

CHAPTER I

FINANCIAL CRISES AND NATIONAL SECURITY POLICIES

"It's a global (financial) crisis. [...] I think it will impact on our national security in ways that we quite haven't figured out yet."

Admiral Michael Mullen, Chairman of the Joint Chiefs of Staff, February 1, 2009¹

What influence do financial crises have on national security policies, specifically military spending, threat assessment, and war prospects?² This crucial question remains unasked and unanswered, and yet present and past historical evidence indicates that national security policies are no longer the same after financial-crisis outbreaks, and that the origins of these changes are unclear. After the onset of the global financial meltdown (GFM), the United States, Great Britain, Germany, and France all endorsed deep cuts in their military arsenals, with Germany announcing the biggest reductions in its military forces since World War II.³ Concurrently, Russia, China, and India defended more ambitious military budgets—as did Indonesia, which, interestingly, had responded to the 1997-98 Asian financial crisis (AFC) by pursuing drastic defense cuts. During the AFC, Thailand behaved like Indonesia whereas Singapore and Australia did not.⁴ Threat assessment and war prospects similarly vary after financial-crisis outbreaks, as

¹ Tom Philpott, "Military Update: Official. Financial Crisis a Bigger Security Risk than War," *The Gazette*, February 1, 2009.

² Like for Reinhart and Rogoff (2009) and for Bordo et al (2001), "financial crisis" in this work refers to a variety of situations (currency crises, banking crises, stock market crises...) in which some financial assets or institutions suddenly lose part of their value. These situations are calculated through a weighted average of changes in exchange rates, changes in short-term interest rates, and reserve changes relative to the United Kingdom or the United States. This work complements this "classical" understanding of financial crises with two distinctive financial-crisis features that regard the collapse of confidence in the existing financial system/s experienced by state and non-state actors, and the related undertaking of measures and/or countermeasures to restore this confidence. Military spending refers to national defense allocations; threat assessment refers to the extent to which a potential adversary is perceived as dangerous; war prospects refer to the perceived probability of interstate war.

³ Stephen Fidler and Alistair MacDonald, "Europeans Retreat on Defense Spending," *Wall Street Journal*, August 24, 2011; "Ministers Work to Reassure US Over Cuts in Defense Spending," *Western Mail*, October 16, 2010; Richard Norton-Taylor, "Russia Overtakes Britain and France in Global Arms Spending League Table," *The Guardian*, April 16, 2012; *SIPRI Yearbooks 2004-2009-2011-2012*; <http://www.sipri.org/yearbook>; "Mark Thompson, "The Proposed Defense Budget: 'Shaving the Balloon,'" *Time*, February 14, 2012; Barney Frank, "How to Save the Global Economy: Cut Defense Spending," *Foreign Policy*, Special Report, January-February 2012; "Big Cuts in Store for Bundeswehr," *The Local*, October 26, 2011.

⁴ "Asia Defense Spending to Overtake Europe," *Financial Times*, March 7, 2012; Keith B. Richburg, "China Military Spending to Top \$100 billion in 2012, Alarming Neighbors," *Washington Post*, March 4, 2012; Richard Norton Taylor, "Russia Overtakes UK and France in Global Arms Spending League Table," *The Guardian*, April 16, 2012; "India in Defense Spending Spree," BBC News April 8, 2012. On the increase in Indonesian military spending during the Global Financial Meltdown see "Shopping Spree," *The Economist*, May 24, 2012. On military spending in East Asia following the AFC, see Simon (2001: chapter 2), and

both the AFC and the GFM show. In 1998, Russia pulled back from its pre-crisis militant Asian policy while China and the United States strengthened their own conciliatory policies in the region—to the detriment of Japan.⁵ Reversing the cautionary military posture maintained since the late 1990s, Russia responded to the GFM by embarking on an ambitious foreign policy agenda. By contrast, the United States withdrew its forces from Central Asia, moved further away from any presence in European defense plans, and transferred its military and diplomatic focus to the Far East and the Pacific.⁶

Variation in national security policies after a financial-crisis outbreak is not a novel feature in world politics. Before the British financial crisis of 1901–05 (or the South Sea Bubble of 1720), and before the Ottoman banking and debt crisis of 1875–76, Great Britain and Turkey were both engaged in designing and pursuing ambitious national security agendas. Yet, Great Britain ditched its expansionist plans after 1905 and 1720, whereas Turkey doubled down on its military ambitions after 1876, waging war on Russia in 1877.⁷ Exhibiting a different national security solution—historically a most memorable one—Japan, Germany, and Italy upturned their military postures from caution to aggression during, and in the aftermath of, the global financial crisis of 1927–33. In contrast, following the outburst of the Latin American debt crisis (August 1982), Argentina’s belligerent national security agenda—which had peaked with the Falklands

Hartfield and Job (2007). Cuts to military spending in the West were not uncontroversial or entirely desired by governments. Compare, for instance, Martin Feldstein, “Defense Spending Would Be Great Stimulus,” *Wall Street Journal*, December 24, 2008, with Robert Kagan, “No Time to Cut Defense Spending,” *Washington Post*, February 3, 2009, and with Fareed Zakaria, “Yes, Let’s Cut Defense,” *Washington Post*, August 4, 2011. The French government during a first stage of the crisis attempted to raise defense spending, to no avail; see Edward Cody, “France Boosts Spending on Military,” *Washington Post*, October 30, 2008.

⁵ See Dibb, Hale and Prince (1998); Johnson (1999); Robert and Kelikov (2000); Denoon (2007).

⁶ John Gray, “A Shattering Moment in America’s Fall from Power,” *The Observer*, September 28, 2008; Balkan Devlen, “Geopolitical Consequences of the Economic Crisis,” *Today’s Zaman*, October, 20, 2008; Mark Mazzetti, “Global Economy Top Threat to U.S., Spy Chief Says,” *New York Times*, February 12, 2009; Helene Cooper, Michael Wines and David E. Sanger, “China’s Role as Lender Alters Dynamics for Obama’s Visit,” *New York Times*, November 14, 2009; “Rebalancing America’s Forces: The Downgrading of Europe,” *Economist*, January 14, 2012; Ian Bremmer, “The Recession Won’t Moderate Russia’s Foreign Policy,” *Foreign Policy*, March 25, 2009. See also Friedberg (2010), and Burns and Price (2010).

⁷ On the British experience, see Carswell (1960:271–72) and Friedberg (1987:15–37). On the Turkish experience, see Pamuk (1987:72); Blainey (1973:chapter 12).

War just a few months earlier (April 1982)—was quickly overhauled. What explains this variation in post-financial crisis national security policies? Why are some states or governments after financial-crisis outbreaks able at times to double-down on their pre-crisis assertive or conciliatory national security policies but need, at other times, to pull back from them? More simply, to emphasize once more a question that has long deserved an answer in academic and policy circles: what influence do financial crises have on national security policies?

This study embarks on a systematic analytical and empirical investigation into the national security influence of financial crises. Its main argument is that financial crises cause a severe shock to crisis-hit governments' financial *and* security policies—also referred to as financial-security agenda(s)—and that, during the process of crisis response, national military spending, threat assessment and war prospects are *inflated, curbed, or become extra prudent* compared to their pre-crisis equivalents.⁸ Which outcome ensues, this dissertation finds, depends on the relationship between crisis-hit governments and high finance during the process of financial-crisis response.⁹

In agreement with a number of works in political science, national security policies are here classified as *assertive* or *cautious*, while the governments pursuing them are assumed to be *statist-nationalist* or *cosmopolitan*.¹⁰ As known, statist-nationalist governments tend to act autonomously from non-state domestic forces and international actors, and resort to rent-seeking

⁸ The influence of financial crises on the policies of states that do not directly experience a crisis are discussed in this dissertation only to the extent that they relate to and help illustrate changes in the financial-security agenda(s) of crisis-hit governments.

⁹ In this dissertation “high finance” refers to the most exclusive financial circle, the no-more-than-a-dozen wealthiest international banking houses in the global economy.

¹⁰ Various expressions of statist-nationalist and cosmopolitan governments exist in practice. Totalitarian governments and confessional or theocratic governments, for instance, provide two different examples of a statist-nationalist government. Similarly, the welfare-state governments, and the governmental members of an international federation of states are two different examples—or at least two not necessarily overlapping examples—of cosmopolitan governments. For a simultaneous treatment of both kinds of governments in political science see, in particular, Solingen (1998:18-61). Rather than “cosmopolitan,” Solingen uses the label “internationalist.” This work offers a more fine-grained approach than Solingen’s to the distinction between cosmopolitan and statist-nationalist governments by postulating that the affinity with high finance of either kind of government can be high or low. On government affinity with high finance, refer to the following sentence and the rest of the chapter.

economic policies as well as assertive military and diplomatic means to defend the national interest (Krasner 1978:10,313,14; Nordlinger 1988:881; Young 2007:109-111). By contrast, cosmopolitan governments are generally keen to safeguard the interests or well being of non-state domestic and international groups, and, to this purpose, they opt for internationalist policies and commit to the maintenance of international peace (Kant 1789:29; Bull 1977:81; Appiah 2006:xv).

Despite this dispositional diversity, both statist-nationalist and cosmopolitan governments can each have, in different historical moments and political contexts, low or high *affinity* with high finance that is low or high predisposition to include the preferences of high finance in their financial and security decisions.¹¹ After the outbreak of financial crises, statist-nationalist and cosmopolitan governments tend to respond exactly on the basis of this affinity, *doubling down* or attempting to redouble on their pre-crisis financial-security agenda.¹² Not always, however, governments' *intended* crisis strategy is either possible to implement after the onset of the crisis or possible to sustain until its end. Specifically, the realm of available strategies of crisis response is defined by governments' high or low *exposure* to high finance, that is the necessity or lack of necessity to consider the preferences of high finance despite or in addition to national leaders' intended strategy of financial crisis response.¹³ The interplay between crisis-hit governments' *affinity* with and *exposure* to high finance after the outbreak of financial crises—this work argues—determines whether the crisis-hit government(s) or high finance leads the process of financial crisis response, and ultimately how pre-crisis national security policies

¹¹ Government affinity with high finance therefore tells us how much governments respect high finance, which is, in turn, an indication of governments' behavioral intentions in the spheres of finance and security.

¹² I clarify why this occurs later in the chapter. For now, keep in mind that what I define as “double-down movement” finds its origins in the field of psychology, and particularly the theory of *escalating commitments*, which holds that, after having endorsed a position, one feels compelled to defend it. Stiglitz (2010) recently used this theory for explaining policymaking after the outbreak of financial crises.

¹³ Why government affinity with and exposure to high finance are either high or low is clarified later in the chapter.

change following the outbreak of financial crises. Explicitly, this work identifies four scenarios of financial crisis influence on national security policies based on four possible combinations between government affinity and exposure to high finance. The security policies of a government having low affinity with high finance are likely to be curbed when exposure to high finance after the start of the crisis is high (*Scenario LA–HE*), and to be inflated when such exposure is low (*Scenario LA–LE*). By contrast, the security policies of a government having high affinity with high finance are likely to become extra prudent when exposure to high finance after the start of the crisis is high (*Scenario HA–HE*). More indeterminate is the destiny of the security policies of a government having high affinity with and low exposure to high finance during the process of crisis response (*Scenario HA–LE*). In each scenario, financial crises change state governments' ability or interest in pursuing their pre-crisis policy agendas, resulting in a departure from pre-crisis national security policies.¹⁴

The four scenarios, and the logic and theoretical underpinnings that explain them are the subject of this chapter. The chapter starts with a short account of the national security influence of military-security crises, noting that some pivotal aspects characterizing the process of resolving these crises are also essential ingredients of the influence of financial crises on national (security) policymaking. It then offers a step-by-step explanation of the above-sketched argument. After an overview of the distinctive challenge to national security policies that financial crises pose, by affecting crisis-hit governments' hold on power and their incentives to respect or close the door to international financial market, the argument develops in three sections. The first section explains the ideal-typical blueprint of financial crisis response recommended to governments by high finance. The second section examines the components of high or low government exposure to high finance during the process of financial crisis response

¹⁴ See the tree diagram drawn later in the chapter.

and clarifies how different combinations of government affinity with and exposure to high finance produce four scenarios of influence of financial crises on governments' financial-security agendas. The third section portrays the change in military spending, threat assessment, and war prospects resulting from each of the four scenarios. Case selection, methods, and data are then discussed. The chapter concludes with a brief illustration of the theoretical contributions of this work, which are further elaborated in the chapters ahead.

MILITARY-SECURITY CRISES AND NATIONAL SECURITY POLICIES

The literature on crisis decision-making has amply documented that interstate military-security crises are pivotal moments where national security policies—and particularly war prospect, threat assessment, and military spending—are susceptible to fundamental reevaluation and adjustment. Reevaluation and adjustment occur because it is in the nature of military-security crises to threaten a state's position or status in the international system. Specifically, military-security crises present state governments with three concurrent challenges: a threat to one or more basic values; uncertainty; and a shortened shadow of the future (Hermann 1969:414; Hermann 1972:13; Holsti 1972:9; George 1979:104; Bretcher et al. 1997:3–10).¹⁵ Responding to the crisis in this context of emergency, rising insecurity, and pressured decision-making, government officials move towards a new consensus on existing problems as perceptions are transformed, policy options become more limited or more numerous, and different approaches to military spending, threat assessment, and war are adopted (Baddeley 1972:537–546; George 1975:284; Jervis 1976:172–202).

Although threats to basic values, finite time for response, and uncertainty are attributes that all military-security crises share, military-security crises do not affect national security

¹⁵ In the crisis decision-making literature, uncertainty has at times been associated with the surprise provoked by military-security crises. At other times, it has been linked to the heightened probability of war.

policies equally. For instance, military-security crises have stricken states and governments committed to the pursuit of assertive national security agendas as well as states and governments maintaining cautious national security postures. In either case, crisis response was reached via doubling down on assertiveness/cautiousness or withdrawing from it altogether. Four examples illustrate these claims: the Cuban Missile Crisis of 1962; the military crisis of 1914; the Suez crisis of 1956; and the Korean crisis of 1950. In 1962, the resolution of the thirteen-day Cuban Missile Crisis put brakes on escalating Soviet-American military competition, and paved the way for conciliatory national security policies as the United States agreed to dismantle all US-built Jupiter intermediate-range ballistic missiles (IRBMs) deployed in Italy and Turkey, and the Soviets agreed to remove their medium-range and intermediate-range ballistic missiles (MRBMs and ICBMs) from Cuba.¹⁶ The opposite outcome occurred during six critical weeks in 1914, when, fearing for their national survival, governments across Europe gradually abandoned cautious military and diplomatic agendas, and spiraled into mobilization and war.

In contrast to the 1962 and 1914 crises, the Suez crisis of 1956 stirred British and French cautionary (pre-crisis) national security agendas towards greater caution, whereas the Korean crisis of 1950 pushed ambitious American policies of containment towards greater assertiveness. Between July and October 1956, British and French attempts to regain control of the nationalized Suez Canal by supporting an Israeli attack and bombarding Cairo both escalated and faded, with London and Paris eventually resuming a more conciliatory security posture in the fall.¹⁷ Vice versa, a few days after the June 1950 crossing of the 38th parallel by North Korea, perceiving a threat to the promise of withstanding aggression recently enunciated in the containment doctrine,

¹⁶ Competition had escalated since 1958, following the American deployment of IRBMs in the UK, Italy and Turkey. A similar military-security crisis is the Berlin Blockades of 1948–49.

¹⁷ Note that British and French national security policies in the 1950s were “cautious” due to the United States’ power to maintain them so—not necessarily because they were inherently peaceful or conducive to peace. On this point, see Curtis (2007). On the Suez crisis see in particular Kunz (1991).

the United States intensified its military involvement in the peninsula, embarking on a three-year-long war to repel the invasion.

Since its inception, scholarship on crisis decision-making has been bound to confront a natural question that applies to these examples and many other cases: what does explain the different origins, escalations, and responses to military-security crises?¹⁸ Why did the Great Powers discard pre-crisis military restraint to adopt an increasingly assertive national security posture in 1914? Why did Britain and France in 1956 end up continuing a policy of non-confrontation? And why were American rearmament policies traded for diplomatic negotiations in 1962, but refueled to wage war in 1950?

A consistent result across much of the literature is that the reconfirmation or curbing of assertive or prudent pre-crisis national security policies hinge on crisis-hit governments' high or low affinity with or exposure to compromising or non-compromising strategies of crisis response. These strategies are based on a number of factors, which scholarship has identified as dominant beliefs, leaders' personality, civil-military relations, institutions, cultural and historical experience, cognitive assumptions and signaling, technology, and coercive diplomacy. Governments' affinity with and exposure to compromising or non-compromising strategies of crisis resolution after the outbreak of military crises determines the character of the military and diplomatic responses—that is, whether pre-crisis national security agendas are intensified or rebutted. For instance, it is conventional wisdom that throughout the summer of 1914, European government officials became highly exposed to preparing for a major military conflagration (as opposed to diplomatic reconciliation) after developing an affinity, or becoming more and more accustomed with policies that prioritized offensive military weapons and doctrines, the fear of

¹⁸ See, for instance, Azar (1972), Herek, Janis and Huth (1987), Richardson (1994), Schultz (1998), and Wilkenfeld, Young, Asal and Quinn (2003).

late mobilization, “bandwagoning” behavior, the misperception that the war would be short and limited, and flawed civil-military relations—policies that undermined ongoing attempts to resolve the crisis diplomatically (Hermann 1972:61; Snyder 1984:110; Van Evera 1984:62,68). By contrast, it is commonly acknowledged that nuclear escalation was restrained in 1962 because American and Soviet government officials re-evaluated past historical experience, institutional procedures, and the odds that a surgical strike would succeed in ways that made them more obliged or exposed to conceding military and diplomatic measures, and choked the spirals of nuclear brinkmanship (Sorensen 1963:31; Abel 1964:19; Allison 1969:697-698; Hermann 1972:64,65).

Finally, Britain and France deflected their ambitious strategic plans in 1956 when an exercise in American monetary statecraft made them more willing to embrace international conciliation, and highly exposed to the negative consequences of refusing it (Kirshner 1995:63–80; Andrews 2006:7,19),¹⁹ whereas, in 1950, memories of the Munich experience (1938–39), perceptions of growing Soviet nuclear capability, and concerns over the domino effects deriving from the failure to contain a North Korean invasion resulted in a low exposure of the Eisenhower administration to diplomatic compromise, thus enhancing American nuclear “boldness” and affinity with confrontational policies, and ultimately accelerating ongoing nuclear races (Dingman 1998:51–54; James and Wells 1993:1–8).²⁰ In each of these four crisis years, state authorities responded to mounting crisis pressures and tense international climates. Yet, their different affinities with or exposures to compromising and non-compromising means of crisis

¹⁹ In 1956, a US-sponsored UN resolution called for immediate ceasefire and withdrawal of military forces from Egypt. Both goals were obtained when, in early November, the pound sterling came under sustained market pressure, and the US threatened to block British access to its own reserves in the International Monetary Fund. From the start of the crisis up until November 1956, the exposure of the British and American governments had been low, suggesting that there might be different crisis stages and different vulnerabilities throughout different crisis episodes. I touch upon this point later in the chapter.

²⁰ The “limited” character of the Korean War does not change the fact that the assertiveness of American national security policies increased from the summer of 1950.

resolution changed the course of their respective national security policies by virtue of an overhaul or intensification of pre-crisis national security agendas. As the following paragraphs clarify, military-security crises are not the only crises that change the course of national military spending, threat assessment, and war prospects, nor are they the only crises that affect states' exposure to compromising and non-compromising strategies of crisis resolution.

*THE SHOCK OF FINANCIAL CRISIS
ON MILITARY SPENDING, THREAT ASSESSMENT, AND WAR PROSPECTS*

Financial crises and military-security crises share a number of attributes. Both are characterized by a high threat to important values, short decision-making time, and uncertainty. Four necessary components of financial crises clarify why important values are threatened under uncertainty and time constraints. One: financial crises signal the end of a period of economic growth or accepted stability. Different financial crises will have different causes, and involve the deterioration of various national financial indicators. When any financial crisis strikes, however, a number of unpleasant and so-called “deadly” conditions appear. GNP growth, liquidity, reserve availability, the value of the exchange rate, deficit and debt levels, credit rating, the rate of bank failure, and price and interest rate levels are susceptible to significant deterioration (Burton 1910; Fisher 1911; Minsky 1972; Kindleberger 1973; Bordo 1986; Capie and Wood 1986:190-239; Calvo 1995; Bordo et al. 2001; Reinhart and Rogoff 2009). Two: as critical financial variables deteriorate, the prospect of greater economic damage materializes, compounding unfavorable national circumstances. Until a solution to the crisis is found, a climate of economic and political uncertainty will remain. Three: and related to the former point, confidence in the workings of the financial system and the power or desirability of existing financial institutions and policies decline within crisis-hit governments, within private financial markets, and amongst the domestic public (Eichengreen 1996a). Four: a series of measures involving, at least potentially,

governmental and non-governmental actors is undertaken in the attempt to respond quickly to the crisis and effectively restore financial and economic stability, confidence, and growth. These considerations buttress the existing scholarly conclusion that financial and economic crises produce a “shock effect” or cast a shadow on the value and sustainability of existing state policies while also testing governments’ capacity to hold on to their domestic power and desired agendas (Katzenstein 1978:15-22; Gourevitch 1986:17,35; Pepinsky 2009:2,3). There is no difference between the threat that local and global financial crises pose: in either case, government leaders are called to select crisis countermeasures and their affinity with and exposure to high finance will drive their policy response.

Many of the ways in which financial crises can affect crisis-hit governments’ military spending, threat assessment, and war prospects are immediate byproducts of the financial and economic deterioration resulting from the crises themselves. For instance, falling GNP, dwindling pro-capital income and revenues, and increasing borrowing costs can translate automatically into reduced national defense spending, and decreased resources for the projection of national diplomatic and military power in foreign lands. The few scholarly works on the geopolitical implications (essentially balance-of-power shifts) produced by the AFC or the GFM base their conclusions on these financial and economic reverberations, and on the relative economic gains and losses for some states versus others that they entail (Dibb, Hale and Prince 1998:5; Devlen 2008; Friedberg 2010:32,35). This approach, which is essentially an application of structural realism to the study of international relations during financial crises, suffers from two limitations. First, it is inapt to evaluate the character of states’ national security policies after the outbreak of financial crises. As Kenneth Waltz (1979) reminds us, interstate balance-of-power shifts have little to say on national foreign policy or diplomatic and military decisions.

Second—and this may explain the apparently limited interest around the research question that this dissertation poses—alterations in interstate economic gains and losses are not, per se, a *distinctive* component of financial crises, since technological innovation or a recession might produce just the same result. These alterations are therefore unsuitable to inspire systematic theoretical and empirical analyses on the national security influence of financial crises.

More appropriate to the scope of this dissertation are two of the above-discussed components that are *idiosyncratic to financial crises*, and also the main source of the damage that financial crises unleash—namely, the collapse of confidence in the existing financial system and institutions that state and non-state actors experience, and the undertaking of measures and/or countermeasures to restore such confidence. At the forefront of these developments are government authorities and high finance, where “high finance” stands for the world’s most powerful financial houses: the small circle of financial interests that is eminently and unconditionally interested in the preservation of the international financial system, and in the crafting of national financial policies that have the credibility and meet the approval of the private financial sector.²¹ From this perspective, financial crises, and the crisis-resolution processes that accompany them, are best regarded as moments wherein crisis-hit governments are called to redefine their participation or non-participation in the international financial system, and to re-establish the credibility of their financial policies vis-à-vis those advocated by high finance.²² Two caveats are in order. One: the enthusiasm with the international financial system of cosmopolitan and statist-nationalist governments will vary. This variation is displayed in the financial and security policies adopted before, during, and after the financial crisis outbreak by either type of government. Two: related to the former point, the power between a crisis-hit

²¹ For an idea of who these financial elites are, see Polanyi (1944), Chernow (1990), Ferguson (1999), and Ahamed (2009).

²² I construct this interpretation based on Kindleberger (1978:17,91,92,94,172), and Eichengreen (1992:3-12).

government and high finance will vary across financial crises and political contexts. After the onset of a financial crisis, the government's ability to continue its pre-crisis agenda given the increased likelihood of domestic unrest and political realignment alters the relative costs and benefits of pursuing that agenda, as well as those of taking part in or being excluded from a liberalized international financial order. As a result, crisis response is a power game between state authorities and high finance, with variations in the former's financial and security preferences and policies, and the ability of the latter's ability to exert successful policy pressure.²³

Elaborating on these caveats, this dissertation makes three claims that are foundational to the framework here developed. The first is that financial crises and the measures undertaken to respond to them affect the destiny of national *financial* policies *and* national *security* policies alike, traditional and interdependent requirements of any government and policy agenda. Having failed to forestall the crisis and the collapse of confidence that is impeding financial and economic stability and growth, pre-crisis national financial policies have lost credibility. Extant national security policies come under scrutiny too, however, because they have jeopardized, or are now jeopardized by a weakened national financial system. Thus, financial crises challenge crisis-hit governments' financial-security agendas, which are, in turn, re-established or surrendered during the process of crisis response, with inevitable implications on the course of military spending, threat assessment, and war prospects. The second claim that this work advances is that the national security measures that governments having a high affinity with high finance—namely governments that are generally cosmopolitan—and governments having a low affinity with high finance—that is governments that are generally statist-nationalist—*intend* and

²³ This project focuses especially on states' responses to financial crises. The immediate effects of crises on national security policies, for instance the fall in military spending deriving from GNP deterioration, are relevant to the extent that they elicit a certain kind of response from crisis-hit governments.

tend to select after the outbreak of financial crises are likely to be different: the former will be keener on resolving the crisis via further downplaying military ambition in an effort to restore financial confidence and economic stability and growth. By contrast, government having a low affinity with high finance will attempt to defend pre-crisis security agendas, subordinating financial measures of crisis response to those agendas, delinking them from national crisis response measures. The third claim that is foundational to the framework presented in the following pages is that while governments have either high or low affinity with the pressures of high finance *before* the onset of the financial crisis, this affinity can change *after* the financial crisis outbreak depending on crisis-hit governments' high or low exposure to high finance.

Justifying this distinction (affinity vs. exposure), which goes beyond semantics, are the political stakes with which financial crises present governments and domestic interests. After a financial crisis outbreak government authorities are urged to redefine their pre-crisis financial and security policies. While governments can rely on their control over domestic institutions and societal support to implement their intended crisis countermeasures, the role, power, and success of high finance in the process of financial crisis response can reinforce or weaken those countermeasures. This power game, in turn, tends to galvanize domestic non-financial forces too, and push them towards or against high finance or crisis-hit governments.²⁴ In sum, after the outbreak of financial crises crisis-hit governments' autonomy vis-à-vis high finance—and non-financial domestic constituencies, as a result—is fundamentally amended.

²⁴ Accordingly, this work does not deny the importance of non-financial interests in influencing crisis-hit governments' strategy of financial crisis response, but rather derives it from the interaction and shifts in balance of power between government authorities and high finance after the onset of the crisis. This primacy of governmental and financial forces in driving the process of crisis response hinges on their greater material and ideological assets to spur recovery compared to the assets of practically any other domestic and international actor.

The Alarm of High Finance and Its Orthodox Medicine

It is no secret that high finance dislikes financial crises. Powerful members of the transnational financial community—including the Rothschilds, Morgans, Warburgs, Bleichroeders and Rockefellers—are driven by profit and investment opportunities that flourish under conditions of financial stability or, in the language of Hyman Minsky or Charles Kindleberger, the confidence that financial stability will be preserved. Because high finance would not even exist in the absence of a shared international faith in the virtues of capital mobility, and the projection of private financial interests from their home bases, this confidence must hold nationally as well as internationally. By upsetting both financial stability and confidence in financial stability, nationally or internationally, financial crises challenge what high finance most cherishes: high returns on investment, and the prospect that these returns will continue and possibly increase in the near future. Global and local financial crises are both sources of concern.²⁵ During such crises high finance loses out, although “losing out” is always preferable to the harsher fate of being “wiped out,” which smaller business is more likely to face.

The recipe for crisis response recommended to governments by high finance is uniform. Crisis-hit governments should act pro-cyclically to the benefit of the financial sector: they should defend the value of the exchange rate, lower interest rates, restore a sound (=balanced) budget and credit rating, and deflate the economy by pursuing more stringent or austere monetary and fiscal policies irrespective of the negative implications for employment, wages, and output growth.²⁶ A first justification for this medicine, which derives from classical liberalism, is that

²⁵ Note, however, that financial crises striking states that are popular destinations for international investments are of more concern to high finance than financial crises affecting states that remain rather marginal in the global economy. Also, global financial crises are of particular concern because of the direct threats to the international financial system and to future financial gains—threats that are less serious in the case of local financial crises.

