p. 220). Echoed Milton Godfrey, an American business consultant, "the proposed support fund has no real justification" (U.S. Senate, 1976, p. 35). By mid-1976, even the FSF's most ardent advocates were beginning to acknowledge the possible risks to the IMF's central role and to search for new ways to more securely nest the two institutions. In July, for example, Illinois Senator Adlai Stevenson, though a firm supporter, felt impelled to introduce an amendment "to insure that the Financial Support Fund is a lender of last resort by requiring that the IMF... first determine that the applicant is unable to obtain all or a part of any loan which it seeks from the IMF" (Congressional Record - Senate, July 29, 1976, p. S11031). But not

even last-ditch efforts like these sufficed to turn the tide of opinion. In October The New York Times, which less than two years earlier had hailed "[T]he breadth of vision in this extraordinary project" (January 21, 1975), now concluded that "the oil safety net is dead.... [T]he scheme may just as well be given a quiet, respectful burial" (October 4, 1976).

By early 1977, when Bergsten and such like-minded colleagues as Anthony Solomon and Richard Cooper came to power with the new Carter administration,²⁸ the handwriting was on the wall. Little would be done to promote any initiative that threatened to dilute the pivotal authority of the IMF. Working group chair Jacques Van Ypersele attributed the subsequent loss of momentum for ratification directly to the "change of personalities" in the executive branch.²⁹ More bluntly, one high OECD official privately blamed the "one-world philosophy" of the new administration's top officials -- "proponents of a one-world concept in the financial sphere, who feel that the IMF can do no wrong."³⁰ Hence despite determined lobbying by the OECD the FSF was put on hold, in effect allowed to linger in legislative purgatory until it simply faded into ignominious oblivion.

The clash of giants

As critical as cognitive considerations may have seemed, however, they tell only a part of the story. Washington's change of heart can hardly be attributed to

improving economic conditions or the evolution of expert opinion alone. There was also another factor, involving issues of fundamental institutional structure, that figured at least as prominently in the minds of U.S. policy-makers. That was the increasingly effective opposition of the IMF.

The Fund, at the time, was an institution in search of a new mission. Its role at the center of global monetary relations had been severely compromised by the shift to currency floating in 1973 as well as by Richard Nixon's earlier suspension of the dollar's gold convertibility in 1971. Subsequently, the failure of the so-called Committee of Twenty, which was formally wound up in June 1974, to agree on any significant measure of systemic reform had only added to the organization's growing sense of impotence and frustration (Williamson, 1977). Even at the best of times, the IMF was bound to view proposals for a new deep-pocketed rival like the FSF with suspicion -- and these were clearly not the best of times. During 1973-74, institutional weakness made it difficult for Fund officials to counter the rush of ideas for new recycling facilities at the OECD or elsewhere.

By 1975, on the other hand, international conditions were beginning to improve and signs of progress were finally becoming evident in the deliberations of the Interim Committee (successor to the Committee of Twenty), ultimately leading to accord on the Second Amendment of the Fund's Articles of Agreement in January 1976. IMF officials, therefore, now felt better positioned to fight back. Their aim

was to reassert the Fund's pivotal authority at the peak of decision-making on monetary matters. The catalyst was Johannes Witteveen, who first took over as Managing Director from a disappointing predecessor in September 1973. In the words of the Fund's official historian:

[Some initiative] was important for the Fund as the organization responsible for international monetary arrangements and for cooperation in the international monetary field... [I]t was essential that the Fund take some action. Already the Fund's influence and functions had been reduced by the collapse of the par value system and the introduction of floating rates earlier in 1973. By the middle of 1973, the Fund's image had also suffered by the failure of world officials to agree on a reformed system. Thus... Mr. Witteveen pushed the Fund into action (De Vries, 1985, p. 359).³¹

Action did not take the form of a frontal assault on the FSF. Though clearly unenthusiastic about the prospect of a new deep-pocketed rival to his organization's primacy, Witteveen never directly challenged Washington's initiative. A skilled politician, who had previously served as finance minister and deputy prime minister of the Netherlands, he knew better than to publicly oppose the IMF's largest and most

powerful member. Rather, his strategy was to emphasize the undoubted strengths of the Fund -- e.g., its universality, experience, and proven expertise -- as well as, more subtly, its essential neutrality in any confrontation between oil producers and consumers. The erosion of the organization's relevancy was not denied. But the problem, he maintained, was financial, not institutional. The only threat that was openly acknowledged was the depleted level of the Fund's usable resources. The main solution, therefore, was a major increase in financing for the IMF. The public message was: The Fund still has a job to do. The subliminal message was: Give us the money to get the job done, and we won't need any sort of supplementary safety net in the OECD.

