

**Working paper — please do not cite.**

## **Attention: Deficit Disorder! Fiscal Coordination in the Group of 7 and Group of 20**

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Paper prepared for the annual meeting of  
the International Studies Association  
Toronto, Ontario  
28 March 2014

**Abstract:** Perhaps the most important development in international economic governance over the past decade has been the emergence of the Group of G20 (G20), and perhaps the most notable of the G20's recent endeavors has been to promote coordination of leading countries' fiscal policies during and after the financial crisis of 2008. The literature has tended to ignore the phenomenon of international fiscal coordination, for the simple reason that it has largely been absent—though the G20's efforts, and more recently the signing of the European Union's fiscal pact, demand new consideration of the conditions under which sovereign states undertake coordinated fiscal actions. In this paper we begin to map the terrain of international fiscal coordination, examining the international and comparative political economy literatures for plausible hypotheses and applying them in three cases: the Bonn accord (1978), the Plaza accord (1985), and the stimulus and consolidation phases of post-2008 G20 agreements. We find particular support for a focus on declining US hegemony, in which Washington's declining scope to offer inducements to others (especially Germany and Japan) to bear costs of adjustment has led it to pursue greater delegation to external monitors (especially the IMF) in the G20 agreements.

**Keywords:** international coordination, fiscal policy, G20, global governance

The 2008 international financial crisis and its aftermath exposed not only how quickly international economic multipolarity has emerged but also the speed with which the Group of 20 (G20) has eclipsed the Group of 7 (G7) as the preeminent forum for international economic coordination. G20 leaders and ministers met several times since the crucible of the crisis in 2008, producing a series of policy recommendations intended to promote economic stabilization, recovery, and growth. Among these prescriptions was a standard menu of macroeconomic measures, including coordination in monetary policy and even exchange rate policy, as well as financial sector governance.<sup>1</sup> But perhaps most notable has been an attempt to influence its members' fiscal policies, specifically toward simultaneous fiscal stimulus during the trough of the crisis and thereafter more differentiated paths of consolidation or expansion as a means to unwind large international imbalances.

The international political economy (IPE) literature has tended to ignore fiscal coordination, because formidable domestic and international political obstacles have meant that attempts at international fiscal coordination are comparatively rare. Groups of leading industrialized economies such as the G7 and the Organization for Economic Cooperation and Development (OECD) occasionally produce fiscal recommendations, but they tend to be nonbinding—and are often ignored. Yet persistent imbalances in the international economy—specifically, between debtor and creditor countries—suggest that the conditions for instability, and thus need for coordination to ameliorate them, remain in place. Indeed, the euro crisis offers not only a possible preview of major disruptions resulting from imbalances but also the clearest example of strong fiscal coordination among sovereign states to deal with them. States' incentives to engage in fiscal cooperation grow in line with the interdependence of their economies and financial systems; what factors are necessary and/or sufficient to overcome the political barriers and act on these incentives? And when some coordination does occur, how are the costs of adjustment distributed?

In this paper we begin to map the terrain of the underexplored territory of fiscal coordination. The paper starts with a conceptualization of fiscal coordination, defining it primarily as a credible commitment among states to mutually adjust their fiscal policies toward international goals of economic recovery and rebalancing. It then introduces three key cases of agreements in leading-economy forums: the Bonn (1978) and Plaza (1985) agreements in the Group of 7 and fiscal stimulus (2008) and consolidation (2010) agreements in the Group of 20, and subsequently identifies a set of propositions from the IPE literature and applies them in a preliminary way to these cases, drawing both on primary interview research and the secondary literature. The final section concludes with some initial observations and plans for further research.

## **I. On international fiscal coordination**

International coordination of national macroeconomic policies has a decidedly mixed record over the past century. Since the collapse of the Bretton Woods system in the early 1970s, leading states have, through forums such as the Group of 7 and Group of 20, occasionally agreed to

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<sup>1</sup> On the G20 and international financial governance, see among others Beeson & Bell 2009; Porter 2009; Bremmer & Roubini 2011; Drezner 2012.

mutually adjust their macroeconomic policies to promote international stability, growth, and/or rebalancing. By contrast, during the Great Depression they engaged in “anti-coordination”—beggar-thy-neighbor policies that had the intent of improving national economic conditions at the expense of trade partners and the effect of further undermining international economic recovery. Overall, according to Drezner (2012: 17), “the history of macroeconomic policy coordination is not a distinguished one.”

Macroeconomic coordination—involving monetary, exchange rate, or fiscal policy—is occasionally necessary to provide the public goods of stability and growth in the international economy, particularly during periods of international economic crisis.<sup>2</sup> Whether in periods of acute crisis (such as the 1930s or 2007-9) or more limited disruptions, macroeconomic coordination is *hard*: according to Willett (1999: 232), “the startling fact is not that there has been so little effective international coordination, but that there has been any coordination at all.” When it has occurred, most such coordination has involved monetary or exchange rate policy; states more rarely mutually adjust fiscal policy—despite the fact that unsustainable deficits and debt can be the cause of systemic crises. And, especially among large economic powers, coordinated economic stimulus can help stabilize a major global slump and restore growth thereafter, while coordinated rebalancing—fiscal stimulus by creditors and consolidation by debtors—can unwind dangerous global imbalances. Such imbalances are currently prevalent among the world’s biggest trading states. (See Table 1 below.)