²⁶ Especially following the growth in states’ budgets in the 1940s and 1950s, this recipe has become increasingly compatible with the presence of international lenders of last resort, such as, for instance, the International Monetary Fund, or the European Central Bank, as well as with cooperation amongst foreign central banks and measures of “quantitative monetary easing.” The

declines in demand, prices, costs, and wages will redirect the flow of resources into private hands and reinforce private incentives to invest, eventually bringing the economy out of its downward spiral (Smith 2008). A second, related justification is that deflating prices and the economy, and defending the value of the exchange rate, signal national financial creditworthiness, and foster restoration of an aura of confidence or “seal of approval,” which thriving international financial markets, a sound international financial system, and ultimately prospering national finances need (Hayek 1945; McClosky 1966:122-158; Cooper 1968:148-173; Helleiner 1994:170). The ultimate message is that governments should express or restate their commitment to free market principles and international financial cooperation, while creating a hospitable environment for encouraging national and international private investment.²⁷ This pro-cyclical response to financial crises that high finance supports can be regarded as a defense of the rules of the existing international financial or monetary system, rules from which crisis-hit governments have strayed.²⁸ The prescriptions imposed by the International Monetary Fund on the Asian economies following the AFC, and the discipline of fiscal austerity endorsed by most European capitals following the start of the sovereign debt crisis in 2009 are symptomatic examples of the high-finance-style crisis-resolution toolkit.²⁹ Although the appropriateness of the toolkit has already been questioned (Feldstein 1998; Willet 2000; Watson 2002), and although debate over its (un)suitability continues to this day, the final words on the general adequacy of crisis

International Monetary Fund and the European Central Bank can be regarded as institutional improvements on the Bank for International Settlement founded in 1929 to promote the stability of the world’s credit structure.

²⁷ In this dissertation, “orthodox” stands for “in agreement with international financial cooperation (=financial orthodoxy), and a liberal international financial order.” Heterodox refers to any financial principle/doctrine that challenges international financial cooperation and a liberal international financial order. With “greater orthodoxy” or “greater heterodoxy,” I intend greater propensity to, respectively, abide by or deviate from the rules of the international financial system. On the use of “orthodox(y)” and “heterodox(y)” see, for instance, Ruggie (1982), Gourevitch (1984:95-129), and Helleiner (1994:181).

²⁸ On this response see, for instance, Gourevitch (1986:37-40); Broz (1997:59); Fischer (1998:103-106); Eichengreen and Temin (2000:18).

²⁹ The crisis response unveiled by US Federal Reserve Chairman Ben Bernanke in early 2009 was driven by a similar objective of refueling international financial cooperation and putting national and international credit markets in the position to reverse the sharp slowing in global financial and economic activity. See Ben Bernanke, “The Crisis and the Policy Response,” January 13, 2009, Stamp Lecture, London School of Economics, UK.

<http://www.federalreserve.gov/newsevents/speech/bernanke20090113a.htm>.

medicine prescribing national financial austerity, and respect for international financial rules favorable to mobile capital, will very likely remain unwritten.

An implication of the use of this toolkit has remained in the shadows. The pro-cyclical medicine requires an extremely prudent approach to national military spending, threat assessment, and war prospects. The carving out of defense funds to face existing or mounting threats would simply backfire on the crisis-resolution efforts that high finance recommends.³⁰ Similarly, lowering defense spending, downplaying existing threats, and avoiding war entanglements are measures that promise to buttress the success of the fiscal straitjacket that high finance desires of governments during financial crises. In other words, restoring financial confidence and national creditworthiness demands reductions in existing military spending. Reduction in military spending requires, in turn, the downplaying of threats, whereas rising threats pave the way for increases in military budgets and decreasing market confidence. The downplaying of threats implies, in turn, decreased war prospects. Thus, the advice of high finance to governments struggling with financial crises is a universal call to *tame national security ambitions or fears*, no matter the status of existing commitments to national security (or of the economy).

The classical or neoliberal crisis-response medicine suggested by high finance is not far removed from its ordinary, or orthodox, financial and security preferences. It is, indeed, an established finding in the literature that high finance prizes stable macroeconomic conditions and cautious national security policies. In this regard, Karl Polanyi (1944:10,13,14) has noted that, by awarding and renewing loans to governments based on good fiscal behavior and creditworthiness, financial elites significantly contributed to international peace in central

³⁰ Assertive national security policies, particularly wars, have historically been associated with distressed financial markets, weakened financial confidence, and a series of negative repercussions on economic stability and growth.

Europe during the hundred years preceding World War I. More recently, Jonathan Kirshner (2007:9) has found that high finance is reluctant to risk and initiate war because of its deleterious macroeconomic consequences. And Benjamin Cohen (1986:14) has observed that the firm interest of high finance in peaceful diplomacy has affected the conduct of American foreign policy more than once.

Yet, only occasionally throughout history have the customary financial and security preferences of high finance been translated into policy. In the hundred years of peace that Polanyi describes, states often propped up their military budgets and pursued expansionary colonial policies to the detriment of national macroeconomic variables, thereby escaping from a strict observance of financial orthodoxy. At the height of the gold standard, only Great Britain constantly maintained full convertibility, and even Great Britain itself did not uphold perfectly balanced budgets at all times (De Cecco 1974:1; Eichengreen 1985:2; 1987:16,19; 1996:20; Friedberg 1987:15; Bordo and Kydland 1990; Broz 1997:53). Interestingly, as the Boer Wars demonstrate, British governments were not strangers to escalating defense budgets and military adventures (Friedberg 1987).

Moreover, while governments' policies often deviate from the prescriptions of financial orthodoxy, high finance itself cares more about the existence of heterodox national financial and security policies at certain times than others. For instance, the tendency of high finance to get caught in financial bubbles and economic booms on its quest for profit maximization (Kindleberger 1978), temporarily losing sight of macroeconomic fundamentals and financial stability, suggests that its commitment to financial orthodoxy is not constantly and staunchly defended. More exactly, financial elites have few incentives to meddle with governments' policies when markets are buoyant. By shattering the expectation of forthcoming high returns to

investment, financial crises awaken the demands of high finance. They are not the sole event to do so—security crises and impending wars are others, for instance—but certainly a notable one. Ultimately, financial crises present high finance with extra opportunities to reassert the value of financial orthodoxy and national security caution. Likewise, governments are similarly offered additional chances to show high finance how seriously or poorly they stand for these values.

Crisis-Hit Governments' Exposure to and Affinity with High Finance

In posing a threat to financial-security agendas, increasing political uncertainty and demanding for an urgent response, financial crises call crisis-hit governments to redistribute the costs of adjustment between society and the state as well as amongst societal sectors.³¹ Amongst various societal groups, the role and behavior of high finance versus governments during financial crises are very much acknowledged by existing literature. Several works in international political economy have shown that financial and economic strategies of crisis response are indicative of a variously fought and resolved power-game between crisis-hit governments and international financial markets over the kinds of interests or ideas to be defended or endorsed (Haggard and Maxfield 1996:214-216; Blyth 2003; Helleiner 1994:169-191; Stiglitz 2010). Shaping this game is the autonomy of crisis-hit governments to undertake and complete their intended strategy of financial crisis response: an autonomous crisis-hit government will either successfully resist the pressures posed by financial elites or accept these pressures only to the extent that they respect the intended strategy of financial crisis response.

The sources of this autonomy—here defined as high or low government exposure to high finance—have been suggested by existing scholarship on the domestic responses to financial crises, exogenous economic shocks, and international liberalization, and they involve coalitional,

³¹ As later pages will acknowledge, and as the literature on the political economy of financial crises has widely shown (Gourevitch 1986; Pepinsky 2009), the domestic political realignment that occurs during financial crises involves societal actors other than crisis-hit governments and high finance.

institutional, and ideational factors born out of specific domestic, regional, and international contexts.³² For example, the coalitional strength or “embedded autonomy” of governments has been linked to the triumph of the leadership’s intended crisis-strategy, and a *low* government exposure to the pressures of transnational financial markets after the financial crisis outbreak (Pepinsky 2007; Haggard and Kaufman 1992:23–28). Along similar lines, the centralization of domestic institutions (MacIntyre 2001), the limited dependence on international financial markets, the scarce domestic or regional clout of neoliberal mental frameworks (Solingen 1998), and the absence, or extreme political weakness, of a domestic financial sector (Frieden 1991), have been associated with greater independence of crisis-hit governments versus transnational financial elites.³³

Building on these findings, this dissertation considers a government highly exposed to high finance when its strategy of financial crisis response cannot discount the following three components, which also define governments’ pre-crisis agendas: the domestic relevance of *orthodox* mindsets (1); the *presence* of a powerful domestic financial sector (2),³⁴ and great ability of *high finance* (and the poor ability of the crisis-hit government) to mobilize the financial and political resources that are needed to respond to the financial crisis (3).³⁵ In contrast, a government is considered minimally exposed to high finance when its strategy of financial crisis response cannot discount the domestic relevance of *heterodox* mindsets (4); the *absence* of a

³² Amongst these factors are, for instance, coalitional cohesion, the degree of centralization of state structures, the distribution of veto authority, the type of business-government relations, the strength of the army or state bureaucracy, the power of neoliberal mental frameworks, and the degree of capital openness. See, for instance, Katzenstein 1978 and 1985:19-27; Gourevitch 1986; Rogowski 1989; Haggard and Kauffman 1992; Garrett 1995:658; Milner and Keohane 1996; Winters 1999; MacIntyre 1999b, 2001; Kirshner 2006; Pepinsky 2009.

³³ This point is in line with the widely held conclusion across much of the literature on capital mobility and state autonomy that states have not surrendered to, or retreated from, global finance but maintain significant freedom to maneuver and have often been at the forefront of financial liberalization. On this point, see Katzenstein (1985), Frieden (1991), Goodman and Pauly (1993), Helleiner (1994), Andrews (1994), Quinn and Inclán (1997), and Oatley (1999).

³⁴ Note that while a well-functioning international financial system strengthens the power of financial interests in the crisis-hit state, the system is no guarantee of the presence of financial interests in the crisis-hit state.

³⁵ The material assets that high finance has during financial crisis are ample liquidity, and the political endorsement of the major social forces of the crisis-hit state.

powerful domestic financial sector (5); and the high ability of *crisis-hit governments* (and the poor ability of high finance) to mobilize the financial and political resources needed to respond to the financial crisis (6).

A transposition of the Mundell-Fleming trilemma (Mundell 1963) in the context of financial-crisis response suggests that it is particularly meaningful, theoretically, to consider government exposure to high finance in the process of financial crisis response as either high or low, and with no equilibrium possible between these two extremes.³⁶ One element of the policy triad that the Mundell-Fleming model considers, namely the target of maintaining a fixed exchange rate, can be thought of as equivalent to the objective of financial crisis response. During financial crises, governments may strive for only two of the following three objectives: exchange rate stability or crisis resolution; fiscal and monetary sovereignty; and respect for high finance and capital mobility. Hence, working on a solution to the financial crisis will demand *either* the full exercise of state fiscal and monetary sovereignty *or* the support of high finance and capital mobility.

Financial crises have historically affected statist-nationalist and cosmopolitan governments.³⁷ For instance, the statist-national government of George W. Bush and the cosmopolitan government of Angela Merkel have both succumbed to the GFM. In the late 1880s, financial crisis hit the statist-nationalist (French) government of Georges Ernest Boulanger as well as the cosmopolitan (Dutch) government of Joan Röell.³⁸ Although the national security principles on which cosmopolitan ruling coalitions or parties thrive tend to make financial crises

³⁶ The Mundell Fleming model assumes that a state cannot simultaneously sustain fixed exchange rates, capital mobility, and independent monetary policy.

³⁷ An overview of the type of governments that have been affected by banking crises in the last twenty years can confirm this statement. For a list of these crises see Reinhart and Rogoff (2009:345-392). As clarified earlier in the chapter, the statist-nationalist or cosmopolitan nature of government is based on national financial/economic and security policies. Either kind of government could also be thought of as a large category encompassing various international or statist-nationalist solutions. The Latin American military-populist governments of the 1970s, for instance, and many confessional, Middle Eastern governments, during the same period, offered different expressions of the statist-nationalist ideal-type.

³⁸ France experienced a financial crisis in 1889, the Netherlands in 1897.

a harsher challenge for this type of government than for a statist-nationalist government, both statist-nationalist and cosmopolitan governments may experience a low or high exposure to high finance during the process of financial crisis response.³⁹ For instance, Suharto's statist-nationalist Indonesian government in financial crisis year 1998 and Berlusconi's cosmopolitan Italian government in financial crisis year 2011 both became highly exposed to high finance. Neither of them was able to withstand its power against overriding orthodox financial ideas, hold its ground vis-à-vis powerful domestic financial interests, and mobilize the political support and financial resources necessary to resolve the crisis. Both Suharto and Berlusconi lost their battle with high finance: the former was forced to abandon its auspicated plan for a currency board; the latter was compelled to accept the advent a more financially sound ruling party or coalition.⁴⁰ Differently, Portillo's statist-nationalist Mexican government in financial crisis year 1982 and the American cosmopolitan government of FDR in financial crisis year 1933 both resorted to monetary and financial heterodoxy as part of the strategy of financial crisis response, indicating low exposure to international financial markets.⁴¹

While statist-nationalist and cosmopolitan governments can be highly exposed or minimally exposed to high finance *after* the outbreak of financial crises, *before* crisis outbreak the affinity of each government to international financial markets tends to differ. Government affinity with high finance is discernible from the pre-crisis financial-security agendas of crisis-hit governments. If this agenda benefits sectors like liquid-asset holders that gain from unprotected

³⁹ For a statist-nationalist government, national financial strain might be a rather common element of the political context in which national agendas are crafted.

⁴⁰ On Suharto's abandonment of its auspicated plan for a currency board in 1998 see Grabel (2003:43). In 2011, the technical government of Mario Monti replaced Berlusconi's, and the latter's more remarkable commitment to national financial stabilization.

⁴¹ Portillo introduced capital controls in 1982. FDR did not need to do that—significant amounts of capital did not enter the United States in the early 1930s—but he similarly undertook a series of heterodox financial policies. See Chapter IV on this point.

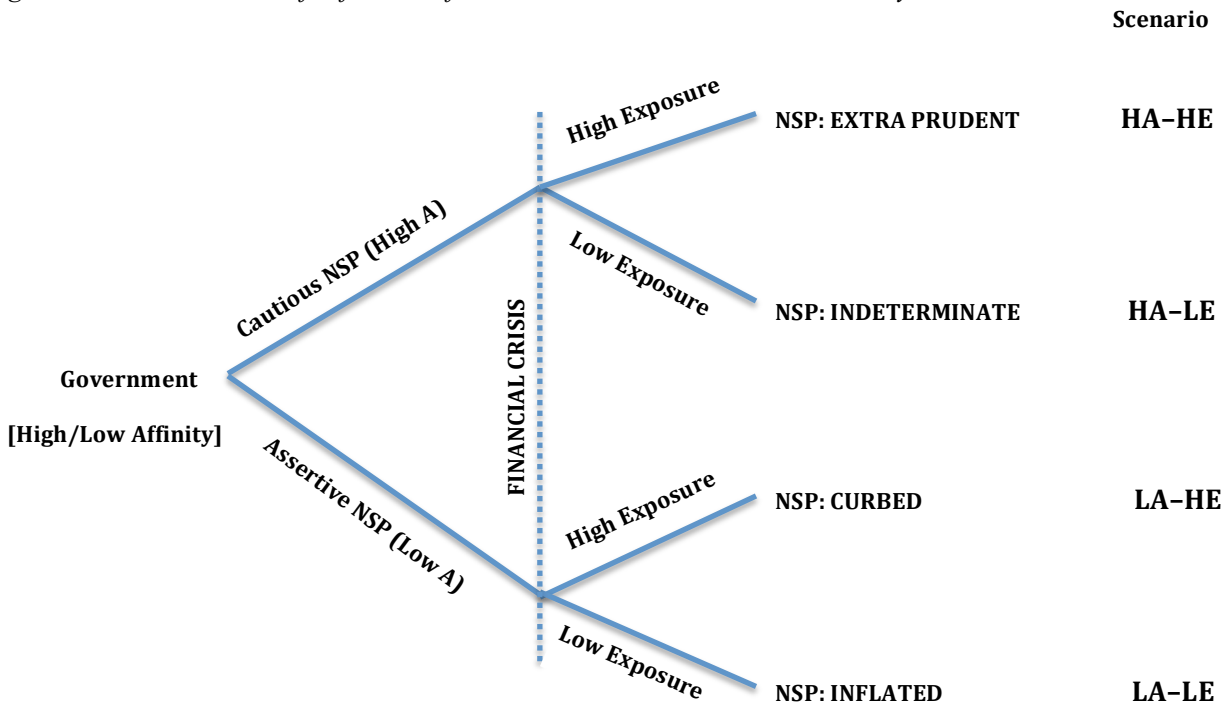
international financial competition, government affinity with high finance is high.⁴² Similarly, affinity is high if this agenda envisions the taking of explicit steps towards international peace. By contrast, government affinity with high finance is low if state entrepreneurship prevails domestically over international financial markets. It is also low if the government commits to the sustained extraction and mobilization of domestic resources for increasing military power and national security. Because of variation in the specific principles and domestic institutional features that filter the relationship between national authorities and global finance (Polanyi 1944; Katzenstein 1978:3–22; Keohane and Milner 1996:16–22), statist-nationalist governments tend to face lesser constraints to pursue assertive national security than cosmopolitan governments do, while, oppositely, cosmopolitan governments tend to face stronger incentives than statist-nationalist governments to pursue prudent diplomatic and military policies. As a result, the pre-crisis affinity of cosmopolitan government is likely to be high, whereas the pre-crisis affinity of statist-nationalist government is likely to be low. For both reasons of simplicity and empirical relevance, the theoretical framework proposed here assumes that the affinity with high finance of the financial and security policies of the same government overlaps.

The interplay between government pre-crisis affinity with *and* post-crisis-outbreak exposure to high finance produces four possible scenarios of influence of financial crises on national financial-security agendas that are displayed in Figure 1, specifically “HA–HE,” “HA–LE,” “LA–HE,” and “LA–LE.” The four-letter labels refer to the values assumed by government affinity and exposure to high finance in each scenario. Each scenario, as it will soon be clear, implies a shift towards greater or lesser caution in national military spending, threat assessment and war prospects. Before examining why this is the case and how this occurs, I offer two

⁴² On the domestic distributional impact of the national policies favoring international financial and economic liberalization, see Rogowski (1989:3–21); Haggard and Maxfield (1996:209–236); and Quinn and Inclán (1997:771–813).

cautionary notes. First, while the theoretical framework assumes that national financial and security policies express a synchronized affinity with high finance, and that cosmopolitan and statist-nationalists governments tend to exhibit, respectively, high and low affinity, this synchrony is occasionally absent in practice. The Nordic welfare model, for instance, is a cosmopolitan government combining a conciliatory approach to military spending, threat assessment, and war prospects, with a financial and economic program heavily weighted towards non-financial domestic groups. High finance is not ostracized, nor it is glorified. Similarly, the statist-nationalist government of George W. Bush (2001–2008) pledged itself to deep, pro-finance tax cuts, financial deregulation, and an explicitly “anti-finance” assertive foreign policy.

Figure 1. Four Scenarios of Influence of Financial Crises on National Security Policies



Legend:

Government: Statist-nationalist or cosmopolitan

NSP: national security policies—military spending, threat assessment, and war prospects;

High/Low Affinity (to high finance): government’s predisposition to include the preferences of high finance in its financial-security agenda;

High/Low Exposure (to high finance): government’s necessity to include the preferences of high finance in its financial-security agenda to solve the financial crisis;

Scenarios: HA-HE → High Affinity and High Exposure; HA-LE → Low Affinity and Low Exposure; LA-HE → Low Affinity and High Exposure; LA-LE → Low Affinity and High Exposure.

Second, in a similar vein, during the process of financial crisis response, there might be moments in practice when government exposure to high finance appears contested, the adopted strategy of crisis response having failed to bring about successful crisis resolution. With little doubt, this occurred during the Great Depression, starting from financial crisis year 1933 (Schlesinger 1957:457)—after that the orthodox medicine had repeatedly failed, and after the power of high finance had shrunk—and it is possibly occurring today, in the midst of the banking scandals that have punctuated the GFM (Grabel 2011; James 2012).⁴³ During these moments, crisis resolution strategies are susceptible to change, as are orthodox or heterodox mindsets, the power or weakness of the domestic financial sector, and the ability of governments and high finance to mobilize the financial and political resources needed to respond to the financial crisis.

The Change in Military Spending, Threat Assessment, and War Prospects in Each Scenario

Because of the value that they attribute to their pre-crisis financial-security agendas, and because national leaderships' political survival rests on them, governments are likely to respond to financial crises by redoubling on their pre-crisis policies. Namely, governments pursuing assertive national security policies will strive for greater assertiveness while governments practicing conciliatory diplomatic and military policies will attempt greater restraint. They make this choice for at least two interrelated reasons. To begin, while financial crises display a problem in governments' policies and policymaking, denying the existence of a problem based on the validity of a financial-security agenda that has shown to work in the past is an appealing, low-cost strategy of political self-preservation. Moreover, the pre-crisis agenda comes with an

⁴³ The Ferdinando Pecora investigations of January 1933, so-called after the American lawyer and judge who instituted them, sealed the loss of power of high finance, and a shifting national and international financial consensus. The investigations were part of a large American legal scrutiny into the practice of banking. Today, sluggish recovery, trading fiascos, and scandals like the LIBOR affair might indicate a similar turn of the tide. See, for instance, Heleen Mees, "The Zero Man," *Foreign Policy*, April 3, 2012; David Rothkopf, "Bleak House," *Foreign Policy*, April 23, 2012; Rana Foroohar, "How Barclays Rigged the Machine," *Time*, July 23, 2012; and Jennifer Steinhauer, "Enduring Drought, Farmers Draw the Line at Congress," *New York Times*, August 12, 2012.

ideational baggage over the “best” or “most apt” financial, military and diplomatic policies. Abandoning them and rapidly transitioning towards alternative solutions becomes unfeasible even if the threat to governments’ survival, the shortened time-horizon, and the uncertainty posed by financial crises cause concern. Recent experience with financial crises confirms the doubling-down hypothesis. Following the outbreak of the Asian financial crisis, for instance, policy analysts and observers around the world, members of governments of the affected and unaffected states, and international institutions like the IMF *denied* that a crisis was under way in East Asia. The existing financial policies were pushed ahead with greater strength, as the crisis spread to Latin America and Russia. A very similar response has occurred, and in some regions of the world is still occurring, since the 2008 onset of the GFM. In the early months of the crisis, the Bush administration denied that there was any serious problem, declaring that it was acting pragmatically in rescuing financially bankrupt firms.⁴⁴

Although this “double-down movement” is the strategy for crisis response envisioned by either kind of government, crisis-hit administrations—for reasons explained in the earlier section—are not always able to implement or pursue it until the end of national financial difficulties. Since the financial and security components of governments’ policy agendas are interdependent, two important implications follow: after the outbreak of a financial crisis, the course of national security policies is likely to change, and this change will depend on the particular scenario within which crisis-hit governments operate. In each scenario, governments committed to assertive or cautious military spending, threat assessment and war prospects will have to choose, or be forced to choose, between the “compromising” solution of validating (or-revalidating) international financial openness, and the “uncompromising” solution of delinking, or continuing to delink national financial and security policies from the imperative of

⁴⁴ On this point, see especially Stiglitz (2010).

international financial coordination, primarily deflation, implied by participation in an international financial system.⁴⁵ The incentives and constraints to select one route over the other will vary.

Imagine a government in scenario “LA–LE.” The government in question is committed to the pursuit of assertive national security policies when a financial crisis strikes. Government affinity with high finance is low, as pre-crisis financial policies have been adjusted to meet this national security agenda, privileging heterodoxy over orthodoxy. Relatedly, national dependence on the international financial systems is limited or inexistent; a domestic financial sector has not yet developed or is powerless; and neoliberal mental frameworks are absent. The coalition or party in power is statist-nationalist in kind—an acceptable hypothesis in view of the lesser constraints to the pursuit of assertiveness that statist-nationalist coalitions or parties encounter. The government is also well positioned to rely on highly centralized institutions; extract financial resources from the people; minimize the social consequences of political dissonance; and deflect to the domestic private financial sector the adjustment costs of crisis response. In sum, government exposure to high finance is low. In this scenario, government authorities have no incentive to abandon existing national security policies and pursue fiscal and monetary deflation to signal credibility to domestic and foreign investors. The reasons are various.

To begin, responding to the crisis by maximizing domestic resource extraction is possible and in line with existing mercantilist-protectionist frames of mind. Secondly, a strong domestic financial sector, and the increasing permeability of domestic borders to foreign capital, are a hindrance to the inward-looking strategy of accelerated economic and industrial development sustaining, and, in turn, being sustained by, a well-oiled commitment to strengthening national

⁴⁵ A state’s participation in the international financial system, a system made by states and for states, will last as long as the state perceives that remaining in the system is beneficial to national financial and economic growth. Financial crises test the value of international financial systems. On this point, see Eichengreen (1996:35).

defense. Thirdly, redressing the extreme skepticism of high finance towards the status of national finances would require abandoning the ambitious approach to military spending, threat assessment, and war prospects propelling the military-industrial complex that maintains the government in power. Fourthly, the experience of exclusion from the international financial system, and possibly the relevance of a regional context that is similarly insulated from international capital markets (Solingen 1998; Katzenstein 2005), will cement government leaders' belief that rival states will not be deterred from taking advantage diplomatically or militarily of a window of opportunity opened by the financial crisis. The collapse of national financial institutions located abroad could further increase the perception of forthcoming diplomatic and military losses. In this context, the domestic private financial sector, if at all present, will not be capable of persuading the government of the benefits of the orthodox medicine. High finance will not dictate the conditions of recovery, and heterodox financial ideas will predominate. This scenario is popular when military governments are in power, and a state-led program of accelerated development and military prowess captures the hearts and minds of the ruling oligarchy.

Consequently, softening national defense policies is an extremely unappealing strategy, whereas inflating militant national security policies and transferring rising percentages of GNP to national rearmament promises to reduce domestic opposition arising from the representatives of the military-industrial complex. Government authorities are therefore likely to focus their energies on counteracting the weakening of existing national security policies, and minimizing the potential or real diplomatic or military losses caused by the crisis. Defending and reinvigorating the national financial system, the fiscal and monetary sovereignty of the state, the government's financial bases abroad, and the success of existing national security policies will

take priority. Governments will redouble the pace of investment in national defense, and further emphasize the risks of existing threats. The increase in military spending will be decreed in an attempt to resupply existing military plans and activities as well as spurring government-led investment and economic growth. Concern over the solidity of existing alliances will increase and government authorities will deem war prospects to be more likely than before the crisis.⁴⁶ Overall, the crisis-hit government will adopt a more assertive set of national security policies than in the absence of the crisis (Fig.1), *exacerbating the existing or perceived security dilemma*. Even if the objective of national authorities is to prevent a worsening of the security dilemma and to defend but not radicalize pre-crisis military and diplomatic policies, governments are very likely to inflate their bold pre-crisis national security plans. The national security context proximate to the Russian-Japanese War of 1904–05 exemplified this logic, as both participants embarked on greater assertiveness following the onset of a financial crisis.

Imagine now the same statist-nationalist government in “LA-HE.” The government wants to continue its assertive security plans, and might even strengthen them after the outbreak of the crisis. The costs of the maneuver are now politically daunting, however. High finance, a powerful domestic financial sector, members of the opposition, and a majority of domestic forces will oppose unsustainable trends in military spending, threat assessment, and war prospects, pointing at their deleterious effect on national financial creditworthiness or the national economy. Abidance by the norms of financial orthodoxy is presented as essential for crisis response and the restoration of financial stability. As the costs of exclusion from international financial markets and possibly of foreign financial dependence soar, the political and financial

⁴⁶ Note that this interpretation of the influence of a financial crisis on war prospects is distinct from the diversionary theory of war, in which economic instability persuades governmental elites to initiate a diversionary war with an opponent in the attempt to divert public attention from domestic troubles that threaten the survival of the regime. In the interpretation offered here, governmental elites might even be concerned for their political survival, but the chief problem lies in diverting the expectation of foreign opponents that the financial crisis has weakened the government and its national security policies.

resources available to national financial institutions to fend off the crisis decrease sharply. High finance, possibly but not necessarily united with domestic finance, will attach conditions to fund disbursement, and will not lend or stop lending without a stronger commitment to fiscal and monetary deflation and to a conciliatory diplomatic and military agenda.

This scenario is likely, for instance, when the domestic institutional support and ideational drive behind a statist-nationalist government fade away as the crisis unveils no-longer bearable adjustment costs and reveals the increasing advantage of defending national financial credibility, placing national finances on a sustainable path, and upholding the principles of a liberal financial order. Heterodox financial models are likely to be rejected, and emerging domestic financial forces are awarded a stronger role within existing institutions. The crisis-hit government is likely to reach a political compromise with emerging political forces or be replaced by a government enjoying the approval of high finance. The timing and character of the transition towards a cosmopolitan security agenda are likely to vary across politico-institutional contexts. Political debate or unrest resulting from the financial crisis might quickly lead to government rearrangement or replacement. Alternatively, political dissent will find its expression through electoral channels, favoring candidates and parties who support sound finances and a compromising military agenda.

Institutional differences apart, if the financial crisis ushers in an increase in the exposure to high finance of a statist-nationalist government, the national security agenda will tilt towards greater caution or internationalism. Old or new state authorities are likely to recognize that assertive security policies have been pushed beyond the state's financial means, and that greater commitment to strengthening national finances requires overhauling pre-crisis plans. Cuts in military spending will be endorsed. Threat assessment will be softened to signal financial

investors at home and abroad that the national economy is on its way to recovery, and that no military ambition or distraction will interrupt it. War prospects will decrease (Fig.1). *The security dilemma will ease*, and national security policies will display greater prudence than in the absence of financial crisis. The peaceful resolution of the 1907 military-security crisis between United States and Japan, for example, was strongly reinforced by the materialization of this scenario triggered by the global financial crisis of 1907.

