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NON-STATE ACTORS AND THE INTERNATIONAL INSTITUTIONAL ORDER: CENTRAL BANK CAPTURE AND THE GLOBALIZATION OF MONETARY AMNESIA

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The role of private, non-state actors in the international institutional and legal order is often praised by scholars as a progressive development that promises greater pluralism, public participation, and transparency in the formulation of legal norms.¹ Often overlooked, however, are the ways that non-state actors undermine the sovereignty and practical capabilities of nation-states to provide for the welfare and security of citizens. Threats from particular non-state actors such as private terrorist networks have received wide attention, but less visible and arguably much more significant is the growing influence of non-state actors in the global financial system.²

The enormous growth of global capital and currency markets, fueled and dominated by non-state actors, has undermined the ability of states to incur deficits, even modest deficits

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¹ Harold Hongju Koh, *The 1994 Roscoe Pound Lecture: Transnational Legal Process*, 75 NEB. L. REV. 181, 194 (1996) (claiming that international institutions and participation of non-state actors reflect "the rule of law, not power"). Others argue that international law scholars are simply ignoring the distributions of power embedded in our institutions. David Kennedy, *Boundaries in the Field of Human Rights: The International Human Rights Movement: Part of the Problem?*, 15 HARV. HUM. RTS. J. 99, 118–25 (2002).

² ASIL's *100 Ways* glosses over the role of private actors in the international financial system by praising the Bretton Woods system for stabilizing currency and inflation rates. AMERICAN SOCIETY OF INTERNATIONAL LAW, INTERNATIONAL LAW: 100 WAYS IT SHAPES OUR LIVES 5, No. 17 (2006). José Alvarez, in his *50 Ways*, provides a necessary corrective, pointing out the damage of Washington Consensus policies and the less-than-transparent decisionmaking processes of Bretton Woods institutions. JOSÉ E. ALVAREZ, INTERNATIONAL LAW: 50 WAYS IT HARMS OUR LIVES, 25, No. 6 (2006).

by historical standards, or to otherwise stimulate their economies.³ The scale of cross-border money flows has also largely overwhelmed the regulatory efforts of nation-states, which are often underfunded and unilateral in scope. As a result, nation-states have become increasingly powerless to prevent or even monitor the movement of all kinds of wayward funds, from the stolen millions of corrupt foreign officials to illegal drug money, terrorist financing, and the billions of dollars seeking offshore tax havens.⁴ This regulatory vacuum also skews our public policies and discourse on a number of issues, such as foreign aid and public investment which are more easily opposed as wasting taxpayer dollars to corrupt regimes. The problem is thereby seen as *their* corruption, not the corruption of *our* legal systems, our payments systems, our banking facilities, our bank secrecy laws, and our failure to implement cooperative capital controls or any kind of effective multilateral regulation of finance.

Non-state actors also shape today's global order by capturing the institutions of the state, contributing to the problem of "democratic deficits": the regulated industry captures the regulator, often with promises of future employment (the so-called "revolving door"), inducements of political support, and campaign contributions. The capture of the two aging Bretton Woods institutions, the International Monetary Fund and the World Bank, has been widely noted by critics of the Washington Consensus such as Grotius Lecturer and Nobel laureate Joseph Stiglitz⁵ and other leading economists.⁶

In contrast to this scrutiny of Bretton Woods institutions, there has been a relative silence about the capture of central banking institutions, perhaps the most significant agency capture by non-state actors in today's international legal order. The capture of foreign central banks, regularly pushed as an IMF loan conditionality, has been largely modeled on the "autonomous" Federal Reserve. It is a model that de-links central banks from any significant democratic political control or direction. The autonomous Fed, in turn, reflects a distinctly biased reading of history, one that forgets an entire decade of Federal Reserve history, 1941 to 1951, which strangely happens to be the most successful decade in U.S. economic and social history.