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

The FSF did not go down without a struggle. Behind the scenes, led by

Secretary General Van Lennep, the OECD Secretariat continued to argue energetically for its ratification, focusing increasingly on the unexpected emergence of second thoughts in the United States. Confidential briefs were prepared responding point by point to objections raised by the safety net's American critics. Private meetings were arranged with legislators and policy officials on both sides of the Atlantic. And public backing was sought, whenever possible, from European governments and other interested organizations like the Bank for International Settlements (BIS). As late as the spring of 1977, the FSF was still being actively promoted by a majority of Washington's allies. At a G-10 meeting in Paris in April, the U.S. was reported to receive "tough criticism" for its failure to ratify its own early initiative (The Times, July 18, 1977). And in June the influential chairman of the BIS, Jelle Zijlstra, appealed for immediate activation of the FSF, even without U.S. participation if necessary.³² "The new IMF capability at present is likely to be inadequate compared to the scale of the problem we face," he declared bluntly (International Herald Tribune, June 14, 1977).

By this time, however, support for the FSF in the United States had dwindled to the vanishing point, to the immense relief of the IMF. Trumpeted a prominent business publication in the summer: "Witteveen's success at repositioning the IMF at the center of the world economy has been a tonic for the morale of the Fund's staff" (Ehrbar, 1977, p. 99). The risk of eclipse had been averted. Even in the cautious

wording of the IMF's official historian it is possible to detect some note of celebration and self-congratulation:

One result of the Fund's supplementary financing facility was that the financial support fund in the OECD, extensively discussed in 1975 and 1976, never came into being. This was an understandable disappointment to Mr. van Lennep, who had initiated the idea independently of U.S. officials, worked hard in developing the plan, and hoped that the OECD would, for the first time, have ample funds available to it (De Vries, 1985, p. 549).³³

The Witteveen facility was formally adopted by the Fund's Executive Board on August 29 -- not by coincidence, the very same day that the OECD was formally informed by Washington of its withdrawal of support for the FSF.

The mediating role of domestic politics

This brings us, finally, to the role of domestic politics. Washington's reversal of preferences over the course of the drama was striking. Although much can be explained by shifts in the cognitive and economic environment and the opposition of the IMF, these are in a sense all "external" variables -- factors that influence the

attitudes and calculations of policy-makers only from the "outside-in." Even with them, the picture remains incomplete unless we take account of "internal" variables too -- factors that make their influence felt from the "inside-out," through political conflict and bargaining within the country rather than abroad. In practice, external variables are unlikely to exercise much impact at all except as they are mediated through the domestic political process.

During the exploratory and negotiation phases of the FSF drama, Secretary Kissinger's anti-OPEC strategy encountered little domestic resistance. Americans, shaken by the perceived threat to their energy security, required little urging to support a confrontational or even aggressive posture in relations with oil producers. Kissinger never even felt the need to consult with Congress before launching his safety-net initiative. Apparently the only serious bargaining sparked by the idea took place within the executive branch, between the Treasury and State Departments, starting soon after Secretary Simon was appointed in April 1974. Simon was too new to his post, however, and as yet too unsure of his place in Washington's power structure to offer much resistance to Kissinger's then dominant voice within the administration. Although never fully persuaded that the markets were incapable of handling the recycling problem, the Treasury Secretary was nonetheless receptive to contingency planning within the government as well as at the OECD³⁴; and by the autumn was persuaded to agree, albeit with some reluctance, to go public with the

joint Treasury-State proposal. Whatever reservations Simon may have held in private about the safety net, no substantive differences could be detected between the rough idea sketched out by Kissinger on November 14 and the more detailed version that he himself elaborated four days later. As Simon's deputy, Assistant Secretary Cooper, insisted the following spring:

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

Apparently, there were also no serious disagreements between the executive branch and Congress -- at least, not at first. Testimony by administration officials soon after the FSF agreement was signed encountered little criticism on Capitol Hill (U.S. House of Representatives, 1975a); and no evidence exists to indicate that ratification would have been unusually difficult had State and Treasury pushed for immediate action.³⁵ In the event, however, nothing was done to promote Congressional consideration for over a year, beyond routine submission of draft legislation in June 1975 (U.S. House of Representatives, 1975b), allowing opposition

ample opportunity to emerge and mobilize. By the time formal hearings got under way in mid-1976, the FSF agreement was plainly in trouble (U.S. Senate, 1976). Once the changeover of administrations occurred in early 1977, its fate was essentially sealed.