In “HA-LE” the picture is exactly opposite. A government that has opted for prudent diplomatic and military policies is shocked by financial crisis, and discovers that it is impossible to stop its consequences for national wealth or welfare by taking the national financial-security agenda to new conciliatory extremes. In this scenario, a crisis-hit, cosmopolitan government acknowledges the costs of domestically unpopular, orthodox measures, and gains significant freedom from high finance and domestic financial interests. Finance writ-large is either disinterested in the country because of the dismal opportunities that it offers to global capital, or weakened by the financial crisis itself. Concurrently, the release of the pre-crisis constraints which international financial markets were posing on the exercise of assertive national security policies empowers domestic groups supporting heterodox financial policies. How important the release of the constraints posed by international capital markets is for the course of national security policies after financial crisis outbreak is highly dependent on how the diminished power of finance modifies specific political contexts. More pointedly, the decreased power of international financial markets—and international economic markets—leaves governments that before the crisis subscribed to a cautionary financial-security agenda in a position of ambiguity. As a result, the change in pre-crisis national security agendas underpinning this scenario is characterized at best as indeterminate (Fig.1). *The security dilemma will also be indeterminate*,

as crisis-hit governments face lesser constraints—but not necessarily more incentives—to include financial, economic, diplomatic and possibly military experimentation in their strategy of crisis response.⁴⁷

Particularly, this strategy will include, most likely, the development of stronger ties with real (non-financial) sectors of the economy, and a more active monetary and fiscal role for the government. Both elements, along with the decreased relevance of international financial markets, will likely keep national defense spending much less under check than they had before. Similarly, the decreased power of orthodox mental frameworks will likely encourage government authorities to see the dangers, rather than the benefits, of pursuing an unreservedly dovish foreign policy, and recognize, even amplify, the threats to national security posed by the behavior of other states. Like national financial and economic policies, national security policies will enter a phase of experimentation. This occurred in the United States during the Great Depression: President Franklin D. Roosevelt’s approach to military spending, threat assessment, and war prospects injected novel assertiveness into a largely restrained national security posture. Differently, in those politico-institutional contexts where the fall of high finance and domestic financial elites empowers previously restrained confrontational interests, cautionary forces will be silenced, threats enlarged, and war and military spending embraced as an engine of national economic growth and prosperity.⁴⁸ This development decided the international political orientation of Italy between 1932 and 1934, as the constraints posed by financial interests on Mussolini’s intentions came off, and so did the exposure of the government to high finance.⁴⁹

⁴⁷ It is noteworthy that this theoretical framework would be much less interesting if most financial-crisis episodes in history had resulted in “HA-LE,” and this scenario only. I can state quite confidently that both the empirical evidence gathered in this work and the existing scholarship on financial crises suggest that this is not the case.

⁴⁸ This interpretation is distinct from and possibly antithetical to the explanation offered by the diversionary war hypothesis. The matter is not “diverting attention” as much as finding more appropriate tools to resolve the financial crisis.

⁴⁹ It is also possible that pro-finance governments and their cautionary security policies are trumped by the increase in relative power of national or subnational military forces, like it occurred in Japan in 1931.

Finally, in “HA–HE,” a crisis-hit, cosmopolitan government makes prominent sacrifices in its national security agendas because crisis resolution *must* be achieved by rescuing financial confidence and national financial credibility through greater deflationary policies. The government is likely to be at the head of a financially and politically decentralized domestic structure where orthodox financial mindsets are dominant. It is also likely to be limited in its ability and willingness to deflect the cost of the crisis to powerful, domestic financial elites, having long experienced the benefits of subordinating national security ambitions to cross-border capital movements and neoliberal mental frameworks. In this scenario, high finance will play a direct, important role in the process of crisis resolution, as the government will need, in order to solve the crisis, to bend its financial-security agenda under the pressure of unfettered capital mobility.⁵⁰ Pre-crisis national security policies included a military budget kept under watchful observance, the downplaying of threats to national security, and a general commitment to international peace. After the crisis outbreak, however, pre-crisis military spending, threat assessment, and war prospects are pushed to new conciliatory extremes, because the prevailing wisdom amongst domestic political circles is that mobile capital is the key to crisis resolution.⁵¹ Creating more suitable conditions for the thriving of business impels further disarmament, and the further downplaying of threats and war prospects (Fig.1). Like in LA–HE, *the security dilemma is lessened*. Notably, intrinsic belief in the virtues of unfettered free markets is not even necessary, although, if present, would explain exceptionally conciliatory national security undertakings by cosmopolitan governments and their disinterest in their potential consequences. What is necessary is that high finance and financial orthodoxy are considered by government

⁵⁰ Note that while in LA-LE government cohesiveness is an asset, in HA-HE domestic support for orthodox financial policies is an advantage.

⁵¹ The number of parties and political forces involved in, or benefiting from, this decision is likely to vary across different contexts.

authorities as the most powerful or convenient tools for crisis resolution for the time being.⁵² The military and diplomatic responses by various governments to the 2009 European sovereign debt crisis fit this scenario.

To sum up, when government exposure to the pressures of high finance is *low* after a financial crisis outbreak, (statist-nationalist) governments pursuing assertive national security policies are likely to double-down their pre-crisis agenda, whereas (cosmopolitan) governments pursuing prudent national security policies are likely to enter a period of uncertainty and policy experimentation. When government exposure is *high*, neither cosmopolitan nor statist-nationalist governments pursuing, respectively prudent and assertive national security policies are likely to see their optimal strategies for crisis response realized. Cosmopolitan governments will be urged by high finance to *go past the point* of redoubling an agenda based on financial orthodoxy and conciliatory national security policies. The result is likely to be an extra prudent and super orthodox financial-security agenda.⁵³ In contrast, statist-nationalist governments will be impelled by high finance to *pull back* from their intended doubling-down of an assertive, financially heterodox pre-crisis agenda (Fig.1). The inflation, curbing, or indeterminate reshuffling of pre-crisis military spending, threat assessment, and war prospects is the influence that financial crises produce by requiring crisis-hit governments to respond to an urgent political and financial threat and redefine their relationship with high finance.

The shift towards greater assertiveness or greater caution does not necessarily affect all three branches of national security decision-making, although this development seems likely to occur in LA–HE, when the pre-crisis security agenda is curbed rather than inflated. More

⁵² For an instrumental understanding of the role of mental frameworks in decision-making, see Goldstein and Keohane (1993), Chapter 1.

⁵³ This occurs because increased pressures from high finance to resort to financial orthodoxy are compounded by the shift towards greater financial orthodoxy than government B, a cautionary government with a high affinity with high finance is, already on its own, willing to implement.

importantly, crisis resolution can entail a number of scenarios. For instance, government exposure to high finance might remain high throughout the first stage of a crisis, when well-known financial and security measures are applied in greater doses and change in fundamental beliefs or perceptions remains difficult.⁵⁴ Yet, repeated strategic failure will induce greater updating in existing beliefs and greater likelihood of policy overturn. In this respect, the American and Italian local financial crises of, respectively, 1893 and 1896–98 first tilted the national security policies of both states towards greater caution. Later, in both states, cosmopolitan governments realized incumbent threats or severely prejudiced military dreams, and frantically responded to the newly acquired military-diplomatic weakness by slating a cautionary posture. In sum, the process of financial-crisis response is best regarded as developing through a series of stages in which national security decision-making concerning military spending, threat assessment, and war prospects could take a different direction each time.

Shifts towards less assertive and more assertive (or less cautious and more cautious) national security policies can both occur before a new equilibrium in the national financial-security agenda is found. Until then, perceptions of the security dilemma, and eventually the real dilemma, will evolve. Notably, the essence of the argument of this dissertation is not that the influence of financial crisis on national security policies is best judged by the degree of disparity in national security policies before and after a financial crisis. Rather, the argument advanced here is that financial crises leave their mark on national security policies; that the characteristics of that mark vary based on the interaction between government affinity with and exposure to high finance; and that the resulting changes in military spending, threat assessment, and war prospects would either not have occurred, or occurred differently had financial crises been

⁵⁴ On the difficulty of replacing existing beliefs see, for instance, Tetlock (1991:27-31).

absent.⁵⁵ As the chapters of this dissertation show, the direction of the changes is not more important than the very fact that these changes occur. Importantly, while governments undertaking them were induced to affect the security dilemma in a certain way, their perceptions were not always correct, especially when change entailed a paramount abdication to military and diplomatic conciliation.

CASE SELECTION, METHODS, AND DATA

The bulk of this dissertation rests on the comparative analysis of four large, heuristic case studies.⁵⁶ I call them “large” not because of their length but because most of them analyze the national security influence of several financial-crisis episodes distributed over a long temporal span. Three of the case studies apply the theoretical inferences so far illustrated to the national security influence of financial crises in, respectively, Japan, Italy, and the United States between 1880 and 1940. The fourth portrays the influence of the 1914 global financial crisis on decision-making concerning military spending, threat assessment and war prospects in three sets of states including Japan, Italy, and the United States. The main cases—Japan, Italy and the United States—were chosen with several aims in mind. To begin with, although the precise influence of financial crises on national security policies differs from case to case as well as within cases, all three states were recognized as significant financial and military powers during the analyzed period. They experienced financial crises—at times the same financial crisis—and they approached decision-making on military spending, threat assessment and war prospects with assertiveness as well as caution. Related to this point, the power of high finance and government exposure to the pressures of high finance varied in each state across the timeframe (1880–1940) as well as across financial crises. Moreover, in each state, financial crises affected statist-

⁵⁵ This point has important implications for the research methods used in this work, as clarified later in this chapter.

⁵⁶ Case studies here are “heuristic” in that they are the raw material for the theoretical foundations of this chapter. On heuristic case studies, see Greenstein and Polsby (1975:104-108).

nationalist governments and statist-nationalist financial-security agendas, as well as cosmopolitan governments and cosmopolitan financial-security agendas.

While these elements indicate that each of the three selected states offers, individually, appropriate terrain for analyzing the national security influences of financial crises in the considered period, Japan, Italy, and the United States are representative candidates for this study even when collectively considered. The national political and financial systems of each case and, more broadly, their cultures, histories, military traditions and geographic locations are significantly distinct. As a result, Japanese, Italian, and American financial-security agendas rested on different ingredients, broadening the latitude of the theoretical inferences of this work.⁵⁷

Three diverse backgrounds also informed the affinity with and exposure to high finance of the Japanese, Italian, and American governments, whatever their international political orientation and national security agendas. Japanese political and financial institutions were strong, centralized, and significantly apt at saving, taxing, and fighting. The Japanese constitutional monarchy legitimized, under divine supervision, the authoritarian rule of an oligarchic cabinet, thrived on the repression or exclusion of dissonant political voices, and rested on a powerful and independent military, directly answerable only to the emperor. The emergence of party government and bipartisan competition, which reached their most satisfactory operation in the 1920s but developed long before then, did not alter the exclusive access and exercise of power to which Japanese rulers were accustomed. Similarly, the Japanese financial system was hierarchically structured around the Bank of Japan and several specialized banks and corporate

⁵⁷ Some of these different ingredients are widely acknowledged in the literature on comparative political economy. See particularly Gilpin (1975:37–50); Katzenstein (1978:4,20,21,22); Strange (1988:23–34, 64–73); Sakakibara (1993); and Hall and Soskice (2001:88,92,94,100,170,459,461).

⁵⁷ On the relevance of this mission for theory development, see Locke and Thelen (1998:11); and George and Bennett (2004:12,19–22).

financing organizations (“zaibatsu”), under the direct regulation and guidance of the government. The system worked by steering household savings to the treasury and national industries to serve the developmental and military purposes of the state (Ranis 1959:440–454; Patrick 1965:187–213; Tsutsui 1990; Francks 1992:29–40; Pauly 1994:351–55; Tamaki 1995:10,62,64; Beasley 2000).⁵⁸ Overall, the presence of a strong army, commonly unconstrained by civilian influences, and the commitment to national financial and monetary autonomy rendered Japan a scarcely hospitable environment for high finance and the internationalization of financial investments. A politically independent domestic financial sector emerged very slowly.

Differently from Japan, the institutions of the Italian government were moderately centralized (or moderately decentralized), and historically exposed to foreign interference—political and financial.⁵⁹ Rather than being organized around a small number of oligarchs, Italian governments were commonly coalitional in nature, reflecting political consensus across a diversity of loosely connected forces or parties (Mack Smith 1997:97–103; Verzichelli 2007:2,6,9,10). Consensus amongst different groups was obtained by charismatic and difficult-to-replace leading figures and, occasionally, by the king. Only in 1934 did Mussolini’s totalitarian regime undermine the exercise of consensual or parliamentary politics. The Italian economy was highly reliant on foreign borrowing, and the national financial system was, as much as the political system, only moderately centralized. Specifically, the state’s development and industrialization rested on a few domestically located commercial banks that, on several occasions up until the early 1930s, depended on British, French, German, or American capital (Posner 1978: 225,229,234,235; Serra 1987:611–612; Goodman 1992:142–143; Fratianni and

⁵⁸ This model also informed the Japanese projection of power abroad. On the continuing relevance of this Japanese model today, see Pauly (1994) and Helleiner and Pickel (2005).

⁵⁹ It is noteworthy that neither a civil war (United States) nor unification by military conquest (Japan) “made” Italy. The process of Italian unification stemmed from the increasing dissatisfaction with foreign domination and was enabled by diffused social and insurrectionary movements. See, for instance, Ziblatt (2006:chapter 5).

Spinelli 1997:88;). These banks were private, often in competition with one another, and regarded by the Italian government as the engine of national economic growth. Although the government remained unable to replicate the Japanese model and compel the banks into coordinated, unified action for development purposes, the banks were, nonetheless, tied to the government for their access to foreign credit.⁶⁰ Those located abroad—mostly in colonies—were brought there under the state’s advice. The Royal Italian Army was also an expression of the Italian model of moderate centralization. Used only rarely to repress popular unrest, and lacking a solid esprit de corps, the Italian Army remained, until the early 1930s, fairly regularly under civilian control. Its track record made it more popular for its startling military losses than for its modest military victories, or heroic instances of military resistance. Still, the army found constant support in the monarchy and enjoyed the respect of an all-but-insignificant share of the political class. Italy’s perpetual position as military alliance partner also made national armed forces all the more necessary, while the penchant for colonial adventurism never faded, even when liberal forces were in power (Rochat and Massobrio 1987:37,60,128,268; Lowe and Marzani 2002:6,7,22). Ultimately, however, in this politico-institutional context, high finance was somewhat comfortably placed vis-à-vis state authorities. Italian borders were certainly much more permeable than those of Japan.

Finally, the American political and financial systems were considerably decentralized, although presidential government and a vibrant judicial system counteracted extreme decentralization. Political decentralization found expression, for instance, in the absence of a specialized, politically insulated American bureaucracy; the trimness of the diplomatic apparatus; and the access of American citizens to congressional and presidential representation

⁶⁰ Italian financial elites were neither as powerful as their British, French, German and American counterparts—the representatives of high finance—nor as “compact” a front as Japanese financial elites were when they climbed to power.

through regularly held elections (Bensel 1990:5,117; Friedberg 1992; Zakaria 1995:40,46,47). The overturning of a cabinet (as in Japan) or complete government reshuffling with or without government overturns (as in Italy), both expressions of centralized bureaucratic government, were impossible in the United States. The American state was also scarcely interventionist in a variety of spheres ranging from national development to colonial occupation. American military forces were unequivocally under civilian control, and their involvement in foreign lands or share of the national budget was modest in comparison to the immense economic and industrial strength of the American state and the behavior of other states (Graebner 1985:202–203; Hung 1987:16–18,43; Kennedy 1987:202,203; Eloranta 2003). From this perspective, the American state was much weaker than that of Italy or Japan.⁶¹ Not irrelevantly, it was also much less exposed to external threats.

Financial decentralization accompanied political decentralization. American financial and economic wealth rested on a deregulated market-based system that continued to operate in the absence of a centralized or semi-centralized financial structure until 1913.⁶² Thereafter, a system of weakly coordinated federal banks was in place until 1934 when, finally and thanks to the Great Depression, financial centralization was achieved (Meltzer 1958:55,140–45; Zysman 1983:12,18; Chernow 1990; Gordon 2008).⁶³ Because of these delayed, and never completed, efforts at strengthening national financial institutions, and because of the bottom-up nature of American involvement in the international financial system, powerful American private financiers effectively acted as the United States' central bank throughout most of the period between 1880 and 1940. American bankers differed from their Japanese or Italian counterparts in

⁶¹ It is noteworthy that American institutional weakness did not apply to important spheres of statehood like enforcement. With regard to the latter, for instance, American institutions were much stronger than those of Italy or Japan. On this point, see, for instance, Fukuyama (2004).

⁶² Financial deregulation was not complete in that the federal government maintained firm control of the money supply.

⁶³ The American financial system was completely reorganized in 1934. Only thereafter could one claim that the US finally had a central bank with the powers it needed to function.

that *they were high finance*, and, during financial crises, they were playing their game versus governments from home.

The distinct politico-institutional contexts of Japan, Italy, and the United States, and the specific relation or solution to international finance with which each state was endowed, are especially suited for an application of the “most-different-systems” design (or Mill’s Method of Similarity) and the “most-similar-systems” design (or Mill’s Method of Difference). I use the former to explain the consistency in national security twists across the three states despite their contextual diversities. A most striking diversity is that Japan, Italy, and the United States were often in very different scenarios when financial crises occurred. Yet, despite these differences, the evolution of the three countries’ national security policies during *some* financial crises showed remarkable consistency. For instance, before the financial crises that hit Italy in 1889, the United States in 1893–95, and Japan in 1907, each state was engaged in assertive national security policies. After the mentioned crises, this assertiveness was replaced by greater military caution in each state—at least for a while—which suggests that at least one of the four scenarios previously presented was accepted across the three states.

Notably, within each state, financial crises have not always led to greater caution. In each case, financial crises created, on occasion, a watershed between pre-crisis national security caution and after-crisis assertiveness. For example, this occurred in Japan and Italy during the financial crisis of 1929–33. On other occasions, financial crises inflated pre-crisis national security policies, marking the end of a period of national security assertiveness with the opening of a period of greater assertiveness—as occurred in the United States following the first stage of the financial crisis of 1884, and in Japan following the financial crisis of 1889–90. I use the “most-similar-systems” design to shed light on this within-state contrast. Specifically, the long-

term stability of, respectively, the Japanese, Italian and American financial and political institutions between 1880 and 1940 is helpful to determine the accuracy of the claim, advanced in this dissertation, that the interaction between government affinity with and exposure to high finance after the financial crisis outbreak ushers in different national security shifts. Finally, by combining the “most-similar-systems” design and “most-different-systems” designs, I minimize the limits that a singlehanded application of either encounters. The focus on analytically equivalent phenomena across different politico-institutional contexts, as well as within the same ones—a focus that the mixing of these two research designs allows—is also especially suited to the theory-building purposes of this work.⁶⁴

In order to demonstrate that financial crises, most of the time, inflated, curbed, or pushed towards new conciliatory extremes pre-crisis military spending, threat assessment, and war prospects, and to explain how they did so, I proceed in three steps in each case. First, I formulate expectations on the character of the national security change following financial-crisis outbreak. Expectations are derived from an assessment of the character (high or low) of government exposure to high finance, which is based, in turn, on an analysis of the power game between high finance and state authorities in the process of financial-crisis response. By pairing the value assumed by government affinity with the pressures of high finance with the pre-crisis national security agenda of the crisis-hit government, I can draw hypotheses on the character of the influence of the financial crises on military spending, threat assessment, and war prospects. Second, I compare national military spending, threat assessment and war prospects before and after each financial-crisis episode. In this process, I engage existing explanations on the evolution of the discussed national security policies—explanations that generally fail to take

⁶⁴ On the advantages of combining these two methods, and on the limits of each, see Przeworski and Teune (1970:32,37); Lijphart (1975:163–65); Skocpol and Somers (1980:184); Gerring (2007:89–90;139–140); and Seawright (2008:298,304). On the relevance of this mission for theory development, see Locke and Thelen, (1998:11); George and Bennett (2004:12,19–22).

account of the influence of financial crises, and, for this precise reason, are incomplete.⁶⁵ Third, I resort to process tracing to illustrate *how* financial crises changed decision-making on military spending, threat assessment, and war prospects.

Process tracing has a number of advantages for a project of this kind. In particular, it provides the opportunity to discern the independent causal role of financial crises on national security policymaking across various combinations of the binomial interaction between crisis-hit governments' affinity with and exposure to high finance given the concomitant national security influence of other variables.⁶⁶ Process tracing is also particularly suited to identifying causal links, and particularly for discerning how financial crises have shaped government leaderships' perceptions within or across specific politico-institutional contexts. Accordingly, in each chapter, qualitative explanations of the national security influence of financial crises are based on chains of events that reconstruct the changes in perceptions and actions due to the crisis.⁶⁷ This reconstruction is crucial to establishing the causality of financial crises—a cause being something that, when counterfactually removed under *ceteris paribus* conditions, fosters a different outcome (Mahoney 2008:417). Finally, the use of process tracing compensates for the limits of underdetermination and equifinality that Mill's methods of comparison encounter.⁶⁸

As anticipated, counterfactual analysis is used extensively throughout the dissertation to show that the realized change in national security policies would either not have occurred or would have taken a different shape in the absence of the examined financial crises. I embed counterfactuals into appraisals of extant explanations of the course of national security policies

⁶⁵ A partial exception is Robert Ferrell's 1957 analysis of the financial crisis of 1929–33. This dissertation offers a distinct explanation on the national security influence of the 1929–33 financial crisis from the one that Ferrell offers. With regard to one financial-crisis episode, the influence of financial crisis runs oppositely to what existing scholarship on the subject (LaFeber 1963) suggests.

⁶⁶ As previously noted, financial crises might coincide with military-security crises.

⁶⁷ History is used and understood in this work as a process of actions that have an inner side consisting of a process of thoughts. On this interpretation see Trachtenberg (2006:ix).

⁶⁸ On the advantages of process tracing for the identification of causal processes and theory development, see Lijphart (1971:685); George and Bennett (2008:214); Achen and Snidal (1989:167–168).

after the onset of the examined financial crises. In synthesis, the question that I try to answer, while pitching the explanation here offered against alternative explanations, is the following: “Was the financial crisis, other things being equal, a necessary condition for the greater caution (or assertiveness) in military spending, threat assessment, and war that followed the crisis outbreak?”⁶⁹ If the answer is “yes” then the financial crisis at hand exerted an independent and overlooked influence on national security policies, stirring them towards greater aggressiveness or greater caution and determining the character of the realized national security outcome.⁷⁰

This method is extremely valuable when financial crises are either the by-product of existing national security policies, or occur in tandem with military-security crises.⁷¹ Most financial crises that hit Japan before the twentieth century, for instance, were (at least in part) the result of national policies of a radical and ambitiously pursued program of national rearmament. Similarly, the global financial crisis of 1907–08 occurred in the midst of arms races, whereas the global financial crisis of 1914 would possibly not have occurred in the absence of an impending war.⁷² Common knowledge would suggest that, in all these instances, ongoing national and international security considerations overshadowed the relevance of financial crises. Counterfactual analysis sheds light on the inappropriateness of this conclusion and helps solve the endogeneity problems deriving from existing scholarship and findings on the causes of foreign policy.⁷³ The fact that financial crises can derive from, or coincide with, remarkable national security developments affecting national or international security does not make them

⁶⁹ On the relationship between necessary conditions and counterfactual analysis see Goertz and Levy (2007:9–45).

⁷⁰ On necessary causes see, for instance, Mahoney et al (2009:218).

⁷¹ In existing literature, the concept of “multiple crises” is generally understood as “a number of crises across time” and not as “a number of crises occurring at the same time.” Both interpretations of the concept are relevant to this work, but in different ways. The former serves to indicate whether there has been a progress towards caution or aggressiveness in the national security influence of the financial crises. The latter concept evokes greater challenges for discerning the specific influence of financial crises on national security policies. On the former understanding, which is the traditional use of the concept of “multiple crises,” see Wright (1965:1272) and McChelland (1961).

⁷² Whether the global financial crisis of 1914 occurred as a result of the war or helped cause the war is still controversial. Refer to Chapter 5 of this dissertation for an overview of the debate.

⁷³ On the utility of counterfactuals to solve endogeneity problems, see King, Keohane and Verba (1994:21).

less qualified than any other variable to exert an independent and strong effect on national security policies.

Importantly, excluded from this dissertation are episodes of financial crises that occurred *during* war. Since the “urgent” and “threatening” character that accompanies financial crises in peacetime—making financial crises real “crises”—is diluted or legitimized in wartime, addressing wartime financial crises is outside the scope of the analytical framework that this dissertation proposes. “Wartime financial crisis” might indeed be an improperly used word combination. More apt seems the word choice “wartime financial pressures,” since in wartime “crisis” becomes the permanent operating status of policymaking. As one scholar fittingly described it, “during wartime financial control is inevitably relaxed and the administration of financial departments is marked by a certain lack of grip and strength especially in regard to the control of expenditures. Things have to be done and done quickly, [with] formulae and conventions brushed aside.”⁷⁴ Not belonging to the category “wartime financial crises” are those financial crises that occurred weeks before crisis-hit governments’ participation in war. Those crises are, by all means, like any other military-security crisis, and they find systematic treatment in this work.

A further note on the financial crises discussed in the following chapters regards their identification. The financial-crisis years that appear in the case studies of this work are not identical to those contained in the datasets of Michael Bordo et al. (2001) and Reinhart and Rogoff (2009)—the most updated time-series on financial crises. The financial crises discussed here, which hit Japan, Italy, and the United States between 1880 and 1940, comprise additional years relative to the financial-crisis years identified by Bordo and Reinhart and Rogoff for Japan,

⁷⁴ Shirras (1936:5). On the challenge posed by war on state finance and the normal conduct of decision-making, see Keynes (1914:460–486); Blainey (1973) pp.193–194; De Cecco (1974:127–170); Capie and Wood (1986:77–116); Brewer (1988:xx).

Italy, and the United States. These years are 1894–95 for the United States; 1889–90 for Italy; and 1889–90 and 1896–98 for Japan. This slight mismatch finds justification, partly, in the broader definition of financial crisis welcomed by the dissertation which, as seen earlier, includes any kind of financial crisis that presents four necessary conditions and applies to banking crises, currency crises, twin crises, stock-market crises and sovereign defaults. Bordo et al. (2001) focus on banking crises, currency crises, and twin crises only, whereas Reinhart and Rogoff (2009) focus on banking crises only.⁷⁵ Additional updating of the datasets by Bordo and Reinhart and Rogoff has been obtained through in-depth exposure and analysis, as required by the project, of Japanese, Italian and American financial histories. Data for the case studies consist of primary historical documents, primary and secondary literature on financial, diplomatic, and military history, and numerical series on financial and military indicators. The use of triangulation amongst a variety of primary sources and the extensive literature on the financial, military, and diplomatic history between 1880 and 1940 minimizes the effects of selection bias.

Elucidations and Contributions

The national security policies and decision-making of crisis-hit governments is shaped by a number of variables other than financial crisis. These variables feed into the financial and security policies adopted by governments to respond to the crisis. Amongst these variables are, for instance, military-security crises and the two core variables of this work, government affinity with and exposure to high finance. The argument here is *not* that the influence of these factors is weaker or in-existent without financial crises, but rather that financial crises transform the roles of these factors and their interplay. This long ignored transformation exemplifies the influence or independent causality of financial crises on national and international security. Accordingly, this

⁷⁵ Michael Bordo et al. (2001:53-82); Reinhart and Rogoff (2009:348-392).

work confutes two null or alternative hypotheses. The first is that no change in national security policies occurs after a financial crisis outbreak. The second is that, after a financial crisis outbreak, changes in military spending, threat assessment, and war prospects are impelled by developments that have little to do with the financial crisis. Both hypotheses are implicit in neorealist theories of world politics, and their understanding of “state capability” as the ensemble of population, industrial and military power, raw material endowment and little else.⁷⁶ Collectively, these theories postulate that the causes of alliances, foreign policy, and war prospects—or, more broadly, states’ answers to the security dilemma—are to be identified in states’ responses to shifts in the distribution of state capabilities; shifts in the offensive power of state capabilities; shifts in perceptions regarding state capabilities; and threats based on each of the aforementioned shifts. By omitting financial stability from their understanding of state capabilities, these theories implicitly negate that financial crises exert an independent causal influence on national security policies.⁷⁷

This work denies the validity of this assumption. By posing a threat to important national security values; by unveiling an uncertain financial and economic future that necessitates an effective crisis-response; and by affecting government exposure to the pressures of high finance, financial crises produce shifts in perceptions regarding state capabilities, shifts in threat assessment, and ultimately shifts in national security in the same way as with military-security crises. In view of its novel take on the factors that ameliorate or worsen the security dilemma, this study is theoretically closer to those works in the field that have recognized a broader understanding of state capabilities in the explanation of national security policies (Snyder 1991;

⁷⁶ See in particular Jervis (1978); Waltz (1979); Walt (1987); Van Evera (1999); Mearsheimer (2001). Neorealist theories such as the balance of power theory, offense-defense theory, balance-of-threat theory, and “window theory” all assume a more limited understanding of state capability or “capacity” than the one that this work accepts.

⁷⁷ State capabilities are commonly understood as referring to a state’s total population, industrial and military resources, and endowment of raw material.