**Table 1. Imbalances among the world’s leading trading states, 2013**

Country	current account balance (%GDP)	budget balance (%GDP)	gross public debt (%GDP)
1. China	2.0	-1.8	22.8
2. United States	-2.4	-4.1	87.6
3. Germany	6.8	0.1	82.0
4. Japan	0.9	-8.2	237.9
5. France	-2.2	-4.0	90.3
6. United Kingdom	-3.8	-6.7	90.3
7. South Korea	3.8	0.5	33.7
8. Netherlands	10.1	-3.5	71.7
9. Hong Kong	2.7	1.8	32.4
10. Canada	-3.4	-3.3	85.6

**Note:** Countries ranked by total trade volume.

**Sources:** current account, budget deficit: Economist Intelligence Unit (1 March 2014); public debt: IMF (April 2013 World Economic Outlook)

Why do we see fewer instances of effective international fiscal coordination than its monetary and exchange rate counterparts? Three factors seem particularly relevant. First, coordination of fiscal policy faces free rider problems. States can not only benefit from others’ stimulative expenditures but also minimize the pain of their own fiscal consolidation by imposing austerity while others are engaging in stimulus—potentially leading to universal austerity that can prolong international slumps (Blythe 2013). Second, fiscal policy is increasingly important as a tool of national economic management, especially if capital mobility forces states to choose between a

<sup>2</sup> According to Kindleberger (1973) a single, hegemonic state can provide such public goods, thereby obviating the need for coordination.

fixed currency and control over interest rates (as per the “trilemma”). Moreover, given the centrality of fiscal policy to national sovereignty—with taxation as the primary form of states’ legitimate economic coercion—international constraints can impose particularly high sovereignty costs on participating states.<sup>3</sup> Third, fiscal policy is less technical and removed from democratic political processes than either monetary or exchange rate policy, and thus is more “public” and subject to interest group pressures (Willett 1999; see also Gowa 1988).

Nevertheless, fiscal coordination does occur, so our first requirement is to define it. Drawing on Abbott et al (2000), we focus on two characteristics of agreements promoting fiscal coordination, *specificity* and *delegation*.<sup>4</sup> Specific rules are highly precise regarding the nature of states’ obligations, particularly if quantitative targets for stimulus, budget deficits, and public debt are identified. Precision limits the scope for states to interpret their obligations under an agreement. Delegation involves the transfer of authority to an international organization to perform agreed-upon tasks such as adjudication or surveillance. Our particular focus for delegation is monitoring: even if rules are nonbinding, surveillance can be an important element of fiscal coordination to the extent that states can be “shamed” into compliance.

The euro area—the group of countries using the single currency within the European Union—offers the clearest example of high levels of international fiscal coordination. During the 1990s, prior to the adoption of the euro, members were required to meet a variety of macroeconomic criteria, including specific targets for budget deficits (<3% of GDP) and public debt (<60% of GDP). These fiscal targets became permanent in the Stability and Growth Pact (SGP), a relatively weak regime adopted in 1997, and were subsequently strengthened in the 2012 Fiscal Compact (formally, the Treaty on Stability, Coordination and Governance in the Economic and Monetary Union), the exemplar of strong fiscal coordination.<sup>5</sup> The 2012 fiscal pact requires signatories to amend their national constitutions and/or enact equivalent national laws to impose “a ‘balanced budget rule’ and an automatic mechanism to take corrective action,” and empowers the more politically independent European Court of Justice to enforce compliance and authorize punishment (fines). The fiscal pact maintains the SGP’s specific targets of 3% of GDP for budget deficits and 60% of GDP for public debt, from which they “may temporarily deviate...only in exceptional circumstances,” and adds precise figures for the size of the structural deficit and appropriate fines for noncompliance, among others. Meanwhile, the fiscal pact expands the delegation of authority to the Commission to monitor euro area members’ fiscal policies and to recommend fines for noncompliance to the ECJ. Though the treaty falls short of the fiscal union some had prescribed for the European Union (or at least the euro area), it is an unprecedented example of a formalized institutional commitment among sovereign states to coordinate their fiscal policies toward stability and (perhaps) growth.

Yet although it is an exemplar of a high level of international fiscal coordination, the Fiscal Compact cannot be readily compared to our cases of interest in the Group of 7 and Group of 20, for two main reasons. First, the euro area is a fixed-rate currency regime, as opposed to the (mostly) floating rates that exist among members of the G7 and G20. As such, currency revaluation and/or monetary policy are unavailable as mechanisms of adjustment in the euro

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<sup>3</sup> On sovereignty costs, see Abbott & Snidal 2000.

<sup>4</sup> In a future iteration of this paper, we will consider a third dimension of fiscal coordination, *compliance*.

<sup>5</sup> The treaty text can be found at [european-council.europa.eu/media/639235/st00tscg26\\_en12.pdf](http://european-council.europa.eu/media/639235/st00tscg26_en12.pdf).

area, which in turn places a far greater burden on fiscal adjustment. Second, the euro area and EU more generally are categorically distinct from the G7 and G20 in terms of the “thickness” of the institutional environment; the EU is an institutionalized vehicle for *integration*, a far deeper and more demanding form of sovereignty pooling than mere policy coordination in the Groups of 7 and 20. So, as we consider these other cases of fiscal coordination, it is essential to recall that (1) fiscal coordination faces greater obstacles than other available forms of macroeconomic coordination and (2) the Groups of 7 and 20 are arenas of relatively limited (if not negligible) institutional capacity, and thus, as Willett claims, *any* degree of coordination is noteworthy and demands explanation.

## II. Cases: Bonn, Plaza, and G20

Following the collapse of the Bretton Woods system in the early 1970s, leading advanced industrialized countries recognized the need to establish new mechanisms to promote international economic stability within the context of the new, floating-rate currency regime. While members of the European Economic Community pursued their own system, Britain, France, (West) Germany, Japan, and the United States—later joined by Canada and Italy—formed the Group of 7 to promote international economic stability more general through mutual consultation and limited macroeconomic coordination. Though the G7 met on a regular basis, they produced two accords in particular—in Bonn in 1978 and in New York (at the Plaza Hotel) in 1985—in which members made commitments to adjust macroeconomic policies to restore growth (in Bonn) and unwind imbalances (at Plaza). Decades later, after the rise of large emerging economies led to the eclipse of the Group of 7 (or Group of 8, including Russia) by the Group of 20, this larger grouping’s members also engaged in mutual macroeconomic adjustments to attempt to prevent a total economic collapse in the wake of the 2008 financial crisis, and to unwind stimulus and redress imbalances thereafter.

In this section, we offer an initial description of the results of these meetings in terms of the commitments to fiscal coordination made by the participants. Table 2 summarizes these coordination commitments in terms of the agreements’ specificity and delegation, as well as enforcement mechanisms.