Several factors seem to have contributed to the change of heart in Washington. Of considerable importance was the improving economic climate, as adjustments to the 1973 oil shock finally began to take hold. With the public's sense of urgency slowly receding, it became correspondingly more difficult to sustain domestic support for a seemingly radical and potentially expensive financial initiative -- particularly as even more demanding emergencies, such as the looming bankruptcy of New York City, began to appear on the horizon.³⁶ Of some salience as well were personal frictions generated by Henry Kissinger's abrasive and muscular style of policy-making. On Capitol Hill, the Secretary of State was resented for neglecting the usual courtesies of prior consultation before formally announcing the U.S. plan.³⁷ In the executive branch, Secretary Simon was reportedly piqued by Kissinger's heavy-handed dismissal of his own private reservations about the safety-net idea.³⁸

Also important was a bureaucratic turf war between the State Department and Treasury triggered by the Kissinger initiative. While Treasury had always enjoyed authority over U.S. representation at the IMF, State was the lead agency for the OECD. Treasury officials, worried that a successful FSF would force them to share

their traditional primacy in international financial policy-making with their counterparts at Foggy Bottom, therefore became the Fund's natural allies in its competition with the OECD.³⁹ And then of course there was the Federal electoral cycle, mandated by the Constitution, which had a major impact on the calculations not only of legislators but of two successive administrations as well. Domestic political weakness made the incumbent, President Ford, increasingly hesitant to push for controversial legislation of any sort.⁴⁰ His defeat brought to power an opponent, Jimmy Carter, who naturally had little interest in sustaining or promoting key policies of his predecessor.

Most important of all, though, was the overarching clash with the IMF, whose campaign for renewed relevancy was notably successful in diverting attention from the FSF. First came a review of Fund quotas -- the formal basis of regular financial contributions by member governments -- which had already begun in early 1974. In January 1975, Managing Director Witteveen engineered agreement in principle on a quota increase of nearly one-third (SDR 10 billion). Although final details were not worked out for another fourteen months, that prospect alone sufficed to delay consideration of the FSF, since the U.S. share (roughly SDR 1.7 billion) would as always require Congressional authorization. Treasury officials argued, with some reason, that legislators were unlikely to approve both financial initiatives simultaneously. In fact, Congress at the time exhibited little interest in even a single

new program of costly foreign assistance, let alone two.⁴¹

And then, in early 1977, came Witteveen's proposal for his Supplementary Financing Facility, which from the start was seen as a direct rival to the FSF. The idea of a new arrangement at the IMF was warmly supported by the incoming Carter administration, partly because it would rely on financing from oil exporters as well as industrial nations (thus making the scheme more palatable to potential donors like Germany) and partly because its resources would be available to all governments, not just members of the OECD (thus making it attractive to developing countries as well).⁴² In both respects, the Witteveen facility thus seemed more consistent with a "one-world philosophy" than did the FSF. It would also restore the Treasury to primacy in international financial policy-making in Washington.

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

SENATOR STEVENSON: With this addition [the Witteveen facility],

if the resources would be adequate, then it follows that the administration does not support an OECD support fund. Is that correct?

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

In effect the executive branch, under two successive presidents, felt compelled to make a choice -- and elected to give priority to the IMF.

V. Review

What can we learn from the FSF experience, either about how actors make their choices or about how the outcomes of bargaining games are determined? It is evident that salient roles were played by each of the key elements highlighted by this historical drama: cognitive considerations, structural factors, and domestic politics. Much useful insight can be gained from a review of all three, first singly and then in combination.

Cognitive considerations

Insofar as cognitive considerations are concerned, the message of the FSF episode seems straightforward. Ideas do matter -- both as stimulus and as constraint. Ideas may be understood as "shared beliefs" (Jacobsen, 1995) or "consensual knowledge" (Rohrlich, 1987). Most relevant for our purposes are ideas as causal beliefs; that is, "beliefs about cause-effect relationships which derive authority from the shared consensus of recognized elites" (Goldstein and Keohane, 1993, p. 10). Causal beliefs provide guides for individuals on how to achieve specified objectives, serving both as "road maps" to help shape strategies for the attainment of goals and as "focal points" to help coordinate action and bond together effective coalitions. Ideas in this sense can be a powerful force for initiative and innovation, particularly in an emergency when actors feel least certain about the prospective consequences of alternative actions. But they can also be a stubborn barrier to change to the extent that they put effective blinders on decision-makers, acting to limit imagination and restrict the number of acceptable outcomes. Both types of influence were evident in the FSF drama.