Solingen 1998; Trubowitz 1998; Lobell 2003; Narizny 2007).⁷⁸ In that scholarship too, however, financial stability and financial crisis have remained very marginal variables at best. Even more importantly, these studies still overlook the most distinctive aspect of financial crises, specifically the threat/opportunity that they pose to national and international financial systems, and, as a result, to national financial-security agendas and perceptions of the security dilemma.

The project also makes a theoretical contribution to the existing debate on scapegoat-war or diversionary-war theories (Levy 1993). These theories assume that, during economic instability, the domestic elite will display a more assertive foreign policy stance, choosing war to divert attention from domestic troubles and shore up their political position. The analytical framework here advanced offers a more nuanced explanation of escalating war prospects in times of economic turbulence. To begin with it suggests that during a financial crisis, a special form of economic instability, war prospects increase when a government's affinity with high finance is low and remains low throughout the process of crisis response. Secondly, it indicates that war prospects increase not as an attempt to divert attention from pressing economic challenges but, to the contrary, in an effort to solve them via increased military spending and linked magnification of existing threats. Diverting attention from the crisis—or obscuring its presence—might be part of the strategy of crisis response, but the diversion will mostly be targeted to foreign governments rather than domestic constituencies, and to high finance above other interest groups. Thirdly, the dynamic analytical framework offered here addresses fundamental questions of causality linking financial crises to shifts in national security policies, which diversionary theory leaves unanswered.⁷⁹

⁷⁸ These works have acknowledged the weight of domestic variables such as coalition, partisan conflict, state structures and institutions as well as international and transnational factors like economic liberalization or international commercial orientation in the crafting of national security policies. Some of these variables figure prominently also in this work.

⁷⁹ On this point, see Stoessinger (1982).

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CHAPTER IV

ABROAD IS AT HOME: WALL STREET CRIES, AMERICAN SECURITY SHIFTS

February 4, 1895, The White House

“If that \$10-million draft is presented, you can’t meet it. It will be all over by 3 o’clock.”
Pierpont Morgan to President Grover Cleveland

October 31, 1936, The White House

“Never before in all our history have these forces been so united against one candidate as they stand today. They are unanimous in their hate for me — and I welcome their hatred.”
*Radio Address by President Franklin D. Roosevelt to the Nation*¹

What should we make of American imperial understretch in the 1880s and 1890s? Why did a Japanese-American war not occur in 1907-08? And were the national security agendas of Herbert Hoover and Franklin Roosevelt fundamentally similar in the early 1930s? This chapter answers these questions based on financial-crisis outbreak and the interplay between American governments’ affinity with and exposure to high finance during the process of crisis response. In the United States, differently from Italy or Japan, government exposure to high finance pitted Washington elites against the financial titans of New York, or Wall Street. Between the 1880s and the early 1930s Wall Street titans were some of the world’s most prominent private financial houses, with no equivalent in Japan or Italy.² The chapter argues that financial crises altered the balance of power between American governments and Wall Street, causing the inflation or curbing of American pre-crisis financial-security agendas and changing the course of American military spending, threat assessment, and war prospects in the Gilded Age, in the late 1900s, and in the 1930s. Discussion proceeds as follows. After a brief overview of the specific traits of this case compared to previous ones, expectations on the national security influence of financial crises are extrapolated based on the interplay between the financial-security agenda of American

¹ Chernow (1990:75); FDR Presidential Library, <http://docs.fdrlibrary.marist.edu/OD2NDST.HTML>

² As seen in chapter II, Japanese financial elites remained significantly weak throughout most of the period under analysis. In the 1920s they achieved short-lived political prominence domestically. As seen in Chapter III, the power of Italian financial elites was usually inferior or subordinate to that of Italian authorities and wealthier international banking houses.

governments stricken by financial crisis, and the exposure of the same governments to high finance throughout the process of crisis response. Then, three major sections illustrate how the foundational hypothesis of this study is a potent device to understand the change in American military spending, threat assessment, and war prospects caused by financial crisis. Of the three sections, the first discusses the national security influence of the local gold crises of 1884 and 1893-96. The second and the third sections are dedicated to the global banking crisis of 1907 and the worldwide financial crisis of 1929-33.³

Financial crisis hit the United States in 1884, in 1893-96, in 1907-08, and again in 1929-36.⁴ Statist-nationalist governments were in power when the 1884 and 1907-08 crises started, whereas cosmopolitan governments experienced the outbreak of the crises of 1893-96 and 1929-36. Ultimately, it was impossible for American cosmopolitan governments, and politically suicidal for their statist-nationalist counterparts, to avoid relying on the political sway and recommendations of Wall Street in response to financial crisis. Interestingly, during or in the immediate aftermath of each financial-crisis episode, Wall Street interests were able to punish statist-nationalist governments who attempted a crisis response that penalized the orthodox medicine. Thus notwithstanding, only after 1884 and 1907 did the power advantage gain by Wall Street versus Washington outlast the end of the crisis.

American national security policies differed from those of Italy and Japan in three major ways: they were less driven by the quest for vital spaces or colonies; they relied on a weaker state apparatus; and their creation and destiny rested on two solidly civilian institutions, the Presidency and the Congress. As the chapter will show, the United States was never disinterested

³ On these crises see Barnes (1931:230-31), Sobel (1968:207,222-24,250-66,297-321), Friedman and Schwartz (1971:99-100,108,156-163,254-255,299-308,324-28), Dewey (1968:415,444-447,481,536), Kindleberger (1978:132,173-74,189-195); Myers (1970:211,218,317-318,335), Chernow (1990:71-77,122-124), Brownlee (1979:270), and Rockoff (1990:742).

⁴ This sample does not include the financial crisis of 1914, which is treated in Chapter V.

in the projection of diplomatic and military power abroad, and American administrations expressed this drive well (May 1961; Kennedy 1987:202-203; Campbell 1976:40; Graebner 1985:314-315).⁵ Yet, to provide for national defense in a dangerous world, American leaderships needed much less vital space to conquer than did their Italian or Japanese counterparts. Geopolitical factors, American civil war experience, and a liberal political tradition also discouraged war enthusiasm and colonial dreams. It is also well known that the American offshore projection of diplomatic and military power relied on a feeble bureaucratic structure and a commonly thin financial apparatus.⁶ While Japanese and Italian statesmen worked on reinforcing the national financial system between 1880 and the mid-1890s, American leaders remained without a solid system until 1913, when the Federal Reserve System was established.⁷ This explains why, in times of financial crisis, Wall Street titans could often act as the United States' central bank (as will be clear later in the chapter).⁸ However, American governments were not defenseless against the power of high finance, nor were their institutions fragile. The steady control over American military forces that the Presidency and the Congress enjoyed, for instance, found no parallel in Italy or Japan.

To augment its domestic power and kick-start shifts towards greater national security caution after financial-crisis outbreak, Wall Street could operate through two or three channels. Namely, it could provide the administration with the liquidity and creditworthiness necessary to impede a worsening of the financial crisis, and it could attempt to stir support for its cause during presidential races and congressional political majorities. Backing an "honest" defender of

⁵ Note that until 1890, the American army ranked fourteenth in the world, after Bulgaria's, and the American navy was smaller than Italy's despite the fact that America's industrial strength was thirteenth times that of Italy.

⁶ See Bensel (1880:106); and Zakaria (1998:40).

⁷ Even then, the state's financial apparatus was not wired to bail out, regulate, or enforce. The New York Federal Reserve never acted as the national lenders of last resort nor capitalized on the nation's financial assets. American leadership steered away from reinforcing domestic financial institutions even when, in the 1920s, the US was financially the most powerful nation on earth.

⁸ A "strong" financial apparatus does not mean a "moral" or a "just" one, as Japanese and Italian experiences well exemplify. Note that the defeat of the titans in the early 1930s allowed for a systematic strengthening of the practice of American central banking. The levels of centralization of Japanese finance were never reached, however.

financial orthodoxy—a gold-standard-friendly presidential candidate—promised to usher in more cautionary national security policies. Similarly, Wall Street could affect the administration’s agenda by compacting a solid Congressional majority behind a stricter adherence to international financial cooperation. Presidential races and mid-term elections were also the channels through which American leadership, Congress, and, as a result, national security policies could withstand the pressures of high finance. Notably, to a greater extent than their Japanese or Italian equivalents, American debates over finance and national defense cut transversely across parties or administrations.⁹ Consequently, neither partisanship nor, more obviously, regime type was *ever* part of the historical equation through which financial crises influenced American national security policies.¹⁰

EXPECTATIONS

The overarching expectation of this chapter is that the relationship, postulated in Chapter I, between the four scenarios of influence and American military spending, threat assessment, and war prospects is accurate. Particularly, the framework is correct if the following propositions hold. The national security policies of a government having low affinity with high finance tend to be curbed when exposure to high finance is high (*LA–HE*), and to be inflated when such exposure is low (*LA–LE*). The security policies of a government having high affinity with high finance are likely to become extra prudent when exposure to high finance is high (*HA–HE*). Finally, the security policies of a government having high affinity with and low exposure to high finance during the crisis (*HA–LE*) tend to be indeterminate. More specific expectations regarding

⁹ For instance, from 1880 to 1896, a bimetallic financial system and the build-up of a strong navy were goals that Presidents Chester Arthur (R) and Grover Cleveland (D) shared. In a similar vein, the administration of Theodore Roosevelt (R) exposed a kaleidoscopic set of financial and security policies, while those of President F.D. Roosevelt (D) evolved drastically between 1929 and 1936. On the relevance of institutional factors other than partisanship in the scrutiny of American politics or foreign policy, see Bense (1984), Lake (1988), Trubowitz (1998), and Kirshner (2007:122-153).

¹⁰ By contrast, shifts in national security policies in Japan are highly correlated to shifts in partisanship, regime type, or regime change. Although less markedly than in Japan, similar conclusions can be drawn for the Italian case. See Chapters II and III.

the character of the change in American national security policies during financial crises can be obtained by discerning the particular scenario or scenarios coexisting with each crisis. It is to this task that I now turn.

In the Gilded Age, the United States experienced two financial crises: the local silver scares or gold crises of 1884 and 1893-96.¹¹ The latter crisis was significantly compounded by the global financial crisis of 1890-91, which the United States escaped but Europe did not.¹² In 1884 as well as between 1893 and 1895, European and American investors threw back American securities upon the US market and recalled their credits in copious quantities, resulting in an intensification of current gold and capital outflows and the most significant GNP contractions between 1880 and 1900 (Table 1). Congressional documents and newspapers of the time reveal that both American state leaders and Wall Street financiers felt grave anxiety, between 1884 and 1895, over the “financial emergency” derived from the loss of ongoing projects to European markets and the risk of an American gold default.¹³ Gold crises meant not only a drastic fall in profits on Wall Street but also a curtailed capacity of the American government to harness necessary state funds and political support to push forward ongoing nation-building ventures.¹⁴ For the statist-nationalist government of Chester Arthur (1881-84), who fully subscribed to silver-friendly financial policies, national building ventures included naval rearmament and the pursuit of an ambitious national defense strategy. For the cosmopolitan government of Grover

¹¹ The crisis of 1884 started after the introduction of the heterodox Tariff Act of 1883 and Treasury Secretary Hugh McCulloch’s decision to coin 200 millions silver dollars. The crisis of 1893-96 started after McCulloch’s successor, Charles Foster, had issued the ultra-heterodox McKinley Tariff Act and Sherman Act of 1890. See “Is this a Mystery?” *The Daily Register*, March 23, 1891; Myers (1970:211); Dewey (1968:440); Chernow (1990:72); Sobel (1968:242); and Friedman and Schwartz (1971:106).

¹² Differently from Great Britain and most of Europe, the United States escaped the Baring crisis of 1890-91 via export increases to the old continent (Tab.1). By 1892, however, the Treasury gold supply was down to only \$14 million over the reserve limit.

¹³ Congressional Record, 53rd Congress, 2nd Session, August 7-September 6, 1893; “Getting All our Gold: Treasury Officials Anxious to Stop the Drain Made by Europe,” *Washington Post*, December 19, 1892; “On the Verge of Panic. Wall Street Alarmed by a Succession of Failures,” *New York Times*, May 17, 1884; “Is this a Mystery?,” *The Daily Register*, May 23, 1891 in *The Papers of Grover Cleveland, 1859-1908*, Library of Congress (1931), Series 2, General Correspondence, 1846-1910, Reel 69; “Nothing But Money,” *Chicago Daily Tribune*, December 19, 1892; and “American Nation in Jeopardy,” *Chicago Daily Tribune*, December 18, 1892.

¹⁴ As the greatest borrower in international financial markets, the US needed foreign funds and depended on a good credit rating. See, for instance, Myers (1970:22).

Cleveland (1893-1896), instead, the national financial-security agenda entailed establishing and maintaining naval plans and a security profile that were compatible with strengthening American commitment to the gold standard.

Table.1. American Financial statistics 1880-1898 (in million \$)¹

Year	Real GNP	Capital Account	Gold Stock Increase	(Exp – Imp)	Net Liabilities on GNP
1881	11483	65884	99.2	235	0.13
1882	12343	145544	84.7	264	0.13
1883	12590	132879	2.1	77	0.13
1884	12348	104394	41.3	127	0.15
1885	11656	63464	10.3	92	0.16
1886	12113	93957	37.2	157	0.17
1887	12162	103471	26.9	83	0.18
1888	12420	111341	64.1	15	0.20
1889	13315	87761	---	-41	
1890	13524	85040	-16.5	24	0.21
1891	13742	26839	16.5	55	0.22
1892	14081	9914	-16.5	122	0.22
1893	14390	2342	-35.1	196	0.23
1894	13937	-61170	16.5	76	0.24
1895	14330	-31466	-41.3	251	0.23
1896	14044	-14037	-26.9	81	0.24
1897	15065	-18052	95.1	232	0.22
1898	15869	-38047	51.7	333	0.19

Before the onset of financial crisis in 1884 and again in 1893, the Arthur and Cleveland governments had, respectively, low and high affinity with high finance. The assertive national security program of the Arthur administration rested on a financial policy of sustained silver printing at home and encouragement of international bimetallism abroad. Cleveland repudiated this platform during the later stages of his 1892 presidential campaign, when he praised the financial benefits of participating in the gold standard and renouncing to an international

¹⁵ Unless differently specified, all data in this chapter are obtained or calculated from *Historical Statistics of the United States*, Washington, DC: Bureau of Census, U.S. Department of Commerce (1975), Millennial Edition Online, Cambridge University Press. The capital account column refers to the change in national ownership of assets.

¹ Unless differently specified, all data in this chapter are obtained or calculated from *Historical Statistics of the United States*, Washington, DC: Bureau of Census, U.S. Department of Commerce (1975), Millennial Edition Online, Cambridge University Press. The capital account column refers to the change in national ownership of assets.

bimetallist agreement.¹⁶ As a result, in 1893 the affinity of the American government with high finance was low. After the onset of either financial crisis, the American administration found itself highly exposed to pressures of Wall Street titans and financial orthodoxy. Neither the Arthur nor the Cleveland government possessed the necessary resources to strengthen American international financial credibility and stop either crisis—these resources being either gold reserves or the ability to obtain, as US Treasury Secretary Foster acknowledged in 1892, the cooperation of the principal European countries to save American commitment to gold.¹⁷ By contrast, J.P. Morgan and his friends had plentiful gold assets and were the earnest receivers of international respect, as demonstrated by their key role in the transnational rescue of the Baring Brothers in 1891. Between 1884 and 1885, and again between 1892 and 1895, Wall Street financiers bailed out the Treasury and prevented an American gold default by cosmopolitan and nationalist statist administrations.

Practically, in 1884 Morgan and his banker acolytes purchased stocks from alarmed American and European speculators and silver from the Treasury in exchange for gold. Scares about an impending silver standard and doubts about the nation's commitment to gold disappeared. Identifying the causes of the crisis in the pro-silver financial policies pursued by the Arthur administration until 1884, Wall Street took advantage of the ongoing presidential campaign to give its full support, successfully, to the more explicitly pro-gold—although not exclusively pro-gold until late 1892—presidential candidate Grover Cleveland. Thus, an administration that had exhibited low affinity with high finance and to the defense of the gold

¹⁶ Until the spring of 1892 American administrations remained interested in establishing bimetallism domestically and internationally. Cleveland too tried incessantly to bring Great Britain and Germany into an international bimetallic agreement with the United States. See “Parity is maintained: Secretary Foster Discusses Relations of Gold and Silver,” *Washington Post*, November 18, 1891; and “The Silver Conference,” *New York Times*, December 31, 1892. See also LaFeber (1963:108); Grenville and Young (1966:41-45); Sobel (1968:242); Dewey (1968:460); Myers (1970:207-208); Rockoff (1990:739-760); Frieden (1997:367-395); and, more recently, Wilson (2000).

¹⁷ “Getting All our Gold: Treasury Officials Anxious to Stop the Drain Made by Europe,” *Washington Post*, December 19, 1892;

standard was relatively quickly replaced with one that promised greater virtue. Rescue efforts similar to those performed in 1884 were undertaken between 1893 and 1895, albeit unsuccessfully this time. By late January 1895, the US Treasury was \$10 million away from gold default and, in a tremendous display of the change in government exposure from low to high following the outbreak of financial crisis, Morgan was able to play a game of “chicken” against the administration. With a signature by the financial magnate on a \$10 million draft that he reserved the right to present to US Treasury Secretary Carlisle, American participation in the gold standard would have ended (Chernow 1990:75). Backed against a wall, the President had no choice and, without Congressional approval, he gave Morgan the green light to bail out the Treasury.¹⁸ Crisis resolution efforts failed, Congressional opposition exploded, anti-Wall Street forces gained popularity, and the exposure of American administrations to high finance moved to low. This second stage of crisis response, which lasted at least until 1897¹⁹ under the succeeding Cleveland and McKinley administrations, saw the emergence of a financially stronger and more independent American Treasury, the defense of silver circulation as much as the gold standard, and a commitment to national financial reform—although the contours of that reform remained ambiguous.²⁰

A first set of expectations is thus formulated. After the start of the financial crisis in 1884, the Arthur administration should have found itself in LA–HE. Instead, the Cleveland

¹⁸ Morgan set up a private syndicate between the Morgan and Rothschild houses in New York and London and the dollar-gold peg was saved. On the financial rescue efforts during both crises, see Dewey (1968:447); Sobel (1968:250-52,266); and Chernow (1990:74,75).

¹⁹ Trade reversal was achieved by 1896, and quite unexpectedly so; American financial policy remained confused thereafter, while bank failures continued and industrial growth stalled. The resumption of a steady inflow of gold from Europe in 1898 significantly eased the recovery process.

²⁰ See US Treasury Secretary Carlisle, *Annual Report for 1896*; and McCulley (1992:40-55). Under the McKinley administration, a financial reform movement that knew no precedent started. Notice that the policy platform of William McKinley defended the interests of high finance only on the surface. The Republican Party was deeply divided over the optimal national financial policy, and the McKinley administration developed an approach to monetary issues that avoided precise definitions and was in practice very consonant to bimetallism. In late 1896, Wall Street only fooled itself by thinking that a staunchly orthodox President had been elected. The first proposals for establishing a national banking system started during these years, and lasted until 1907. With high finance having failed to restore financial and economic stability and growth, the American government was next in line to try out, challenging the limited financial role that the state and the Treasury had occupied since the Civil War.

administration should have been, from the start of the crisis in 1893 to the end of a first stage of crisis response in early 1895, in HA–HE and, after early 1895, in HA–LE. According to the framework, both the Arthur administration and, until 1895, the Cleveland administration should have faced pressures to endorse, and eventually endorsed, more cautious national security policies—that is, policies signaling greater American commitment to the dictates of the international gold standard. The outcome should have been, following 1884, the curbing of Arthur’s agenda of military and diplomatic assertiveness, and, after 1893, the inflation of Cleveland’s diplomatic and military prudence. The failure of orthodox medicine and the partially related mounting of Congressional opposition from early 1895 onwards should have freed the Cleveland administration first, and the McKinley administration thereafter, from the former constraints of avoiding assertive national security policies to solve financial crisis.

Table 2. American Financial statistics 1900-1913 (in million dollars)*

Year	Real GNP	Public Debt	Total Bank Assets	Gold Stock Increase
1900	18694	1263417	4115	93
1901	19991	1221572	4897	68.2
1902	21180	1178031	5420	70.3
1903	22099	1159406	5905	68.2
1904	22828	1136259	6382	31
1905	25043	1132357	7217	74.4
1906	27171	1142523	7820	167.4
1907	28443	1147178	8390	16.5
1908	28765	1177690	7954	49.6
1909	31647	1148315	8780	-16.5
1910	31792	1146940	9432	70.3
1911	33712	1153985	9941	88.9
1912	35502	1193839	10638	80.6
1913	37609	1193048	11024	39.3

The global financial crisis that spread across Great Britain and Europe between late 1906 and 1907 did not fully reach the United States until the late summer/fall of 1907.²¹ Before then, as the growth in total bank assets between 1900 and 1907 shows (see Table 2), the fortunes of Wall Street titans had been swelling while the nation had transformed from a peripheral, highly dependent financial borrower into a financially creditworthy world frontrunner in manufacturing and trade.²² Wall Street's soaring financial fortunes had not stalled Theodore Roosevelt's statist-nationalist agenda, however. Denoting low affinity with high finance, the Roosevelt administration between 1901 and 1907 crafted a foreign policy of unprecedented ambition while remaining firmly committed to strengthening financial regulation and trust-busting policies, thereby stirring the anger of American financial elites who blamed primarily the American government for the spreading of the global financial crisis.²³ Embittered Wall Street titans John Rockefeller and E.H. Harriman squealed and staged pro-business protests but were unable to change the course of Roosevelt's financial policies for most of 1907. Early that year, the American government remained visibly absent from ongoing British and European attempts to save the international gold standard. Ultimately, joint rescue efforts between the Bank of England, the Bank of France, the German Reichsbank, and the Russian State Bank—efforts in which Wall Street titans and other major transnational financial houses participated—succeeded

²¹ Global financial crisis started following the San Francisco earthquake of April 1906. It spread in Great Britain and the rest of the world following a massive gold outflow to the United States. British companies had underwritten most of the fire insurance policies in San Francisco. In October 1907, the collapse of the copper shares of the Knickerbocker Trust Company in New York brought the crisis to the United States. As shown in Table 3, official gold reserves decreased, stock market and security prices fell, bank runs and a credit crunch seized the nation, and a sharp drop in output and employment occurred. On the crisis of 1907-08 and its causes, see in particular Odell and Weidenmier (2004); Bruner and Carr (2007); H.D.S. Greenway, "The Panic of 1907," *New York Times*, 09/23/1908; and Chernow (1990:122-124).

²² From the world economic boom that took place between 1899 and 1907, the United States benefited more than any other member of the international financial system. The financial gap between Uncle Sam and Great Britain shrank fast throughout this period. See Dewey (1968:469); Myers (1970:243); De Cecco (1974:26-29); Lake (1988:120); Bense (1963:40-54).

²³ *Theodore Roosevelt Papers* (1967), Library of Congress, Series 1, Reel 78, 79 and Series 2, Reel 347, October, November 1907; George B. Cortelyou *Papers*, Manuscript Division, Library of Congress, DC, Box 62, "General Correspondence," November 1907; *The Papers of William H. Taft*, Secretary of War, "Correspondence with Roosevelt," reel 321, March 1907 through November 1908. These were also the years when the powers of the Executive were significantly expanded, greatly but not exclusively by the hand of Teddy Roosevelt. On these developments, see Sundquist (1973:155-164); Schulzinger (1984:24-25); Leuchtenburg (1952:483-504); and Chessman (1969:143).

in bringing relief and restoring confidence at the core of the international financial system. By the spring of 1907 European states had overcome the crisis, leaving the United States to face its own, by then much accrued, financial troubles.

Table 3. American Financial statistics 1924-1937 (in million dollars)

Year	Real GNP	Number of Banks	Investments		Real Government Spending	Number of Unemployed (in Thousands)
			Income Receipts of US Assets Abroad	Government Deficit/Surplus		
1924	87115	20908	762	963367	2908	2341
1925	88315	20376	912	717043	2842	2115
1926	96735	19770	953	865144	2916	1321
1927	97187	18860	981	1155365	2899	1808
1928	99113	18113	1080	939083	3005	2235
1929	103900	17440	1139	734391	3127	1383
1930	94359	16432	1040	737673	3405	4340
1931	85562	14854	766	-461877	3970	7721
1932	67011	12598	527	-2735290	5274	11468
1933	59786	9310	437	-2601652	4849	10635
1934	64291	9931	437	-3629632	6443	8366
1935	71945	10063	521	-2791052	6342	7523
1936	83000	9961	569	-4424549	8321	5286
1937	89189	9801	577	-2777421	7472	4937

Mistrusted and attacked by high finance, Roosevelt had a difficult time creating national financial and economic recovery once the crisis hit full bloom in the United States in the summer and fall of 1907: government exposure to high finance was high.²⁴ As archival evidence indicates, without the cooperation of high finance, national remedies such as the issuing of Panama bonds and the deposit of customs receipts in national banks were failing. Once again, the pressures of Wall Street on the Roosevelt administration tilted the domestic balance of power to

²⁴ Letters sent to and received from Emlen Roosevelt (October 29, November 22, 1907; January 13, 1908); Douglas Robison (November 16, 1907); American Ambassador to France Henry White (November 27, 1907); financial magnate Andrew Carnegie (February 15, 1908) Presidential Papers Microfilm, *Theodore Roosevelt Papers*, Series 1, reels 78, 79, 80,81; Series 2, Reel 347. Exchange between the President and US diplomat Cecil Arthur Spring Rice on December 21, 1907 in John M. Blum, Alfred D. Chandler, Jr., and Sylvia Rice, eds., *The Letters of Theodore Roosevelt*, Cambridge: Harvard University Press (1952), vol.6, Madison Library, Library of Congress; "Power of the Treasury," *The Wall Street Journal*," April 25, 1907; "Rothschild Scouts Panic," *Washington Post*, March 26, 1907; "Causes of Declining Prices," *Wall Street Journal*, March 30, 1907; "Remedy Found," *Los Angeles Times*, November 19, 1907; "Power of the Treasury," *The Wall Street Journal*," April 25, 1907; "The Secretaryship of Mr. Shaw," *Wall Street Journal*, September 13, 1907.

the former's advantage. Although the Treasury took on a more active role compared to the previous crises, the intervention of a Morgan-led clique of American bankers became crucial to legitimating the Treasury's injection of liquidity into the system, organizing a private pool to collect extra funds, and ultimately restoring faith in the creditworthiness of the administration at home and abroad.²⁵ The administration's need to preserve a well-functioning capital market to push forward its agenda rendered it highly exposed to high finance shortly after the outbreak of the financial crisis at home. In the summer of 1907, as animated discussions between the President and Secretary of War William Taft illustrate, Roosevelt's trust-busting policies came under harsher scrutiny in the face of their seemingly unrelenting "harm to business." President Roosevelt distanced himself from his "middle-of-the-road" policy by asserting, in late 1907 and again in 1908, that American "businessmen" had done an "invaluable service" to the country "in checking the panic" and bringing the nation into "excellent financial standing."²⁶ The Anti-trust Act was also bent on a few occasions between late 1907 and 1908.²⁷ This trend was further strengthened by (and arguably contributed to) the victory, in the presidential elections of 1908, of William Howard Taft, by then the paladin of high finance.

In view of these observations, the Roosevelt administration should have confronted LA–HE. As the financial crisis reached the United States between the summer and fall of 1907, pressures on the administration for endorsing greater caution in military spending, threat

²⁵ Within a few weeks from the spread of the crisis in New York in October 1907, J.P. Morgan rallied some of the titans of Wall Street, organized a pool of \$35 million and came to the rescue of several trust companies, stopping further stock price declines. Concurrently, Cortelyou deposited an equal amount of currency with the reserve city banks of New York. Panic subsided. Letter of Cortelyou to Teddy Roosevelt, November 16, 1907, in Theodore Roosevelt Papers, Series 1, reel 78; Roosevelt's reply to Cortelyou of the same day in Series 2, reel 347. "Issue of Panama Bonds Might Bring Out the Hoarded Cash," *Wall Street Journal*, November 18, 1907; "Ghost of 'Panic' Vanishes in Air," *Chicago Daily Tribune*, November 19, 1907. On Shaw's effort to bolster national bank circulation see Timberlake (1963:41).

²⁶ TR to Cortelyou, October 25, 1907, *Theodore Roosevelt Papers*, Series 2, reel 347; letter to Jacob Schiff from TR in *The Selected Letters of Theodore Roosevelt* (2001:448); Annual Message of the President to Congress, *Journal of the Senate*, 68th Congress, 1st session, p.4. The anti-trust laws were indeed bent on a few occasions during the crisis, most notably with the purchase of the Tennessee Coal and Iron Company by Morgan's United States Steel. See Chernow (1990:123-24).

²⁷ On August 16, 1907, for instance, TR was writing Taft "you are asking me to abandon the effort to enforce the laws [...] and this because you think harm will come to 'business' if corruption is exposed." *The Papers of William Taft*, "Correspondence with Roosevelt," reel 321.

assessment, and war prospects should have escalated, while the Roosevelt government should eventually have settled on a more cautionary national security path. Pre-crisis, ambitious national security policies should have been curbed as a result. The pull back from diplomatic and military assertiveness should be even more evident after the election of the cosmopolitan administration of Howard Taft.

