

## Fate of the Baker Initiative

# AN ENDURING WORLD CURRENCY ORDER

**SUMMARY:** The President has said the "economic constitution" of the world must be strengthened to meet the needs of the future. This means James Baker's efforts at currency coordination must be raised to the constitutional level and common democratic procedures established for the industrial democracies to manage their currencies together.

It is eighteen months since Treasury Secretary James Baker first undertook to organize collaboration among the world's major currencies. He has shown extraordinary resilience in the face of adversity, always finding a way to infuse his project with new life just when it seems to have run into a dead end. He is aided in this by his own extraordinary abilities, and by the still-enormous weight of America in the world economy. But in the long run his initiative will need more than the resilience of one individual to survive, and America will need more than one Treasury Secretary to make good on its global role.

Baker's effort has helped thus far in staving off Congressional pressures for protectionism, if only by making a public point of helping to bring the dollar down to a more competitive rate. But international economic cooperation has remained insufficient, most visibly in the German and Japanese resistance to economic expansion and U.S. resistance to fiscal discipline. The U.S. has gone to the brink of full-scale trade wars with the European Community and Japan—wars that could bring down the entire free world economy. Meanwhile protectionist pressures continue to mount.

The effort has not been concretized into any arrangements for permanent cooperation. The Tokyo Summit agreed on what one commentator aptly described as an outline for a "government of the world economy," but lacked concrete provisions for implementation. Nearly a year later, Baker and his Japanese counterpart gave an exchange of opinions that the dollar was at about the right level; this was hailed as an informal target zone and thus a precursor of an enduring institution. Then Baker, dissatisfied with the paucity

of economic expansion in Germany and Japan, allowed or encouraged the dollar to slide still farther. A February 22, 1987 G-6 meeting in Paris pledged to "cooperate closely to foster stability of exchange rates around current levels," thereby implicitly establishing target zones but without any formal commitments to intervene or procedures for revising the targets. Subsequent declines in and disputes over dollar exchange rates have already revealed limitations inherent in such a loose arrangement

Baker has shown unique initiative in keeping the cause of coordination afloat and zig-zagging forward, but everything has depended on his initiative. In the absence of visible institutions embodying substantial mutual commitments, this means that the whole effort could well go by the wayside when Baker leaves.

### **The Root Problem: The Myopia of National Politics**

The motive for German and Japanese resistance to pressures for economic expansion is instructive. In Japan it has been expressed diplomatically, but in Germany the resistance has been emphatic and nationalistic.

Germany has loudly declared that it will not expand its economy very far lest it rekindle inflation, the evils of which Germans know from their trauma of 1923. It has gone on to announce its intention to insure its national economic stability and insulate itself against whatever may happen in other countries.

These arguments have been treated with undeserved respect. The autarkic idea that Germany can be stable no matter what happens abroad is simply incredible in view of Germany's dependence on trade and its integration into the Common

Market. And the fear that expansion would cause inflation is at best arbitrary in view of Germany's present negative inflation rate. Just as in 1923, when the real cause of the inflation lay in uncontrolled international pressures, so in the future the only serious danger to German economic stability will lie in international economic chaos, engendered perhaps by the very refusal of Germany to collaborate with its economic partners in managing the common economy.

The illogic of the German argument is evidence that the real motive lies elsewhere, in nationalism—the very force that brought on the disaster of 1923. It is the spirit of nationalism that leads people to shut their ears to evidence and to repeat lines whose only logic is to flatter the pride of the group. In this case the lines must be made to sound humble, in order to reassure the world that Germany is being sober; thus we are told that "we must understand how afraid the German people are of inflation." But for Germans, the subliminal message of this is that they alone are trustworthy to control inflation.

In Japan as well as Germany, resistance to cooperation is fueled by a desire to prove that the country will not bow to American pressure. If these countries took sensible counsel, they might well reflate their economies out of domestic motives, thus serving also the international interest. It is at least arguable that the American pressure has done as much harm as good, by inspiring nationalistic resistance.

This points out a defect in Baker's system in its present, uninstitutionalized form: that it depends entirely on "peer pressure". In the absence of an objective umpire, "peer pressure" tends to degenerate into jawboning of one nation by an-

other. This cannot help but inflame nationalistic resistance.

Only deeper transnational institutions can avoid this defect. Only deeper political initiative can establish such institutions. The real problem, then, is political and institutional.

