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From the Interwar Period to Today's Global Imbalances***
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CHAPTER NINE

THE RISE AND FALL OF TRADE AND MONETARY LEGAL ORDERS: FROM THE INTERWAR PERIOD TO TODAY'S GLOBAL IMBALANCES

Gregory Shaffer and Michael Waibel

Many analysts of globalization see in the process of 'legalization' (Abbot and Snidal, 2000) the tendency of informal rules to harden over time, either because practice clarifies ambiguous rules over time, or because institutions for dispute resolution are created to interpret and apply them – a characteristic in the evolution of international legal orders. The poster child for this development is the World Trade Organization (WTO) and its Appellate Body created in 1995. In this chapter, we take issue with this account of the purposeful character of the evolution of transnational legal regimes at two levels.

First, we find that not all regimes of rules harden over time, but that a process of de-legalization and the turn to informal law can weaken or even eclipse hard multilateral rules. To illustrate this first point, we trace the process of legalization of the monetary order from the League of Nations to the creation of the International Monetary Fund (IMF), which was followed by a process of de-legalization when the dollar lost its parity to gold in the 1970s and the IMF had to re-invent a role for itself other than that of the arbiter of a system of fixed exchange rates. The post-1973 IMF has, or more precisely its member states have, limited interest in law, preferring instead to rely on soft law such as standards and codes to safeguard international financial stability. Formalized dispute settlement has never featured prominently in the monetary sphere.

Second, multilateral institutions often have overlapping jurisdiction. We argue that the dual processes of legalization and de-legalization can

challenge existing settlements and complementarities between international organizations, and that these changing equilibriums can add another source of complexity (and sometimes uncertainty) to the governance of the international economic system. To illustrate this second point, we tell the parallel story of two organizations with overlapping mandates but opposite trajectories: the WTO, where the creation of a strong mechanism of dispute resolution started a process of judicialization in the global trade regime in the mid 1990s and the IMF, whose function shifted in the 1970s from being a multilateral institution charged with currency stabilization to an institution charged with the surveillance of country-specific macro-economic policies. The paper shows that, the degree of legalization today differs significantly within the trade and monetary spheres, ranging from the use of formal legal norms to informal means of cooperation. We argue that the dual processes of judicialization and de-legalization have created zones of obscurity in the overlapping areas where each organization could claim jurisdiction before those shifts occurred.

To demonstrate these points, this chapter charts the rise and fall of the legal orders in the trade and monetary spheres, the turn from discretion and informal means for macro-economic policy coordination up to World War II and the gradual legalization of the trade legal order until its rapid legalization and institutionalization in the WTO. The first section shows that jurisdictional overlaps are largely a product of the post-World War II era, as the League of Nations provided a comprehensive framework for both monetary and trade oversight, although one that was not very legalized and was incapable of avoiding the backlash against free trade in the wake of World War I and the onslaught of the Great Depression. We address the absence of lawyers within the offices of the League in relation to the League's failure to legalize its regulatory regime, which reflected the fact that there was little positive law upon which legal arguments could be based during the inter-war period, such that international economic law did not yet exist as a distinct discipline. Indeed, there were virtually no legal rules governing international economic exchange aside from bilateral commercial treaties.

The chapter shows why the architects of the post-World War II order had good reasons to opt for greater legalization and for creating two separate but interrelated transnational legal orders at the multilateral level: one for international monetary matters, and the other for international trade. Such functional legal differentiation was supposed to

encourage institutions to focus on their comparatively narrow mandates, which they could then implement according to hard rules, creating two effective transnational legal orders for ordering international trade and monetary affairs. By a transnational legal order, we refer to a collection of formalized legal norms and associated organizations and actors that authoritatively order the understanding and practice of law across national jurisdictions (Halliday and Shaffer, 2015). The second section shows that the decision by the Nixon administration to delink the dollar from the price of gold and let the US currency float effectively broke the system of hard rules that the IMF was to police. The IMF had to reinvent a role for itself. This process of de-legalization had implications that we explore in the third section.

The third section shows that at the same time that the IMF lost its hard law jurisdiction over currency stabilization, and as it moved into macro-economic policy advising, lending, and technical assistance (functions which included advising countries on their specific trade policies), the WTO evolved into an increasingly legalized and judicialized institution for dispute resolution in the field of global trade. The dual move of the IMF toward trade and macro-economic policy, coupled with its de-legalization, and the judicialization of the WTO, increased the uncertainty over the coherence of the system of international economic rules. It raises the specter of misalignment between the two transnational legal orders with real potential consequences. More recently, bilateralism and new challenges arising at the interface of the trade and monetary legal orders (such as currency misalignment) have raised questions regarding the effectiveness of the trade legal order. We argue in this section that the uneven effectiveness of the trade transnational legal order is partly due to the trade order's deference to the (now weak) monetary legal order on issues regarding monetary relations and the monetary legal order's relative silence on the issues of exchange rate undervaluation and capital controls on the capital account.

TRADE AND MONETARY DISORDER BEFORE WORLD WAR II

The first era of globalization and its demise

The volume of world trade grew at a rapid and unprecedented pace in the nineteenth century. The period 1870–1913 saw the birth of the first era of trade globalization and the period 1914–1939 its death (Estevadeordal, Frantz and Taylor, 2003). Great Britain moved to free trade in the

1840s, most notably with the repeal of the Corn Laws and the Anglo-French Cobden-Chevalier Treaty of 1860 that included a most favored nation (MFN) clause. A network of similar bilateral trade treaties followed, covering most of Europe. Free trade became the dominant doctrine. Before 1870, only a few countries adopted the gold standard. As more countries adopted this multilateral commitment device, the multilateral payments system based on gold convertibility underpinned trade liberalization.

In the second half of the nineteenth century, the international trade and monetary order rested on established norms of international conduct, rather than legal norms. The best example of the informal arrangements that ordered the international economic system was the gold standard. It 'tended to make international payments more or less automatic' (Vagts, 2006, p. 770). At that time, international economic law did not exist as a separate field. As a corollary, 'exchange controls were more or less unknown' (Cooper 1967, p. 1276; Vagts, 2006, p. 772). In the first golden era of global capital, from 1870 to 1914, 'the flows of economic factors were largely unregulated' (Vagts, 2006, p. 782). That system of spontaneous international cooperation coupled with the stability resulting from Great Britain's financial hegemony (Kindleberger, 1981) came to a sudden stop with World War I.

With the outbreak of World War I, tariffs, quotas, and other barriers to trade multiplied (Findlay and O'Rourke, 2007, p. 430). Concomitantly, World War I brought about a wave of exchange restrictions, such as in German legislation of November 1915 (*Gesetz über Verbot der Ausfuhr und Durchfuhr von Gold*, 1915). The war wreaked havoc on the open international economic order. Blockades hampered trade not only among belligerent countries, but also affecting neutral countries. Shipping, central to the transportation of goods, was under constant threat of attack, especially from German submarines. Transportation and insurance costs rose sharply. Even Great Britain broke with free trade by introducing the McKenna Tariff in 1915.

The gold standard and the international payment system it underpinned had ceased to function. When peace returned to the European continent, a legacy of protectionist policies hampered economic reconstruction in Europe. Views among economic historians differ as to whether the 1920s saw a normalization of trade policy towards greater openness (Kindleberger, 1989). Some hold the view that 'normalization in commercial policy was more hoped for than achieved' (Kindleberger, 1989, p. 163). After a brief sense of normalcy in the mid 1920s, the

Great Depression delivered the deathblow to the first period of globalization. The international trade and monetary system based on the pre-war gold standard was gone by the mid 1930s. In 1933 the United States went off the gold standard. Countries increasingly resorted to exchange controls. If law played a role in dealing with these difficulties, it was private international law, involving domestic courts hearing commercial disputes among parties from multiple jurisdictions, rather than public international law.