Between 1929 and 1933, financial crisis spread around the world much more radically than it had between 1907 and 1908. This overlapped with crises of significant proportions in other sectors of the economy, ending a decade of financial boom and prosperity in the United States (Table 3) and an equally long period of financial instability and tentative economic recovery around the world.²⁸ By April 1933 the international financial system had officially disintegrated and, although widespread banking crises subsided after 1933, prices did not stabilize until 1936 (Eichengreen 1992:4; Friedman and Schwartz 1963:300; Gourevitch 1986:24; Eichengreen 1957:4,48; Eichengreen and Temin 2000:183-207; Clavin and Wessels 2004:765-795). From shortly before the onset of the Wall Street crash of October 1929 until the inauguration of Franklin D. Roosevelt in March 1933, the White House was led by the cosmopolitan administration of Herbert Hoover who clearly committed to international financial cooperation and a conciliatory foreign policy posture. Although the Hoover government continued America post-WWI pledge to fiscal protection of the American shipping industry, and fiscally conservative bilateral trade (Lake 1988:180-182), the administration's affinity with high finance and financial orthodoxy was unquestionably high. Its exposure to high finance after the

²⁸ Crisis in the United States took the form of several waves of banking panic, mostly concentrated between 1931 and 1933. The crisis itself was initially given little importance by the Hoover administration and high finance. Financial crises had been a staple abroad throughout the 1920s and international financial cooperation had always triumphed, or so it seemed. National alarm mounted after the spread of the crisis across Europe, the related failure of the Austrian Creditanstalt (May 1931), the closure of a number of German banks, and the freezing of British short-term assets in Germany (July 1931). Things kept worsening. Austria and Germany suspended the convertibility of their currencies (summer of 1931); Great Britain abandoned the gold standard in (September 1931); Japan devalued the yen (December 1931); and France defaulted on its war debt payments (December 1932).

financial crisis outbreak was also high. Noting the deterioration of national finances and a low-performing international financial system a year and half after the stock market collapse of October 1929, President Herbert Hoover committed to crisis-resolution efforts which, first and foremost, brought about “a condition of affairs favorable to the beneficial development of private enterprise” internationally as well as domestically.²⁹ The one-year moratorium on international payments (summer 1931); the encouragement of rescue-loans organized by eminent American bankers Jack Morgan and Thomas Lamont to save Austria, Germany, and Great Britain—or better the schilling, the deutschmark and the pound (May-September 1931); resistance to wide-ranging proposals for federal action on behalf of the unemployed (1930-32); and unrelenting commitment to multilateral economic negotiations are just some primary examples of Hoover’s pro-business strategy of financial recovery.³⁰ This strategy failed resoundingly; financial scandals flared, and the Senate Committee on Banking and Currency began a harsh grilling of the American banking community in March 1932.

The failure and increasing domestic resistance to Hoover’s orthodox strategy of crisis response resulted, in 1932, in the overwhelming political victory of Franklin D. Roosevelt (1932), whose government was still cosmopolitan in kind—an assertive government would have been unelectable—but with low exposure to high finance. Having run on a clearly anti-Wall Street agenda, funded by lawyers rather than bankers, Roosevelt’s crisis-response strategy entailed a retreat from financial internationalism and the “replacement,” as the President put it, of “old fetishes of so-called international bankers” with “efforts to plan national currencies” aimed

²⁹ Hoover’s words in Schlesinger (1957:238). See also *The Memoirs of Herbert Hoover: The Cabinet and the Presidency 1920-33*, New York: The Macmillan Company (1952), pp.11,179-180; and Schlesinger (1957:474).

³⁰ Significantly, private debts were not excluded from the moratorium. On Hoover’s response to the crisis, see also Schlesinger (1957:236) and Chernow (1990:319). Challenges to the workings of orthodox crisis measures were concrete, however, as Hoover himself admitted and as some of his policies (like the infamous Smooth Hawley tariff) proved. Letter of President Herbert Hoover to Secretary of State Henry Stimson, April 21, 1931, and letter by Stimson to Hoover, same day, in *The Papers of Henry Stimson*, reel 81, Manuscript Division, Library of Congress; *The Memoirs of Herbert Hoover: The Cabinet and the Presidency 1920-33*, New York: The Macmillan Company (1952), pp.29-31.

at “giving those currencies a continuing purchasing power.”³¹ Examples of this new financial stance included the issuing of a national banking holiday (March 1933); the introduction of a Silver Purchase Act (June 1934) and major banking laws that strengthened the financial power of the Treasury versus the Federal Reserve (1933, 1935); the lifting of the gold-dollar par during the London financial conference (July 1933); the Johnson Act, ending any possibility of international debt revision (1934); the Reciprocal Trade Agreements Act (1934); and the Tripartite Monetary Agreement of 1936 (Dallek 1979:35-38,51; Rhodes 2001:98-101; Eichengreen and Uzan 1990; Lake 1988:204-209). For a number of reasons that are well documented in the literature, a full transition to new financial and security principles throughout the crisis did not occur (Schlesinger 1958:18; Dallek 1979:38,93,94).³²

Despite the greater complexity of this crisis compared to the previous ones, the framework should apply here just as well. The Hoover administration should have found itself in HA–HE and have inflated its cautionary national security agenda. Since the demands of high finance for a convincing display of financial firepower hardened Hoover’s personal commitment to signal national credibility and save the gold standard, American military and diplomatic restraint should have reached alarming tones between mid-1931 and early 1933. Differently, the Roosevelt administration should have found itself in HA–LE, and American national security policies should have assumed a more indeterminate character as a result. *Ceteris paribus*, low government exposure to high finance should have released, after 1933, some of the earlier constraints on greater national security assertiveness.

³¹ Quoted in Freidel 1973:478-89; Dallek 1979:54; Rhodes 2001:101.

³² For instance, after rather consensual Hundred Days Congressional political divisions and domestic unrest often paralyzed crisis response. As many within the administration noticed, the spirit of Roosevelt’s New Deal clashed with the democratic tradition of free trade and ingrained domestic abhorrence to public spending. Additionally, the Democratic Party had not been in power since the Presidency of Woodrow Wilson. Even the Democratic majority that overwhelmingly elected F.D.R. in 1932 remained a patchwork of disparate political forces and divergent philosophies thereafter.

SAVING THE GOLD-DOLLAR PAR AND SHELVING EXPANSION:
Explaining American imperial understretch in the 1880s and the 1890s

An examination of whether the local financial crises of 1884 and 1893-96 paved the way for, respectively, LA-HE and HA-HE—both crises steering American security policies towards a major cautionary position—provides an excellent outlet for contributions to two debates in the literature of international relations and international political economy: one concerning the role of the world economic depression in triggering the process of American expansionism, and the other regarding the reasons behind the United States' delayed rise to global influence. The first debate originates from the works of Walter LaFeber and William Williams, who attributed American military awakening to persistent price deflation, low consumption, and overproduction suffered by the United States between 1873 and 1897. The phenomenon, the authors reckoned, stimulated American interest in the acquisition of foreign lands and markets to sell accumulated surplus.³³ Since their appearance in the 1960s, important limits to these studies have been recognized. David Pletcher, Donald Mitchell, and Walter Herrick observed that while the deflationary periods identified by LaFeber and Williams had a persistent and enduring character, the movement towards a new, expansionist American strategic posture was sluggish.³⁴ More pointedly, as Figure 1 shows, the process of naval revival stalled exactly during those intervals where, according LaFeber, it should have been most virulent.

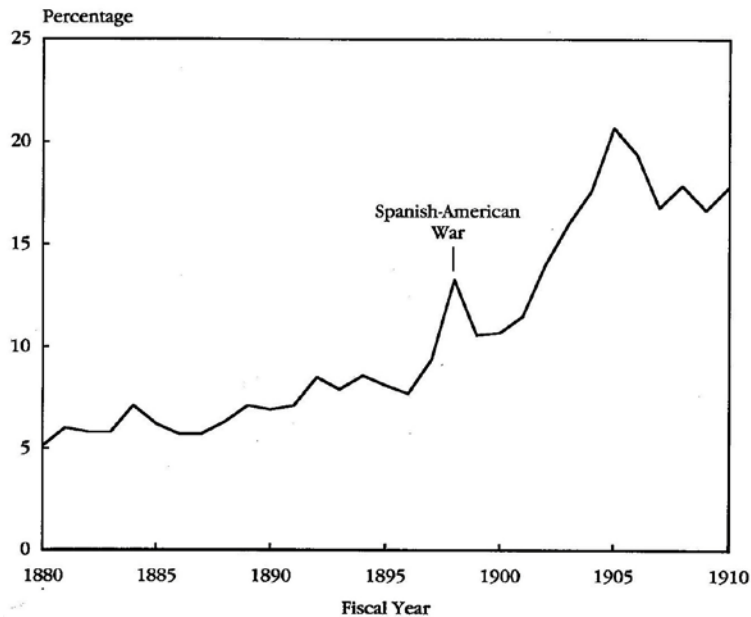
The second debate, which emerges from the writings of analysts such as Henry Kissinger and Fareed Zakaria, stems from the very same evidence that LaFeber and Williams overlooked, that is, the lack of translation of American manufacturing power into military expansion until

³³ LaFeber identifies three macro-periods within the interval 1873-1897 and specifically 1873-78, 1882-85 and 1893-97. He argued that there were moments within these periods during which the impetus for foreign market search and expansionism peaked due to the worsening depression. See LaFeber, (1963:20,217), and Williams (1969).

³⁴ This is not the only problem that has been noted in relation with the glut theory thesis, but it is by far the most relevant for the purposes of this work. See David M. Pletcher (1984:125); Mitchell (1946); and Herrick (1966:3,160,230). Also see William H. Becker (1973:466-481).

1898.³⁵ Explaining this oddity, a clear challenge to the predictions of classical realism, Zakaria argued that the lack of a strong central government, which could harness the nation's enormous wealth for the purposes of expansion, forced American statesmen to diplomatic and military inactivity. Zakaria observed that presidents and administrations attempted to set the United States on an expansionary path whenever they saw an increase in the nation's relative economic power, yet a weak state and a small central government curbed their plans.³⁶

Figure 1. Naval Share of the Federal Budget, 1880-1899, *Historical Statistics of the US, Colonial Times to 1970, 1975, p.1115, Series Y 457-465. Adapted from Trubowitz, Defining the National Interest, p.39.*



While recognizing the value of Zakaria's emphasis on institutional variables, this section offers an alternative explanation to the delayed or better conflicted and inconstant American embrace of the expansionist path—one grounded in the national security influence of the local financial crises of 1884 and 1893-96. In agreement with the formulated expectations, and

³⁵ Notice that in the mid-1880s the United States' industrial power had surpassed that of Great Britain's, then considered the world's industrial power, in manufacturing output. See Kissinger (1994:37).

³⁶ Zakaria considers this position as consistent with realist theories of international relations. Kissinger offers a different institutionalist explanation for slow American conversion to expansion, one that focuses on the role of Congressional pressures. The American Senate, Kissinger argues, remained focused on domestic priorities and thwarted all expansionist projects, keeping the army small (25,000 men) and the navy weak. The explanation, however, is more an allusion than a statement backed by solid empirical evidence.

contrary to the arguments of LaFeber and Williams, both of these crises overturned American attempts at rearmament and expansion, thus setting the nation on a radically cautious national security path. The withdrawals from expansion occurred, respectively, between 1884 and 1889, and between 1893 and 1898—that is, during, and in the aftermath, of the discussed crises—and they were so radical as to infringe on American national security. The following paragraphs explain these claims.

In the early 1880s, the national security policies of the Arthur administration (1881-1885) rested on four major security objectives, which the nation had pursued since the end of the Civil War and the administration of President Ulysses Grant.³⁷ In their most toned-down formulation, these objectives consisted in impeding the construction of a foreign-built isthmian canal in Central America; protecting the Caribbean Sea; and defending American influence in Hawaii. This national security trinity demanded, in turn, the construction of a strong American Navy, although debate continued over whether the acquisition of naval bases for the control of the Caribbean and Hawaii was preferable to the establishment of closer commercial relations with those lands.³⁸

In line with these objectives, between 1881 and 1884 the Arthur administration embarked on a plan to modernize the navy and intensify national expansionist efforts. This policy was rooted in the preservation of heterodox financial policies, namely bimetallism and silver coinage. Without the printing—by Treasury Secretary Hugh McCulloch—of 200 million silver dollars to assist in the national industry, this expansionist ambition would have collapsed.³⁹ Congressional

³⁷ See, amongst many, Campbell (1964:50-84); Leopold (1962:3-143); Stevens, (1945:201-202); Grenville and Young, (1966:83); Pletcher (2001); Pratt (1936:257); Trubowitz, Goldman, and Edward Rhodes (1893); Schulzinger (1984:18,19).

³⁸ A strong navy was linked to the acquisition of naval bases as much as to the intensification of commercial relations between the United States and the Caribbean and Pacific islands. See Kissinger (1994:37); Mitchell (1946:11-16); Trubowitz (1998:36-37); Trubowitz et al. (1983:12). Building up a strong navy was a commitment of Democratic and Republican administrations alike. See the electoral campaign platforms between 1869 and 1900 in Porter and Johnson (1961).

³⁹ "Is This a Mystery?" *The Daily Register*, March 23, 1891.

documents show that, between December 1882 and April 1884, increases in appropriations for the naval service were satisfactorily adopted. In April 1884, before the financial crisis had reached momentum, Secretary of State Frederick Frelinghuysen lauded the bill which approved, for the fiscal year ending June 30, 1885, the build-up of “a new American navy, and, as an installment of that navy, [...] seven additional cruisers.”⁴⁰

The administration’s interest in propping up naval budgets dovetailed with the adoption of a militant security posture in Central and Latin America, a position which brought the United States in sharper conflict with Great Britain. Building on its assertiveness, Frelinghuysen successfully concluded a number of reciprocity treaties, including the Frelinghuysen-Zavala Treaty negotiated in late 1884. By virtue of this Treaty, Nicaragua granted the US permission to construct an interoceanic canal in exchange for a permanent American-Nicaraguan alliance.⁴¹ The project, which violated the requirements of the Anglo-American Clayton-Bulwer Treaty banning the construction of an American canal, was welcomed by President Arthur in December 1884 as an achievement whose “political and commercial advantages could scarcely be overestimated.”⁴² By this time the financial crisis had practically reached its conclusion.

These developments seem to refute the expectation that the Arthur administration was in LA–HE, facing strong pressures to endorse cautionary national security policies during the financial crisis (May through November 1884). Indeed, if the financial crisis was having an effect on national security policies, curbing the expansionist plans of the *incumbent*

⁴⁰ *Record of the US House of Representatives*, Committee on Appropriations, Department of the Navy, 47th Congress, Second Session, HR48A-F3.11, Box no.15, NARA; Naval Appropriation Bill, Congressional Record, House, vol.15, part 3, 48th Congress, 1st session, April 14, 1884, pp.2920-2927. In 1883 Congress had also authorized the construction of the country’s first steel warship. On these efforts see also, more broadly, Mitchell (1971:10-16); Narizny (2007:88); Long (1903:chapter 1); Sprout and Sprout (1946:162-64); and LaFeber (1963:104,105).

⁴¹ Treaties were negotiated, for instance, with Mexico, the Dominican Republic, Cuba, Puerto Rico, Hawaii, and Nicaragua.

⁴² Message of the President, *Journal of the Senate*, 48th Congress, Second session, December 1, 1884, NARA; “The Nicaragua Treaty,” *New York Times*, December 3, 1884. See also Walton (1953). Concluding a treaty with Nicaragua had been on the agenda since 1876, the year in which the Canal Commission unanimously recommended this route for an interoceanic canal. Frelinghuysen had tried to pressure Great Britain to abrogate the Clayton-Bulwer Treaty and recognize the Monroe Doctrine even in 1882, and then Britain’s refusal did not weaken the administration’s efforts to overrule the treaty with Britain.

administration was not one of them. This lack of influence on the Arthur administration, however, has a simple explanation that strongly corroborates the framework and the rest of the earlier formulated expectations on the national security influence of the 1884 crisis.

The Arthur administration doubled down on its pre-crisis, assertive security posture because it was convinced that it was operating under LA–LE. This assumption was clearly wrong, although it remains unclear whether President Arthur would have benefited politically from behaving as if he were under LA–HE (as he indeed was). As the New York Stock Exchange collapsed in mid-1884, spreading alarm across the transnational business community and American financial elites, the presidential campaign was about to start.⁴³ Rather than trying to fix the policies of an incumbent administration, which transnational financial markets regarded as tainted by an unorthodox financial record, American financial elites worked towards assuring the election of the presidential candidate who would most successfully signal credibility to financial markets and stopped the gold drain.⁴⁴ Despite their growing concerns regarding the “impairment of the national credit,” candidates Chester Arthur and James Blaine, respectively incumbent president and incumbent secretary of state, faced extremely bleak re-election prospects.⁴⁵

As financial newspapers of the time indicate, between May 1884 and November 1884, American business magnates Daniel Manning, Samuel Jones Tilden, and Thomas Bayard sided with Grover Cleveland. Cleveland was a more credible opponent of free silver and inflation than Arthur or Blaine could ever be. Cleveland also abhorred imperialism, interventionism, and

⁴³ “On the Verge of Panic: Wall Street Alarmed by a Succession of Failures,” *New York Times*, May 15, 1884.

⁴⁴ Arthur’s re-election prospects were already dim before the campaign started. He withdrew due to health reasons.

⁴⁵ Neither Arthur nor Blaine could calm the business fears of pursuing a policy at variance with sound monetary principles, even though both had pledged to greater respect of international financial cooperation during the campaign. They kept being associated with inflationary policies and panics. Compared to Cleveland, a member of the Bourbon Democrats, they stood basically no chance of re-election. *Message of the President to Congress*, December 1, 1884, 48th Congress, 2nd session, NARA; “The Reason and Remedy,” *Washington Post*, May 17, 1884; “Mr. Blaine of Panics,” *Washington Post*, June 10, 1884; “Blaine and the Business Men,” *New York Times*, October 13, 1884; “Better Business Prospect,” *Washington Post*, January 2, 1885.

entangling alliances.⁴⁶ As a banker put it, American financial elites were looking for “a business man” who could defend “sound monetary principles” and “the honest, commercial law of the world,” as much as a statesman who was diffident “about making star route contracts.”⁴⁷ No presidential candidate fit this profile better than Cleveland. In March 1885, during the installment of the new administration, the business community would happily declare that “Mr. Cleveland [would] never place himself at variance with sound monetary principles” and that “the character of his foreign policy” promised to “keep [the US cabinet] religiously aloof from all entangling alliances and fully in line with the characteristic reluctance of American people to meddle with other people’s affairs.”⁴⁸ The expectation that the financial crisis of 1884 created pressures for endorsing more cautious national security policies is therefore verified. The electoral campaign was the terrain upon which these pressures played out, while the victory of Cleveland and his financial and security platform attested to their strength. As expected for a statist-nationalist government meeting financial crisis in LA–HE, the pre-1884 national security agenda was overhauled, and the withdrawal from expansionism involved the broad spectrum of national security policies, namely military spending, threat assessment, and war prospects.⁴⁹ I will examine them in turn.

The ambitious expansionist agenda of the Arthur administration started to crumble as early as December 1884, when the conclusion of the financial crisis and the presidential

⁴⁶ Cleveland had also the advantage of having no connection with the running Republican candidates whose policies had allegedly caused the financial crisis and endangered American commitment to the gold standard. Cleveland’s letter to Senator Morrill, December 8, 1884, in *The Papers of Grover Cleveland, 1859-1908*, Manuscript Division, LOC, DC, Series 2, General Correspondence, 1846-1910, Reel 3; “Rallying to Cleveland: The Great Demonstration of the Business Men,” *New York Times*, October 10, 1884; “The Great Parade Today: The Monster Procession of the Business Men Who Favor Cleveland,” *New York Times*, October 24, 1884; “The Administration Outlook,” *Washington Post*, March 13, 1885. See also Grenville (1966:42-45).

⁴⁷ “Rallying to Cleveland,” *New York Times*, October 10, 1884.

⁴⁸ “The Administration Outlook,” *Washington Post*, March 13, 1885. Notice also that Cleveland had held no federal or military office before becoming president in 1885.

⁴⁹ A number of scholars have already noted the prudent national security policies endorsed by the Cleveland administration after 1884, although no one has recognized the fundamental role of the financial crisis of 1884 in engineering this foreign policy calmness. Amongst these scholars are, for instance, Narizny (2007:39-92); Campbell (1964); and Trubowitz (1998:37-38).

campaign left no doubt about the binding commitment of the newly elected administration to defend gold and financial orthodoxy, and, inevitably, the ostracizing of silver production and coinage.⁵⁰ A letter sent to the House by the Secretary of the Navy Chandler reveals that by late December 1884, existing bills for appropriating additional cruisers had been dropped in the Senate.⁵¹ By January 1885 the House, too, had approved a Navy bill that suspended naval construction for two and half years, in an attempt to impede “money squandering.”⁵² After its official installment in March 1885, the Cleveland administration pushed forward military retrenchment and rejected pleas for battleships from the navy department in order to place American finances “on a sound and sensible basis.”⁵³ As Table 4 exhibits, between 1883 and 1886, the naval modernization program of the Arthur administration stalled. Military spending decreased 32 percent compared to a GNP decrease of 4 percent, and a decrease in total government spending of “only” 8 percent. In the summer of 1886, *The New York Times* denounced 16-month delays in contract assignments for vessel building, and the laying off of thousands of navy employees for “lack of funds.”⁵⁴

Military retrenchment was accompanied by the endorsement of a more cautious foreign policy stance, and a milder threat assessment. With the exception of the treaty between the United States and Hawaii, which Cleveland firmly defended and renewed in 1886, all reciprocity treaties concluded by the Arthur administration were withdrawn under the premise that the United States, in Cleveland’s words, was committed to a policy of “peace, commerce, and honest

⁵⁰ In 1885, Daniel Manning took possession of the Treasury, replacing “tainted with heterodoxy” Hugh McCulloch.

⁵¹ Letter sent by Chandler to Chairman of the Committee of Appropriations of the House Samuel Randall on December 31, 1884 in *Record of the US House of Representatives*, 48th Congress, HR48A-F3.11, Box 14, NARA.

⁵² Naval Appropriations Bill, Congressional Record, House vol.16, part 3, 48th Congress, 2nd session, February 23, 1885, pp.2041-43; and “Appropriations for the Navy,” *Washington Post*, January 13, 1885; Message of the President of the United States to Congress delivered on December 8, 1885, *Journal of the Senate*, 49th Congress, 1st session, NARA.

⁵³ James D. Richardson, ed., *A Compilation of the Messages and Papers of the Presidents, 1789-1897*, Washington, DC, (1899), vol. VIII, p.302.

⁵⁴ “The New Navy,” *New York Times*, June 26, 1885; and “The Navy Yard Deserted: Over 1,000 employees laid off because of lack of funds,” *New York Times*, July 2, 1886.

friendship with all nations, and entangling alliances with none.”⁵⁵ Supporting framework and expectations, Cleveland justified this withdrawal from expansionism and the related promotion of international peace with the necessity of pursuing financial policies that expressed greater commitment to the gold standard. “Nothing,” he stated in a speech to Congress in December 1885, was “more important” than the “present condition of [...] currency and coinage.”⁵⁶

Table 4. American real military spending (ME), GNP and government spending (CGE) between 1880 and 1897

Year	Real ME	Real CGE	Real GNP	ME/GNP	ME/CGE
1881	56	261	11483	0.004	0.21
1882	59	258	12343	0.005	0.23
1883	65	270	12590	0.005	0.24
1884	58	250	12348	0.005	0.23
1885	60	265	11656	0.005	0.22
1886	49	249	12113	0.004	0.19
1887	54	266	12162	0.004	0.20
1888	55	268	12420	0.004	0.21
1889	68	308	13315	0.005	0.22
1890	68	324	13524	0.005	0.21
1891	75	366	13742	0.006	0.21
1892	76	345	14081	0.005	0.22
1893	81	387	14390	0.006	0.21
1894	90	386	13937	0.006	0.23
1895	83	363	14330	0.006	0.22
1896	78	352	14044	0.006	0.22
1897	85	369	15065	0.006	0.23
1898	151	443	15869	0.010	0.34

The lack of adequate financial means and the necessity to strengthen national financial credibility was reiterated when the Frelinghuysen-Zavala treaty was scrapped in early 1885, providing for the most remarkable “softening” of American threat assessment compared to the pre-financial crisis period. Previously established plans to construct an American canal were abandoned by the administration and Congress because of their excessive financial cost and the

⁵⁵ *Annual Message of the President*, December 8, 1885, Richardson, A Compilation, VIII, pp. 327-28; Cleveland expressed his conviction of the necessity to preserve the American-Hawaiian Treaty in a message to Congress of December 6, 1886; *Journal of the Senate*, 49th Congress, 2nd session. See also Richardson, A Compilation, VIII, pp.500-501.

⁵⁶ Message of the President of the United States to Congress, *Journal of the Senate*, 49th Congress, 1st session, December 8, 1885.

“embarrassing” alliance against Great Britain—the primary defender of the gold standard—that the US-Nicaragua treaty entailed.⁵⁷

Ultimately, with the withdrawal of the Frelinghuysen-Zavala treaty and the cancellation of the progress made towards the construction of an American canal, the United States moved from its pre-crisis position as Great Britain’s foremost challenger in Central America to Great Britain’s best ally, determined to preserve the Clayton-Bulwer Treaty and subordinate American national security decisions to the British will.⁵⁸ Rearmament and the acquisition of an American canal were pushed out of the agenda and there remained for many years. British-American war prospects collapsed as a result. Had the financial crisis of 1884 not occurred, and had American financial elites and the transnational power of financial orthodoxy not been strong, the US Treasury would have not complied to a strict program of adherence to the gold standard; silver coinage would have continued, enlarging the financial capacity of the Treasury; military and expansionist plans would have moved forward; the construction of a Nicaragua canal would have been at the very least initiated; and stronger alliances between the United States and countries in Central America would have been concluded. American national security policies between 1884 and 1887 would have been remarkably different from what we know about them today.⁵⁹

⁵⁷ *Journal of the Executive Proceedings of the Senate* (Washington 1901), XXIV, 453, pp.456, 481; the treaty failed ratification in February 1885. “The Nicaragua Canal Bad Bargain,” *New York Times*, January 9, 1885; “Cleveland on Expansion: His Views Clearly Defined in Connection with Nicaragua and Hawaii,” *Washington Post*, October 30, 1900; “The President’s Message,” December 9, 1885, *New York Times*.

⁵⁸ The Cleveland administration also withdrew American participation in the international convention concerning the Congo Free State, lest it entangle the US in diplomatic conflicts with England or Europe in Africa. The US had joined the Berlin Conference in November 1884, in view of the trade opportunities offered by the Congo. The American representative in Berlin signed the Berlin Act, but Cleveland declined to submit it to the Senate. His explanation was the same as the one offered for the ditching of the United States-Nicaraguan Treaty. President Cleveland, Message to Congress, *Journal of the Senate*, 49th Congress, 2nd session, December 6, 1886. See also Kasson (1886:119-33).

⁵⁹ Interestingly, the election of the Harrison administration in 1888—an administration which was visibly in favor of an expansionist foreign policy—occurred in the absence of a financial crisis and when American gold reserves were rising, as Tab.1 shows. Also, by 1888 Cleveland’s incentives for a strict observance of financial orthodoxy had receded as exports kept shrinking and financial conditions failed to match the enormous manufacturing power (Tab.1). Significantly, in 1888 President Cleveland was newly pressing for an international conference on bimetallism. In 1889, before the installment of the Harrison administration, Cleveland had shown an increasingly belligerent attitude by sending American warships to deter Germany from taking control of the Samoan islands. See Hagan (1991:193-227); Herrick (1966:11).

The Cleveland administration faced strong pressures to endorse—and eventually did endorse—greater national security restraint even during the financial crisis of 1893-96. More so than between 1884 and 1885, and by HA–HE, diplomatic and military wariness reached alarming heights in the mid-1890s, providing further confirmation of the framework. This time, as emerges from press records and presidential papers, American financial elites had acted preventively before the outbreak of the crisis. When *fears* of a national gold default surfaced between 1891 and 1892, shortly after the global financial crisis of 1890-91, Wall Street bankers took advantage of the electoral campaign of 1892 to support, once again (and once again successfully), Grover Cleveland.⁶⁰ As Table 1 shows, gold outflows increased between 1891 and 1892, following the global financial crisis of 1890-91. Although the American economy had escaped the crisis, alarm newly spread across American financial circles. As in 1884, pressures on presidential candidates mounted.