**Table 2. Fiscal coordination in the G7 and G20**

	<i>Specificity</i>	<i>Delegation</i>	<i>Enforcement</i>
Bonn Summit	Moderate	Low	Low
Plaza Accord	Low	Low	N/A
G20 (2008-2009)	Low	Low	Low
G20 (2010-2011)	Low-Moderate	Moderate	Low

### *Bonn Summit*

The Bonn Summit of 1978, regarded as one of the most successful cases of economic policy adjustment, produced a moderate degree of specificity regarding fiscal targets. The goal of the summit was to stimulate global growth by having the major economies—particularly the US, Germany, and Japan—serve as a “locomotive” for world economy while also keeping inflation in check. Coordinated economic policies would also address the growing current account

imbalance between the US and other leading economies. The Bonn Summit Conference Declaration (July 17, 1978) outlined fiscal stimulus commitments, as well as targets for energy policy. The stimulus commitments varied, though, in their degree of specificity. Germany committed to a clear fiscal target. Despite vigorous initial resistance, Germany committed to stimulus (understood to be fiscal stimulus) of 1% of GDP to boost growth. The UK's fiscal stimulus of 1% of GDP was also included in the text, although this was merely the inclusion of a pre-existing domestic policy decision. Japan, Italy and Canada committed to growth targets but not specific fiscal targets, although in the case of Japan there was inclusion of wording that growth would be achieved through stimulating domestic demand. In contrast to other G7 countries, the US committed to reducing inflation through measures aimed at fiscal consolidation. Concrete commitments included reducing the size of a planned tax cut by \$10 billion and committing to tighter budgets.

The level of delegation to a third party for surveillance was low after the Bonn Summit. The G7 had been established as a more flexible venue than existing international organizations (IOs) like the IMF, emphasizing discretionary management over rule making and enforcement (Putnam & Bayne 1987). Over time, the G7 did, however, develop linkages with other IOs. The OECD and G7 strengthened their ties in the late 1970s. The primary impetus was the push by OECD countries excluded from the G7 for greater voice. This pressure then led to the custom of holding OECD Ministerial Council meetings several weeks before G7 meetings. After summit meetings, sherpas from the G7 would also report back to the OECD. This arrangement facilitated continuity between meetings, but it did not lead to the delegation of monitoring functions to the OECD. At various times, the OECD provided economic analysis, but the relation with the G7 grew strained if policy prescriptions diverged (Putnam & Bayne 1987).

Although there were no clear enforcement mechanisms in place, the Bonn Summit agreement was largely observed. Germany met and perhaps exceeded its fiscal stimulus target. Japan also pushed through a large supplementary budget despite a change in power after the summit. The US also pushed through a reduced tax cut.

### *Plaza Accord*

The Plaza Accord of 1985 is a case of noncooperation on fiscal policy. The impetus for the accord was large imbalances in the global economy. The US was pursuing a policy of loose fiscal policy, which the Federal Reserve then countered with a tight monetary policy to dampen inflation. High interest rates spurred capital inflows that pushed up the value of the dollar sharply, which in turn contributed to large trade deficits.

To address these imbalances, other G5 members called for the US to reduce budget deficits. Many within the US government agreed that the US should reduce deficits, but the gridlock in Congress made deficit reduction an unrealistic option (Henning & Destler 1988). Conversely, the US wanted Japan and Germany to use stimulative fiscal policy, in conjunction with monetary and exchange rate policy, to maintain global demand as the US reduced imports. Fiscal policy coordination, however, foundered. The US was unable to commit to budget deficit reduction, and Germany and Japan resisted US pressure to use fiscal stimulus. In lieu of fiscal and monetary policy coordination, the G5 agreed on a large-scale coordinated exchange rate intervention to

address the global imbalance. The exchange rate intervention succeeded in lowering the value of the dollar relative to the Yen and Deutschmark.

### *Group of 20 (2008-2009)*

As the global financial crisis unfolded, the G20 gathered to avert an economic and financial meltdown. From the end of 2008 through 2009, the G20 held three summits. Given the faltering world economy, the G20 focused heavily on fiscal stimulus. In terms of the degree of specificity and delegation, the level was low. None of the summits led to country specific targets for fiscal stimulus targets, although as discussed later some countries pushed for them. The London Summit did call for an aggregate G20 stimulus of 5 trillion dollars, but the headline figure reflected the pre-summit fiscal commitments of individual countries, and thus did not reflect actual policy coordination. The subsequent Pittsburgh Summit declaration did not contain concrete numerical targets, but instead called for maintaining short-term stimulus while preparing a shift toward fiscal consolidation. One notable outcome, though, from the Pittsburgh Summit was the call for assistance from the IMF to monitor fiscal and monetary policy. The box below highlights key recommendations from each summit.

SUMMIT	FISCAL RECOMMENDATIONS	TEXT	COUNTRY RECS
Washington Summit November 14-15, 2008	Short term fiscal stimulus and medium term fiscal sustainability.	Use fiscal measures to stimulate domestic demand to rapid effect, as appropriate, while maintaining a policy framework conducive to fiscal sustainability.	No.
London Summit April 1-2, 2009	Large and coordinated fiscal expansion to stimulate employment and growth. Prioritization of stimulus over short-term concerns of fiscal sustainability.	... unprecedented and concerted fiscal expansion, which will save or create millions of jobs...that will, by the end of next year, amount to \$5 trillion, raise output by 4 per cent, and accelerate the transition to a green economy.  ...by implementing our agreed policies we will limit the longer-term costs to our economies, thereby reducing the scale of the fiscal consolidation necessary over the longer term.	No.
Pittsburgh Summit September 24-25, 2009	Maintain short-term fiscal stimulus but plan for an eventual shift to fiscal consolidation.  Assistance from IMF to monitor fiscal and monetary policies and evaluate G20 recommendations  G20 members with external deficits will commit to eventual fiscal consolidation; those with surpluses will focus on increasing domestic demand.	We will avoid any premature withdrawal of stimulus. At the same time, we will prepare our exit strategies and, when the time is right, withdraw our extraordinary policy support in a cooperative and coordinated way, maintaining our commitment to fiscal responsibility.	No.