The debt overhang left behind by World War I

The cost of World War I was enormous and the treasuries of the countries that fought in it were severely depleted by 1919. Germany's currency totally collapsed, triggering hyperinflation. The Versailles Treaty failed to create the conditions for macroeconomic stability in Europe. Many sectors of the economy were keen to retain the protection for domestic production dating back to the war (Findlay and O'Rourke, 2007, p. 439). Most importantly, the Versailles Treaty failed to deal decisively with the large debt overhang left by World War I. Unsustainable levels of debt cast a long shadow over post-war economic recovery. The protracted dispute over German reparations prompted France to occupy the Ruhr in 1923. Germany and Austria then experienced further hyperinflation. In Eastern Europe too, macroeconomic instability was the order of the day. Against the background of these severe tensions in the international economic system, central banks found it much harder to cooperate compared to the pre-World War I period.

The US Congress created the World War Foreign Debt Commission in February 1922 to offer a solution to the rapidly growing problem of inter-governmental indebtedness (US Congress, 1922; United States World War Foreign Debt Commission, 1927, pp. 1–10). Due to the prevailing economic conditions, many governments could not pay their debts according to their terms. The United States realised it needed to make some adjustments in the form of definite settlements to allow national economies to recover. The Commission reduced the interest payable and stretched the maturities. As a rule, however, it did not write off any principal.

During the Great Depression, all European countries, with the exception of Finland, defaulted on loans advanced by the United States to aid their war effort. Many debtor governments pleaded their inability to pay the full face value of their debts due to the effects of the worldwide economic depression, which commenced in 1929. The capacity of

the Allies to repay the United States depended on receiving German war reparations, which were not forthcoming as promised. The financial quagmire illustrates the vicious circle of borrowing and inability to pay that bedeviled inter-governmental fiscal relations in the interwar period.

Bilateralism was also the order of the day in debt renegotiations. The Commission's task was not to supervise and implement a general debt cancellation scheme, especially of the various European countries among themselves. A global debt settlement could have achieved equal treatment of debtor countries, and could have taken equitable considerations related to these interlinkages into account in drawing up the settlement (United States World War Foreign Debt Commission, 1927, pp. 1–10). An alternative to bilateral debt negotiations would have been a multilateral joint settlement – an option that was less attractive to the United States that wished to preserve its own bargaining power.

The debt overhang from World War I was partly responsible for a series of banking crises in the late 1920s and early 1930s. This led to a wave of sovereign defaults in Latin America. In early 1932, there were isolated yet ultimately unsuccessful attempts to break with growing protectionism, most importantly in the World Economic Conference of 1933 in London. Globalization's demise, however, was sealed with Hitler's rise to power in 1933, and Germany's gearing up for war and self-sufficiency. The underdeveloped international economic law of the time was incapable of defusing these macro disputes – but the same could also be said in respect of modern international trade law, which has on the whole been able to resolve micro-level trade disputes focused on specific sectors or products, but much less successful in dealing with macro-level disputes such as global imbalances.

A tentative return to economic openness

The victorious Allies insisted in the peace negotiations on the inclusion of provisions regarding economic openness. In the Versailles Treaty, Germany undertook not to discriminate against the Allies and Associated States in respect of tariffs, customs regulations, internal charges, export duties, and import as well as export prohibitions. The League of Nations was an important player, especially its Economic and Financial Organization which moved quickly to re-establish some degree of economic openness after the war had left the international economy

shattered by restrictions on trading with the enemy and other impediments to trade.

This pattern of liberalization continued in the interwar period, not just through the League of Nations but also more generally. A striking feature of the work of the League of Nations in the economic and financial sphere was the absence of formal legal ordering. Lawyers played a very limited role in the League's operation. Even though the League in general had a Legal Advisor who was a senior staff member, the Economic Relations section was staffed virtually exclusively by non-lawyers. In the interwar period, international lawyers produced no textbook or other significant piece of writing on international economic law. For all practical purposes, the discipline came into being only after World War II.

Promises to abolish quantitative restrictions and lower tariffs given in Brussels in 1920 and in Portorose in 1921 were not realized however. Not a single country ratified the Portorose Protocol (League of Nations, 1944; Kindleberger, 1989; James, 2001; Findlay and O'Rourke, 2007, p. 443). The Genoa conference of 1922 urged a return to non-discrimination and tariff barriers instead of quantitative barriers, but without success. The League took up the subject, but to no avail. It summarized the interwar experience with rising protectionism in the following words: 'the international conferences unanimously recommended, and the great majority of Governments repeatedly proclaimed their intention to pursue, policies designed to bring about conditions of "freer and more equal trade;" yet never before in history were trade barriers raised so rapidly or discrimination so generally practiced' (League of Nations, 1944, p. 101). The Great Depression only increased demand for tariff protection in many countries, both industrialized and commodity producing ones. Deflation increased the barriers because tariffs were fixed in nominal terms (Findlay and O'Rourke, 2007, p. 447).

The League of Nations Covenant was not entirely silent on trade, and the League did regularly produce studies on trade. Article 23(3) of the Covenant bound member states to 'maintain freedom of communications and of transit and equitable treatment for the commerce of all Members of the League'. However, this provision was an empty shell given the qualification of the obligation in the chapeau of Article 23, which provided that this obligation was 'subject to and in accordance with the provisions of international conventions existing or hereafter agreed upon'. Thus, not only did the Covenant grandfather existing commercial treaties, it also placed no restrictions whatsoever on the

ability of governments to enter into bilateral and preferential trade and financial agreements. Many governments availed themselves of this opportunity in the 1930s.

Furthermore, the League of Nations lacked compulsory, binding dispute settlement, unlike the WTO today. Article 14 of the Covenant of the League of Nations mandated the Council to develop plans for a standing international court. The parties established a Permanent Court of International Justice (PCIJ) three years later in 1922, but its name was soon to prove inauspicious. The League could request advisory opinions from the PCIJ, though they were only advisory, and not binding on the parties, and were not backed by enforcement measures. In practice, only one out of twenty-one advisory opinions rendered by the PCIJ arguably concerned economic or financial matters. That judgment, the PCIJ's Advisory Opinion in *Customs Regime between Germany and Austria*, centered on the question of whether Germany's and Austria's plans to enter into a customs union at the height of the Great Depression breached Austria's obligations under Article 88 of the Saint-Germain-en-Laye Peace Treaty designed to guarantee Austria's political independence.

In addition, some of the Court's contentious (non-advisory) cases concerned economic and financial matters, most famously the *Serbian and Brazilian Loans* cases. These two disputes, however, exclusively concerned the application and interpretation of national law governing sovereign bonds. Given the absence of economic and financial provisions in the Covenant itself, the Court's case law in the economic and financial sphere bore mostly on the interpretation of the economic and financial clauses of the Peace Treaties. Formalized legal dispute settlement in general, and in economic and financial matters in particular, played little role during the interwar period.

When the League sponsored new conventions that sought to facilitate the expansion of trade, the latter failed to be adequately implemented. For instance, in 1927, countries signed an ambitious agreement on the Abolition of Import and Export Prohibitions and Restrictions, following a resolution of the League Assembly and a recommendation of the International Economic Conference held at Geneva in May 1927 (Convention for the Abolition of Import and Export Prohibitions and Restrictions, 1927; Vagts, 2006, p. 774). All major developed states, including non-members of the League itself, such as the United States, were signatories. The Convention contained a general prohibition on prohibitions and restrictions on importation (Article 1) and provided

for dispute settlement, but only with the agreement of the parties after a dispute had arisen (Article 8). But the Convention was undermined by a series of exceptions, including the general exception in Article 5 that allowed countries to restrict imports or exports ‘in extraordinary and abnormal circumstances’, in order to protect ‘the vital interests of the country’. States also attached a significant number of reservations. The Convention was short-lived. For example, the United States and the United Kingdom withdrew from the Convention in the summer of 1933 (United States Department of State, 1933, pp. 783–786; Irwin, 2011).