During the exploratory and negotiation phases, when governments were still reeling from the shock of sharply higher oil prices as well as the earlier abandonment of pegged exchange rates, consensus over the management of international monetary relations effectively broke down. No one could be sure that the multilateral structures established at Bretton Woods were up to the job of coping with prospective

recycling needs. Minds were open to new suggestions about how to cope with impending payments imbalances. In this climate, the perception of dramatically altered economic circumstances produced an intense demand for institutional reform of some kind. Out of the ensuing competition of ideas the FSF proposal emerged a viable contender, in part precisely because it seemed to offer both a clear road map at a time of uncertainty and a potentially effective focal point for collective action. Quite clearly, the initiative would never have received the attention it did -- even apart from the power of its sponsor, the United States -- had there not been, in effect, a severe jolt to the prevailing cognitive order.

During the ratification phase, by contrast, as the general sense of urgency abated, more traditional notions began to reassert themselves -- particularly regarding the crucial issue of where institutional authority should properly reside in the global regime. Most recognized experts continued to hold to the view that monetary affairs are best managed in a unitary fashion. Just as national money systems are governed by a single central bank, the international system should have just one center of decisionmaking: the IMF. At the level of elite opinion, therefore, opposition began to build up to implementation of the FSF agreement, ultimately prevailing despite conciliatory efforts like those of Senator Stevenson. Here too ideas had a powerful impact, aided by the existence of an articulate and far-flung network of knowledge-based experts -- an "epistemic community"⁴³ -- with access to key policymakers and

a comparatively uniform point of view. It helped as well that some of the most prominent members of the community actually became policy-makers themselves, with positions of real political authority in the U.S. Government, while the issue of ratification was still pending. In the end, the same idea that had seemed so attractive in conditions of worrisome uncertainty came to be precluded once more normal times returned.

Structural factors

The message here too seems fairly straightforward. Power also matters -- like ideas, both as stimulus and constraint. The role of power in determining the shape of global institutional arrangements has long been emphasized by students of world politics: most generally in the well known theory of hegemonic stability; more specifically in that strand of the literature labeled by David Lake (1993) "leadership theory," which highlights the impact of dominant powers ("hegemons") on the production of an "international economic infrastructure." The patronage of the powerful is clearly critical for effective organizational reform. On the one hand, significant regime transformation is less likely to be attempted without the active support or sponsorship of one or more leading governments. On the other hand, major reform is more likely to be rejected if that support or sponsorship is withheld. Here too both types of influence were evident in the FSF drama.

The OECD safety net represented a potentially dramatic change in global institutional arrangements. Looking back, it seems improbable that such a grave challenge to the IMF would even have been contemplated without the explicit intervention and forceful diplomacy of the United States. Few governments paid serious attention to the Secretary General Van Lennep's proposal when it was first floated in the summer of 1974. A financial facility at the OECD, with resources to rival the IMF's, became a plausible possibility only when it was promoted by Washington. Plainly evident throughout the exploratory and negotiation phases was what Scott James and David Lake (1989) term the first "face" of hegemony: overt "use of positive and negative sanctions aimed directly at foreign governments in an attempt to influence their choice of policies" (James and Lake, 1989, p. 4). Some use, in addition, was also made of hegemony's third face -- the projection of ideas -- to legitimate the Kissinger proposal.⁴⁴ In effect, Washington took advantage of the uncertainty generated by the oil problem to promote its own conception of an appropriate solution. But most vital to the rapid success of the FSF negotiation, quite clearly, was an unabashedly open exploitation of power by the U.S. Government.

Washington's power also proved decisive during the ratification phase -- ironically now by its lack of use rather than its utilization, as the executive branch first procrastinated and then turned actively hostile to the FSF. Despite appeals from figures as prominent as Jelle Zijlstra, no government was prepared to activate the

safety net without participation by the OECD's richest member. Despite efforts by Van Lennep and his Secretariat to continue the fight for ratification, few wished to cross swords with the IMF without Washington's blessing. The Fund and OECD were two giants locked in combat. But neither could prevail except through the influence of the United States. In effect, having changed its mind, Washington exercised a veto over the whole process. What the hegemon wrought, the hegemon then discarded.