### *G20 (2010-2011)*

Following the trough of the global recession, the degree of fiscal cooperation increased. There was only a slight increase in the degree of specificity. In Toronto (June 2010), the advanced countries agreed to reduce deficits by half by 2013 and to “stabilize or reduce” government debt levels. In none of the summits through the Toronto Summit, though, did G20 members make clear country-specific commitments for fiscal policy.

SUMMIT	FISCAL RECOMMENDATIONS	TEXT	COUNTRY RECS
Toronto Summit June 27, 2010	Continue stimulus based on fiscal position. Those with “fiscal challenges” should move toward fiscal consolidation.  All countries should start planning mid-term fiscal consolidation. Deficit countries should transition more rapidly.  Need to address external imbalances.	...follow through on delivering existing stimulus plans... put in place credible, properly phased and growth-friendly plans to deliver fiscal sustainability, differentiated for and tailored to national circumstances.  ...advanced economies have committed to fiscal plans that will at least halve deficits by 2013 [from 2010 base] and stabilize or reduce government debt-to-GDP ratios by 2016.	No
Seoul Summit November 11-12, 2010	Same as Toronto.  Strengthen the Mutual Assessment Process (MAP) and work with other IMF and other IOs to develop indicative guidelines on imbalances.	Advanced economies will formulate and implement clear, credible, ambitious and growth-friendly medium-term fiscal consolidation plans in line with the Toronto commitment, differentiated according to national circumstances	Yes.
Cannes Summit November 3-4, 2011	Clear and specific commitment to mid-term fiscal consolidation.  Reduction in reliance on public demand for countries with current account deficits.	Advanced countries, taking into account different national circumstances, will adopt policies to build confidence and support growth, and implement clear, credible and specific measures to achieve fiscal consolidation	Yes.

With the Seoul Summit, the G20 for the first time included “policy commitments” for individual countries— see box above. The level of specificity is still modest. In most cases the policy commitments are quite general (for example see China’s commitments below). In cases where specifics are offered, some of the policy commitments are those that had been made prior to the summit. In the case of the US, for instance, items such as the fiscal impact of healthcare legislation were included, while Japan included spending for reconstruction after its earthquake.

For the Cannes Summit, the G20 continued with country policy recommendations. In terms of fiscal commitments, the G20 called for mid-term fiscal consolidation, but recommendations were also tailored to reflect specific national circumstances. Many countries included numerical targets for fiscal consolidation, but the policy commitments stated that countries with stronger public finances—including China and Germany—should take the lead in using fiscal stimulus if the global economy slowed. This differentiation according to the fiscal position of specific countries was a step forward, although how specifically the burden of fiscal stimulus would be shared, in the event it was deemed necessary, was left open. Overall then, there has been a gradual increase in specificity from a low base, but commitments are still relatively vague.

A more significant change involved delegation. The G20 delegated a growing list of monitoring functions to the IMF, such as assessment of member country policies’ consistency with G20 goals—including progress toward reducing global imbalances—and provision of scenario analysis. At the Pittsburgh Summit, G20 leaders called for the creation of the Mutual Assessment Process (MAP) to help countries coordinate policies to speed recovery and to ensure sustainable growth. The IMF’s role in this process is to assess the policies and macroeconomic framework of members, and to ensure that information provided by member countries utilized consistent assumptions and were consistent with G20 growth goals. In accordance with its mandate, the



IMF delivered the “IMF Report on G20 Mutual Assessment Process” prior to the Seoul Summit. Also starting in 2009, the IMF began to publish a biannual report called the Fiscal Monitor, which provides data and analysis on global and country-specific fiscal trends. The IMF also maintains a Fiscal Monitor website with key fiscal data on individual countries.

During the Toronto Summit, the G20 increased delegation to the IMF calling for assistance in developing an “enhanced MAP.” The G20 asked the IMF to monitor country policy commitments at Toronto Summit. The IMF was also asked to provide technical assistance in developing “indicative guidelines” to “identify and assess imbalances.”<sup>6</sup> Several months later, the G20, in conjunction with the IMF, which provided technical assistance, agreed on specific indicators, including public debt, fiscal deficits, private savings rate, private debt, and external imbalance.

Carrying out its expanded mandate, for the Cannes Summit the IMF delivered three sets of reports that represent its expanding monitoring function. The IMF “Accountability Report” assesses whether countries have made progress in meeting their policy commitments from earlier summits, specifically Seoul and Toronto. The “Sustainability Report” analyzes global imbalances, including causes as well as steps for addressing them. The “MAP Report” assesses medium-term macroeconomic frameworks of countries to ensure consistency with G20 goals, which the IMF updates every several years.

Collectively, these reports represent an expanded role for the IMF. The expansion of the IMF’s role began with its medium-term assessment of macroeconomic frameworks. Beyond this initial function, the IMF also now monitors specific country commitment and progress toward reducing global imbalances.

### **III. Hypotheses**

We consider propositions from the IPE literature to explain these outcomes by organizing them into two broad, overlapping approaches. The first (“international”) emphasizes conditions prevailing in the international system, notably power dynamics and institutional functions. The second (“globalization”) emphasizes factors associated with the intersection of national politics and an increasingly global economy. In this section, we articulate hypotheses drawing from each broad approach and consider the available evidence to support them in our four cases.

#### *International*

Among the work in IPE relevant to macroeconomic coordination, two schools predominate—realism and liberal institutionalism.

Realists emphasize states’ security imperatives and the distribution of power among them, and expect international economic cooperation to be low, except under very specific conditions. A system in which there is a single hegemonic state is typically understood to be most conducive to international economic cooperation, whether because the hegemonic state acts on its overriding incentives to institutionalize international economic rules that benefit it most (Krasner 1976)

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<sup>6</sup> See [www.imf.org/external/np/exr/facts/g20map.html](http://www.imf.org/external/np/exr/facts/g20map.html).

and/or that assign adjustment costs to weaker or dependent states (Drezner 2007; Mastanduno 2009). Economic multipolarity, by contrast, would be expected to produce low levels of coordination. From a more dynamic perspective, Gilpin (1981) focuses on the relationship between rising and declining great powers and each's attempts to use international rules to improve its relative position. In general, when concerns about relative gains are high, the prospects for institutionalized economic cooperation will be relatively bleak.