Backlash and retreat into economic autarky and bilateralism in the interwar period

The Great Depression further revealed the weakness in the legalization of the multilateral trade and financial orders provided by the post-WWI treaties and League’s statutes. As regards trade, in the United States, the Smoot-Hawley Tariff Act of 1930 increased the barriers on imports. It had a domino effect in other countries, leading to further tariff increases. Great Britain increased tariffs on many imported goods in 1932 to 10 percent. Even before Adolf Hitler came to power in 1933, Germany curtailed imports through exchange controls and licensing. Autarky became in vogue virtually everywhere.

Up to the Great Depression and the banking crises in many countries in its wake, most countries refrained from adopting capital controls. However, capital controls mushroomed from the early 1930s, particularly in response to capital flight related to banking crises. Argentina, Austria, Brazil, Czechoslovakia, Germany, Greece, Hungary, Uruguay, and Yugoslavia all adopted capital controls in 1931 (Mitchener and Wandschneider, 2013). China and Italy followed in 1934, and the United States applied capital controls from March 1933 to November 1934. Italy, for instance, introduced systematic capital controls to alleviate a sustained balance of payments deficit. Even though countries such as Australia, Canada, India, Mexico, South Africa, Sweden, Switzerland, and the UK refrained from using capital controls in the interwar period, by World War II, ‘hardly a country [was] without exchange restrictions’ (Nussbaum, 1939, p. 448).

Neither formal nor informal norms were able to substantially stem the rising tide of capital controls during this period. In reaction to the growing number of capital controls, a couple of Friendship, Commerce, and Navigation Treaties limited the freedom of states to adopt capital

TABLE 9.1 Selected capital controls in the interwar period
(United States Tariff Commission, 1943)

Country	Types of capital controls introduced
Italy	In 1925, initial curbs on speculative capital movements through regulation. In May 1934, Italy prohibited any transaction in foreign exchange except for the purpose of financing effective trade and industry requirements or for travelling abroad. Any purchase by Italian investors of stocks and bonds issued abroad, as well as export of banknotes and checks, were also prohibited. Increased utilization of bilateral clearing agreements as a device for circumventing the restrictive effects on international trade of quotas and exchange rate controls.
Bulgaria	In 1933, the Bulgarian National Bank raised interest rates imposing further import restrictions to keep foreign capital in Bulgaria and halt depletion of foreign reserves. Bulgaria also concluded a series of bilateral clearing agreements.
Germany	During the early 1930s, Germany created a complex system of bilateral trade clearing agreements. German capital controls were initially imposed to curb capital outflows and maintained in order to keep the official foreign exchange rates for the Reichsmark at the old parity; thereafter, an extensive trade clearing system was created to offset the distortions of the capital controls. In 1931, Germany also introduced a flight tax to limit capital outflows.

controls (e.g. Greece–UK Treaty 1938). Others provided for the non-discriminatory application of exchange restrictions, or most-favored nation treatment with respect to foreign exchange restrictions (Shuster, 1973, pp. 98–100). The inclusion of these clauses was a response to the rising tide of unilateralism in international monetary affairs in the interwar period, including through capital controls. A small number of treaties prohibited the use of capital controls entirely, such as the Czechoslovakia–US Trade Agreement (Article X, Czechoslovakia–United States Trade Agreement, 1938), the Ecuador–US Trade Agreement (Article X, Ecuador–United States Trade Agreement, 1938), the Liberia–US trade agreement (Liberia–US Trade Agreement, 1938) and the Greece–US Trade Agreement (Article X, Greece–US Trade Agreement, 1938), but overall they had little global impact.

To be able to maintain trade relationships with countries that had imposed capital controls, countries increasingly entered into various

clearing and transfer arrangements that ‘facilitated the transfer of funds from one country to another in such a manner as to maintain the balance of payments between the two countries in a state of reasonable equilibrium’. (Hahn, 1990, pp. 310–313, p. 128.) Countries competed with one another to enter into bilateral clearing agreements to preserve their export market shares. Increasingly, capital controls not only supported the balance of payments. Governments also relied on them to give preferential treatment to certain sectors of the economy, and to restrict expensive imports.

As the multilateral regime fractured, countries increasingly turned to bilateral agreements to preserve their export markets. For example, in the United States, the Reciprocal Trade Agreements Act of 1934 gave authority to the President to negotiate agreements for the reciprocal reduction of tariffs. Renewed in 1937, 1940, 1943, and 1945, the United States entered into thirty-two such agreements under this authority (Vagts, 2006, p. 775). In the 1930s, Germany entered into a series of preferential agreements for the supply of raw materials, especially with countries in Eastern and Southern Europe that suffered from balance of payments difficulties. In this way, Germany secured access to raw material at preferential prices. This web of bilateral trade deals proliferated, involving Germany and other colonial empires such as Great Britain, including under Great Britain’s Imperial Preference system established at Ottawa in 1932. This ‘pernicious bilateralism’ left the MFN principle as an empty shell (Findlay and O’Rourke, 2007, p. 451). As the League of Nations reported, ruefully looking back at the limited impact of the MFN clause in the interwar period: ‘instead of facilitating, the [MFN] clause tended to obstruct the reduction of tariffs by means of bilateral or multilateral agreements, owing to the reluctance of governments to make concessions which would be generalized by it. This was the result, mainly of two causes: first, the refusal of the United States to reduce its own very high tariff by negotiation while claiming to benefit from any tariff reduction negotiated between European countries; secondly, the opposition of certain countries – notably the United Kingdom, the United States, and the British Dominions – to derogations from strict MFN practice permitting the conclusion of regional or similar agreements for tariff reduction, the benefits of which would be limited to the participants’ (League of Nations, 1944, p. 119).

The Tripartite Agreement of 1936, under which France, Great Britain, and the United States agreed to consult on any changes in exchange rates, was a very soft precursor to the Bretton Woods System

of fixed exchange rates. The three signatory countries pledged to consult with one another in advance. The IMF, by contrast, would later establish hard legal obligations on countries to adhere to fixed exchange rates backed by gold, and have a much broader membership.

To sum up, following the catastrophic experience of World War I and the enormous human and economic costs of the war, countries struggled to return to the pre-war normalcy in international economic relations. They succeeded somewhat at first, however imperfectly, but within the space of a bit more than a decade, the economic and political challenges became almost insurmountable, and the world economy relapsed into autarky. Despite being a comparatively strong international institution for its time, the League of Nations was ultimately powerless to prevent the backlash against economic openness in the interwar period. As we have seen, this failure may have been linked to the fact that international economic law as a distinct discipline did not exist in the interwar period, and that there were virtually no legal rules governing international economic exchange, aside from bilateral commercial treaties. To the extent formalized legal rules existed in the interwar period in the monetary and trade sphere, they were bilateral in character. The absence of multilateral disciplines led to widespread beggary-neighbor policies. Non-discrimination, which had been central to the first golden era of globalization before World War I, was emasculated by the proliferation of bilateral trade agreements. The international trading system was dominated by an economic system based on preferential agreements – the most notorious example being Britain's imperial preferences for trade with its colonies and dominions.

Even though the contours of a distinct field started to emerge in the early twentieth century, the world had to wait until the institutionalization of the Bretton Woods institutions following World War II, for international trade to receive a multilateral legal frame.