This forgotten decade of U.S. monetary history included massive federal spending on World War II and the two most expensive Cold War programs, the Marshall Plan that rebuilt much of post-war Europe and Japan, and the G.I. Bill of Rights that provided education, housing, and jobs to more than 16 million returning U.S. war veterans. There were several distinctive features about this period: federal spending and real economic growth were magnitudes greater than before or since, and the Federal Reserve was not functionally autonomous but, rather, was under the strict direction of the Treasury Department.⁷

Federal spending did not just double or triple during World War II. It rose more than fifteen-fold, from \$6 billion in 1940 to \$95 billion in 1944, from about 10% to 43.6% of

³ These limits on the capabilities of nation-states were made evident by the 1990s currency contagion and the continuing growth of hot money portfolio capital flows. Timothy A. Canova, *Banking and Financial Reform at the Crossroads of the Neoliberal Contagion*, 14 AM. U. INT'L L. REV. 1571 (1999).

⁴ For instance, the international financial regulatory system was unable to prevent or investigate the theft of billions of U.S. taxpayer dollars from Iraq's reconstruction to secret bank accounts in Arab and non-Arab countries. Fouad Ajami, *Blind Liberation*, NEW REPUBLIC, Apr. 23, 2007, at 48.

⁵ JOSEPH STIGLITZ, GLOBALIZATION AND ITS DISCONTENTS 53-54 (2002).

⁶ Jagdish Bhagwati has referred to the "Wall Street-Treasury-IMF complex," suggesting the capture of federal and multilateral agencies by private financial actors. JAGDISH BHAGWATI, IN DEFENSE OF GLOBALIZATION 205-06 (2004). The capture of Treasury by Wall Street interests has been personified by the revolving-door career of Robert Rubin. Robert Kuttner, *Friendly Takeover*, THE AMERICAN PROSPECT, April 2007, at 12.

⁷ Timothy A. Canova, *Closing the Border and Opening the Door: Mobility, Adjustment, and the Sequencing of Reform*, 5 GEO. J. L. & PUB. POL'Y, n. 275-300 (2007).

gross domestic product (GDP). This boost in federal spending fueled an economic boom that won the war in less than four years, with real (inflation-adjusted) economic growth rates above 15% for three consecutive years and averaging double digits throughout the war. The economy doubled in size in less than five years.⁸ By comparison, today's federal spending is about 20% of GDP,⁹ and in the five years since September 11th, real U.S. economic growth has been less than one-fifth of the peak World War II growth rates.¹⁰

Where did the federal government get the financial resources for such massive spending programs? Although federal income taxes were much higher than today, taxes covered only about 41% of war costs. The rest was borrowed by the Treasury Department through its bond sales. The federal government debt rose from 50% of GDP at the beginning of the war to 120% of GDP soon after the war ended, and throughout the Marshall Plan/ G.I. Bill period it remained mostly over 90%. Today, the federal debt is about 65% of GDP.¹¹

Although most of the federal debt was held by the public, the Federal Reserve was forced to purchase significant amounts of Treasury debt to maintain a low interest rate for federal borrowing. For much of the "pegged period," interest rates on U.S. government borrowing were pegged at 0.375% for short-term ninety-day Treasury bills and 2.5% for long-term (ten-year) Treasury bonds. The Fed was required, by convention with the White House and Treasury, to purchase government securities at any price and in any amount necessary to keep interest rates at these pegs.

With an inflation rate that averaged about three percent a year during the final three years of the war, the federal government was borrowing at negative real interest rates.¹² Quite simply, under such conditions, it paid to borrow and spend, and not surprisingly, the nation-state boomed, and no problem at home or abroad seemed too great for solution.¹³

This arrangement—a politically directed Federal Reserve, neutralized monetary policy, and hyperactive fiscal policy—was recognized at the time by every finance text, economics text and monetary history, and from every ideological camp. It was accepted by the Fed itself as a necessary and established fact of life. According to Lester Chandler's seminal text, *The Economics of Money and Banking*, the Fed "stood ready to buy without limitation" the range of government securities to maintain the pegged interest rates.¹⁴ The comparison with today's texts in economics, finance and history is troubling. The pegged period of 1941–1951, the most impressive decade of U.S. economic growth, has been airbrushed away.¹⁵ It should be no small wonder that most Ph.D. economists and M.B.A. graduates are completely unaware of the pegged period and accept Federal Reserve autonomy as a matter of faith.

⁸ Annual Report of the Council of Economic Advisers 220, 223 (1984), Tables B-1, B-2.