Different scholars in this broad tradition have different perspectives on what constitutes power in the context of international economic relations. For Mastanduno (2009), military power is highly relevant, less as a means to punish noncooperation than as a resource to offer side payments to militarily weaker states. For Drezner (2007), market power—and the capacity to threaten closure of a large domestic market—is a means of leverage. Subramanian (2011), for his part, suggests that not only these elements of power matter but also that states which are international creditors can use this status to impose costs of adjustment on debtor states.

In the post-Bretton Woods environment, then, we would expect to see the United States attempting to use its relative power to not only try to retain systemic privileges (e.g., fiscal flexibility as a result of the reserve status of the dollar) but also to seek international fiscal rules that (1) promote relatively higher economic growth in the United States, and (2) require a shift in Germany, Japan, and China's economic policies that would reduce their surpluses with the United States. Rising states, for their part, would be expected to seek rules eliminating US systemic privileges and enhancing their own positions, particularly as surplus countries on which the United States was dependent to maintain its own standard of living. Given the low degree of overlap between these strategic objectives, we would also expect low levels of international fiscal coordination.

**H1:** High levels of fiscal coordination are only possible in the presence of a hegemon, which can offer positive and negative inducements to accept costs of adjustment.

**H2:** States with greater economic leverage—including market power and creditor status—will be more able to impose agreements that assign the costs of adjustment to weaker states.

**H3:** Levels of coordination will be higher among allies, among which relative gains concerns are lower. Militarily stronger states can impose costs of adjustment on weaker allies.

Liberal institutionalists view international institutions such as the G7 or G20 as mechanisms states create to help them solve collective action problems and capture joint gains from cooperation, even “after hegemony” (Keohane 1984). From this perspective, states may create institutionalized mechanisms for fiscal coordination to reduce cheating (i.e., noncompliance with international fiscal recommendations) and free riding (i.e., benefiting from other states' fiscal adjustments) (Martin 1992; Keohane & Martin 1995; Abbott & Snidal 2000). International institutions that monitor states' fiscal policies (to reduce fears of defection) can increase states' incentives to seek future gains from global growth and stability rather than short-term benefits from maintaining fiscal flexibility. However, as Abbott & Snidal (2000: 448) claim that powerful states are particularly wary of delegating significant authority to international institutions, because their relatively greater freedom of action will be most constrained by such delegation.

In their “rational design” approach, Koremenos, Lipson, and Snidal (2001) posit that three factors in particular—the number of actors involved,<sup>7</sup> the extent of uncertainty, and the intensity of distributional conflicts—determine the extent of international economic cooperation. They claim that effective institutionalized cooperation is more likely if there are low levels of uncertainty about the “state of the world,” few concerns regarding the distributional effects of international agreements, and a large number of actors involved. Other liberal institutionalist approaches predict that states delegate more authority to international organizations as uncertainty about the state of the world increases, suggesting a higher level of delegation during crisis and a steady decrease thereafter (see Lombardi & Woods 2008; Sharman 2009).

**H4:** As the potential joint gains from fiscal coordination increase, states will be more likely to create robust institutional mechanisms to promote cooperation and limit cheating and free riding.

**H5:** States will be more likely to engage in fiscal coordination (especially delegation) when there is a low level of uncertainty about the state of the world—notably, when all believe international economic crises are acute.

**H6:** The larger the distributional effects of proposed fiscal adjustments, the more unlikely it will be for states to institutionalize coordination.

### *Globalization*

A wide variety of literatures grouped here under the heading “globalization” focus on the implications for states’ macroeconomic policies of the growing interconnectedness of national economies and integration of global capital markets. At the broadest level these literatures probe the disjuncture between the global scale of economic activity and the national (and subnational) scale of political dynamics, and the implications of this disjuncture for international economic cooperation (see among others Cerny 1995, 2010; Rodrik 2000). They tend to emphasize the growing constraints on national fiscal policies in the context of an integrated international economy and the choices national governments face in satisfying domestic interests with distinct preferences over economic policy. Here we broadly distinguish between two strands of this literature: work highlighting “outside-in” versus “inside-out” dynamics.

The outside-in strand emphasizes fiscal constraints national governments face due to the increase in international capital mobility and the integration of global capital markets (Boix 1998; Garrett 1998, 2001; Mosley 2000). International market players (especially institutional bondholders and credit rating agencies) exert influence over countries’ fiscal choices as a result of their capacity to reward “good” policies (broadly, small/shrinking deficits and debt) with low interest rates and punish “bad” policies (large/growing deficits and debt) with interest rates.

Two distinct expectations emerge from this literature regarding international fiscal coordination. The first emphasizes overall levels of national integration into the global economy: fiscal

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<sup>7</sup> Beginning with Olson (1965), approaches based on strategic interaction have emphasized the need for a small, “privileged” group to provide public goods given individual incentives to free ride within larger groups. While Kindleberger (1973) claimed a single, hegemonic state was necessary to ensure stability, Snidal (1985) claimed a handful of actors in a privileged “k-group” could cooperate to provide this collective good.

coordination should make it easier for states that are highly integrated into the global economy to coordinate on fiscal consolidation in particular, because such states would have already experienced convergence toward comparatively orthodox policies (or what Thomas Friedman called the “golden straitjacket”). In this circumstance, binding themselves international fiscal targets can offer a credible commitment to fiscal rectitude at relatively low cost. The second emphasizes overall levels of sovereign debt. Fiscal coordination involving stimulus should be harder for countries with high public debt since markets will act as a constraint on government spending; coordination involving consolidation should be easier among countries with larger debt burdens because a credible commitment would not only signal to lenders their intent to behave responsibly but also because their fiscal flexibility will already have been curtailed by concerned bondholders and/or credit rating agencies.<sup>8</sup>

The inside-out strand emphasizes the differential effects of international openness and the resulting competition among national interest groups to impose their policy preferences on the state apparatus. Prominent in this strand is the “open economy politics” approach, which focuses on the mobilization of domestic interest groups based on their relative vulnerability within the global distribution of labor (Frieden 1991; Frieden & Rogowski 1996; Milner & Tingley 2011; Lake 2009). Although the impact of different groups’ mobilization may vary based on their degree of organization or the nature of the domestic institutional environment, the general expectation is that more vulnerable or uncompetitive domestic interests will mobilize in favor of a more flexible and/or expansive fiscal policy (i.e., involving high spending and more tolerance for budget deficits) and more competitive domestic interests will mobilize in favor of a more orthodox fiscal policy (i.e., involving lower spending and/or deficits). Political parties are expected to reflect these divisions, with the left supporting more expansive fiscal policy to benefit lower-income groups and/or labor and the right supporting more orthodox fiscal policy to reflect the interests of business (Hibbs 1977). Therefore, because international fiscal coordination generally implies greater constraints on national fiscal policy—and greater adjustment costs for states with higher spending and/or deficits—we would expect levels of fiscal coordination to rise or fall based on the relative influence of competitive versus uncompetitive domestic interests respectively.