THE RISE AND DECLINE IN LEGALIZATION OF THE MONETARY LEGAL ORDER: FROM WORLD WAR II TO THE 1970S

From the disastrous turn towards autarky and economic nationalism in the trade and monetary sphere during the interwar period, a strong commitment to a multilateral monetary order emerged after 1945. Leading policy makers, led by those in the United States and UK such as Harry Dexter White and John Maynard Keynes in particular, found that a

robust multilateralism was necessary for prosperity and growth. Out of the ashes of World War II arose a new spirit of cooperation, not only in the political sphere with the creation of the United Nations as successor to the League of Nations, but also in international economic relations with the establishment of the Bretton Woods institutions. The trade regime followed, but took longer than the monetary regime to be formalized, with the World Trade Organization only being formed in 1995 as the successor to the 1948 General Agreement on Tariffs and Trade (GATT) following the Cold War's end.

The legalization of the monetary and trade orders from 1945 to the 1970s

In the preparations for the Bretton Woods conference, policymakers considered a unified organization for global economic governance on the model of the League of Nations (Dubin, 1983). In the Interwar Period, in some sense a peak organization (the League of Nations) addressed the different, but complementary, functions of international monetary stability and trade liberalization. The Economic and Financial Organization persistently advocated trade liberalization and the coordination of member state policies in the monetary sphere, but also without much success (Clavin, 2013). But it largely operated in the absence of formalized legal rules in either the trade or monetary sphere. Moreover, the organization was not universal and did not include all the important powers, most importantly, the United States, but also Germany and Italy after their withdrawal from the organization in 1933.

Thus, the Bretton Woods architects concluded that the League may not be the best model to replicate after World War II, as the trade and monetary non-order of the interwar period was characterized by 'competitive currency devaluations, excessive tariff barriers, uneconomic barter deals, multiple currency practices and unnecessary exchange restrictions' (U.S. State Department, 1948, p. 1226). The stated aim of the peak organizations of the trade and monetary legal orders since World War II – the GATT/WTO and the IMF – is to confine these 'desperate tactics of the past' to the dustbin of history. Instead of one, the framers of the Bretton Woods financial and trade framework decided to create two separate organizations, the IMF and an International Trade Organization, the latter not being formed because of US resistance and being substituted by the 'provisional' GATT. This decision would raise issues regarding the interface of these two legal orders and

how they align in areas of overlapping jurisdiction, as Article I of the IMF Articles of Agreement includes not only financial stabilization, but also trade expansion, among the 'purposes' of the IMF: its goals are 'to promote international monetary cooperation through a permanent institution', 'facilitate the expansion and balanced growth of trade', 'promote exchange stability', 'maintain orderly exchange arrangements among members', and 'avoid competitive exchange depreciation'. This definition parallels the purpose of the GATT, and its successor, the WTO, which is to facilitate agreement among the organization's members for a liberalized trading order, and to oversee, monitor, and facilitate the maintenance of such order, including through legalized dispute settlement.

Still, the decision of states to opt for functional differentiation into separate trade and monetary regimes was largely due to the lessons that the architects of Bretton Woods drew from the comprehensive failures of macro-economic policy coordination in the interwar period. Functionally differentiated regimes, built on a higher degree of formalization, were to provide a stronger foundation for effective international economic governance. The IMF during the Bretton Woods system was at the center of overseeing and policing a system of fixed exchange rates. As the guardian of international monetary stability and the central mechanism for exchange rate coordination, the IMF had a comparatively narrow mandate. The greater focus of its work, compared to the League of Nations, may well have been an important ingredient in its higher degree of effectiveness as an international organization. Vesting narrow mandates in separate peak organizations is a perfectly understandable strategy in light of the failure of the League of Nations in the economic and financial sphere. Furthermore, following World War II, the new international monetary system was underpinned by a series of multilateral legal commitments, embodied chiefly in the IMF Articles of Agreement. This new monetary order was placed on a treaty footing, in contrast to the League, which had pinned its hopes for macro-economic policy coordination on informal coordination by providing economic expertise and a forum for political exchange among national economic policymakers. The contemporary Bank for International Settlement, created in 1930, and to a significant degree the IMF after 1971, fit into the same mould.

The original architects of the Bretton Woods system, in particular, were wary of unchecked capital flows, and wished to retain room for states to address financial instability and crises. But they did not vest

such authority in the IMF, partly because there was consensus among professional economists regarding the desirability of capital controls (Chwieroth, 2010). Nurske, the leading economist at the League of Nations working on the international monetary system in the interwar period, commenced in 1942 to write ‘an historical account of the interwar experience of monetary problems... with the objective of determining some principles of future monetary arrangements’ (Clavin, 2013, p. 309). This led to Nurske’s famous work *International Currency Experience: Lessons of the Interwar Period* (1944).

His book was highly influential and played a central role in shaping the Bretton Woods negotiations for creating the IMF and World Bank. It establishes the need for monetary order, and sought to avoid a repeat of the spaghetti bowl of capital controls and bilateral clearing agreements that had helped unravel the international economic system in the interwar period. Even more so than Nurske, the lead negotiators at Bretton Woods, Harry Dexter White for the United States and Keynes for the British, had long been concerned about the risks of ‘hot money’ to national and global financial stability, based primarily on the disastrous experience with free capital mobility in the 1920s in the lead up to the Great Depression. Keynes and White were both particularly suspicious of private capital flows. According to Keynes ‘control of capital movements, both inward and outward, should be a permanent feature of the post-war system’, a sentiment echoed by White who thought ‘a good case could be made for... the [government’s] power to control the influx and efflux of capital’ (Steil, 2013, p. 145). U.S. Secretary of the Treasury Henry Morgenthau even rejoiced that the IMF was located at a distance from Wall Street, and thus would ‘drive... the usurious money lenders from the temple of international finance’ (Steil, 2013, p. 167). Morgenthau and his fellow New Dealers wanted an international financial system centered on the US Treasury, rather than one in the hands of private financiers, either on Wall Street or in the City of London.

The original IMF Articles of Agreement thus prioritized currency stability over capital mobility, and left untouched the ability of countries to regulate and restrict capital account transactions. Accordingly, the IMF Articles subject only current account transactions to the IMF’s jurisdiction (such as those related to trade in goods), so that IMF members are free to restrict all capital account transfers (such as portfolio investment), provided these restrictions do not unduly delay current transactions (Article VI.3). The IMF Articles did not formally

recognize the ability of states to impose capital controls in hard law, but permitted their introduction by their silence.

The framers of the Bretton Woods architecture knew that the establishment of a legalized framework facilitating the expansion of global trade would be arduous. In effect, it took several decades to dismantle the protectionist legacy of the two world wars and the interwar period, and the IMF was only one cause among many others (including, decolonization). One contemporary commentator wrote of the newly established International Monetary Fund: 'World trade cannot be restored and expanded unless the United Nations abandons the restrictive and discriminatory currency practices that became so prevalent in the 1930's. Their very existence is a threat to friendly economic relations. The International Fund, established to deal with this problem of currency warfare, is intended to facilitate the full flow of trade by promoting stable and orderly exchange arrangements. The members of the Fund have undertaken to maintain fair currency standards, under which trade can expand and grow' (Pehle, 1946, pp. 1127–1139, 1129).

But as long as imperial states (such as the UK and France) maintained systems of preferential trade with their colonies, the IMF could do little, and promoters of free trade would need to use various policy instruments. For the United States, one of the key objectives at the Bretton Woods conference was the abolition of imperial preferences and the creation of a level playing field. Britain fought a rear-guard and ultimately an unsuccessful action to defend the colonial system and imperial preferences. The United States used its leverage from its lending to Britain under the Lend-Lease program to pressure the UK to abandon these preferences that privileged trade between the UK and its colonies. With the GATT, the United States aimed to institutionalize the removal of such trade discrimination, although it would take some time (Zeiler, 1997).