Domestic politics

Once again, the message here seems straightforward. Domestic politics matters too. As Robert Putnam (1988) has reminded us, international diplomacy is a game played at two levels, not one -- within countries as well as between them. At the international level, negotiators seek accord through mutual accommodation and compromise. But agreements reached abroad must also be capable of winning political support at home, particularly when formal legislative ratification is called for. At the domestic level, key constituencies must be satisfied that their interests, or their conception of the public interest, are being adequately served. No inter-governmental negotiation, however artfully conducted, can be considered truly "successful" if implementation is subsequently blocked by domestic discord.

In this sense the FSF initiative was obviously not a success, despite Henry Kissinger's best efforts. In the rush to win over governments in Europe and Japan, little was done to gain hearts or minds on Capitol Hill or neutralize potential opposition. The legal requirement of ratification, apparently, was not expected to be much of a problem. No special effort was made to cultivate key Congressional figures or mobilize public opinion; nor was anything done to mollify critics at the Treasury, from Secretary Simon on down. Instead of moving rapidly to organize a winning coalition, backers allowed the agreement to linger in the legislative hopper while, over time, preferences gradually shifted in favor of the IMF alternative. In the end, the FSF failed because its sponsors neglected to tend their own back yard. The game that was won at the international level was thus lost at the domestic level.

Implications

Several implications emerge from this analysis, concerning both causal linkages among the three key elements in the story and the validity of some of the hypotheses on game-change efforts suggested by Vinod Aggarwal in his introductory essay.

Among the three elements, one stands out clearly as decisive: the role of power, both at the structural level and at the level of domestic politics. Ideas may have mattered in the climate of uncertainty generated by OPEC's oil shock, as "road

maps" and "focal points," but the choice among them plainly depended on the relative strength of their respective sponsors. Opposition at the level of elite opinion may ultimately have helped kill the FSF proposal, but the influence of the relevant epistemic community would have been far less had key members not been appointed to positions of formal authority in Washington. The FSF, as negotiated, might have taken a different shape, but not given the distribution of state capabilities in the bargaining game. The OECD might have prevailed in its clash with the IMF, but not once the patronage of the United States was withdrawn. Ratification by the U.S. Congress might have been possible, but not without the requisite effort to capture the domestic political process. In every act of the drama, manifestations of power took center stage.

To put the point simply: Other considerations may have been necessary to the development of each act, but without the exercise of material capabilities they were insufficient to explain outcomes. Many factors set the agenda, but power was the final arbiter.

Among the hypotheses proposed by Aggarwal, several are confirmed by this experience. First is his suggestion that provision of a common-pool resource may well be stimulated, rather than inhibited, by large numbers of actors. Following the rise of oil prices, available liquidity sources were clearly at risk of overcrowding. A disorderly scramble for financing, which might have triggered a self-destructive

conflict of protectionism or other deficit-reduction measures, was a real threat. In these circumstances, the question was not whether to act, but rather how and on what scale. Governments knew they had to restrain their own worst impulses.

Likewise, regarding institutional choice, it is evident that the first instinct of all concerned was to utilize or modify an existing institution rather than pursue the more difficult path of creating a wholly new organization. The only question was which existing institution, the IMF or OECD? Henry Kissinger preferred the latter because it fit better with his grand geo-political designs. William Simon, as well as the later Carter team, were far more partial to the former because of its pivotal role at the center of the international monetary system.

Third, regarding both type of institution and bargaining route, the choice of multilateral approaches was manifestly affected by the type of institutions already in existence. No one (save possibly the French government) seriously questioned the need to act together rather than separately, though there was of course much room for disagreement over specifics. Should the collective response of oil importers be confrontational or conciliatory? Should there be one new recycling mechanism or two? How firmly should any safety net be nested under the wing of the IMF? Answers to these questions were heavily influenced by power considerations. But as Aggarwal suggests, the use of material capabilities in such a highly institutionalized context was bound to be constrained by existing institutional power resources as well

as by the initiatives of existing organizations and bureaucracies.