In agreement with expectations, between 1893 and early 1895 the course of national security policies gave in to these pressures. In 1892, Cleveland clearly knew how to give business elites a run for their money. His position against the coinage of silver dollars, his anti-imperialist views, and his overall cautious presidential record made him extremely appealing to high finance. By contrast, as was true for James Blaine in 1884, the financial record of incumbent president and runner-up Benjamin Harrison was tainted. Since Harrison's ambitious national security policies stood little chance of being realized without enlarging the financial capacity of the US Treasury through silver coinage, between 1889 and 1892, the administration

⁶⁰ Letter of the State Treasurer of Missouri to Cleveland of November 5, 1891 in *The Papers of Grover Cleveland, 1859-1908*, Manuscript Division, LOC, DC, Series 2, General Correspondence, 1846-1910, Reel 69; "Secretary Foster Discusses Relations of Gold and Silver," *Washington Post*, November 11, 1891; "Gold Supply and Bimetallism," and "Finances of the Nation: Annual Report of Treasury and Results of Reciprocity," *Washington Post*, December 7, 1892; "Alarm in Financial Circles," and "Getting All our Gold: Treasury Officials Anxious to Stop the Drain made by Europe," *Washington Post*, December 19, 1892; "American Nation in Jeopardy," and "Nothing But Money: This has been the Absorbing Topic on Wall Street" *Chicago Daily Tribune*, December 19, 1892.

had pursued heterodox, silver-friendly policies, as well as expansionist and inflationary military policies (Tab.1 and Tab.5).⁶¹ In particular, the latter set of policies included an offensive naval strategy and the related build-up of a world-class battle fleet; the creation of American commercial empire through sustained trade reciprocity; and a spirited defense of the Monroe Doctrine.⁶² A foremost pillar of these plans was the furthering of the American hold on Hawaii. Envisioning the forthcoming annexation of the Islands, the Hamilton administration aided in the overthrow of the native monarchy of Queen Liliuokalani in January 1893, hastily negotiating an annexation treaty with the provisional government.⁶³

Cleveland's victory in November 1892 shattered this ambitious national security agenda. Confirming framework and expectations, immediately upon his March 1893 installment—and, just as the financial crisis was starting, Cleveland curbed his predecessor's imperialist policy by withdrawing the Hawaiian annexation treaty from the Senate.⁶⁴ The administration justified the maneuver with ethical considerations on the circumstances surrounding the downfall of the Hawaiian government.⁶⁵ Yet the President's inaugural speech made clear that the withdrawal did

⁶¹ Secretary of the Treasury John Foster was wholeheartedly committed to silver coinage and justified it based on the country's remarkable economic growth. "Mr. Foster's views," *New York Times*, June 26, 1891.

⁶² On the expansionist program of the Harrison administration, see "The Grand Possibilities of Secretary Blaine's Reciprocity Policy," *Chicago Daily Tribune*, February 15, 1891; Charles Hedges, *Speeches of Benjamin Harrison: A Complete Collection of His Public Addresses from February 1888, to February 1892*, New York, (1892), pp.287,325,388,409,415,467-68,499-500; Hagan (1991:194-95); Herrick (1966:3); Trubowitz et al.(1983:32); Grenville and Young (1966:93); and Richardson, *A Compilation*, pp.122-123. Under Secretary of the Navy Benjamin Tracy, a series of ambitious naval acts was passed. Over the course of 1890, the Navy's share of the federal budget more than doubled. Between late 1891 and early 1892, the United States had also come very close to a war with Chile. LaFeber (1963:130); Hagan (1991:199).

⁶³ After the Hawaiian revolution of mid-January 1893, which deposed the Queen and established a provisional government, American Hawaiian minister John Stevens urged the administration to annex the islands before Great Britain "plucked the Hawaiian Pear." Stevens to Foster, February 1, 1893, *House Executive Documents*, 53rd Congress, 2nd session, no.48, p.136; the text of Stevens' announcement is in *Congressional Record*, 53rd Congress, 2nd session, p.191.

⁶⁴ Secretary of State Water Q. Gresham to Blount, March 11, 1893, *House Executive Documents*, 53rd Congress, 2nd session, n.47, p.2. The withdrawal of the Hawaiian annexation treaty in 1893 echoed the withdrawal of the Frelinghuysen-Zavala canal treaty soon after the crisis of 1884. Cleveland accompanied the withdrawal of the Treaty with the setup of a commission to investigate the causes of the revolution and Hawaiian sentiment towards annexation. James Blount was the commissioner appointed by the administration to investigate the Hawaiian revolution.

⁶⁵ The emphasis on moral factors to justify the righteousness of hijacking the annexation treaty emerges from a variety of the administration's declarations with regard to Hawaii in 1893 and 1894. The interference of the Harrison administration in the process leading up to the Hawaiian revolution also made ethical debates rather legitimate. *Foreign Relations of the United States*, 1894, Appendix II, pp.197-205; Committee on Foreign Affairs of the House, *Record of US House of Representatives*, 53rd Congress, 1st session, HR 53A-F11.1, box 139, NARA; *Congressional Record*, 53rd Congress, 2nd session, pp.5499-5500; Lorrin

not respond *primarily* to considerations of morality, but to the need to abide by the principles of international financial cooperation. In March 1893, Cleveland stated: “*Nothing is more vital to our supremacy as a nation [...] than a sound and stable currency. [...] In dealing with our present embarrassing situation [...] we will be wise if we temper our confidence and faith in our national strength and resources with the frank concession that even these will not permit us to defy with impunity the inexorable laws of finance and trade.*”⁶⁶ Further tempering confidence in American national strength was the concomitant decision, in March 1893, to scrap warship authorizations for that year. As displayed in Figure 2, however, no warship was authorized for two years, indicating that the financial crisis of 1893-96 pushed cautionary national security policies forward and caused what Herrick has defined as a “hiatus” in American naval revolution.⁶⁷

Archival records confirm that, between 1893 and 1895, the House and the Senate strongly supported Cleveland’s policy of economy in the naval appropriations bills so that legislative energies could center, as one senator put it, on the supreme issue of “how to maintain the present standard of gold and not have to adopt monometallism.” Congressional pressures for economies in the naval appropriations bill began in early February 1893, before Cleveland entered office, and before the start of the 1893-96 crisis.⁶⁸ Yet, the historical record indicates that had the financial crisis not occurred, Cleveland’s national security decisions between 1893 and 1895 would have been remarkably different from the ones actually undertaken. To begin

A. Thurston, *Memoirs of the Hawaiian Revolution*, Honolulu: Advertiser Publishing Co. (1936), p.302; Blount to Gresham, July 17 and 31, 1893, *House Executive Documents*, 53rd Congress, 2nd session, n.47, pp.144,164. Ethical debates on the issue of Hawaiian annexation occurred frequently in Congress in 1893 and 1894.

⁶⁶ Grover Cleveland, Inaugural Address, March 4, 1893. “President’s Address: Cleveland’s Inaugural Speech Smooth and Well,” *Chicago Daily Tribune*, March 5, 1893.

⁶⁷ Herrick (1966:153,154).

⁶⁸ Committee on Foreign Affairs of the House; Various Sessions; Record of the House, 53rd Congress, 1st session, HR 53A-F11.1, Boxes 100,139, NARA; Committee on Banking and Currency of the House Record of the US House of Representatives, 53rd Congress, 1st session, HR 53A-F4.1, Rg 233, Boxes 39,41,44, Statement of Mr. W.T. Grant of Louisville, Kentucky on July 2, 1894 in Committee on Banking and Currency of the House Record of the US House of Representatives, 53rd Congress, 1st session HR 53A-F4.1, Rg 233, Box 41, NARA; “Economy in the Naval Appropriations Bill,” *Washington Post*, February 8, 1893.

with, the President was not a dove. Cleveland was strongly persuaded of the vital importance of Hawaii to American security. From the conclusion of American-Hawaiian Reciprocity Treaty in 1875 until the financial crisis of 1893-96, no Republican or Democratic administration had refused to renew the Treaty or dared to question the strategic significance of Hawaii and American military presence in the Pacific—nor did Cleveland before 1893. Even when retrenchment plans were undertaken during and soon after the crisis of 1884, the Bourbon Democrat had saved and strengthened the American reciprocity treaty with Hawaii, considering it an unyielding bastion of US foreign policy and concluding—in 1886—that the “paramount influence” acquired in Hawaii and “the telegraphic communications between those Islands and the United States” needed to “be maintained.”⁶⁹

Figure 2. Warships Authorized 1893-9 (Mitchell, *History of the Modern American Navy*, p.26)

TABLE II				
WARSHIPS AUTHORIZED, 1890-97				
name	class	tonnage	speed knots	main armament
1890				
OREGON	B. S.	10,288	16	four 13", eight 8", four 6"
MASSACHUSETTS	B. S.	10,288	16	four 13", eight 8", four 6"
INDIANA	B. S.	10,288	16	four 13", eight 8", four 6"
COLUMBIA	P. Cr.	7,375	23	one 8", two 6", eight 4"
One torpedo boat				
1891				
MINNEAPOLIS	P. Cr.	7,375	23	one 8", two 6", eight 4"
1892				
IOWA	B. S.	11,340	17	four 12", eight 8", six 4"
BROOKLYN	A. Cr.	9,215	22	eight 8", twelve 5"
1893				
Three gunboats, one submarine.				
1894				
One tug, three torpedo boats.				
1895				
KEARSARGE	B. S.	11,525	16	four 13", four 8", fourteen 5"
KENTUCKY	B. S.	11,525	16	four 13", four 8", fourteen 5"
1896				
ALABAMA	B. S.	11,565	16	four 13", fourteen 6"
ILLINOIS	B. S.	11,565	16	four 13", fourteen 6"
WISCONSIN	B. S.	11,565	16	four 13", fourteen 6"
Ten torpedo boats.				

⁶⁹ Message of Cleveland to Congress, December 6, 1886, *Journal of the Senate*, 49th Congress, 2nd session, NARA. Notice that American fears of British influence in Hawaii had been the most impellent reason behind the conclusion of the treaty in 1875. Article IV of the US treaty with Hawaii expressed its essence. It prohibited Honolulu from granting “any special privilege or rights or use therein to any other power, state or government.” See Kirshner and Abdelal (1999:128).

Moreover, despite his distaste for Harrison’s imperialism, Cleveland completely understood the necessity of strengthening the American navy for defending the nation’s seacoast, confronting the first-class vessels of other powers, and preventing an infringement of the Monroe Doctrine. By endorsing economies in the naval appropriations bill in early 1893, Cleveland did not intend to scrap American naval rearmament.

In March 1893 he even appointed Hilary A. Herbert, an ex-colonel commonly known for backing expansionist bills, as head of the Department of the Navy. In fact, Herbert was quite successful in mustering support for allocating resources to the navy (slowdown in battleship construction aside), which also explains why military spending did not drop

Table 5. Total Investments of American Bank

Year	Commercial Bank Investments	Year	Commercial Bank Investments
1900	1410	1880	904
1901	1676	1881	985
1902	1821	1882	1055
1903	2016	1883	1028
1904	2226	1884	1041
1905	2523	1885	1042
1906	2563	1886	1051
1907	2744	1887	1011
1908	2912	1888	1131
1909	3153	1889	1129
1910	3156	1890	1173

substantially between 1893 and 1895, as Table 5 shows.⁷⁰ The President placed no opposition on Herbert’s work indicating that, had the financial crisis not occurred, naval spending figures for the years 1893 and 1894 would have been much higher.

Further attesting that American national security decisions between 1893 and 1895 would have been markedly different had the financial crisis not occurred and had the administration not felt the utmost need to reassure financial markets of American creditworthiness, President Cleveland did not limit American retreat from expansionism to the withdrawal of the American-Hawaiian annexation treaty. He went further, and then some. As the crisis deepened between July 1893 and January 1895, Cleveland felt an increasing obligation to defend the nation’s

⁷⁰ See sketch of Herbert in DAB, VII, 572-73, in *Philadelphia Evening Telegram*, February 23, 1893; and in *Troy Daily Press*. See also Herrick (1966:154-155).

respect of the inexorable laws of international finance, and plunged into an exceedingly restrained national security path. Between July and August 1895, as the depletion of gold from the vaults of the Treasury continued, Cleveland convened an extra session of Congress to alert the State to the immediate necessity of obtaining the seal of approval of international financial markets. As the President stated, “lack of confidence at home and abroad” over American pro-silver financial policies was “shunning the country out of the nations of the first class.”⁷¹ A few weeks after this statement, the administration instructed the American minister in Honolulu, Albert S. Willis, to tell the deposed Queen that the United States regretted American military presence in Hawaii and supported her reinstatement *provided that she promised to assume the provisional government’s debt*.⁷²

Besides further exposing the weakness of American Hawaiian policy, the decision to reinstall the Queen would have been unthinkable for a moralist of the caliber of Grover Cleveland had he not been increasingly entangled in his battle to defend American adherence to the gold par, and therefore unable to take on foreign debts.⁷³ Indeed, how could someone concerned with American and international morality reinstall a government that, as the Blount report of July 1893 made clear, was undesired by the Hawaiians to the point that they preferred American annexation to a return of the Queen? The picture of a Democratic president advocating monarchy was already strange enough. Unfortunately, in his assessment of the reasons “shunning

⁷¹ Message from President Cleveland, *Journal of the Senate*, 1st session, 53rd Congress, 1893, August 7, 1893, NARA. Cleveland could not have used stronger words to convey the necessity, at this stage of the crisis, of a stricter adherence to orthodoxy. As he put it, “the present perilous condition is largely the result of a financial policy which the executive branch of the government finds embodied in unwise laws, which must be executed until repealed by Congress.” He was referring here to the Sherman Act.

⁷² Albert S. Willis, new US Envoy and Minister Plenipotentiary in Honolulu after the ousting of Stevens carried the message to the dethroned Queen and Hon. S.B. Dole, who was head of the provisional government. Gresham to Willis, October 13, 1893, FRUS 1894, Appendix II, pp.1189-91; Willis to Gresham, January 14,16,19 and February 10, 1893, Committee on Foreign Affairs of the House, Various Sessions, *Record of the US House of Representatives*, 53rd Congress, 1st session, HR 53A-F11.1, Box 100 NARA; Oliver T. Morton to Gresham, November 17, 1893, in *Papers of Walter Quintin Gresham*, vol.41, August 23, 1893 to Jan 9, 1894, Manuscript Division, Library of Congress, Washington, DC. See also Alexander (1896).

⁷³ The American Congress took the side of the Hawaiians, agreeing on one basic point (which Cleveland would not have disputed in the absence of a financial crisis): the United States should not attempt to undo the Hawaiian revolution. Cleveland and Gresham accepted the recommendation in the end. The Queen was not reinstated. On the Blount Report, see *Senate Reports*, 53rd Congress, 2nd session, n.227, pp.xxi,xxxiii-iv.

the United States out of the nations of the first class,” Cleveland could not have been more mistaken. Taking advantage of American “disinterest” in the Pacific, Great Britain in October 1894 drafted an agreement with Honolulu to lay a submarine cable between the British colonies of Canada and Australasia.⁷⁴ It is impossible to underestimate the significance of this plan for Great Britain: the domain of the British Empire would have been enlarged, while two British colonies would have served as counterweights to America’s rising power. The only condition barring the Hawaiian government from concluding the agreement was its reciprocity treaty with the United States.

Providing extra support to the hyperbolic diplomatic and military carefulness foreseen by HA–HE, in January 1895 the administration brought its cautionary foreign policy stance to its most dangerous extreme, practically repudiating the US Reciprocity Treaty with Hawaii and American Hawaiian policy more broadly. While the treaty had been consistently renewed by American administrations from 1875 onwards, Cleveland had fully endorsed and pledged to defend it.⁷⁵ In December 1895, however, engaged in what he later defined as “averting” the “imminent disaster” resulting from the “collapse of the entire system of credit,” Cleveland asked Congress to amend the existing reciprocity treaty with Hawaii so that telegraphic rights could be awarded to Great Britain, and British colonies Canada and Australia, instead of the United States.⁷⁶ Concurrently, American naval forces were withdrawn from Hawaiian waters.⁷⁷ In doing so, Cleveland was letting Great Britain “pluck the Hawaiian pear,” to use an expression that was

⁷⁴ Memorandum of the Agreement between the Hawaiian government and representatives of Great Britain and the British colonies, Honolulu, October 1894, Committee on Foreign Affairs of the House, Various Subjects; *Record of the US House of Representatives*, 53rd Congress, 1st session, HR 53A-F16.1, Box no.100, NARA.

⁷⁵ Message of the President relative to proposed submarine cable in Hawaii, *Congressional Record*, Vol.27, part 1, January 9, 1895, p.768; and Message of Secretary of State Gresham, Committee on Foreign Affairs of the House, Various Subjects; *Record of the US House of Representatives*, 53rd Congress, 1st session, HR 53A-F16.1, Box no.100, NARA; “Hawaiian Cable Looks Certain Now,” *Chicago Tribune*, February 1, 1895; “Cleveland is keeping up a policy of infamy,” *Chicago Daily Tribune*, January 15, 1895; “Hawaiian Cable: The Question Comes Before Both Houses,” *Los Angeles Times*, February 19, 1895; “Will Not Aid the Hawaiian Cable,” *Chicago Daily Tribune*, February 22, 1895.

⁷⁶ Annual Message of the President, December 2, 1895, *Journal of the Senate*, 54th Congress, NARA.

⁷⁷ On the withdrawal of naval forces from Hawaii between late 1894 and January 1895, see Leopold (1945:136).

popular at the time—and not the only pear to pluck, as revealed by British statements and actions towards Nicaragua in May 1895 and towards Venezuela shortly thereafter. Between 1894 and 1895, Great Britain assumed an increasingly interventionist posture in Central America. In May 1895, British marines occupied the Nicaraguan port of Corinto for a few days, expelled the British consul there, and demanded an indemnity after the government incorporated the Mosquito islands. The Cleveland administration closed one eye. The United States' prudent threat assessment lured Great Britain, and a couple months later London intensified its demands towards Venezuela over the boundary line of the British Guyana.

The administration's exposure to high finance was making a mockery of the Monroe doctrine and trumping American national security. Things were about to change, however. Pressures for pursuing greater national security caution eased off starting in late February 1895 when, in agreement with framework and expectations, Cleveland's cosmopolitan government found itself in HA–LE. In the following months, a move away from an exceedingly cautionary security stance occurred but, as expected, the American government did not unwaveringly embark on a more assertive national security course, instead showing substantial ambiguity—arguably the same ambiguity that characterized its post-February 1895 financial policies of crisis response. Soon after the failure of the Morgan-Cleveland agreement, Congress voted out the proposed amendment to the American Hawaiian treaty and a bolder program of battleship construction was authorized (Fig.2 and Tab.5).⁷⁸ Between spring and summer of 1895, President Cleveland and newly installed Secretary of State Richard Olney adopted a much less dovish foreign policy stance towards Great Britain. In July 1895, Olney notified the British cabinet that

⁷⁸ President Cleveland and Secretary of State Walter Gresham resisted the rising tide of American bellicosity until February 1895. On the rising bellicosity and the resumption of military build-up starting in February 1895 see *Congressional Record*, 53rd Congress, 3rd session, p.3113; Richardson, *Messages and Papers*, pp.540-41; "New Battleships and Torpedo-boats Authorized to be constructed," *Los Angeles Times*, February 21, 1895; Navy Department, Annual Report, 1894-95. See also Mitchell (1946:22-26); LaFeber (1963:175-8); Herrick (1966:175-85); Grenville and Young (1966:120-123); Leopold (1962:138); and Ferrell (1987:188).

its Venezuelan demands infringed upon the Monroe Doctrine, and that the United States would act as a Venezuelan ally if needed.⁷⁹ Strategically and diplomatically, this increase in national security readiness was far from being a secure foray into international assertiveness. The American government was just defending principles of regional security that it had established back in 1823. Moreover, Cleveland waited months before responding to British provocations; he continued to advocate for an international arbitration of the Venezuelan dispute; and had he really wanted to flex American diplomatic and military muscles, he could easily have begun by liberating Cuba from the Spanish oppressor—an action that was explicitly opposed by both Cleveland and Olney even when domestic pressures to intervene mounted throughout 1895.⁸⁰ However, when the British refused to take Olney's message seriously, Cleveland pledged to “resist by every means in its power” ongoing British efforts to exercise jurisdiction over Venezuelan territory, a promise that the government would not have made in 1893, 1894, or early February 1895.⁸¹

In this context of ambiguity regarding threat assessment, war prospects, and, obliquely, military spending too, one thing was clear: Cleveland was no longer linked to or could no longer rely on a pro-finance friendly, pro-British, and anti-Treasury American foreign policy to kick-start national financial and economic recovery. Preserving national honor after a phase of conciliatory diplomacy “gone bad” was surely a reason for this development.⁸² Another reason, which validates HA–LE, was an increased uncertainty in the administration's crisis response

⁷⁹ In April 1895 British marines landed in Nicaragua for a few days after Nicaragua had expelled the British consul from the Mosquito islands. On the Venezuelan border dispute between Great Britain and the United States, Cleveland's stance, and its resolution, see Campbell (1976:chapter 11).

⁸⁰ On the Cleveland administration's position versus an American-Spanish conflict, see Grenville and Young (1966:181,182,184); Trask (1981:11-22); Offner (1992:2,25); and Kirshner (2007:32-33). See also “No Action Toward Cuba: The President Will Not Recognize the Insurgents,” *New York Times*, June 12, 1896.

⁸¹ See Cleveland's Presidential Address to the Royal Historical Society in Humphreys (1967), pp.131-164.

⁸² As Cleveland stated in November 1895, “I am nevertheless firm in my conviction that, while it is a grievous thing to contemplate the two great English-speaking peoples of the world as being otherwise than friendly competitors in the onward march of civilization [...], there is no calamity which a great nation can invite which equals [...] the loss of national self-respect and honor”; Cleveland's words in Whittle (1920:216).

strategy. After February 1895, this strategy no longer required the demands or suggestions of high finance.⁸³ Throughout that year, Morgan and his acolytes continued to stand ready to assist the Treasury with individual and collective offers of syndicates and gold deposits to save the nation from bankruptcy but Cleveland and Carlisle regarded a new private loan as “politically inexpedient” and opted for a public loan in January 1896 (Carosso 1987:340-343).⁸⁴ In sum, American financial policies and security policies in 1895, during the second stage of response to the financial crisis of 1893-96 reproduced a political fracture between the Cleveland administration and high finance that helped polarize domestic politics.

Under McKinley, the ambiguity in national financial policy increased as the president continued along the path laid by his predecessor by strengthening the taxing and spending powers of the Treasury in reaction to the financial crisis,⁸⁵ and by *reaching an international bimetallic agreement* to preserve American participation in the gold standard (McCulley 1992:54). This investment in the independence of the American Treasury, a strategy that insulated the government politically from the pressures of “gold monometallists” and “silverites,” is a fundamental variable to help explain how an cosmopolitan administration like that of McKinley’s, which in stable financial conditions would have committed to international peace, was slowly dragged into a war that it did not want to fight between 1897 and 1898. The transition to assertiveness would have been much more difficult had the administration not prioritized national legislation favoring a stronger Treasury—a policy heritage of the financial crisis—and had the financial crisis not contributed, as previously illustrated, to alienating Wall

⁸³ Many eminent Wall Street firms (including J.P. Morgan) were very close to exhausting their available gold too at this point.

⁸⁴ Facing a much more undecided American government, and convinced that the American public was the culprit for a failed financial recovery, Wall Street titans embarked on a reform movement against Free Silver in the attempt at converting the American public to gold monometallism. On Wall Street’s attempts to convert the masses, see Livingston (1986:88,89).

⁸⁵ In his acceptance speech to the G.O.P. Notification Committee, McKinley stressed the government’s need of raising sufficient revenues and avoiding paying excessive interest rates to private finance because of the negative financial and economic repercussions of this policy domestically. See the *Cleveland Gazette*, August 8, 1896.

Street from the rest of the American public, the administration from Wall Street, and ultimately the administration from financially splintered interests. All of these elements are compatible with the expectation that the American administration after February 1895 found itself in HA—LE—guarded national security policies being gradually abandoned.

Ultimately, the financial crisis of 1893-96 profoundly shaped American threat assessment and war prospects. Without it, American financial elites would not have placed such intense pressures on the Cleveland administration as they did during the first stage of the crisis; Cleveland would not have miscalculated the British threat and staged an American military withdrawal from the Pacific or accepted a more timid interpretation of the Monroe Doctrine; heterodox financial policies would not have gained the popular support that they did between 1894 and 1895; polarization in Congress between gold-standard defenders and silverites would not have been as strong; the cosmopolitan government of Cleveland and McKinley would not have leaned towards a more assertive national financial policy and, as a result, a less cautionary national security policy; and a Spanish-American war would have appeared much less inevitable in Washington.

It is difficult to determine which factor mattered most in bringing about the national security shift from greater caution to greater assertiveness after February 1895—Cleveland's "collusion" with high finance until February 1895 and following populist backlash, or the very timid national security course that Cleveland agreed to pursue and that stunned the president himself in due course. Regardless of the answer, which might entail a combination of the two factors, it is worth noting that neither would have occurred without the financial crisis of 1893-96.⁸⁷ This assessment and the evidence backing it suggests that LaFeber might have overestimated the causal role of heterodox financial policies and underestimated the cautionary influence of the financial crises of 1884 and 1893-96 on American expansionist plans. On the

other hand, Zakaria's explanation does not account for the timing and variation of American retreat from expansionism between 1880 and 1900. In addition, the independent variable 'weak state and a small central government' does not do a good job of explaining the yo-yo effect of American leaders' expansionist attempts. Why would state weakness matter more at certain times and less at others? Zakaria does not fully explain this phenomenon, although he argues that jumps forward in relative economic wealth changed American leaders' attitude towards expansionism. That said, Zakaria's explanation is not incompatible with the one proposed here. A weak state and a small central government or, more exactly, a poor Treasury, are here described as epiphenomenal products of the relative power of American financial elites vis-à-vis national authorities and particularly the change in the domestic balance of power following financial-crisis outbreak and its influence on national security policies. Overall, evidence suggests that the financial crises placed significant limitations on the translation of American wealth into power.

⁸⁷ On the relevance of both factors see Humphreys (1967:131-164).

SOLVING A SECURITY DILEMMA WITH INTERNATIONAL FINANCIAL COOPERATION:
How Japanese-American war scares disappeared and dollar diplomacy thrived

At the start of the global financial crisis of 1907-08, international arms races were in full swing, and diplomatic and military tensions had been mounting in some corners of the world, like the Pacific, for quite a while.⁸⁸ Throughout 1907, as the financial crisis spread around the world, escalating military measures by Washington and Tokyo and long-standing diplomatic tension between the United States and Japan brought the two countries to the verge of war. Interestingly, between the summer of 1907 and early 1909, war scares subsided. With the possible exception of Schweller (2010:26), who has recently acknowledged that the United States and Japan were facing a security dilemma in 1907 over the defense of the Philippines, international relations literature has shown substantial disinterest in the peaking and subsequent resolution of this diplomatic and military crisis. Explanations as to how—or why—a worsening of the Japanese-American security dilemma was avoided in 1907 can be derived from structural realism's balance of power theory as well as from one of its analytical rivals, Schweller's theory of underbalancing. The former would predict that conflict escalation in the Pacific in 1907 and 1908 was avoided through successful balancing, namely by strengthening military deterrence and establishing new alliances. The latter would emphasize the role of elite consensus, social cohesion, and strong state structures in explaining successful balancing by either side. This section demonstrates that both explanations fail to reveal the evolution of American national security policies in this period and that the global financial crisis of 1907-08, and its resolution according to LA-HE, mattered greatly in the non-escalation of the 1907 Japanese-American security dilemma and war scare. These conclusions are attuned to and shed further light on the observation—advanced by many studies in American foreign policy—that between 1907 and

⁸⁸ The failure of the Hague conventions of 1899 and 1907, respectively, diminished the prospect of an international court for compulsory arbitration and of an international agreement over arms limitations.

1909, a paramount departure from Roosevelt's global strategy of "balanced antagonism" occurred as the White House became more eager to accept Japanese influence in Manchuria and the Far East and resort to dollar-diplomacy in the conduct of American foreign affairs.⁸⁹

Dangers of a Japanese-American war materialized over the issue of Japanese immigration to California. Following the October 1906 decision by the San Francisco Board of Education to exclude Japanese children from regular schools, along with mounting anti-Japanese riots in California and anti-American riots in Japan, the ministry of Prince Kimmachi Saionji raised sharp diplomatic protests in December 1906. A long path of diplomatic negotiations between Tokyo and Washington began while anti-Japanese rioting continued, peaking in the spring, summer and fall of 1907. Between the fall of 1906 and the spring of 1908, *The Washington Post*, *New York Herald*, *Chicago Daily Tribune*, *Los Angeles Times*, and much of the world press predicted a Japanese attack on the Philippines within five years at most.⁹⁰ War scares were buttressed by escalating military orders or agendas on both sides of the Pacific, which made an incident possible. For instance, in April 1907 the Imperial Defense Policy approved by the Japanese Emperor gave its navy the freedom to designate the United States as its most likely opponent, authorizing the construction of a modern fleet inclusive of battleships, cruisers, and

⁸⁹ American dollar diplomacy was initiated under Roosevelt as the administration decided to supervise the finances of Central and Latin American states to prevent British or German incursions into American waters. Between 1907 and 1909, there was a jump in quality in its exercise. Taft and Knox elevated international business to the position where they, rather than diplomats, represented the best interests of the United States overseas. See, amongst many, Beale (1956:157,326-28;332-334); Esthus (1959:46-51); Esthus (1966: chapters 8 and 11); Griswold (1938:87-132); Neu (1966:433-449); Kennedy (1987:247-248); Schulzinger (1984:39); Leopold (1962:chapter 18 and 19); Becker and Wells, *Economics and World Power*, chapter 4; John P. Campbell, "Taft, Roosevelt, and the Arbitration Treaties of 1911," *Journal of American History* 53:2 (1966), pp.279-298.