Between 1945 and 1971, the IMF was in many ways the world's most influential and independent international organization. It oversaw an exchange rate system in which all currencies were pegged to the US dollar, which was, in turn, backed by gold at \$35 per ounce. Under the Bretton Woods system, coordinated activist monetary and fiscal policy with a view to remedying balance of payments imbalances replaced gold flows under the gold standard to which countries had tried to return during the interwar period, or automatic adjustment through floating exchange rates. By and large, the Bretton Woods system managed to internalize the externalities arising from monetary policy.

In the words of its former General Counsel Joseph Gold (1990, p. 2), the original par value system overseen by the IMF was 'unprecedented as a system for regulating the exchange rates of currencies under a multilateral treaty administered by an international organization'. The IMF rules on exchange rates were strict and states generally abided by them. Central banks regularly intervened in foreign exchange markets to maintain the pegs, and in practice, the pegs were rarely changed. The government treasury/central bank (depending on the national system) committed to exchange domestic currency for foreign currency at the par value. With a system of pegged exchange rates, there was no room for currency manipulation, unlike in the interwar period and from the 1970s onwards. Under the policies of embedded liberalism of the Bretton Woods system, countries maintained capital controls to provide stability and enhance their ability to develop social welfare systems.

The trade order was longer in the making than the monetary legal order, but its establishment also originated from the immediate post-war context. Unlike the IMF, the GATT was a weak organization when it began in 1948 as a 'provisional' agreement. The GATT nonetheless contained a series of detailed legal rules on trade in goods, as well as clear non-discrimination provisions (GATT Articles I on MFN treatment and GATT Article III on national treatment) that over time helped bury the preferential, bilateral legacy of the Interwar Period for trade in goods. The GATT brought about a secular decline in applied tariff rates through negotiated tariff ceilings.

The de-legalization of the monetary order and the collapse of the Bretton Woods system

The Bretton Woods system collapsed in the early 1970s when the United States unilaterally ended the dollar's convertibility to gold and imposed an across-the-board tariff increase of 10 percent (Gardner, 1985). The dollar, as a result, became a fiat currency, one no longer backed by gold or any other precious metal. The Bretton Woods system of pegged exchange rates rapidly gave way to a world of national choice of exchange arrangements, with the United States and other major economies moving to floating exchange rates, subject to periodic government interventions.

Europe was more ambivalent about the move to floating exchange rates, at least insofar as it concerned fluctuations of European currencies against each other. In 1969, the heads of state of the EEC first called for the progressive creation of an economic and monetary union, and the

EEC Council created the so-called 'snake' in 1972, which operated outside the formal EEC Treaty. Pursuant to it, the members' central banks were to coordinate the management of their currencies within narrow margins of fluctuation against the dollar. The 'snake' quickly failed, a casualty of the breakup of the Bretton Woods system, but it represented a predecessor of the European Rate Mechanism of the European Monetary System (EMS) established in 1978, to be subsequently followed by the creation of a single currency for seventeen European states, the Euro.

Another way of viewing the change following the collapse of the Bretton Woods system is that political and market ordering displaced legal ordering. Legal ordering of trade and monetary relations, certainly on a multilateral level, was substantially new following World War II. As we have seen in Section I, no comparable legal order existed in the interwar period; and the stability of the pre-World War I system resulted from informal cooperation, largely among central banks, rather than legalized ordering in the modern sense. Pre-1914 and post-1989, markets determined the value of floating currencies, although with important exceptions, such as the People's Republic of China on account of its market interventions.

Following the collapse of the Bretton Woods system, the IMF's role significantly decreased as regards developed economies. This secular decline of the monetary legal order echoes the weakening of the informal monetary legal order that developed in the first golden period for global capital in the late nineteenth century. The Banque de France, the Bank of England, and the German Reichsbank were the central decision-makers in international economic affairs at the beginning of the twentieth century. At the beginning of the twentieth century, the United States was absent from this exclusive club as Congress established the Federal Reserve system only in 1913.

The percentage of lawyers among the staff of an international organization provides a rough proxy for the degree of legalization of a legal order. In the case of the League of Nations – apart from its work in the political sphere where lawyers played at times an influential role – the number of lawyers providing legal advice was close to zero. A substantial percentage of League staff had trained as lawyers. Yet their role at the League, by and large, was not to provide legal advice. Rather, like all other staff, they were mostly engaged in providing policy advice and report on the state of the economies of League member countries. A

good example is Leon Bourgeois, a lawyer by training who was elected the first President of the Council of the League. For the IMF today (which has been the case since its creation in 1945), the percentage of lawyers working for the organization is around 3 percent (around fifty lawyers out of a total professional staff of about 2,000).

Another way of evaluating the role of law in an international organization is to attempt to measure the influence of lawyers on the policy-making process. There is little doubt that lawyers influence the policy-making process more directly and more frequently at the WTO than at the IMF or in the League of Nations. On the whole, the IMF Legal Department is not centrally involved in the formation of policy-making at the Fund, even though it plays a central role in ensuring compliance with Fund policies and has increasingly been involved in providing technical assistance to IMF member countries on matters as diverse as effective corporate insolvency frameworks, the formulation of central banking statutes, and financial regulation. Economists play the dominant roles in the IMF on matters of policy generally and for the IMF surveillance missions in particular.

From the early 1970s, the IMF's primary function changed from being coordinator and potential enforcer of an international monetary system of rules-based pegged exchange rates, to being a surveillance organization that issues country reports regarding a country's economic and balance-of-payments situation, and a lender and adviser for developing countries facing balance-of-payments problems. In the contemporary world of floating exchange rates, there are few monetary rules left for the IMF to police and enforce. This return of the monetary legal order to informality and central bank coordination harks back to the interwar period.

Whereas the creation of the IMF resulted in considerable exchange rate stability for the duration of the Bretton Woods system of fixed exchange rates so that the interface of the trade and monetary legal orders raised a few questions, that interface became much more challenging as regards global imbalances and exchange rates following the collapse of the Bretton Woods arrangement and the turn to floating exchange rates by the world's major economies in the 1970s. IMF Article IV now permits countries to choose their exchange arrangements, subject to IMF surveillance and member compliance with a series of principles that are rather soft in nature and in practice. As Andreas Lowenfeld (2010, p. 582) writes, 'the *fundamental rule* [of

pegged exchange rates] was *replaced by a non-rule*’ (emphasis added). Law receded as a means to resolve conflicts between debtor and surplus countries.

The revised IMF Articles (of 1978) create only minimal legal requirements, ones that are difficult to apply and enforce in practice. The preamble to revised Article IV provides that ‘each member undertakes to collaborate with the Fund and other members to assure orderly exchange arrangements and to promote a stable system of exchange rates’. Section 1(iii) of Article IV provides, ‘in particular’, that members shall ‘avoid manipulating exchange rates or the international monetary system in order to prevent effective balance-of-payments adjustment or to gain an unfair competitive advantage over other members’. The legal standard for showing ‘manipulation’ is a delicate one because it includes both objective and subjective criteria – that of government intervention in exchange markets, and that of a country’s intent. The IMF has never made such a finding.

Pursuant to Article IV, the IMF adopted a surveillance system to ensure members’ compliance with their obligations, and thereby protect the stability of the global monetary system. Article IV, Section 3(a) mandates that the IMF shall ‘oversee the international monetary system in order to ensure its effective operation, and shall oversee the compliance of each member with its obligations under Section 1 of this Article’.