⁹ Annual Report of the Council of Economic Advisers 324 (2007), Table B-79.

¹⁰ Timothy A. Canova, *American Wartime Values in Historical Perspective: Full-Employment Mobilization or Business as Usual*, 13 ILSA J. INT'L & COMP. L. 1, 5, n. 13 (2006).

¹¹ Annual Report, *supra* note 7.

¹² JOHN BLUM ET AL., *THE NATIONAL EXPERIENCE: A HISTORY OF THE UNITED STATES SINCE 1865*, at 720 (1977).

¹³ It was not until the 1951 Treasury Accord that the Federal Reserve regained its independence from the Treasury and White House.

¹⁴ LESTER V. CHANDLER, *THE ECONOMICS OF MONEY AND BANKING* 482–93 (5th ed. 1969). See also BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM, *THE FEDERAL RESERVE SYSTEM, PURPOSES AND FUNCTIONS* 105 (1947); MILTON FRIEDMAN & ANNA JACOBSON SCHWARTZ, *A MONETARY HISTORY OF THE UNITED STATES 1867–1960*, at 557–58 (1963); PAUL A. SAMUELSON, *ECONOMICS* 351–55 (1948).

¹⁵ ROBERT H. FRANK & BEN S. BERNANKE, *PRINCIPLES OF MACROECONOMICS* 280–86 (3d ed. 2007) (providing Federal Reserve and monetary history that includes pre- and post-pegged period, but nothing on the pegged period itself). Bernanke's skewed history has not harmed his professional standing. To the contrary: he now serves as chairman of the Federal Reserve Board. For other leading texts that omit this period of history, see Canova, *supra* note 7, at n. 274.

As John Maynard Keynes once observed, "In economics you cannot convict your opponent of error, you can only *convince* him of it."¹⁶ But apparently there is no convincing an economics establishment that simply ignores the empirical evidence and has a vested interest in the ideology of an autonomous central bank.

Legal scholars have largely deferred to the amnesia of the economics establishment.¹⁷ There have been numerous constitutional challenges to the Federal Reserve's unique institutional structure which conducts monetary policy through its Federal Open Market Committee that includes significant private representation, the privately-selected regional Federal Reserve Bank presidents. The challenges, based on the Appointments Clause as well as the private nondelegation doctrine, have all been dismissed on procedural grounds, such as lack of standing.¹⁸ In obvious disregard for the empirical evidence, the U.S. Court of Appeals for the D.C. Circuit has denied that any plaintiff could trace any economic injury to any of the Fed's interest rate decisions. When standing has been found, such as for Congressional plaintiffs, the court has simply dismissed on grounds of "equitable discretion." Since the Supreme Court's only contribution has been to deny certiorari, constitutional law scholars have remained equally silent on the suspect status of the Fed's institutional structure.¹⁹

The monetary amnesia of constitutional scholars extends much further back, at least to the First and Second Bank of the United States, and the Civil War Greenback.²⁰ But those are yesterday's institutions. The Federal Reserve is here today, and its capture has been so complete and so little recognized, and the range of acceptable monetary policies so limited that we are now in danger of forgetting just what it is we have lost.²¹

During the 1941–1951 pegged period, the annual federal deficit peaked at about 30% of GDP; today it is less than 3% of GDP.²² There are times when the needs of the present and hopes for the future require democracies to spend and borrow on a grand scale. Perhaps the nation-state is once again in such a time. If so, the most important questions are those related to the terms of such borrowing. During the pegged period, the federal government borrowed on a grand scale, but it borrowed at zero interest rates (even at negative real interest rates) and it borrowed from its own citizens and central bank. How different from today when the federal government borrows at 5% (other Americans at even higher interest rates), borrows

¹⁶ As Keynes also pointed out, "Even if you are right, you cannot convince him, if there is a defect in your own powers of persuasion and exposition." JOHN MAYNARD KEYNES, 12 THE COLLECTED WRITINGS OF JOHN MAYNARD KEYNES 470 (D. E. Moggridge ed., 1978).

¹⁷ Alas, another example of how our law schools today have become the "seminaries of yesterday's orthodoxies." ELDON J. EISENACH, THE LOST PROMISE OF PROGRESSIVISM 6 (1994).