Finally, on the specific issue of linkages, attitudes clearly were dependent on how threats were perceived by key actors, again as Aggarwal suggests. Early in the drama, when OPEC's oil weapon seemed by far the most salient issue, the U.S. naturally put most emphasis on the parallel tactical linkage between the FSF and IEA. Possible conflict with the IMF seemed less important than reinforcing trans-Atlantic solidarity through the regionally based OECD. Later, however, as OPEC's surpluses started to decline and Western economic conditions improved, the need for a strong OECD correspondingly faded. As a result Washington's preferences shifted, now stressing the safety net's substantive linkage to the IMF instead. Ultimately, the Fund's triumph in the clash of giants reflected the broader transformation of policy perceptions that occurred once the atmosphere of crisis began to recede.

VI. Lessons for the Future

The FSF was not a bad idea. Given the atmosphere of crisis prevailing in 1974-75, it made perfectly good sense for governments to take any precautionary action possible. Nor was the safety net poorly conceived. Proponents were well aware of the need to ensure institutional compatibility with the operations of the IMF. Yet despite careful crafting and the patronage of a powerful sponsor, the FSF

founded -- an enterprise left stranded by time. The experience suggests several lessons for comparable future efforts to nest regional initiatives within broader global structures.

First, there must be a perceived **need** for any such project -- a cognitive consensus that institutional reform is indeed called for. Key actors must be persuaded, and remain persuaded, that existing structures may be inadequate to cope with present or prospective challenges.

Second, the project must be **credible**. Proponents must be able to make a convincing case for the effectiveness of the proposed reform -- that it should indeed be capable of achieving its declared objectives and can potentially be implemented at acceptable cost. In a world of imperfect information, no argument can be absolutely irrefutable. But it must be plausible.

Third, the project must be **non-threatening** -- posed as a supplement rather than as a substitute for prevailing global structures. Every effort should be made to avoid institutional rivalries, particularly in circumstances where existing organizations already have reason to feel weak and challenged (as the IMF did in 1973-74). Useful steps might include inviting representatives of existing organizations to participate at the negotiation stage, incorporating the policy frameworks of relevant global institutions into the new initiative's own legal framework, and perhaps even providing for regular consultations or standing joint

committees.

Fourth, the project must have an influential **sponsor** -- the backing of one or more governments with sufficient clout to gain formal international agreement.

Fifth, state sponsors in turn must be able to assure the project's necessary **ratification**, formal or informal, at home. Domestic political support must be actively cultivated and mobilized.

And finally, a high priority must be placed on **speed**, both in negotiation and in ratification of an agreement. While time may be needed to build a credible case for the proposed reform, it also creates an opportunity for a build up of opposing forces. In politics, it is always advantageous to strike while the iron is hot.

None of these six conditions, by itself, is likely to ensure a successful nesting of regional and global institutions. But judging from the FSF experience, they would certainly all appear to be necessary; and in combination might well prove sufficient as well. The FSF itself was both a product and a victim of contingency -- conceived in response to a perceived threat, abandoned after it was felt that the crisis had passed.

But even if the safety net did turn out to be an idea whose time came, and then went, its story is instructive as a cautionary tale. From its failure, much can indeed be learned for comparable circumstances in the future.

ENDNOTES

¹. The content of this paper is based on verified historical documentation, some publicly available and some graciously provided from the archives of the OECD Secretariat, as well as on interviews initiated while I was still personally involved in the events discussed as a consultant to the OECD in 1976-77. All opinions, however, are mine alone. The OECD bears no responsibility for any of the analysis in these pages. I am grateful to Paul Boeker and Emile Van Lennep as well as to Vinod Aggarwal and my other colleagues in this collective project for helpful comments and suggestions. The able assistance of Lynne Bernier is also gratefully acknowledged.

². Remarkably little has been written about the Financial Support Fund. The only serious full-length study that I have been able to locate is an early analysis, in French, by Belgian scholar Jean-Victor Louis (1975). More cursory comments may be found in Camps (1975), De Vries (1985), and James (1996).

³. Characterization of the first phase as "successful" is intended only in the narrow sense that the FSF negotiations managed to achieve formal accord. The question of whether, in view of the subsequent failure to achieve ratification, the first act can

truly be described as successful will be postponed until further below.

⁴ Kohl (1976). In fact, Kissinger's concession was less conciliatory than it seemed to the Europeans, who hoped that a dialogue might ease tensions between oil producers and consumers. For Kissinger, according to one highly placed State Department source, the dialogue would provide one more opportunity to erode OPEC's power, much of which derived from its solidarity with other Third World governments. By highlighting the adverse effects of higher oil prices for non-oil developing economies, Kissinger hoped to drive a wedge between OPEC and the other countries of the South.