Members are to cooperate fully with the IMF and, to this end, ‘shall provide the Fund with the information necessary’, and ‘when requested by the Fund, shall consult with it on the member’s exchange rate policies’ (Article IV.3.b.). In 1977, the IMF Executive Board adopted a ‘Decision on Surveillance over Exchange Rate Policies’ which established several factors that the Fund must consider ‘which might indicate the need for discussion with a member’ (IMF Executive Board Decision 1977). Included in these factors is ‘protracted large-scale intervention in one direction in exchange markets’. In this way, the IMF can attempt to use the shadow of IMF rules to persuade countries to change their behavior.

As Rosa Lastra writes, ‘[f]rom being a virtually self-enforcing arrangement subject to *strict rules*, surveillance now becomes a function in which judgment is of the essence. Surveillance is no longer a rules-based regime but a “*discretion based regime*”’ (emphasis added) (Lastra, 2006, p. 400). The monetary legal order for exchange rate governance had largely folded. That left it ill-equipped to deal with new challenges,

such as increasingly frequent allegations of currency misalignment and manipulation. Currency misalignment and manipulation was a central factor in the fracturing of international cooperation in the interwar period, and would once more pose a major challenge following the financial crisis and so-called Global Recession of 2008.

In practice, the role of the IMF has been very limited, leaving an important gap in the institution whose mandate is to safeguard global financial stability. The Fund has initiated and conducted formal consultations with members regarding their exchange rate policy only twice, on an ad hoc basis, with Sweden in 1982 and South Korea in 1987 (Goldstein, 2006, p. 150). In both cases, the IMF did not make a finding that the country was unlawfully manipulating its currency, but only consulted with it in order to induce it to change its domestic practices. On global imbalances, the world similarly lacks hard legal rules, just like in the interwar period. When disputes arose following the collapse of Bretton Woods system of fixed exchange rates, governments used diplomacy and political pressure to coordinate a realignment of exchange rates, as reflected in the 1985 Plaza Accord – similar to the 1936 Tripartite Agreement for exchange rate coordination between the UK, France, and the United States.

Under the Plaza Accord of 1985, the United States, United Kingdom, France, Japan, and West Germany collectively intervened in currency markets to induce an appreciation of the yen and deutsche mark, and thereby help stem protectionist pressures from the private sector for restrictive trade measures in the United States. They did so, however, in a particular geopolitical context in which Japan and Europe depended on the US security umbrella in the context of the Cold War, and the United States exercised greater market power than it does today.

Formal dispute settlement likewise plays no role in international monetary law under the IMF today. Even though the IMF Articles contain binding rules, and the IMF in theory can impose sanctions to enforce them, such as withdrawing eligibility of a member's access to Fund resources, suspending its voting rights, or even compelling it to withdraw from the Fund, in reality, ineligibility for funds and suspension of voting rights are rare occurrences in Fund practice, and no country has yet been forced out of the IMF. The Fund, moreover, lacks a formal dispute settlement system. Rather the Fund relies on consultations with IMF members where IMF authority is based on Fund professional 'expertise', and, if applicable, any leverage the Fund has over a country in financial difficulty, as in the context of IMF financing

arrangements. Although some of the IMF's legal provisions are formally hard, they are in practice rather soft, in particular because their enforcement depends on consultations (Gold, 1982).

Although IMF members attempted to elaborate new rules to address exchange rate controversies in the 2000s, the rules remained weak in practice. There has been a similar turn towards informality in international finance more generally. Even though international monetary law retains a bedrock of hard legal rules, international monetary law is curiously silent about the major risk to global monetary stability – private international finance, where soft law predominates.

POST-1989: MISALIGNMENT, FRAGMENTATION AND POSSIBLE ECLIPSE

After 1989: the judicialization of WTO and the de-legalization of the IMF

When the Berlin Wall fell and the Soviet Union collapsed, ideas of market liberalization triumphed, reflected in the rise of the 'Washington consensus', a term coined in 1989 regarding neoliberal reform packages advocated by international financial institutions and other policy makers for developing countries to become more market-oriented (Williamson, 1990). The Uruguay Round of trade negotiations, which had been initiated in 1988, concluded with the agreement to create, for the first time, a formal international trade organization, the WTO, in 1995. Following the WTO's formation, the trade legal order reached the height of its influence. The WTO expanded the trade order's legal scope to include an array of new agreements covering non-tariff barriers, services, and intellectual property protection. The WTO's geographic scope continued to expand significantly, as its membership grew to 161 by May 2015, including China and Russia that joined in 2001 and 2012 respectively.

Under the post-Cold War trade legal order, WTO dispute settlement panels and the WTO Appellate Body issue legal rulings are binding on the parties to the dispute. These rulings are likewise regularly cited for their interpretations and applications of WTO law in subsequent disputes and rulings. If the respondent fails to comply with a ruling, the complainant has the option to enforce it through withdrawing trade concessions in an equivalent amount, something unthinkable in the IMF context. The WTO system also provides mechanisms for consultations and peer review that can facilitate compliance, but they exist

and operate in parallel and in the shadow of the formal WTO dispute settlement system.

The WTO system has become much more legalized than the original GATT and is now built on a hard law model that can affect deliberations in its soft law-type forums. WTO members filed 492 cases before the WTO dispute settlement system as of May 2015. WTO hard law thus exercises a much greater shadow effect on interactions within the WTO committee system. This judicialization of the trading order has curtailed the power of diplomats in favor of lawyers (Weiler, 2002), and potentially made it more challenging to reconcile the trade and monetary organizational cultures.

This increased legalization is reflected in the rising percentage of lawyers among the staff of the WTO: the percentage of lawyers at the WTO today is higher than before (WTO Annual Report, 2013). The number and role of lawyers has risen significantly within the WTO secretariat compared to under the GATT. With the decline of negotiating activity in the WTO and the ongoing importance of formalized dispute settlement, the WTO's Legal Affairs division (servicing all dispute settlement panels other than for import relief matters), the Rules division (servicing all panels on antidumping, subsidy, and safeguard relief matters), and the Appellate Body division (hearing appeals of all panel decisions), have risen in importance.

The rise of the influence of lawyers in the modern trade legal order is a recent phenomenon. The GATT Director General laid the seeds for the increasing influence of legal professionals when he created a small legal affairs division of three lawyers within the secretariat in 1982. This staffing of GATT dispute settlement panels with lawyers reflected and facilitated the move towards a more legalized dispute settlement system. With the WTO's creation in 1995, WTO members created a compulsory dispute settlement system to interpret and apply its legal requirements and authorize enforcement measures. No longer could a defendant unilaterally block the creation of a panel or the adoption of a panel report. The role of lawyers in the WTO secretariat accordingly rose.

Both the WTO agreements and the IMF Articles – whose reach was widest during the Bretton Woods period – formally imposed hard law obligations, but today, the density of hard rules differs considerably. Whereas the WTO agreements contain hundreds of pages of legal rules, backed by a formalized dispute settlement system, the number of hard law obligations in the IMF Articles is small. The result has been

coordination challenges in key areas affecting the interface of the two regimes, and in particular regarding the issue of currency manipulation when a WTO member intervenes on the currency markets or otherwise engages in macro-economic policies that depreciate its currency and provide commercial advantages to its domestic producers in international trade.