**H7:** Higher levels of fiscal coordination are more likely among countries with similar, high levels of integration into the global economy, as global capital markets will have already induced some convergence among these countries.

**H8:** Fiscal coordination is more likely among countries with similar profiles of winning coalitions of interest groups and/or parties in power. Left governments reflecting the interests of more vulnerable groups are more likely to agree on coordinated stimulus; right governments reflecting the interests of business are more likely to agree on coordinated consolidation. Greater variability among such governments reduces the prospect for either type of fiscal coordination.

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<sup>8</sup> Willett (1999), for one, questions such claims. He argues that international capital markets can more effectively punish “bad” monetary policy than fiscal policy, because the expansion of global capital markets has made it easier rather than more difficult for national governments (as well as private actors) to finance debt.

#### IV. Analyzing the Cases

Returning to the cases, how can we explain the observed patterns of fiscal coordination, and in particular the growing specificity and delegation from Bonn through the G20? At the international level, the cases illustrate a mixture of realist and liberal institutionalist factors coming into play. Liberal institutionalism explains the push for greater specificity and delegation, but these factors have become salient only in the context of a declining ability of the US to coerce its major economic partners. As a declining hegemon, the US has less ability to coerce its major economic partners, and thus has sought to bind them through pushing for greater specificity and delegation by using its agenda-setting influence in the G20.

Across the cases, we see a pattern of states trying to free ride on the efforts of others—in essence pushing for fiscal adjustment so that they themselves benefit economically and avoid difficult domestic adjustments. In the case of Bonn, the US wanted to push the costs of global fiscal stimulus onto Germany and Japan. Other countries in the EC as well, such as France and the UK, also advocated greater fiscal stimulus, particularly from Germany, to help revive their own economies. The French government was in the midst of pushing for a fiscal stimulus plan and believed that German stimulus would offset the contractionary effects (Putnam & Bayne 1987: 75). Germany also pushed for coordinated stimulus to combat rising unemployment and economic slowdown, but resisted, like Japan, the pressure from other G-7 countries to commit to large stimulus packages themselves. In the run-up to the Plaza Accord, Germany and Japan argued that global imbalances should be addressed through US fiscal adjustment. Prime Minister Nakasone made the Japanese position clear two years after the Plaza Accord, stating candidly to President Reagan, “Please cut the budget deficit, in serious and significant ways. Otherwise, the world economy will be in a serious situation. I think the other heads of state think the same way” (Funbashi 1988, 1). The US resisted at Plaza, and during pre-summit negotiations, called for a comprehensive package of fiscal, monetary, and exchange rate coordination, in essence again trying to push the burden of adjustment onto its major economic partners.

Why was there lower fiscal coordination in terms of specificity and delegation for the Bonn Summit and Plaza Accord? The short answer is there was less need for it from the perspective of the US. In the context of greater hegemonic standing, the US had less need for an institutional framework to facilitate cooperation since the direct pressure that it could bring to bear directly on Germany and Japan sufficed. The US not only provided vital security to Japan and Germany during the Cold War, the US market was the largest market for both countries. As Mastanduno (2009, 135) points out, in West Germany it was widely understood that one of the means of adjustment for the economic imbalance between the two countries was to draw down the US troops in Europe, a fact that undergirded German economic cooperation, including the commitment to deficit spending at the Bonn summit. Japan had arguably more security dependence on the US, relying on the US-Japan Security Treaty, US troops in Japan, and its nuclear umbrella. Despite the lack of a strong mechanism to monitor through delegation to a third party, both Bonn and Tokyo complied with their commitments. The lack of the need for a larger institutional framework is illustrated well when there was a change in power in Japan after the Bonn Summit. Prime Minister Fukuda had committed to additional expenditures totaling 1.5% of GDP, but his successor, Prime Minister Ohira—from the same political party, the Liberal Democratic Party (LDP)—began to backtrack on this commitment. The US’s threat to not attend the next summit in Tokyo was enough to have the Japanese government step back into

line (Funabashi 1988, 81). In short, bilateral pressure sufficed, thus there was no need for more formalized forms of cooperation.

In the case of the Plaza Accord, there was no fiscal cooperation per se, but the reality was more complicated. On the one hand, the US did push for fiscal policy coordination, specifically stimulus from Germany and Japan. From the perspective of other G-5 countries as well, fiscal policy was the key issue, but the responsibility for adjustment fell squarely on the US. The large US budget deficits were viewed by other members as one of the principal causes of the strong dollar and record trade deficits. The gap between G-5 countries proved to be too wide to bridge in terms of fiscal as well as monetary policy. Nonetheless, the Plaza Accord led to exchange-rate cooperation targeted at addressing the trade and capital flow imbalances through a coordinated effort to depreciate the dollar vis-à-vis the Yen and Deutschmark, which proved to be successful. In essence, the exchange rate served as a substitute for fiscal and monetary policy cooperation. Here too, the US's position as hegemon facilitated compliance obviating the need for binding targets, delegation, or an enforcement mechanism. The US succeeded in getting Japan in particular and other allies to appreciate the yen largely through the threat of reduced access to the US market. With protectionism growing in Congress, the US had leverage that it could use to prod the Japanese into exchange rate cooperation.