⁵ According to a well placed OECD official (interview, July 1977), the term "safety net" was first suggested by Paul Volcker, then Under Secretary of the Treasury, at a meeting of an OECD working party in Tokyo in April 1974. The same official also expressed confidence that Volcker was the chief author of Secretary Kissinger's speech in November, though other sources credit Assistant Secretary of State Thomas Enders.

⁶ In the words of the Financial Times: "Mr. Simon's speech leaves little doubt that it is part of a co-ordinated effort to break the OPEC cartel" (November 20, 1974).

⁷ The G-10, first formed in 1963, initially included Belgium, Britain, Canada, France, Germany, Italy, Japan, the Netherlands, Sweden, and the United States, plus Switzerland on an ex officio basis. Though Switzerland now participates officially and Saudi Arabia has become formally affiliated as well, the group continues to be known as the Group of Ten.

⁸ OECD (1975). For technical reasons the signature of one member, Turkey -- which was then in the middle of a transition between governments -- was actually delayed until May.

⁹ In the original French: "Rarement, une negociation portant sur un accord aussi complexe et aussi important aura ete menee a ce rythme."

¹⁰ The only exceptions, apart from the United States, were Finland and Luxembourg.

¹¹ Parallels with the International Trade Organization, a post-World War II American initiative that was also ultimately killed for lack of U.S. ratification, are of course striking. For more on the ITO experience, see Gardner (1969), especially ch. 17.

¹² The total resources of the Fund, including all member currencies and gold holdings, were of course considerably larger. But Fund gold could not legally be

disposed of; and most member currencies, being inconvertible, were unavailable for lending purposes. Only the currencies of a small number of industrial countries were technically classified as "usable."

¹³. Specifically, the Van Lennep proposal would have authorized the Bank for International Settlements, acting as financial agent of the OECD, to raise funds directly from international and national financial markets under a collective OECD guarantee for lending to individual OECD members as needed. First sketches of the plan were circulated within the OECD as early as July 1974. A chief author of the proposal was Stephen Marris, Van Lennep's economic advisor.

¹⁴. Earlier, in a formal declaration adopted in May 1974 (the Trade Pledge), the members of the OECD had unanimously promised to refrain from introducing or intensifying trade restrictions in response to the oil shock. By the fall of 1974, however, according to a knowledgeable OECD official, some governments were threatening to rescind their pledge unless assured additional financial assistance in some form. Interview, July 1977.

¹⁵. Snubbing OPEC, of course, was precisely what Kissinger had in mind. As The Economist wrote, "American global strategy demands that the Arabs not be given too easy, too safe a home for their surplus petrodollars [which] could underwrite yet

higher oil prices" (January 11, 1975, p. 49).

^{16.} France, for example, was reported to be opposed because, among other things, "the U.S. plan would give Washington too great a say as to whom the funds would go and when." International Herald Tribune, December 9, 1974.

^{17.} Earlier, in December 1971, Nixon had described the realignment of exchange rates agreed by the G-10 at a meeting in Washington -- the so-called Smithsonian Agreement -- as "the greatest monetary agreement in the history of the world."

^{18.} Chacellor Healey credits himself with personally persuading the American side to accept the two-sided bargain. Healey (1989), pp. 425-426.

^{19.} A ceiling of \$6 billion, considerably less than the \$7-10 billion first suggested by the IMF, was reportedly demanded by the United States as a condition for its acceptance of the 1975 oil facility in addition to the FSF. The Banker, February 1975, p. 116.

^{20.} The North-South dialogue, formally labelled the Conference on International Economic Cooperation, met intermittently for the next three years before ending inconclusively.

^{21.} Specifically, France was able to participate indirectly in the IEA, although not as a

formal member, through the mechanisms of the European Community (now European Union), which was permitted to sit in the IEA as an observer. Members of the EU typically consult among themselves before taking positions within the IEA.

^{22.} Specifically, votes were to be determined in proportion to member quotas, which were denominated formally in Special Drawing Rights (SDRs). Of aggregate quotas amounting to 20 billion SDRs, Washington accepted a quota of SDR 5.56 billion, equal to 27.8 percent of the total (OECD, 1975, Article III).

^{23.} Interview, September 1977.

^{24.} The quotes are from an interview with an IMF official who was closely involved with these events, September 1977.