In contrast to the process of judicialization that has taken place in the WTO, the IMF has been more and more sidelined as a possible third party in international financial and commercial disputes over issues that fall under its jurisdiction, as illustrated by the recent evolution of the regulatory framework over capital controls. As said before, the founders of the Bretton Woods architecture had been very wary about the destabilizing effects of the free flow of capital, but the IMF did not create a clear system of hard law over the issue. Over the last decade, the implied authorization for capital controls that is inscribed in the IMF Articles has been increasingly overridden by bilateral free trade and investment agreements. The first step in this turn to bilateralism was a generalized move away from capital controls. During the 1970s and 1980s, US officials reversed their views on capital controls. In 1972, the United States announced for the first time at an IMF meeting that it opposed capital controls and would remove its own by the end of 1974. US officials then led a movement to overturn Keynesian views towards capital controls in the IMF and abroad. In the 1990s, the United States targeted controls that particularly affected the US financial sector (Chwieroth, 2010, p. 146).

This shift of views in the United States would soon lead to a domino effect in Europe and subsequently elsewhere. During the late 1980s and the 1990s, a new regional legal order emerged in Europe that provided for the elimination of capital controls. Under the Maastricht Treaty on European Union in 1993, European Union Law prohibited capital controls, and free capital mobility has since been further entrenched in EU law (now Article 63 of the Treaty on the Functioning of the European Union (TFEU)). Today, 'the very definition of a "European" state includes a commitment to capital mobility' (Abdelal, 2007, p. 83). This prohibition of capital controls underpins the European Monetary Union.

During the 1990s, the IMF too became increasingly receptive to the liberalization of global finance. IMF management and staff appeared to lead the charge as part of a neoliberal ideological turn, despite resistance from some of the IMF's membership, especially developing

countries (Abdelal, 2007). First, the Second Amendment to the IMF Articles in 1978 partially constrained countries' seemingly unqualified right to impose capital controls (under Article VI) by extending the IMF's surveillance function (under Article IV) to address the implications of national measures for global financial stability in a system without multilaterally fixed exchange rates. In its surveillance and technical assistance, IMF staff advocated and spurred countries to liberalize their capital controls, as well as to adopt financial standards and codes built largely from US and UK models (Chwieroth, 2010).

In the mid 1990s, IMF management, supported by developed country members of the Executive Board, pushed for an amendment of the IMF Articles to grant the IMF explicit jurisdiction over capital account transactions. The Executive Board approved a mandate to work on a new amendment to promote capital account liberalization through which countries' capital accounts would be progressively liberalized, just as their current accounts had been earlier (Fischer, 1998). The East Asian crisis of 1998 undermined these efforts. Developing countries opposed the IMF initiative almost in block. In September 1998, Malaysia banned all international capital transfers for one year to prevent contagion from the devaluation of the Thai baht. Its decision attracted considerable controversy, as it went against economic orthodoxy of the time, but the decision is now widely considered to have been a prudent measure (Kaplan and Rodrik, 2001). India and China continued to maintain limited openness in their capital account, and unlike many of their Asian peers, were spared serious banking and financial crises. The IMF quietly shelved its initiative and then altered its position over capital controls after being severely chastened for its handling of the crisis (Blustein, 2012).

When multilateral initiatives to guarantee free capital mobility failed to make much headway, the United States and some countries in Europe, lobbied by their financial sectors, became active in negotiating mostly bilateral free trade and investment agreements that restrict the use of capital controls and lead to patchwork liberalization of capital accounts through the backdoor (Waibel, 2009). Bilateral investment treaties (BITs) and free trade agreements (FTAs) with free transfer clauses are misaligned with the monetary legal order when it comes to addressing financial crises. Unlike the WTO's General Agreement on Trade in Services (GATS), the great majority of these clauses do not refer to the IMF Articles of Agreement, nor foresee any role for the IMF and its expertise in assessing whether restrictions on capital account are

justified on balance-of-payments grounds. German and US BITs typically do not even contain a balance-of-payments exception. By contrast, ASEAN member countries learned painful lessons in the Asian financial crisis of 1998, and these lessons are reflected in the detailed exceptions to the free transfer provisions in the ASEAN Comprehensive Investment Agreement of 2009 (Desierto, 2012). The agreement contains extensive references to the IMF Articles in order to justify the imposition of capital controls.

These BITs and FTAs also grant private rights to investors to enforce the commitments through investor-state arbitration, so that host states become liable for compensation to investors when they impose transfer restrictions. The threat of such investment disputes can change the calculus of governments and chill the use of capital controls. The turn away from informality and towards enforceability of norms of free capital mobility in BITs and FTAs risks restricting policy space for governments. Provided these norms guaranteeing free capital mobility are effective, they will prevent a vicious circle of capital controls. Notwithstanding, on the basis of the experience in the interwar period, these bilateral agreements may go too far by ruling out an instrument of macro-economic policy management that may be necessary, in extreme cases, to prevent rapid capital flight, such as in Iceland in October 2008. It also leads to fragmentation in the international monetary order based on competition for market access rather than policy coordination.

Thus, today, we observe further differentiation on geographic lines within the trade and monetary legal orders, resulting in growing fragmentation. Regional and bilateral alternatives and complements to the multilateral regime have risen to prominence, especially since the Doha Round of trade negotiations stalled and since the failure to create a multilateral regime for investment – the Multilateral Agreement on Investment, or MAI). For example, today the WTO, the EU, US, and other nations' bilateral free trade and investment agreements address capital transfers and capital controls in different ways (Shaffer and Waibel, 2015).

Even though bilateralism in trade and finance is not nearly as pervasive in trade and monetary affairs today as it was in the interwar period, the rise of bilateralism in trade and investment agreements over the last decade in particular poses challenges to both the modern trade and monetary legal orders, and their interface. Both the trade and the monetary transnational legal orders may now be past their peaks. The monetary regime, whose rapid decline – compared to the former glory of

the IMF under the Bretton Woods system – came with the transition towards floating exchange rates by the world's major economies, may provide a crystal ball into the future of the trade regime.

The failure to deal with disputes between debtor and creditor states

Post-1989, the functional differentiation between the IMF (whose main purposes, although they include the expansion of global trade, focus on financial issues dealing with balance of payments imbalances) and the WTO may have become the Achilles heel of the trade and monetary transnational legal orders. New challenges have arisen at the interface of the trade and monetary legal orders that neither order is able to satisfactorily resolve, such as the issues of exchange rates and global imbalances. These challenges of institutional interaction are substantially new since the WTO, the peak organization for the trade regime, was established only in the mid 1990s, and informal policy coordination has become more challenging with the diffusion of economic power, reflected in the rise of China and other emerging economies and the relative decline of US and European economic power.

Over the last decade, global imbalances and associated allegations of currency misalignment and manipulation have become one of the most pressing issues facing the international community. What role can the trade and the monetary legal orders play in ensuring the orderly unwinding of global imbalances? This unwinding poses a major threat to not only cross-border trade in goods and services, and cross-border financial transactions, but to the stability of the international economic system as a whole. Thus far the monetary and trade legal orders have not assisted countries in alleviating these global imbalances, as actors have considered but so far been unable or unwilling to use law for such ends. These global imbalances are widely seen as one of the proximate causes of the global financial crisis that started in 2008.

It is a time-honoured pattern that surplus and deficit countries tend to disagree about the solution to global imbalances, one that goes back to the interwar period involving disputes among debtor and surplus countries (Meissner, 2010). Debtor countries tend to advocate multi-lateral solutions that require creditor countries to assume some responsibility for limiting global imbalances. Yet time and time again, surplus countries, whose identity has changed over time, resist such moves. As a result, we presently have no hard rules and precious little soft law that could help with unwinding global imbalances resulting from exchange

rate misalignment. Germany in the interwar period, and the UK following World War II, adopted the position characteristic of the deficit countries, contending that part of the burden of adjustment should fall on surplus countries, such as the United States. At Bretton Woods, the United States, which was the major surplus country at the end of World War II, blocked Keynes' initiatives for multilateral rules to be introduced which imposed obligations on both surplus and deficit countries to adjust imbalances (Steil, 2013, p. 208).