⁹⁰ "Note from the Japanese Embassy," October 25, 1906, Record Group 59, *General Records of the Department of State*, 1797/16, NARA; "Japan is warlike" and "Paris Thinks War with United States Inevitable," *Washington Post*, December 1, 1906; "Expect Japan war within five years," *Chicago Daily Tribune*, December 8, 1906; "Must Fight Japan," *New York Herald* December 11, 1906; "Europe expects a war," *Washington Post*, December 16, 1906; "Predicts war with Japan: Eminent Japanese urges his countrymen to prepare," *Los Angeles Times*, December 21, 1906; "Hawaii, the Philippines and American Pacific Commerce all at the Mercy of Japan's Many Effective Warships," *The Washington Post*, January 20, 1907; "Japan has War Plans: Believed destroyers could work havoc with battleships on the Pacific," *The Washington Post*, July 6, 1907; "Japan Must Secure the Philippines Islands: Manila Bay Believed Inevitable Destination of the Mikado's fleet," *Los Angeles Times*, September 8, 1907; "Russians Want Us to War with Japan," *New York Times*, December 1, 1907. See also Roosevelt to Charles Fairbanks, February 21, 1908, Morison (ed.), *Letters of Theodore Roosevelt* VI, pp.950-52. On the war scare, see Esthus (1966), chapters 8 and 11; and Bailey (1934:54-55). See also Chessman (1969:106,121-122); Leopold (1964:273-75); Sprout (1946):259-264.

destroyers (Evans and Peattie 1997:148-151; LaCroix and Wells 1997:1-4; White 1995:217).⁹¹ The Japanese government also signed an agreement with France in June 1907, and another with Russia in July 1907. Adding to the existing Anglo-Japanese alliance these understandings formed, potentially, a quadruple front against the United States and Germany (White 1995:256).⁹²

American leadership was not standing militarily idle, either. In October 1906, Roosevelt started to fear “a bitterly humiliating and disastrous [defeat] which would turn not only the Philippines but [also] Hawaii to Japan.”⁹³ Almost a year later, the Philippines still remained, in Roosevelt’s view, the United States’ “heel of Achilles,” and “all” that made the American “situation with Japan dangerous.”⁹⁴ The stationing of American ships in the Atlantic, the lack of a Panama Canal ready to use, and the absence of an American logistical base in the Pacific increased Roosevelt’s fear that a Japanese attack would find the United States unprepared or helpless. As a result, between December 1906 and March 1908, Roosevelt embarked on three tasks that would keep him occupied until March 1908: “pushing forward” battleship construction, guaranteeing a “formidable defense” of American naval bases in California and the Philippines, and completing canal works in Panama.⁹⁵ Not surprisingly, as displayed in Table 6,

⁹¹ The fleet consisted of a squadron of eight battleship and eight cruisers. It was to be supported by second-class armored cruisers and ocean-going destroyers. Japanese rearmament plans were stimulated by American rearmament plans, which, in turn, had originated from the Anglo-German naval race.

⁹² A quadruple alliance in the formal sense did not materialize, but attempts to bring it out in practice were made.

⁹³ Roosevelt to Senator Eugene Hale, October 27, 1906; Roosevelt’s letter to Cecil Spring Rice, December 21, 1907, pp.462-64; H.C. Barns, *The Secret Letters of Theodore Roosevelt*, New York: First Copper Square Press (2001), pp. 436-438; Manuscript Division, Library of Congress, Washington, DC.

⁹⁴ Roosevelt to Taft, August 21, 1907, *The Papers of William H. Taft*, reel 321, Correspondence with Roosevelt, Library of Congress, Manuscript Division, DC. Note that the fleet was kept in Atlantic and Caribbean waters to demonstrate American determination to uphold the Monroe Doctrine.

⁹⁵ Taft to Roosevelt, March 9; Roosevelt to Taft August 21, 1907; Taft to Roosevelt, August 31; Taft to Roosevelt, January 13, 1908; Roosevelt to Taft, January 15, 17; Roosevelt to Charles W. Fairbanks, February 29, 1908; Roosevelt to Victor Metcalf, March 9, 1908; Roosevelt to Henry Cabot Lodge, April 22, 1908; *The Papers of William H. Taft, Secretary of War*, reel 321, Correspondence with Roosevelt; *Theodore Roosevelt Papers*, series 1, reel 81; series 2, reel 347; Manuscript Division, Library of Congress, DC; *The Letters of Theodore Roosevelt*, John M. Blum, Alfred D. Chandler, Jr., and Sylvia Rice, editors, Harvard University Press, Cambridge Massachusetts, 1952, v. 6; Message of the President of December, 3, 1907; Roosevelt to Harrison G. Otis, a veteran of the Civil War and the Spanish-American war, January 8, 1907 and Roosevelt to Stone, July 26, 1907 in Elting E. Morison, *The Letters of Theodore Roosevelt*, Cambridge: Harvard University Press (1951), vol. V, pp.547, 728;

between 1907 and 1909 American military budgets reached the American pre World War I record level of 43-45 percent of total government spending, and, as revealed by much of Roosevelt's internal and external correspondence, Japan was the primary target of American rearmament efforts.⁹⁶

Additionally, in early 1907 the American Presidency and the Navy and War departments began to work on contingency war plans in preparation for a possible Japanese attack in the Pacific. Before 1906, neither service had seriously considered an invasion of the Philippines, but in January 1907, at the president's suggestion, the American Army and Navy undertook joint studies on the conduct of a possible war with Japan.⁹⁷

Between March and the summer of 1907, Roosevelt's alarm grew and his military orders intensified. In March the War Department was ordered to complete permanent fortifications in the Philippines and in California "as promptly and expeditiously as possible."⁹⁸ In June and July, Roosevelt directed the Navy Department to mount the advanced defense of Subwig Bay, resolving to send the American fleet on a practice voyage around the world as a precautionary war measure.⁹⁹ With the American blue-water navy heading to the Japanese coast, the Japanese-American security crisis reached its most intense stage. British Ambassador to the US (and Roosevelt's friend) Cecil Spring Rice expected that a Japanese-American war was about to begin

Roosevelt to Henry Cabot Lodge, April 22, 1908 in selections from *Selection from the correspondence of Theodore Roosevelt and Henry Cabot Lodge 1884-1918*, Vol.II, Charles Scribner's Sons, New York, 1925, Library of Congress, Washington, DC.

⁹⁶ Roosevelt to Secretary of State Elihu Root, July 13, 1907; Roosevelt to British ambassador James Bryce, June 10 1907; *The Secret Letters of Theodore Roosevelt*, pp.452-54; in July 1907, Roosevelt confessed to being "more concerned" over the situation with Japan "than almost any other."

⁹⁷ Admiral Dewey to Victor H. Metcalf, March 5, 1908, General Board Letterpress V, pp.196-201 in Braisted (1954:37).

⁹⁸ Admiral Dewey to Victor H. Metcalf, March 4, 1907, R.G. 80, File No.11406-159. NARA, DC. See also Morton (1949:95-104) and Braisted (1954:32,33).

⁹⁹ The fleet needed to be sent, as Roosevelt put it, to "show that it can be done," and avoid running the risk of "experimenting in a matter of vital importance in time of war." TR to Henry Cabot Lodge, July 10, 1907, and to Elihu Root, July 13, 1907, in Barnes, *Secret Letters*, pp.451-454; On this point, see also Beale (1956:328-29) and Esthus (1966: chapter 11); Roosevelt to Charles Fairbanks, February 21, 1908; TR to Cortelyou, April 19, 1908 in *The Letters of Theodore Roosevelt*, John Blum et al., p.1013. Fearing not only a war with Japan but a military defeat to Japan, the President even confided to Taft that he would award the Philippines independence rather than seeing United States lose them "under duress." Roosevelt to Taft, August 21, 1907. Morrison (ed.), *Letters of Theodore Roosevelt* V, pp.761-62.

at that point.¹⁰⁰ Hawaiian governor G.W. Carter claimed that Hawaii would be taken hands-down, while Senator Latimer of South Carolina was ready to give the Philippines to Japan to put an end to the war scare.¹⁰¹ In the spring of 1908, American rearmament stopped and the fleet returned home.

The described American military preparations show that, in 1906 and the first half of 1907—when the global financial crisis had not fully reached the United States—President Roosevelt could behave as if he were in LA–LE, pushing forward its financial and national security agenda. Showing low exposure to the demands of high finance, the President firmly stood his ground vis-à-vis notable financiers, like Andrew Carnegie, who demanded a reduction in national military spending.¹⁰² Like President Harrison had done during the global financial crisis of 1890-91, Roosevelt’s first response to this crisis was to ignore the demands of high finance and strengthen American defense. By doing so, however, he fueled the war scare and hastened the outbreak of financial crisis in the United States. Indeed, it was not a coincidence that worsening financial conditions in the United States and the Japanese-American war scare peaked exactly in the second half of 1907, as the two events fueled each other. *The Washington Post* made this clear in June 1907, when it reported that London brokers had sold an estimated total of 15,000 shares on the New York Market chiefly owing to the Japanese-American situation (“War Scare in Wall Street: Liquidation starting from London depresses stocks”).¹⁰³ In other words, the war scare was causing losses to Wall Street, and Wall Street, in turn, could find further reason to believe that a war was imminent, fueling further war rumors and further

¹⁰⁰ Taft to Roosevelt, July 26, 1907; Roosevelt to Admiral William Brownson, July 26, 1907; Roosevelt to Taft, August 21, 1907; Roosevelt to Cecil Spring Rice, December 21, 1907. See also Krauss and Nyblade (2004:122-24).

¹⁰¹ “Hawaii at Japan’s mercy,” *the Washington Post*, June 30, 1907; “Give Philippines to Japan: Senator Latimer suggests that it would settle the war scare,” *New York Times*, July 14, 1907.

¹⁰² Roosevelt to Andrew Carnegie, March 28, 1906, and August 6, 1906 in Brands, *The Secret Letters*, pp.410-11;423-424.

¹⁰³ Newspapers of the times could not describe this phenomenon any better. See, for instance, “War Scare in Wall Street,” *Washington Post*, June 2, 1907; and “War Scare Affects American Stocks,” *New York Times*, October 6, 1908.

liquidations. As expected, after the spread of the financial crisis in the United States in the second half of 1907, government exposure to high finance was high, and the administration found itself in LA–HE. Assertive military measures could no longer withstand the wrath of high finance as easily as they had previously. In various exchanges with Secretary of War William Taft in the fall of 1907, a frustrated President complained of the “senseless folly” of American “high financiers” who resolutely attacked the administration and “objected” to the American fleet going to the Pacific.¹⁰⁴ The pressures of high finance on Roosevelt’s policies continued through November 1907 as Wall Street, once again, warned the president not to “demand an increase in the navy” or “alarm” would “spread through the country and through the world” at the worst “juncture.” Andrew Carnegie kept reminding Roosevelt that the United States should have followed the example of Great Britain, which had apparently reduced its shipbuilding program for 1907 and, “in all probability,” would have done the same in 1908.¹⁰⁵

The president defended American military efforts to balance Japan against the demands of high finance as strongly as he could. He briskly replied to Carnegie that naval rearmament had to be pushed forward and evocatively wrote that he would not “‘surrender’ to the bankers,” or any “‘secret midnight conference’ with any big financier, or anyone else.” In February 1908, the president gave orders to fortify Pearl Harbor and informed congressional authorities of his determination not to let “considerations as to the needs of the economy” offset “the greater need of guaranteeing the preservation of peace, honor and national interests.”¹⁰⁶ This resolve on the

¹⁰⁴ Roosevelt to Taft, September 5 and September 19, 1907, *The Papers of William Taft*, reel 495.

¹⁰⁵ Andrew Carnegie to Roosevelt, November 18, 1907; *Theodore Roosevelt Papers*, series 1, reel 79; Roosevelt to Mr. Schroers, November 11, 1907; *George Cortelyou Papers*, “General Correspondence, Box 62; Roosevelt letter to Douglas Robinson, *Theodore Roosevelt Papers*, series 2, reel 347; Emlen Roosevelt to Roosevelt, December 23, 1907 and T.E. Watson to Roosevelt, December, 16, 1907 in *Theodore Roosevelt Papers*, series 1, reel 80.

¹⁰⁶ Roosevelt to Carnegie, November 19, 1907; Roosevelt to Thomas E. Watson, November 12, 1907, *The Secret Letters*, p. 459. Roosevelt letter to Henry White, November 27, 1907; Roosevelt to Cecil Spring Rice, December 21, 1907; Roosevelt to Thomas E. Watson, December 21, 1907; *The Secret Letters*, pp.461-66; Roosevelt to Charles Bonaparte, January 2, 1908; Roosevelt to Charles Fairbanks, February 21, 1908; Roosevelt to Victor Metcalf, March 9, 1908; and Roosevelt to Cortelyou, April 19, 1908

part of Roosevelt signals that the President attempted to behave as if LA–LE could occur, and the administration could overcome the crisis by relying on the national advantages of pursuing greater assertiveness in military spending, threat assessment, and war prospects, *and* having business activities resume as normally as possible. History proved him wrong.

In the end, the administration’s necessity to side with financial elites to solve the crisis, differently from what had occurred after February 1895, counteracted ongoing attempts at balancing Japan.¹⁰⁷ Roosevelt eventually promised to do “everything in [its] power” to revive financial confidence: this statement, and the policy decisions that accompanied it, dampened war prospects and softened diplomatic and military tensions between Washington and Tokyo.¹⁰⁸ The propaganda campaign that the State Department started in late April 1907, just as the financial crisis gained momentum in the United States proves this point. Between April and December 1907, Secretary of State Elihu Root issued statements on the “groundless” nature of the Japanese-American war scare, and on the continuing “friendship,” “absence of friction,” “harmonious path,” “enduring peace,” and “unthinkable war” between Washington and Tokyo. American papers started publishing “calm statements of reason” by the Department of State over the “absurdity” of a Japanese-American conflict in view of the “respect and love” Americans felt for Japanese state officials. This discourse served to reassure financial markets that there was nothing to fear; that international financial cooperation would continue; and that Japan stood in “good faith.” *The Washington Post*, *Wall Street Journal*, and *Chicago Daily Tribune* concluded

in *The Letter of Theodore Roosevelt*, Blum et al.; Confidential letter to the Speaker of the House February 29, 1908, *Theodore Roosevelt Papers*, series 2, reel 347.

¹⁰⁷ As the international gold standard triumphed abroad, and the United States risked being excluded from it, the costs of behaving as between 1895 and 1898 became increasingly clear to the American public and the administration. Further scrutiny into the preferences of the American public and how they influenced the administration might be needed.

¹⁰⁸ Roosevelt became increasingly concerned about the national financial situation as his reassurance speeches regarding the nation’s sound economic position failed to instill business confidence throughout 1907. In December 1907, the President confessed to being “under great strain with financial matters” and to “have more difficulty with the currency than anything else.” Roosevelt to Emlen Roosevelt, December 13, 1907; Roosevelt to T.E. Watson, December 16, 1907; *Theodore Roosevelt Papers*, series 1, reel 80; Roosevelt to Cecil Spring Rice and T.E. Watson, December 21, 1907, *The Letters of Theodore Roosevelt*, Blum et al.

that financial interdependence between Washington and Tokyo could only draw the two countries together and that “the mere thought of war” would have been, in the words of Japanese vice-finance minister Reiziro Wakatsuki and Japanese ambassador to the US Aoki, “a grave injury to civilization.”¹⁰⁹

Secretary of War Taft, too, committed to publicly downplaying the prospects of a war with Japan to help relieve national financial conditions and respond to Wall Street’s outcry. While visiting Japan in early October 1907, Taft delivered a sensational speech in which he condemned American jingoists as “infamous” and “criminal.”¹¹⁰ It is unlikely that these public declarations would have been made had they not been necessary, and perceived as necessary, in refueling the confidence of American financial interests and increasing the appeal of presidential candidate Taft amongst Wall Street financiers and a large majority of the American public—who, after 1900, had come to depend on the international gold standard as never before.¹¹¹ As Japanese Minister of Foreign Affairs Count Hayashi noted in December 1907, disavowing assertive national designs created the unfortunate impression that some critical military situation was being covered up. Covering up and making his platform as appealing to Wall Street was exactly what Taft was doing when he delivered his speech in Tokyo. The American fleet had started its journey to reach the Japanese coast. Albeit unsound from a military point of view, Taft’s allusion to war as a criminal act gained points within financial circles, painting him as the “honest” man high finance needed.

¹⁰⁹ “Japanese War Scare Groundless Root Says,” *Chicago Daily Tribune*, April 20, 1907; “Japan’s Future and the United States Along Harmonious Path,” *Wall Street Journal*, June 9, 1907; “Why War is Unlikely: Notwithstanding our Misunderstandings with Japan,” *Washington Post*, June 30, 1907; “US War with Japan? No, Says Envoy Aoki,” *Chicago Daily Tribune*, July 4, 1907; “Why Japan wants no war: Lack of money, if nothing else, would prevent it at this time,” *Washington Post*, August 18, 1907; “War with Japan Out of Question: Tokyo in Good Faith,” *Chicago Daily Tribune*, December 5, 1907.

¹¹⁰ Taft’s visit to Japan had been decided by Roosevelt in late September 1907 while Secretary of War Taft was visiting the Philippines to make sure that military plans proceeded expeditiously. The visit had two major goals: calming transnational business and investigating Japan’s military preparedness. Taft to McIntyre and to TR, October 4, 1907; *The Papers of William Taft*, reel 495; “War is a Crime, Taft tells Japs,” *Cable to the Chicago Tribune*, October 1, 1907; “Taft Removes Cloud,” *Washington Post*, October 1, 1907; “Tokyo Cheers Taft’s Message of Peace,” *Los Angeles Times*, October 2, 1907.

¹¹¹ In the US, a gold standard had been the only legitimate national financial system since 1900.


By the same token, this propaganda campaign to stir business confidence worked entirely against the rallying of Congressional support around Roosevelt's military agenda. In March and April 1908, the rearmament plans that the administration had since then successfully advocated were halted in both the House and the Senate. The requested increases in naval appropriations to match "four battleships in the Japanese fleet" that were "superior to any four [American]" were blocked in Congress due to "harmonious relations between the United States and Japan" and the obstacles that further rearmament attempts would pose to the "gospel of peace throughout Asia." Strengthening the cause of high finance and paving the way for the triumph of international financial cooperation over a worsening security dilemma, Congress had concluded that there was "nothing to provoke the multiplication of American battleships."¹¹² By late 1907, the President, too, was aware that the realization of his military agenda was being hindered by the political alliance between the administration and high finance established to solve the financial crisis. Early in 1907 he would carelessly voice his concern in Congress about the Japanese threat and the necessity of keeping the navy at the highest point of readiness as he had done in early 1907. By later that year, however, he knew that using Japanese-American tension to influence Congress would have meant trouble: thus, when high financiers objected to the fleet going to the Pacific in October 1907, Roosevelt ordered that all military measures, including those related to the voyage of the fleet, be conducted "as quietly as possible."¹¹³ Had preparations not proceeded quietly, domestic outcry would have compounded financial and economic recovery.

¹¹² Roosevelt to Metcalf, March 9, 10, 28, 29, 1908, and Roosevelt to Cabot, April 22, 1908, in *The Letters of Theodore Roosevelt*, Blum; Roosevelt to Taft, April 16, 1908 *The Papers of William Taft*, reel 321; "Hale Attacks Taft: Clash Over Army Plan," *Washington Post*, April 8, 1908; "Two Are Enough," April 10, 1908, *Chicago Daily Tribune*; "Big Navy Needed, Says Taft," *Chicago Daily Tribune*, April 11, 1908; "Naval Plan Causes Clash: Congressman Hobson Fears Nation is in Grave Peril," *Chicago Daily Tribune*, April 12, 1908. The Naval Appropriation Bill originally foresaw the creation of eight battleships to curb Japanese ambition. Only two were approved in 1908.

¹¹³ Taft to Roosevelt August 31, 1907, *The Papers of William H. Taft*, reel 321; Taft to Roosevelt, October 18, 1907, RG 59:1797/383, NARA. See also Neu, "Roosevelt and the Far East," p.441.

Gradually and as expected, the administration had to pull back ambitious security policies. As Table 6 shows, starting in the spring of 1908, American military spending stopped growing. Similarly to what occurred in Italy after the financial crisis of 1893-94, American military appropriations from 1909 onwards were consistently, or “orthodoxly,” firm at the ceiling of 41 percent of total government spending. This was not coincidental, as evidence shows that American business elites throughout 1907 and 1908 openly supported the adoption of stable military budget “quotas.”¹¹⁴ More importantly, in May 1908, military withdrawal from the Pacific began: the war vessels placed in defense of the Philippines and Hawaii—those vessels that were supposed to resist a Japanese attack as the American fleet mobilized—returned home. During the same month the *Indianapolis News*, under “Why Wall Street Switched to Taft,” reported: “Something happened which convinced Wall Street that Taft is the man for it.”¹¹⁵

Table 6. American military spending (ME), GNP, and government spending (CGE), 1880–1897 (in million \$)

Year	Real ME	Real CGE	Real GNP	ME/ GNP	ME/ CGE	CGE/ GNP
1900	189	516	18694	0.01	0.37	0.028
1901	204	520	19991	0.01	0.39	0.026
1902	178	480	21180	0.008	0.37	0.022
1903	196	503	22099	0.009	0.39	0.022
1904	266	578	22828	0.012	0.46	0.025
1905	246	573	25043	0.010	0.43	0.023
1906	243	560	27171	0.009	0.43	0.020
1907	237	556	28442	0.008	0.43	0.019
1908	299	671	28765	0.011		0.024
1909	314	707	31647	0.010	0.44	0.023
1910	272	664	31793	0.008	0.41	0.020
1911	283	691	33712	0.008	0.41	0.021
1912	277	672	35502	0.008	0.41	0.018
1913	288	703	37610	0.008	0.41	0.018

A few months later, the battle-fleet also made its way to American shores, while Roosevelt was called to deny that he had ever contemplated a war against Japan. The portrayal of a relationship of mutual “gratitude” and “friendship” between Washington and Tokyo replaced previous allusions to an impending war. Japan “shuddered” at the idea of war, it was said, and fully committed to deflationary orthodoxy and cuts to the military budget.¹¹⁶ By 1909, the United States and Japan were no longer on the brink of war. Diplomatically, and militarily, they were moving away from power balancing.

The shift away from power balancing occurred in three stages. It started with Taft’s visit to Japan and the Asian mainland in late 1907, and the anti-war, pro-business speeches that he delivered throughout the journey.¹¹⁷ It then gained momentum throughout 1908, as American financial elites reached the pinnacle of their power vis-à-vis the administration because, as discussed earlier, the administration needed their complicity to quell the financial crisis and restore business confidence. Lastly, the shift became a reality with Taft’s electoral victory in 1908, thereby confirming once again the relevance of this variable for studying the national security influence of financial crises in the American context.¹¹⁸ In 1908, Taft was Wall Street’s honest man as much as Cleveland had been in 1884 and 1892.¹¹⁹ As explained in *The Washington Post* of October 18, 1908, one major issue set Taft on a different level from his competitors to the Presidency: his support of a foreign policy of market enlargement and financial penetration on the Asian mainland. As *The Post* wrote, Taft had the advantage of

¹¹⁶ “War scare has Subsided: Secretary Metcalf Says the Navy Beats Diplomacy,” *Los Angeles Times*, May 18, 1908; “Roosevelt Denies Remark Touching War with Japan: Hobson must be misquoted,” *Chicago Daily Tribune*, July 10, 1908. “Japan Shudders At War: Mikado’s Representative Says His Country is Grateful to United States,” *New York Times*, July 11, 1908; “Japan’s Economies Severe: They Involve Heavy Sacrifices in Navy and Army Expenditures,” *New York Times*, September 15, 1908; “Our Fleet in Japan,” *New York Times*, October 20, 1908; “Friendship with Japan,” *Washington Post*, February 4, 1909.

¹¹⁷ See in particular “Taft’s Significant Shanghai Speech,” *New York Times*, November 24, 1907; and “Taft Ridicules Japan War Talk: War Chief Tells Easterners There’s No Possibility of Conflict,” *Washington Post*, February 20, 1907.

¹¹⁸ Roosevelt had decided not to run for President in 1908, a decision that he later regretted; he supported his Secretary of War, who would have disappointed him later. Roosevelt letter to Kermit Roosevelt, January 27, 1908, *The Secret Letters*, pp.74-5.

¹¹⁹ “William Taft is Wall Street’s man,” *Indianapolis News*, May 19, 1908.

“realizing that the amazing industrial growth of the US” made the creation of new markets abroad “an imperious necessity.”¹²⁰

With the installment of the Taft-Knox administration in 1909, US leadership openly legitimized national security policies that were tailored to the desires and protection of financial elites. American leaders embarked on the very same plan that Roosevelt had consistently opposed during his two terms as president—the overly ambitious agenda of “civilizing” regions of the world through the promotion of international financial competition.

The contrast between this American foreign policy and pre-1907 American national security objectives was explicitly and enthusiastically acknowledged by the new administration.¹²¹ A “crusade for peace” only on paper, the new foreign policy transferred international competition from the military to the economic sphere and made it universal and perpetual—as opposed to localized and intermittent, as it had been in the pre-1907 context and as Roosevelt understood it.¹²² Knox’s 1909 neutralization proposal and, during the same year, the linked establishment of an international investment consortium in China killed the spirit of the Open Door and sowed the seeds of the forthcoming Chinese Revolution of 1911 and 1912. Thus, in creating the conditions for transferring competition from the military sphere to the economic sphere, the financial crisis of 1907-08 still increased the probability of conflict, though the results

¹²⁰ “Taft Foreign Policy: One Important Point in which He and Bryan Differ,” *Washington Post*, October 18, 1908; “Talks of Money and Taft,” *Los Angeles Times* March 19, 1908. *The Post* also wrote, “Mr. Bryan evidently has no conception of that greater America which Mr. Taft sees so clearly and would work to build up. Mr. Bryan’s political outlook does not extend beyond our Atlantic and Pacific seaboard. Mr. Taft’s view sweeps over a wider area”.

¹²¹ Many members of business and/or political figures like William Straight and Francis M. Huntington, who staunchly opposed Roosevelt’s pro-Japanese and investment-shy Asian stance, were now promoted to high-ranking positions. William W. Rockhill was removed from the scene and sent from Peking to St. Petersburg in May 1909. Inaugural Address of William H. Taft, March 4, 1909; “Diplomatic Changes: Taft’s Appointments to Foreign Policy Posts Meet With Strong Approval,” *Washington Post*, December 22, 1909; “Carnegie Aids Peace Crusade: America’s Aim Stated,” *Chicago Daily Tribune*, May 30, 1909; “President Taft Delighted,” *New York Times*, July 16, 1909; “Germany is Warned of Our New Policy: Chinese Loan First Step,” *New York Times*, July 18, 1909. On Taft and Knox’s “dollar diplomacy,” see Ferrell (1957: chapters 9 and 10); Esthus (1966: chapter 14); Schulzinger (1984:39); Beale (1956:333).

¹²² Archival evidence shows that between Taft’s electoral victory and the installment of the new administration, Roosevelt tried to resist the national security change. In a few letters to future Secretary of State Philander Knox and future President Taft, TR stressed the necessity of maintaining good relations between United States and Japan and preserving the existing spheres of influence in China, as Japan needed to “feel safe” and be prevented from “attacking the United States” down the road. TR to Knox, February 8, 1909; and TR to William H. Taft, March 3, 1909, *The Secret Letters*, pp.510-515.

were not fully visible until a few years after the crisis. Moreover, international financial competition in Manchuria did not improve American relations with Japan or Germany, or among Japan, Russia, and China. Rather, it involved all nations in complex political entanglements that, along with the ambitious goals of the new foreign policy course, pointed towards a far less cautious American foreign policy stance. Notably, unleashing international financial competition in China was an option that the Roosevelt administration had deliberately shunned, as this promised to disregard Japanese and Russian security interests and negatively affect Chinese territorial integrity.

Thanks to the financial crisis, war scares and mutual suspicions between the American and Japanese leaderships were quelled, and military competition in the Pacific was replaced with financial and economic antagonism. Being in LA–HE caused this redefinition or change of direction of American national security policies. As historians like Howard Beale and Raymond Esthus have observed, in late 1906 and early 1907 the Open Door policy and the strategy of international balancing that underpinned it were more established in Asia than ever before. The policy enjoyed the full backing of prominent Japanese, French, and Russian statesmen as well as a large majority of American diplomats, including Secretary of State Root and the American minister to Peking William Rockhill.¹²³ Ito Sajonji, prominent Japanese statesmen like Foreign Minister Tadasu Hayashi, and important Japanese newspapers similarly favored a strict observance of the Open Door.¹²⁴ More remarkably, respect for China's sovereignty, a foundational principle of the Open Door and power balancing, was also very successfully upheld by Roosevelt when he used the threat of force to defend American trading rights against Chinese

¹²³ Beale (1956:121;333) and Esthus (1966:34).

¹²⁴ The *Nichi Nichi Shimbun*, the paper of Foreign Minister Takaaki Kato, stated that nothing would be more detrimental to Japan than violating the principle of the Open Door. The leading newspaper *Jiji Shimpō* agreed. *Jiji Shimpō*, March 28 and April 25, 1906, and *Nichi Nich Shimbun*, April, 11, 1906, in Beale (1956:121;333) and Esthus (1966:34).

boycott and staunchly stood against further Japanese incursions into Manchuria in 1905-06.¹²⁵ Roosevelt *intended* to keep balancing Japan in 1907 and 1908, but his crisis resolution strategy—that is the strategy that he needed to endorse to solve the crisis—prevented this, forcing him to opt for greater international financial cooperation and greater national security caution. American Asian policy was therefore transformed. In 1907, given the strengthening of relationships among Japan, Russia and France, balancing Japan would have required the United States to form an American-German-Chinese entente. Although this relationship was actively pursued by Germany and China, the United States did not consider it. Instead, in July 1908 Washington signed the Root-Takahira agreement, which reinforced Japan's position in Eastern Asia by isolating China diplomatically and drawing the United States much further into the treaty network by granting special privileges to foreigners in the Chinese Empire.¹²⁶ Successful balancing would also have required an increase in military build-up between 1907 and 1910, but, as explained earlier, was stopped when the war scare intensified.