^{25.} This theme was echoed by U.S. Government officials privately as well as publicly. As late as the summer of 1977, a ranking official of the U.S. mission to the OECD insisted that "the FSF is an insurance policy, a bridging operation... No one would think of giving these functions permanently to the OECD." Interview, July 1977.

^{26.} A hint of the kind of problems that could arise was suggested inadvertently by Jacques Van Ypersele who, even while insisting that "the IMF must have a say on

establishing loan conditionality," added that "the OECD need not follow its advice one hundred percent." Interview, July 1977.

^{27.} Admitted Cooper in the same Congressional testimony: "At the end of two years, of course, circumstances may show that we have been too optimistic and the life of the Fund should be extended [though] that does not appear likely at this stage." U.S. House of Representatives (1975a), p. 4.

^{28.} Bergsten was named Assistant Secretary of the Treasury for International Affairs. Solomon, an investment banker, became Treasury Under Secretary; Cooper, an economics professor, became Under Secretary of State for Economic Affairs.

^{29.} Interview, September 1977. This view was also expressed by Secretary General Van Lennep himself in private correspondence to me in 1995 (reprinted with permission): "I, personally, still believe that the strong publicly stated opposition of Fred Bergsten combined with the fact that the IMF is based in Washington were decisive in turning the U.S. position around."

^{30.} Interview, July 1977.

^{31.} Another source puts the point more bluntly: Witteveen "turned out to be very much in favor of reasserting the IMF's power." Ehrbar (1977), p. 101.

^{32.} As indicated, 21 of the 24 members of the OECD had ratified the FSF agreement by the spring of 1977, representing 71.3 percent of total voting power. This was more than enough for formal activation of the plan, which legally could have been accomplished by a decision of as few as fifteen members holding as little as 60 percent of total quotas (OECD, 1975, Article XXIII).

^{33.} The disappointment may have been more than just professional. According to at least one informed source, running through the whole episode was some underlying personal rivalry between Witteveen and Van Lennep, both of whom had previously served for many years in the Dutch government. Interview, July 1977. Washington insiders spoke of the "Double-Dutch rivalry" -- Witteveen vs. Van Lennep as well as the clash between the IMF and OECD.

^{34.} Reportedly, as early as July 1974 during a stopover at OECD headquarters in Paris, Simon privately encouraged the Secretariat in its preparation of the Van Lennep proposal. According to a well placed OECD official, this was "the first sign of official endorsement" of an OECD-administered safety net. Interview, July 1977.

^{35.} Quite the reverse in fact. Most sources suggest that ratification was indeed feasible at the time. In the words of one IMF official, no friend of the FSF: "The administration might have gotten the FSF through the Congress in 1975 had they

moved quickly." Interview, September 1977.

^{36.} New York's financial difficulties were cited in particular by Jacques Van Ypersele -- "a condition," he suggested, "which made anything that resembled foreign aid look questionable." Interview, September 1977.

^{37.} One Congressional staffer referred to the safety-net initiative as "one of those grandiose Kissinger schemes." Interview, September 1977.

^{38.} In fact, according to one highly placed State Department source, Simon was "regularly humiliated by Kissinger power plays" and "was never convinced the FSF was needed or that useful."

^{39.} Indeed, for some key players this seemed the real clash of giants, not the Double-Dutch rivalry of Witteveen's IMF and Van Lennep's OECD. One State Department official recalls a European minister saying: "We Europeans can only hope for peace between the world's two superpowers -- the U.S. Treasury and the U.S. State Department." State, of course, remained the natural ally of the OECD, but by 1976, with the OPEC threat fading, its influence over financial matters was clearly on the wane.

^{40.} Political weakness also made Ford increasingly attentive to the views of Secretary

Simon, who carried much weight in the Republican party. In the words of one Washington source, "Ford, facing an election, needed Simon more than he needed Kissinger." Simon's reservations about the FSF were of course well known inside the beltway.

⁴¹. Interviews, September 1977.

⁴². De Vries (1985), pp. 548-549. See e.g., the statements by Carter Under Secretary of the Treasury, Anthony Solomon, in U.S. House of Representatives (1977), p. 56; and U.S. Senate (1977b), p. 33.

⁴³. The term is due to John Ruggie (1975) and has been popularized by Peter Haas (1992).

⁴⁴. The second face of hegemony, the influence of the hegemon's international market power on incentives and interests in foreign countries, does not appear to have played a major role in the story.

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