In the intervening decades, the United States has become the world's largest deficit country, and China the world's largest surplus country. Not surprisingly, in the last decade, the United States has pressed the IMF to interpret and apply IMF rules to induce China to change its exchange rate policies so as to reduce China's surplus, and has toyed with the idea of imposing sanctions on China for deliberately undervaluing its exchange rate through interventions on the currency markets. More recently, Germany has come under pressure from its Eurozone partners and the US government, among others, to do its part in reducing imbalances by boosting domestic demand and investment, and as a consequence, at least partly unwinding its sizeable trade surplus.

Because China is the largest creditor in the world and has a huge trade surplus, China became a center of concern in the United States during the 2000s regarding the interface of trade and monetary policy. China has actively and regularly intervened on foreign exchange markets to stem the likely appreciation of its currency (the renminbi, or yuan). China's foreign exchange reserves have risen in the process from \$403 billion at the end of 2003 to over \$3.3 trillion by the end of 2011 (CIA). US policy makers have responded by raising allegations of currency manipulation, as reflected in the 2012 US political campaign in which Republican candidate Mitt Romney proclaimed that he would declare China a currency manipulator on his first day of office.

In comparison, the relationship between the United States and China in the trade legal order has been considerably less contentious. The approach of China to the WTO has been largely cooperative. As of May 2015, China has been complainant in thirteen cases, and respondent in thirty-three cases before the WTO's Dispute Settlement Body (WTO website). The United States brought fourteen of the cases against China. As a rule, China has complied with panel reports and Appellate Body decisions, with the recent exception of the *Publications and Audiovisual Products* (WTO, DS363) where China only implemented the AB's ruling with a delay of two-and-a-half years (Zhang and

Li, 2014). Since 2008, China has proactively used WTO dispute settlement, increasingly also acting as a complainant as a result of rising legalism and socialization (Harpaz, 2010; Huang and Ji, 2012).

The US government's attempt to press the IMF to be more aggressive towards China in its Article IV surveillance, aiming to induce the IMF to pressure China to permit the renminbi to appreciate. These actions divided IMF staff, some of whom found 'that the US Treasury wanted them to do its dirty work' (Blustein, 2012, p. 11). The IMF staff felt under considerable pressure from the US Treasury to find that renminbi was fundamentally misaligned, allegedly even sparking remarks from IMF Managing Director Dominique Strauss Kahn that it was 'black-mail' because the IMF needed Congressional votes to maintain the Fund's financial viability (Blustein, 2012, p. 21).

In 2007, the IMF staff prepared and the Executive Board adopted a revision to the IMF's surveillance guidelines, called 'Decision on Bilateral Surveillance over Member's Policies'. Controversially, the IMF Decision adopted 'fundamental exchange rate misalignment' as its key term for surveillance, which was the very language used in a US Senate bill sponsored by Senators Charles Grassley and Max Baucus, the Republican and Democratic leaders of the Senate Finance Committee. The IMF Executive Board adopted the principles despite China's vote to the contrary, after considerable IMF and US efforts at persuading non-OECD members of the Executive Board who initially opposed it. This 2007 Decision could be read as tempering the reference to 'currency manipulation' (the 'scarlet M' in the words of U.S. Treasury Under Secretary Timothy Adams) (Blustein, 2012, p. 12) with the less politically-charged language of 'fundamental exchange rate misalignment', and to do so in the context of an open-ended, but formally binding IMF Article IV undertaking.

The Fund's staff attempted to implement the Decision in preparing the next Article IV report on China in September 2008, finding that 'there are significant concerns that the exchange rate may be fundamentally misaligned and exchange rate policies could be a significant contributor to external instability'. However, the IMF did not publicly release the report in light of the bankruptcy of Lehman Brothers that catalyzed the global financial crisis. It was an inopportune time to pick a fight with China (Blustein, 2012, p. 21).

China reacted vigorously to the IMF Decision and draft surveillance report. It was particularly concerned that such a report could provide ammunition for a WTO complaint against it, as well as

justification of unilateral protectionist measures. China stopped high-level contacts with the IMF. The IMF eventually backed down and, abandoned use of the term ‘fundamental misalignment’. It quickly adopted a ‘revised operational guidance’ for its 2007 decision that it put on its website, noting: ‘The attempt to apply exchange rate-related “labels” – for instance the use of specific terminology such as “fundamental misalignment” ... has proved an impediment to effective implementation of the Decision’. The IMF acknowledged that this episode had been ‘damaging [to] the Fund’s credibility’ (Blustein, 2012, p. 23). It abandoned the use of the term ‘fundamental misalignment’ and rather used terms such as ‘under-or overvaluation’ in its ensuing country reports under Article IV (IMF 2009, [8]).

In light of the United States failure to enlist the IMF in challenging China’s exchange rate policy, the handling of the issue of global imbalances and currency valuations shifted to the G20, reflecting the rise of emerging economies in global governance and a move away from international law and independent international institutions such as the IMF. The G20 launched a new process at its Pittsburg summit in September 2009, entitled a Framework for Strong, Sustainable, and Balanced Growth. Under the framework, members agreed to a multilateral Mutual Assessment Process under which they identify objectives, policies to achieve them, and a peer-review monitoring process. Positions, however, continue to divide, such as between the United States, which wants quantitative benchmarks and a peer-review mechanism for assessing currency misalignment, and China, which resists constraints on it. In short, law has played little role, and the turn to political ordering has been unsuccessful.

CONCLUSION

In the 1940s, the United States and UK took the lead in creating new international institutions to address international monetary and trade issues through law. They created two distinct trade and monetary legal orders, one governing monetary affairs through the IMF, and the other governing trade matters through the GATT. How they interact, and how the terms of this interaction have changed over time, tells us something important about the history of economic globalization.

However, when the international economy moved towards floating exchange rates and free capital mobility in the 1970s and with increasing liberalization post-1989 with the collapse of the Berlin Wall

symbolizing the end of the Cold War, the interface between the monetary and trade legal orders became more conflicted. In particular, the issue of exchange rates is a non-law area today, much like during the interwar period. The fragmentation of law reflected in the rise of bilateral trade and investment agreements further opens up the prospect of conflict on the issue of capital controls, curtailing government policy space to prudentially address financial stability and to respond to financial crises. As the monetary legal order under the IMF has become less legalized, the trading order has become more so under the WTO and bilateral agreements, with many of the latter guaranteeing the free movement of capital and thus countering the implied authorization for capital controls under the IMF Articles.

The misalignment of the two legal orders on exchange rates, in turn, spurs demands for trade protectionism, in a global economy still dealing with the hangover of the global financial crisis of 2008, much like the overhang of debt in the interwar period that was intimately linked to the issues of exchange rates, balance of payments, and the use of capital controls to stem capital flight. The absence of third party dispute settlement leaves the issue of exchange rate coordination entirely to negotiations between governments. Similar to the interwar period, both surplus and deficit countries struggle to fashion solutions in multilateral and bilateral negotiations to unwind global imbalances.

In the interwar period, the collapse of the gold standard and the rise of currency instability affected trade and investment with a lag. A repeat of this experience is a possibility. Dark clouds stemming from the backlash against financial globalization are likely to hang over the contemporary international economic system for some time. The resilience and adaptability of the trade and monetary legal orders are likely to face particular challenges in the coming years. The interwar experience points to the limits of political ordering. Diplomacy cannot substitute for weak legal ordering in all circumstances. The shadow of international economic law can provide useful stimulants for governments to reach cooperative solutions to some of the gravest challenges facing the world economy, such as global imbalances and high levels of private and public indebtedness. But there is no guarantee that it will do so.

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