The effect of domestic factors is indeterminate in the cases. While partisan alignment of the governments might be assumed to facilitate cooperation, the results are mixed. In the case of the Bonn Summit, the left-orientation of the US and German government might plausibly be said to have facilitated fiscal cooperation. In the case of the US, though, President Carter pushed for lower deficits. On the other hand, Putnam and Henning (1989) argue that while Chancellor Helmut Schmidt publicly opposed being pressed on deficit spending, he in fact supported the stimulus, which would benefit key constituencies. In the case of Japan, we see have governments from the same political party – the LDP – taking a variety of positions, including agreeing to stimulus under Bonn then attempting to renege with a change in government with the same ruling party in charge. Then during Plaza Accord negotiations, the Japanese side, again still ruled by the LDP, took a much stronger stance against fiscal stimulus.

In the wake of the global financial crisis, the G20 incrementally moved toward more fiscal cooperation after Plaza in terms of greater specificity and delegation of surveillance functions to the IMF. The extent of such cooperation still, however, remains relatively low. In looking across the cases, three inter-related factors become apparent. First, the US has had less ability to coerce other countries. Second, as a result, the US has attempted to rely on the G20 as a forum to address global imbalances. Third, due to the US's inability to impose adjustment costs on other countries, domestic factors have played a larger role in shaping outcomes than at Bonn or Plaza, which has created limits to higher levels of fiscal cooperation.

In contrast to Bonn or Plaza, the US has faced less tractable partners for several reasons. First, the security environment has changed significantly with the end of the Cold War and the rise of China. The largest global imbalances are now between the US and China. By contrast, earlier imbalances were between the US and Germany and Japan, two key allies during the Cold War. As a potential rival to the US and one with little need to cooperate with the US on vital security issues, China has been less willing to take on the burden of adjustment, particularly in the realm

of exchange rate policy, which discussed below has hindered cooperation on fiscal issues. Due to the changing security environment, allies as well have been less willing to bear adjustment costs. For instance, Germany, no longer facing an existential threat from the Soviet Union, has taken a harder stand against US pressure. Second, the changing global economy has muted US influence. In addition to the US's shrinking share of the global market, a multilateral trade regime has reduced the possibility of US retaliation by reducing market access.

As a consequence of the declining ability of the US to coerce its economic partners, the US has attempted to use the G20 to promote cooperation and avoid free riding. This can be seen in the G20 efforts to coordinate fiscal stimulus in the wake of the global financial crisis. Among the largest economies, only the United States (5.9% of GDP) and China (4.8% of GDP) pursued a fiscal stimulus of larger than 4 percent; the stimulus packages of the four euro-area G20 countries (2.3% of GDP), Japan (2.2%), and the United Kingdom (1.5%) were notably smaller.<sup>9</sup> In the lead up to the London Summit in April 2009, fiscal stimulus was reported to be one of the most contentious and heavily debated issues, with the Obama administration pushing hard for coordination. Obama bluntly stated:

If there is going to be new growth it can't just be the United States as engine. Everybody is going to have to pick up the pace...Our goal is simply to make certain that each country, taking account its differences in economic circumstances and political culture is doing what is necessary to promote economic growth. The US will do its share but in some ways the world has become accustomed to the United States being a voracious consumer market, the engine that drives a lot of economic growth worldwide.<sup>10</sup>

To reflate the global economy with the onset of the financial crisis, the US government advocated in G20 negotiations specific targets, calling, with support from Japan, for countries to increase spending by two percent of GDP.<sup>11</sup> The UK also advocated concerted stimulus. France and Germany ruled out any specific commitment to fiscal stimulus.<sup>12</sup> In the end, the G20 Leaders' Statement, included a pledge to fiscal stimulus—an impressive sounding \$5 trillion—but the figure was merely the sum of existing fiscal stimulus plans of member countries, not additional stimulus agreed by members at the summit.<sup>13</sup> Germany also blocked an idea suggested by the IMF of “naming and shaming” countries not doing their share to contribute to boosting global demand.<sup>14</sup> As one French economist noted, “If we were in a cooperative game, everyone would offer stimulus. But we are in a very noncooperative game between the European leaders and the US. All Europeans are waiting for stimulus from outside...Germany's best solution is to wait for the US, France, the UK, and others for a big stimulus that will help exports.”<sup>15</sup>

While the US push for coordinated fiscal stimulus did not lead to a meaningful increase in specificity of targets or delegation, subsequent G20 summits produced incremental increases in

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<sup>9</sup> The 2.3 percent figure is an unweighted average of the stimulus figures for Germany (3.4%), France (0.7%), Italy (0.3%), and Spain (4.5%). Figures from Eswar Prasad and Isaac Sorkin, “Assessing the G20 economic stimulus plans: a deeper look,” Brookings Institution (March 2009), available at [http://www.brookings.edu/articles/2009/03\\_g20\\_stimulus\\_prasad.aspx](http://www.brookings.edu/articles/2009/03_g20_stimulus_prasad.aspx).

<sup>10</sup> “Obama: growth is not the duty of US,” The Daily Telegraph, April 2, 2009, p. 1.

<sup>11</sup> “Unresolved issues may upset G20 unity,” The Daily Yomiuri, April 4, 2009 p. 4.

<sup>12</sup> “Amid the back slapping and smiles, G20 leaders strike a deal,” The Daily Telegraph, April 3, 2009, p. 4.

<sup>13</sup> “Gambling on a dream: but do the G20 figures add up?” The Herald, April 5, 2009, p. 16.

<sup>14</sup> “France and Germany take deal to the brink,” The Independent, April 2, 2009, p. 2.