### **Baker States the Contradiction**

On April 15, 1987, Baker himself gave voice to the core contradiction, saying the economically strong democracies must take up their global leadership responsibilities "despite the sometimes parochial concerns of national constituencies."<sup>1</sup>

Democratic governments are and must be responsible to their constituents. Yet they also bear global responsibilities, and have an overriding common interest in meeting those responsibilities. Baker's experience has thus led him to the fundamental paradox of contemporary democracy. If reliance on national constituencies favors myopic concerns at the expense of the common interest, the only solution consistent with democracy is to build a transnational constituency.

### **President Reagan Defines the Problem on the Constitutional Level**

On September 30, 1986, President Reagan went to the core of the issue in his speech to the IMF and World Bank—a speech literally historic in its potential importance.

He repeatedly called the international economic institutions the "economic constitution" of the postwar world. He showed that they are in a crisis due to their very success in spreading economic power to Europe and Japan; America can no longer give them the coherent and effective leadership they have depended on, but needs to find a way to lead together with these two new giants. He called for their renovation through "expansion of] our international constitutions." In calling the international economic institutions the "economic constitution" of the postwar world, the President was not indulging in hyperbole; rather, he was finally giving these institutions the high political status they deserve. What it means is that the democracies have nothing less than an international constitutional crisis on their hands, even if most citizens remain blissfully unaware that

they have any kind of constitution at all on the international level.

The President asked point blank: "How should we expand our international constitutions so that the hopes and opportunities of the last generation can also be the hopes and opportunities of the next?" Thus did he pose the basic question facing the democratic world in our time.

### **A Successful Constitution Must Be Rooted in the People**

An adequate answer can be found only on the level of the question—the constitutional level.

The root defect of the current international economic constitution is that it relies entirely on diplomats and technocrats and ignores the people. This is why it is unreliable and inefficient; states tend to insist on unanimous consent in order to satisfy their sovereign pride, whereas individuals have the wisdom to operate by majority rule in common business. This is also why the people fail to appreciate its enormous worth. Diplomats and technocrats, who fancy themselves the sole bearers of international cooperation and are unaware that the people can play any role in this cooperation except to confound it, are incapable of proposing a solution commensurate with the problem.

***Economically strong democracies must take up their global leadership responsibilities "despite the sometimes parochial concerns of national constituencies"***

—James Baker

It is essentially the same problem as the Founding Fathers faced in Philadelphia in 1787. They met then to revise the Constitution of a Confederation that was primarily of, by and for the States, and decided to make it "of, by and for the people" by re-routing the Federal political processes through the people. It was an act of unprecedented daring in terms of the political theory of the time. Yet it was this that enabled America to stabilize and grow from generation to generation.

Today's international economic constitution has too much in common with the old Articles of Confederation:

1. It depends entirely on the initiative of the member States, and too often on their unanimous consent.

2. Its numerous member States cannot possibly agree regularly enough on issue after issue to be able to carry through any complex or demanding policy. It got around this problem for many years, as President Reagan pointed out, by relying on American hegemony to get things done. But hegemony induced resentment and could not last forever.

3. New generations do not realize its importance, because they have not been through the horrors that flowed from its absence in earlier years (a point President Reagan has underlined with feeling and concern), and also because they have no way to experience or participate in its actual role in the world.

A constitution unknown to the people cannot long endure among free and democratic peoples. If President Reagan is to solve the historic problem he has posed, he must draw upon the experience of the Founding Fathers and undertake to re-route the international economic constitution through the people, so it will be visible to them and will be able to draw on their loyalty and energy.

### **The Baker Initiative Must Be Raised to the Political Level**

This means President Reagan must take up Baker's courageous initiative, now entangled in contradictions, and raise it to the high political level on which alone the contradictions can be resolved.

Baker has carried his initiative remarkably far on the technical level, but it is running into mounting resentments for being kept on this level so long.

This may be seen from Baker's own speech to the IMF a day after the President's, a speech eloquent in its very contradiction. Baker said the process of consultation could not insure agreement or decision, and adjustments were not in fact coming fast enough to stave off the wolves of protectionism; yet the process "must" be made to work.

Baker has little choice but to live within the contradiction and to exude confidence in the viability of his initiative on its present level. The game is well worth his efforts on this level. But others are free to look beyond; indeed, Baker needs them to look beyond. He inserted an escape clause into his IMF remarks by speaking of an "evolving framework" and "something exciting" with room for "ambition". Thus did he keep the door open.

It would be unwise to wait too long before entering the door. Already, Baker's effort is degenerating into rancorous jaw-boning at allies.