¹⁸ Canova, *supra* note 7, at n. 309–314, 326 (discussing John Hart Ely's characterization of the Federal Reserve as "the poster child of an unconstitutional delegation").

¹⁹ Reform of the Federal Reserve need not be radical or destabilizing. The late Henry B. Gonzalez, Chairman of the House Banking Committee, had proposed making the FOMC members subject to Presidential appointment and Senate confirmation, a reform which could make the Fed more inclusive of the diversity of interests and opinions in our society, from organized labor to student debtors and industrial and manufacturing corporations, as opposed to firms involved solely in banking and finance capital. James K. Galbraith, *The Federal Reserve: Give It Till Sunset*, in RECLAIMING PROSPERITY 197–209 (Todd Schafer & Jeff Faux eds., 1996).

²⁰ This monetary amnesia is on display when a leading scholar takes a swipe at Andrew Jackson for "indulging in legally problematic uses of executive power to withdraw federal deposits" from the Second Bank, while making no mention of the constitutionally far more problematic use of legislative power to create a central bank controlled by private shareholders, i.e., an unconstitutional delegation of one of the most important legislative powers into private hands. Bruce Ackerman, *This Is Not a War*, 113 YALE L. J. 1871, 1872, n.3 (2004).

²¹ Jane Jacobs warns how mass forgetfulness can present an insurmountable barrier to a culture's development and survival. She notes the historical lessons taught by Jared Diamond of the mass forgetting that can lead to collapse of nations, civilizations, and ecosystems. JANE JACOBS, DARK AGE AHEAD 3–14, 21–26 (2005).

²² And so it is with personal finances that there are times when individuals must borrow far more than 30%, or even 100% of their annual income, to invest in their educations, for example.

much from abroad (more than \$2 billion a day from abroad), and increasingly from lawless regimes such as the People's Republic of China and corrupt Gulf monarchies.²³ In *The Revolt of the Masses*, José Ortega y Gasset compared modern western man to a spoiled child, concerned with only his own well-being, at the same time ignorant about the causes of that well-being, believing that the material and social organization of civilization has been placed at his disposal like the air, unable to see that behind the benefits of civilization are marvels of invention and construction which are only maintained by great effort and foresight.²⁴

Today's generation is apparently too busy enjoying all the wonders and frivolity of civilization to remember that it was built on a foundation of massive public investment, public spending and borrowing on a far grander scale than today. Not surprisingly, we witness deteriorating infrastructure, from collapsing bridges to failing public institutions. It becomes harder to imagine how it could be done again. Proposals made by Nobel laureate economists are easily dismissed in the state of amnesia. The so-called Tobin Tax (named after the late James Tobin), a proposal for a small turnover tax on cross-border currency flows to protect the monetary capabilities of nation-states, while endorsed by European parliaments and presidents, was killed off during the Clinton Administration by a captured Treasury Department, the very Wall Street-Treasury Complex.

Today's monetary amnesia is a collective forgetting of our own American history. We forget what it took to build this and other nations, and then we cannot remember how to rebuild after hurricanes or how to reconstruct war torn countries abroad.

This is also an amnesia that is quickly becoming globalized by the Bretton Woods institutions, responding to powerful non-state private financial actors, requiring client states to accept central bank capture and then to call it central bank autonomy. Most of those pushing the program no longer even remember that there was once any alternative, a highly effective alternative. This amnesia, serving private interests, undermining public ends, has now become one of America's most insidious ideological exports, a perverse contribution to the international legal and institutional order that constrains social progress at home and around the world.

²³ Perhaps control of U.S. interest rates is passing to Chinese President Hu Jintao. Paul Krugman, *China Unpegs Itself*, N.Y. TIMES, July 22, 2005, at A19. "Hu's in charge here," according to Robert J. Barbera, chief economist of ITG/Hoenig. Floyd Norris, *Who's in Charge of Determining U.S. Interest Rates? It May be Beijing*, N.Y. TIMES, May 13, 2005, at C1. It is sad enough to remind one of the old Abbott and Costello routine, "Who's on first." "Hu's setting U.S. interest rates?" "Exactly!"

²⁴ JOSÉ ORTEGA Y GASSET, *THE REVOLT OF THE MASSES* 58-60 (1932).