<sup>15</sup> “Germany's hard line on the stimulus: Why Merkel says ‘nein,’” Christian Science Monitor, March 31, 2009, p. 6.

cooperation. The US advocated clear targets for addressing global imbalances. A senior US Treasury official summed up the problem for the US as follows:

There is an element of free riding. In Pittsburgh 2009 [G20 summit] on the topic of changing the composition of growth, the US argument was that, for too long, some countries have oriented their economies toward other countries'—i.e., US—demand, which leads to US deficits. And this is unsustainable. The US needs to change the way it works (boost savings, etc.) and rely less on domestic demand for its economy. But this hurts global demand, so surplus countries (Japan, Germany, China) must boost demand.<sup>16</sup>

Beginning with the Seoul summit in November 2010, the G20 agreed to address structural imbalances, but no specifics were agreed upon and the issue is still under further study by the IMF. During negotiations prior to the Seoul summit, Washington pushed for limiting current account imbalances to 4%.<sup>17</sup> China and Germany resisted US pressure and refused to numerical targets. German Chancellor Angela Merkel stated that, “Targets are neither economically appropriate nor appropriate from a financial perspective...Current account balances are hard to target.”<sup>18</sup> Germany also pushed for shifting the focus away from trade exclusively to fiscal and monetary policy and clarifying that deficit countries should bear responsibility for adjustment. China, asserting itself more forcefully than in previous summits, pushed for softer language on imbalances and rejected calls for a quick appreciation of the Renminbi.<sup>19</sup>

As discussed earlier, G20 targets have laid out differentiated responsibilities for members, but the degree of specificity is still relatively low. This is not surprising given that the key members – the US, China, and Germany – have basic disagreements over who has responsibility to adjust. A senior US Treasury official commented bluntly: “There has been no rotation in global demand; the Chinese and Germans would like to take it off the table altogether.”<sup>20</sup>

In addition to trying to establish targets, the US has been part of a coalition supporting a larger role for the IMF as an “independent” arbiter.<sup>21</sup> This group has advocated using the G20 to move beyond weak self-assessments or country-to-country surveillance and orienting IMF surveillance and advice toward broader G20 objective of “strong, sustained, balanced growth.”<sup>22</sup> A US Treasury official commented frankly, “We believe the IMF has a job to do, and hasn’t been doing its job...it should be a ruthless truth-teller.”<sup>23</sup>

Divisions within the G20, however, have limited the role of the IMF. Some countries emphasize the primacy of the G20 and have been unwilling to delegate too much authority to the IMF; these countries would like to limit the role to an exercise in “box-ticking.”<sup>24</sup> While IMF staffers are not

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<sup>16</sup> Senior US Treasury official (June 2012)

<sup>17</sup> “G20 chiefs near accord on reducing imbalances, but agreement unlikely to require major changes for China and Germany,” *International Herald Tribune*, November 12, 2010, p. 7.

<sup>18</sup> *Ibid.*

<sup>19</sup> “G20 chiefs postpone action on imbalances; Leaders agree to curtail mismatches, but put hard choices off until next year,” *International Herald Tribune*, p. 5, November 13, 2010, p. 5.

<sup>20</sup> Interview with senior US Treasury official (June 2012).

<sup>21</sup> Interview with IMF staffers (June 2012).

<sup>22</sup> *Ibid.*

<sup>23</sup> Interview with senior US Treasury official (June 2012).

<sup>24</sup> *Ibid.*



allowed to comment on individual countries, one can infer that these differences of view cleave largely along the lines of the whether a country is a current account deficit or surplus country.

Despite these political limitations, the IMF appears to be having some degree of autonomous influence. Even in the early stages of G20 negotiations over fiscal stimulus, two sources confirm that the IMF shaped the conversation of around a target minimum fiscal stimulus of 1.5-2.0%.<sup>25</sup> The IMF also has taken an expansive view of monitoring imbalances. The IMF chose not to limit their analysis to external balances but to include also fiscal and financial imbalances in their technical reports. The IMF also is working with countries to track progress in achieving goals.<sup>26</sup>

In comparison to the Bonn Summit and Plaza Accord, domestic factors play a larger role. This is not to say that domestic factors did not play a role in earlier agreements; they did. But the comparisons are instructive. For instance, Germany has a long history of fiscal conservatism. Yet despite these views about the proper role of fiscal policy, the Bonn Summit produced a clear and large commitment to fiscal stimulus. In the case of the G20, however, Germany (as well as France) were able to block mention of any numeric target for fiscal stimulus. Commenting on why Germany opposed stimulus, one US Treasury official attributed it to their world view, or specific set of policy ideas: “But [Germans] they also strongly believe—and it’s been this way for 30 years—that fiscal policy works differently...The only thing that’s novel about it was that April 2009 [i.e., stimulus] even happened.”<sup>27</sup>

## V. Conclusion

In our preliminary analysis of three prominent cases of international fiscal coordination—Bonn (1978), Plaza (1985), and the Group of 20 (2008, 2010)—we find the outcomes to be primarily consistent with propositions drawn from International Relations theory, notably Realism and Liberal Institutionalism. Specifically, we find that the higher levels of specificity and especially delegation in the context of the Group of 20 reflects the waning, if still significant, influence of US power and leadership. As US security and economic leverage over allies and other states has decreased since the late 1970s, it has proven less able to impose costs of adjustment on other states, notably Germany, Japan, and now China. Nevertheless, members of both the G7 and G20 have sought to ensure the public goods of international economic stability and growth, and thus have engaged in higher (if modest) degrees of formal coordination to steer the international economy through the rocky shoals of the 2008 global financial crisis and its aftermath. Although Bremer & Roubini (2011) may be correct that we are in a “G-zero” world in the sense of absent hegemonic leadership and dissensus regarding the distribution of costs of fiscal adjustment, a larger and more diverse group of states in the Group of 20 did manage to achieve greater levels of *institutionalized* fiscal coordination than observed among Group of 7 countries in Bonn and Plaza.

Given the preliminary state of our analysis we are quite limited and tentative in drawing conclusions and implications. Within the current scope of the paper our immediate goals will be twofold. First, we will narrow the range of hypotheses and identify specific independent

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<sup>25</sup> Interview with senior German Finance Minister (July 2012) and interview with IMF staffers (June 2012).

<sup>26</sup> Interview with IMF staffers (June 2012).

<sup>27</sup> Interview with senior US Treasury official (June 2012).

variables associated with each, which will facilitate more systematic cross-case and within-case analysis. Second, we will reexamine the initial causal narratives through a fuller and more comprehensive analysis of available data in each case. What we believe we have established here, however, is that institutionalized fiscal cooperation is a “real thing” in an increasingly interconnected international economy, and there is space for much new research on the past experience and future prospects of this emerging phenomenon.

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