The consultative process, left to itself, is not likely to become smoother with time. Quite the opposite: If it becomes routine within an inadequate system of commitments, it is likely to degenerate into rancor on the one hand and polite get-togethers on the other. Indeed, the only thing that has moderated these tendencies thus far is the fact that Baker has kept the process zig-zagging slowly toward stronger systems. If the effort were to bog down, the forces of nationalism and protectionism would be likely to gain the upper hand and the entire Free World economy could crash.

By now it has become less risky to step forward with a grand political initiative than to wait passively for events to take their own course.

Baker will need the President's leadership to do this and save his initiative for posterity. With less than two years left in the Administration, there is not much space for delay.

This is the Administration's best option for truly emerging from its crisis recovering the initiative in foreign policy. It has the virtue of being independent of the vicissitudes of superpower relations. And it would have solid political foundations; there was strong bipartisan support for at the Congressional Summit in November 1985 for efforts in Baker's direction but going even further.

The President's IMF speech was an excellent first step.

### What Countries to Start With?

If the Baker initiative is to go forward, it will be necessary to bring together more effectively the NATO countries, plus Australia and Japan. These countries are the core group of the incredibly complicated confederacy of democracies which includes such institutions as the OECD, Economic Summits, European Community and NATO. They are also the core group of the IMF, GATT and World Bank.

The constitution of this confederacy is as confusing as it is obscure. But it exists: It is this constitution that Baker has been trying to rewrite (albeit on the technician's level) in his Group of 5 (or 7).

Of these countries, the Allied ones have the most will and commitment to act together. Neutral countries would only get in the way during discussions of stronger commitments, due to their nervousness about compromising their neutrality. A Union of the Allies—NATO, Australia and Japan—would suffice for global economic leadership.

### A Strategy for Reshaping the Democratic Confederacy

How can the President go about this? The complexities will be innumerable. The most important cautions are not to get bogged down in the complexities or rely too much on bureaucracies. The instinct of bureaucracy will surely be to counsel political passivity while it pursues the issue on the technical and diplomatic levels—and entangles it in a myriad of complexities on these levels. The issue is complicated enough to give the bureaucracy in any case a thousand openings for its obstructionism. To keep the initiative in the hands of those with political will and vision, the President will need a definite strategic plan and a group of close advisors who are interested in succeeding with this initiative.

A general strategy might be: 1. Convene a special continuing summit of the allied democracies with a single agenda item: to work out a mandate for a common system of governing our common economic affairs. 2. Establish a drafting committee to translate the mandate into treaty or constitutional terms, in consultation with the summit. 3. Sign and ratify the resulting document.

The pact could come into force among ratifying countries once a "critical mass" had ratified. The first step might be for Congress to put its support for the goals of the Baker initiative into the form of a resolution calling on the Executive to convene this special summit.

Simply convening a summit with an agenda like this would make the President the main Founding Father of the Constitution of the Free World, even if an enduring constitution were adopted only decades later.

It will require great diplomatic resolve—a combination of patience and impatience, politeness and pressure—to get past even the first hurdles. It will also require all of the President's tremendous

personal leadership skills—initiative, tenacity, optimism, and a grasp for what is essential and a willingness to insist on it.

### The Political and Strategic Setting Is Favorable

The political pieces are well-positioned for a far-reaching political initiative on currencies.

The commitments made at the Tokyo Summit are still on the books, waiting for someone to pick up on them and undertake seriously to get them fulfilled.

People have been partly prepared by the Baker initiative. By carrying the democracies several steps up the ladder of cooperation and encouraging thinking about the contradictions of the next several steps, Baker has cleared ground for a solution on the constitutional level.

The Baker initiative has strong bipartisan support. The extraordinary Bradley-Kemp "Congressional Summit on Exchange Rates and the Dollar" provided political impetus for Baker's initiative in its early phases, and indeed indicated support for as closely-knit an organization of the international currency system as might prove feasible. There remains a widespread sentiment in Congress—a sentiment which is competing anxiously against the still-rising protectionist pressures—that it would be best if a constructive and collaborative solution were found to America's international economic problems.

It is a project like this which is inevitably the basis of bipartisanship; no position which is associated with a partisan place on the spectrum could play the same role. The Baker initiative, raised to the political level, would mean the regeneration of America's bipartisan foreign policy under President Reagan's leadership.

The President himself has laid out a vision of the constitutional significance of Baker's effort. His vision has lain on the back burner since American foreign policy started on its present rollercoaster at Reykjavik and got ensnared in the Middle East arms bazaar, but it remains available to point the way to steadier ground. It is the thing in the Administration's repertoire that offers the best chance of pulling its foreign policy out of the fire and securing its place in history. It is the President's greatest opportunity.