Ultimately, the argument that the Japanese–American security crisis was solved through balancing diplomacy—an argument derived from existing IR theory on power balancing—is unconvincing.¹²⁷ In actuality, its resolution lay in the defense of sound financial and trade relations between Washington and Tokyo to relieve the confidence of high finance and escape financial crisis. It also seems likely that, in the absence of the financial crisis, American business elites would not have persuaded Roosevelt's administration to backtrack from the pursuit of an

¹²⁵ Roosevelt dispatched battleships to Asia and threatened the Chinese government with military intervention to end the Chinese boycott of American exports (1905-06). Five destroyers were sent to Canto, two cruisers went to Shanghai, a battleship squadron arrived in Hong Kong, and a warship was transferred from Chefang. On this point, see Beale (1956:213) and Riccards (2000:55). The Open Door doctrine or policy, coined by Secretary of State John Hay in 1900, justified and defended Chinese territorial integrity and international spheres of influence in China for trade and commercial purposes. Roosevelt to Cecil Spring Rice, June 13, 1904; Roosevelt to Baron Kentaro Kaneko, May 31, 1905; TR to Elihu Root of July 13, 1907; TR to Cecil Spring Rice, June 16, 1905, in Brands, *The Secret Letters of Theodore Roosevelt*, pp.361-362 and pp. 381-385. Esthus (1959:435-454).

¹²⁶ Reid (1935:34); and Bailey (1940:28-29).

¹²⁷ Roosevelt to Cecil Spring Rice, June 13, 1904; Roosevelt to Baron Kentaro Kaneko, May 31, 1905; TR to Elihu Root of July 13, 1907; TR to Cecil Spring Rice, June 16, 1905, in Brands, *The Secret Letters of Theodore Roosevelt*, pp.361-362 and pp. 381-385. See also Dennett (1924:15-21), and Reid (1940:66-70).

assertive foreign policy towards Japan; the Roosevelt administration would not have felt pressured to abandon its military plans in the Pacific to resolve the crisis and restore business confidence; the American rearmament program would have continued; the public defense of an alleged “enduring friendship” between Tokyo and Washington would have been much less necessary; the American Japanese conflict would have escalated much more easily; American–Asian policy would have focused more on the Pacific than on the Asian mainland; and President Taft and his administration would have adopted a less pro-business set of national security policies. US diplomatic and military policies would have manifested significant differences.

MILITARY CAPITULATION VERSUS GREATER NATIONAL DEFENSE:

Hoover, Roosevelt, and their different approaches to crisis resolution and American security

In contrast to the financial crises discussed so far, the national security influence of the financial crisis of 1929-33, more commonly known as the Great Depression, has been long acknowledged. Robert Ferrell concluded as early as 1957 that, “more than any other single factor,” the Great Depression “palsied” American statesmen’s hands, resulting in a timid diplomatic and military response to the disruption of peace in the Far East and the rise of a threatening new order in Europe.¹²⁸ Since then, works at the intersection of international political economy and security studies (Trubowitz 1998:159,160,163; Narizny 2007:107,146) as well as a number of historical studies (Divine 1961; DeConde 1989; Doenecke and Stoler 2005; Schmitz 2007) have acknowledged that the Depression constrained the American national security agenda, curbing the military budget and reinforcing the isolationist, defensive, and anti-military tendencies in American foreign policy. From this perspective, which the American State Department shares, the collapse in state revenues and the related need to rescue the regions or

¹²⁸ Ferrell (1957:5, 278, and chapter 2).

sectors of the country most affected by the Great Depression created strong incentives within the administration and Congress to economize on armaments, compounding the development of a timid foreign policy and American disinterest in war.¹²⁹

This analysis emphasizes a distinct but equally important aspect of the influence of the crisis of 1929-33 on American national security policies. Specifically, the diverse exposure to high finance characterizing the crisis responses of Hoover's and Roosevelt's cosmopolitan administrations channeled American military spending, threat assessment, and war prospects towards extreme prudence if not military surrender under Hoover, and an indeterminate agenda with new assertive avenues under Roosevelt. In other words, although American national security policies remained much closer to internationalism than assertiveness for most of the decade and throughout both administrations for reasons that have been amply shown in the literature, Roosevelt's diplomatic and military *intentions* were much less timid than commonly recognized by existing accounts on the national security influence of the Great Depression. This lessened timidity was largely due to the low exposure to high finance at the core of the New Deal.

Notably, throughout most of the 1930s, as was true throughout most of the 1920s, American national security policies had an inherent, unprecedented bias towards caution or internationalism in security affairs (Trubowitz 1998:96-168; Narizny 2007:147). In 1923, for instance, the share of total government spending going to defense was lowered by 20 percentage points compared to the prewar years, and remained there for several years.¹³⁰ This cautionary bias was primarily a reaction to the Great War, its deleterious military and financial consequences, and the resulting American shift towards isolationism. Second, national security

¹²⁹ <http://history.state.gov/milestones/1921-1936/GreatDepression>

¹³⁰ *Historical Statistics of the United States*, Washington, DC: Bureau of Census, U.S. Department of Commerce (1975), Millennial Edition Online, Cambridge University Press. See also Hoff (1971:48-50); Offner (1975:80); and Eloranta (2003).

prudence was intrinsic to the post-World War I, Anglo-American architecture of world economic reconstruction—an architecture that depended upon the promotion of international peace and disarmament efforts, was initiated by the Washington Treaty of 1921-22, and was carried forward at the Geneva Disarmament Conference of 1927, the London Naval Conference of 1930, and the Geneva Disarmament Conference of 1932-34.¹³¹

Linked to the presence of weighty reasons for pursuing a cautionary set of national security policies, the impact of a number of other variables and related snowballing effects that influenced national security policies in this period complicates an analysis of the national security influence of the financial crisis of 1929-36, and renders problems of multi-causality, multicollinearity, and over-determination particularly daunting to solve. In the 1920s, and even more so in the 1930s, for instance, American national security policies were also affected by the workings of a flawed international financial system; the greater political relevance of previously marginalized domestic groups; and the concomitance of financial crisis with crises in the agricultural, farm, and real estate sectors. Determining the relative weight of these factors versus that of the financial crisis is a complicated enterprise and one into which this work does not venture. Despite these analytical constraints, the following pages suggest that the framework's scenarios, particularly scenarios HA–HE and HA–LE, are as analytically useful to discern the national security influence of this crisis-period as they have been for the examined crisis periods.

Validating the formulated expectations, between 1930 and 1932 the financial crisis led the Hoover administration to escalate its pre-crisis national security caution. To begin, significant reductions in military spending were deemed necessary to solve the crisis and implemented at

¹³¹ As Herbert Hoover stated when he was Secretary of Commerce in October 1922, a message earnestly repeated thereafter by President Warren Harding and Calvin Coolidge, “reductions in armaments” were “contributing to the balancing of budgets and the cessation of inflation” and, ultimately, world economic recovery and growth. Hoover’s address at Toledo, Ohio, October 16, 1922 in Records of the House, 67th Congress (1921-23), Committee on Foreign Affairs, Box 392, HR 67A-F17.7, NARA. DC.

least twice between 1930 and 1932. As Table 7 displays, American defense spending was on the rise when the stock market crashed in October 1929. The ascent had begun in 1927, after the failure of the international disarmament talks in Geneva and growing fears of arms races (Dewey 1968:536; Carlton 1968:573-598; Offner 1975:78; Rhodes 2001:69).¹³² In an attempt to strengthen American diplomatic leverage and reignite international cooperation on naval disarmament, the Coolidge administration had amended the cautious set of national security policies pursued since 1923 with a slightly more assertive program of military spending.¹³³ President Hoover initially carried forward his predecessor's "tougher"—or, more appropriately, "less dovish"—military stance and passed legislation that increased military spending for four years, from July 1929 to July 1933, just a few months before joining Britain, France, Japan, and Italy in London for the London Naval Conference held January-June 1930.¹³⁴

By late 1931, this greater military vigor had come under criticism and the American cruiser program begun under Coolidge had been abandoned, allowing the US Navy to fall, numerically at least, far behind Great Britain and Japan (Rhodes 2001:79). Archival evidence shows that the administration's efforts to stop the spread of the crisis demanded military retrenchment. As Hoover explained at the opening meeting of the International Chamber of Commerce in May 1931, "arms cuts" and "world disarmament" were primary factors in

¹³² At the Geneva Conference of 1927, cooperation failed due to incompatible goals between the Americans and the British over whether large or small cruisers needed to be protected. Fearing British armed merchantmen, the Coolidge administration insisted on the right to build large rather than small cruisers and arming any small cruisers with eight-inch guns. The British refused to abandon their naval supremacy in cruisers. France and Italy had declined to attend the conference.

¹³³ A diluted Naval Construction Act for the buildup of fifteen cruisers was therefore authorized in February 1929 while dialogue with Britain and Japan over the upcoming naval conference in London continued in the spirits of the Kellogg-Briand pact of war renunciation approved by Congress. The Act, which President Calvin Coolidge had strenuously backed in view of the waning bargaining leverage against Britain at disarmament meetings in 1927, was diluted by a clause providing for its suspension if a naval limitation agreement became a reality. On these developments, see Hagan (1991:276-279).

¹³⁴ President Hoover's Press Conference Statement of July 23, 1929 in William S. Myers, *The State Papers and Other Public Writings of Herbert Hoover*, vol.1, New York: Doubleday, Doran and Company (1934), p.76; Message of the President to Congress, December 3, 1929, *Senate Journal*, 71th Congress, 2nd session and special session 1929-1930; *Memoirs of Herbert Hoover: The Cabinet and the Presidency*, 1920-33, New York: MacMillan (1951), p.330; James T. Shotwell, "The London Conference: Parity for Defense and the Impossibility of a Purely Mathematical Adjustment," *New York Times*, March 12, 1930; James T. Shotwell, "Navies and Policy: Necessity of Deciding Whether Naval Armaments is to be Determined by the Needs of Defense," *The New York Times*, March 14, 1930; "Outlines Naval Treaty Success," *Wall Street Journal*, May 13, 1930; "Prosperity Glimpsed by Occasionally in 1930," *Los Angeles Times*, December 28, 1930.

“encouraging the revival of world business.” Along similar lines, in the following days and months “sharp economies in national defense budgets” and “particularly the naval budget” were described by the administration as “necessary” for promoting a “vast plan of *capital* expenditures” and promoting the “rehabilitation of the country.”¹³⁵ In the words of Treasury Secretary Odgen Mill, “drastic reductions in arms expenditures across the world and at home” were “essential” for their “profound,” “psychological” promise of stirring business out of the “present lethargy.”¹³⁶

Table 7. American military spending (ME), GNP and government spending (CGE), 1926–1937 (in million \$)

Year	Real ME	Real CGE	Real GNP	ME/ GNP	ME/ CGE	CGE/GN P
1926	583	2916	96736	0.006	0.200	0.030
1927	586	2899	97187	0.006	0.202	0.030
1928	665	3005	99113	0.007	0.221	0.031
1929	696	3127	103900	0.007	0.222	0.030
1930	753	3405	94359	0.008	0.221	0.037
1931	813	3970	85562	0.009	0.205	0.051
1932	795	5274	67011	0.012	0.151	0.089
1933	683	4849	59786	0.011	0.141	0.085
1934	524	6443	64291	0.008	0.081	0.097
1935	694	6342	71945	0.009	0.109	0.0861
1936	903	8321	83000	0.012	0.108	0.099
1937	905	7472	76404	0.010	0.121	0.081

The intensification of Japanese military incursions in the Far East between late 1931 and early 1932 stirred fears in California over United States’ naval weakness, raising voices in Congress to stop ongoing cuts to national armaments.¹³⁷ But the world disarmament conference

¹³⁵ “Hoover Urges Arms Cut to Revive Trade in Opening World Chamber of Commerce, Special cable to the *New York Times*, May 4, 1931; “Plea for Reduction of Armament as Essential to Peace and Prosperity,” Hoover’s Opening Address at the Opening Meeting at the Sixth General Congress of the International Chamber of Commerce, Washington DC, May 4, 1931; Stimson to Hoover, several messages, May 27, 1931; in *Stimson’s Papers*, reel 81. “Cabinet Inquiry Into the Financial Situation of the Government: Hope for Relief in Expenditures,” July 18, 1931; “Drastic Economies in Public Expenditures are proposed with special reference to Naval Budget,” October 16, 1931; Announcement of Reductions in Departmental Budgets,” Hoover’s Press Statement, November 6, 1931; in Myers, *The State Papers*, vol.1, pp.358, 558, and vol.2, pp.11, 27.

¹³⁶ Mill to Young 12/16/1932; Mill’s preliminary draft Jan. 1932; and “Undermining Confidence,” *New York Herald Tribune*, 10/05/1933, in *The Papers of Odgen Mills*, Box 11, General Correspondence, Manuscript Division, Library of Congress, DC.

¹³⁷ “A Feeble Navy, *Washington Post*, August 10, 1931; “Uncle Sam’s Navy Weakness: Our Perilous Inferiority at Sea Both to Japan and England,” *Los Angeles Times*, January 17, 1932. *Congressional Record*, 72nd Congress, 1st session, January 2, 1932,

of 1932 was about to begin in Geneva, and the Hoover administration was committed to going full speed ahead with its disarmament plans. Hoover further solidified America's extra cautious military stance by offering, during Geneva's inconclusive disarmament talks, a radical plan for scrapping one-third of all arms. This proposal marked the capitulation of the American Navy. On January 1, 1932, the United States had in commission only 148 fighting vessels of all classes, compared to 187 for Great Britain and 219 for Japan. By December 31, 1932, the American Navy was down to a mere 101 compared to 140 for Great Britain and 184 for Japan.¹³⁸ Hoover's maneuver is especially striking if one considers that it was proposed *after* Hugh Gibson, the American delegate to the Geneva disarmament conference, had alerted the State Department that further American initiative on the disarmament front needed to stop, the American fleet being already far below the limits of the London Treaty.¹³⁹

Not surprisingly, national military spending for the year 1932 exhibited a 10 percent decrease compared to its 1931 levels (Table 7). Had the financial crisis not occurred, there would have been no reason for these cuts to be as swift and radical as they were. The commitment of the Hoover administration to attempt to respond to the financial crisis in central Europe and Britain starting in May 1931 provides exactly that reason.

Although the influence of the financial crisis on American threat assessment and war prospects is possibly less striking than the examined influence of the crisis on military spending, evidence indicates that the crisis tilted the Hoover administration towards a softer assessment of the Japanese threat than would have otherwise occurred. Indeed, the administration's primary commitment to rescue the international gold standard from collapse and win the confidence of

p.2948-49; "Hoover and Cabinet Act," *New York Times*, February 1, 1932 "Crisis in East Stirs Congress Activity," *The New York Times*, February 2, 1932.

¹³⁸ See in particular Mitchell (1946:278,292); and Rhodes (2001:69).

¹³⁹ Hugh Gibson to Stimson, June 4, 1932, *Stimson's Papers*, reel 83; "New Role at Home Seen for Stimson," *New York Times*, May 15, 1932; "Hoover Urges World Cut in Armies, Navies," *Chicago Daily Tribune*, June 23, 1932.

high finance impelled the adoption of a strategy of “watchful waiting” towards Japan. The Far Eastern Crisis—the staging of the Mukden incident by Japan’s Kwantung Army—started on September 18, 1931, just three days before the collapse of the pound and British abandonment of the gold standard on September 21, 1931. After the failure of international financial cooperation, financial troubles mounted at home, too, with a second wave of banking crises in October 1931. Hoover’s absorption in promoting international financial cooperation and buttressing the confidence of high finance internationally and domestically took priority over the Manchurian crisis.

More importantly, investing in national financial credibility and restoring confidence amongst financial elites to save the international gold standard demanded a response to rising military threats with greater military sacrifices and commitment to world disarmament. This is symptomatically illustrated by Stimson’s non-recognition doctrine, the toothless American policy articulated in January 1932 after the Japanese occupation of the Chinchow port.¹⁴⁰ As Stimson specified in late February 1932, American authorities refused to accept Japanese territorial changes *based on* American “willingness to surrender its commanding lead in battleship construction” and “leave its positions at Guam and in the Philippines without further fortification.” The administration’s maneuver would appear nonsensical to military strategists, if not to most people who ignored the mental frames sustaining a properly functioning international financial order.¹⁴¹ In Japan, where those frames held together a small minority and alienated the masses, Stimson’s doctrine could only appear, as has been acknowledged (Rhodes 2001:83), a

¹⁴⁰ Stimson stated in his non-recognition note that the United States would not recognize any treaty, agreement, or de facto situation that impaired the rights of American citizens or the territorial and administrative integrity of China, or that violated the Kellogg-Briand Pact of war renunciation.

¹⁴¹ Stimson to The Secretary of State to the Chairman of the Committee on Foreign Relations (Borah), United States Senate, February 23, 1932 in U.S., Department of State, Publication 1983, *Peace and War: United States Foreign Policy, 1931-1941*: U.S., Government Printing Office, Washington DC (1943:167-173). See also “Secretary Stimson’s Speech at Philadelphia on Hoover’s Foreign Policy,” *New York Times*, October 2, 1932; and Rhodes (2001:84).

“bluff.”¹⁴² To the Hoover administration, however, bluffing meant negating the value of those frames at a time when resolving the global financial crisis made them most necessary. The costs of this strategy became clear a year and half after the October 1929 crash.

In alignment with the expectations and the analytical framework, Roosevelt’s strategy of crisis response replaced *some* of the constraints pushing American national security policies towards caution with incentives to pursue greater assertiveness. Like Hoover’s before him, the Roosevelt’s administration had to coexist with a number of forces within the nation buttressing a foreign policy of isolationism and virtual pacifism. Yet, Roosevelt’s low exposure to high finance during the second stage of crisis response pushed American military spending, threat assessment, and war prospects away from Hoover’s conciliatory stance *even if* passing the various reforms and legislative acts of the New Deal required defending military and diplomatic caution. The result, in conformity with HA–LE, was an indeterminate security posture in which caution and assertiveness coexisted. Policy paralysis was often reached, but elements for the curbing of appeasing military spending, threat assessment, and war prospects appeared too.

Evidence shows that, from his first days in office, President Roosevelt backed naval military buildup as a means to create jobs, contribute to national economic recovery, and defend the country against the rising Japanese threat. In June 1933, as part of the National Industrial Recovery Act, Roosevelt allocated \$238 million in public works funds for the modernization of 32 cruisers, destroyers, and submarines—the largest naval building program since 1916. Under the new administration, crisis resolution and naval rearmament were no longer, or not always, at odds. Naval rearmament was pushed further at the beginning of 1934 when Roosevelt gave full

¹⁴² Coming under Congressional pressure for action, after the Shanghai incident of February 1932, the White House had decided to dispatch the Thirty-First Infantry Regiment together with four hundred marines from the Philippines to Shanghai, to reinforce the marine contingent permanently stationed in the International Settlement. Ultimately, however, American leaders stood by the toothless non-recognition policy (Stimson’s doctrine). *Congressional Record*, 72nd Congress, 1st session, January 2, 1932, pp.2948-49; “Hoover and Cabinet Act,” *New York Times*, February 1, 1932 “Crisis in East Stirs Congress Activity,” *The New York Times*, February 2, 1932.

support to the Vinson-Trammell bill, which provided for the construction and replacement of ships up to the limits allowed by the Washington and London naval treaties of 1922 and 1930 (Borg and Okamoto 1973:207-208; Dallek 1979:75; Rhodes 2001:127,130; Doenecke and Stoler 2005:30). Had the American leadership not desired investment in naval rearmament from 1933 onwards, the capitulation of the American Navy that had begun with Hoover would have gone forward. Notably, despite Roosevelt's determination to keep the Navy on course, it was only in 1938 that Congress approved a comprehensive rearmament program, the second Vinson Act.¹⁴³ One must wonder what would have happened had response to the financial crisis continued along Hoover's lines after 1933.

Because his naval program created accusations of ultra-nationalism and widespread criticism across the country, Roosevelt went to great lengths to persuade critics that the White House stood by further international reductions in armaments—especially naval—and that the newly authorized naval building program would not draw the nation into a crisis with Japan.¹⁴⁴ Pursuing disarmament and military restraint, sanctioning a Far Eastern policy of non-provocation and lecturing the Japanese about the principles of good behavior—a task in which Secretary of State Cordell Hull and Chief of the Far Eastern Division Stanley Hornbeck were particularly invested—became key American foreign policy guidelines for allowing national economic reform and rearmament. Crucially, although both Hoover and Roosevelt were fighting for disarmament and attempting to prevent the collapse of the Treaties, their purposes were different. For Hoover, world disarmament *and* sharp cuts to the American Navy were the means for bringing relief and confidence to high finance and solving the financial crisis at home and

¹⁴³ The Act authorized the construction of three new battleships armed with 16-inch guns, two additional aircraft carriers, nine new cruisers, 23 new destroyers and nine additional submarines (Rhodes 2001:152).

¹⁴⁴ As a result, the policy towards disarmament and the Far Eastern policy that the Hoover administration had pursued were not abandoned but kept as a bargaining chip for passing economic reforms. The same was true for Hoover's policy of non-intervention in Latin America.

abroad. For Roosevelt, the pursuit of world disarmament and respect for the Treaties were necessary means to overcome Congressional opposition to arms construction, build up the American Navy to treaty limits, and neutralize hostility to New Deal legislation to solve the financial crisis at home.¹⁴⁵

Roosevelt's strategy for crisis response also conveyed, in agreement with expectations, greater alarm vis-à-vis the Japanese threat, and a greater determination not to respond to war prospects with military unpreparedness. On assuming the powers of the Presidency in March 1933, Roosevelt sent a request for a partial arms embargo to Congress. The target was obviously Japan, with the implicit message that the United States would not refrain from punishing aggressors. The act was blocked in the Senate, but Roosevelt resisted the ensuing Congressional pressures to sign a neutrality law and an impartial arms embargo until late 1935, when the Italo-Ethiopian crisis made the passage of any embargo preferable to no action. It is hard to believe that Hoover would have been willing to present Congress with an impartial arms embargo request or send a similar message. American financial interests, upon which Hoover's national security policies depended after the financial-crisis outbreak, equated "economic sanctions" against Japan with "cowardly war," and the mere thought of conflict escalation between Japan and the United States was regarded as an "absurdity" in view of Japanese-American investment opportunities and Japan's faithful service to its obligations.¹⁴⁶ Hoover himself, in August 1932, forced Stimson to redact any allusion to a discriminatory arms embargo from a speech he was

¹⁴⁵ On the aura of domestic legitimacy that the Treaties carried domestically, see Dallek (1979:31,53; Rhodes 2001:127). In May 1934, Roosevelt moved unsuccessfully to prevent the collapse of the Geneva Conference on Disarmament (1932-34). In 1935-36 the administration participated in the Second London Naval Conference (December 1935-March 1935) to renegotiate the Washington and London Treaties. The Treaties would have expired in 1936.

¹⁴⁶ "Foreign Entanglements," *Washington Post*, February 1, 1932; "Japan's New Policy," *Washington Post*, September 21, 1933; "Is Japan Our Enemy? Expert Brands War Fears as Fantasy," *Washington Post*, August 19, 1934; "Clash of America's Foreign Policy with Japan's Causes Concern," *Washington Post*, October 28, 1934. The American business community thus expressed itself with regard to the prospect of economic sanctions towards Japan (February 1932): "The suggestion that the United States should set up an economic boycott against Japan is so silly as to be worthy of the theorists who bungle international relations through the League of Nations. An economic boycott is merely cowardly war."

about to deliver to the Council on Foreign Relations.¹⁴⁷ Against both the preferences of high finance and Hoover's foreign policy stance, Roosevelt in the summer of 1933 justified naval build-up based on the fact that "the whole scheme of things in Tokyo" did not "make for an assurance of non-aggression in the future" (Dallek 1979:75).¹⁴⁸ Although FDR had no intention of risking war in the Far East when he assumed power, his very admission of the possibility of being attacked by Japan in the future imbued his national security policies with a tone of gravity that Hoover could not afford. In the array of national security responses to the financial crisis that Hoover considered, the Kellogg-Briand Pact for the renunciation of war *could not* be questioned. For Roosevelt, however, the Pact itself was a nuisance.

That Roosevelt's strategy of crisis response unleashed a less cautionary threat assessment than was possible under Hoover's strategy of crisis response is also evident from Roosevelt's use of the post-World War I treaty structure. Like Hoover, Roosevelt was committed to playing within this architecture.¹⁴⁹ Unlike Hoover, however, FDR envisioned a more flexible use of this structure to serve the United States' national defense needs. Following the failure of the Geneva disarmament conference, in 1934, when the arms races in Japan and central Europe were in full swing and the Italo-Ethiopian conflict was brewing, American isolationist pressures had gained momentum, forcing Roosevelt to accept the passing of the Neutrality Act in August 1935.¹⁵⁰ Knowing that the Act would expire in early 1936, and well aware of the strident opposition by

¹⁴⁷ Richard N. Current, *Secretary Stimson: A Study in Statecraft*, New Brunswick (1954), pp.99,100,108. The summer of 1932 witnessed the start of the Chaco War between Bolivia and Paraguay. Hostilities continued between Japan and China.

¹⁴⁸ It is true that by then Japan had officially withdrawn from the League of Nations and disclosed its intention to abandon existing naval limitation agreements. Had Hoover been in power rather than Roosevelt at the time, a similar overhaul of American pre-1933 policy stance on war prospects seems unlikely.

¹⁴⁹ These intentions were clear during the Geneva disarmament conference of 1932-34, when Roosevelt stated, in an address to various Chiefs of Staff: "A profound hope of the people of my country impels me, as the head of their government to address you, and through you, the people of your nation. This hope is that peace may be assured through practical measures of disarmament, and that all of us may carry to victory our common struggle against economic chaos." In Roosevelt's Address to various Chiefs of Staff in Geneva, May 16, 1933, *The Papers of Herbert Feis*, box 123, Manuscript Division, Library of Congress, DC.

¹⁵⁰ This measure also embargoed munitions and war materials and barred loans to belligerents, but it denied the President any say over when and how these things would be accomplished (Dallek 119). Roosevelt needed the support of isolationist forces in the Senate to pass New Deal reforms at home. In 1935, the New Deal had come under assault from conservative critics.

domestic pacifists and isolationists to armament expenditures, Roosevelt used the upcoming Naval Conference in December 1935-March 1936 in London to further the rearmament program. There, he insisted on an extremely unappealing cut of 20 percent on overall naval tonnage, which Japan refused and Britain regarded with skepticism. Concurrently, he pressed for the introduction of an escalatory clause permitting the signatories, and, practically, the United States and Britain, to ignore the agreement if Japan refused to go along with it and embark on rearmament—an outcome that was virtually certain (Rhodes 2001:132).¹⁵¹ Roosevelt's use of the treaties to make Japan appear the aggressor—Japan exited the conference in January 1936—and Great Britain uncooperative—the British stepped up rearmament in February 1936—paved the way for Congressional approval, in March 1936, of the largest peacetime naval appropriation ever requested by an American president (Pelz 1974:202; Dallek 1979:90).¹⁵²

This analysis suggests that the financial crisis of 1929-33 steered American national security policies initially towards greater caution, as per HA-HE, and then towards an unspecified security posture with dashes of assertiveness, as per HA-LE. The complexity of the international context in the 1930s—with increased militarism, the advent of revisionist regimes, spiraling arms races, financial crises spreading within nations and across the world, the collapse of international finance and trade, and states' response to these developments over several years—makes it difficult to assess the relative importance of the national security influence of the financial crisis versus that of other variables. To discount the role of financial-crisis, however, seems misguided. Had the financial crisis not occurred, the Hoover administration would have had little reason to opt for military capitulation or to exalt American abidance by the

¹⁵¹ Japan had denounced the Washington agreements in 1934. See Rhodes (2001:136,137).

¹⁵² Facing the outcry of pacifist forces, Roosevelt could respond that the appropriations were strictly for defense reasons and that his attempts to rescue the Treaties demonstrated his commitment to peace. The appropriation included funds for only two new battleships, and most of that money would provide replacements for outmoded destroyers and submarines.

international treaty structure in the hope of eliciting a similar response on the other side. By the same token, the United States' slow path towards military activism and the strengthening of the Navy would have been even slower in the absence of a strategy of financial-crisis response like that of Franklin D. Roosevelt. Ultimately, it is also difficult to believe that the described shifts from the normal course of American national security policies brought about by the financial crisis of 1929-33 had no effect on other states' policies or produced a safer international security environment.¹⁵³

Financial crises and American national security policies in nuts and bolts

The American case confirms that financial crises changed the direction and character of American national security policies. This occurred when the ruling administration subscribed to an ambitious security agenda (1884; 1907) and when the American government acted as a dove in international affairs (1893-95; 1929-33); when the national contribution to arms races and war prospects was significant (1907) and when it was not (1893; 1929); when government authorities opposed high finance (1884, 1907-08; 1933-36) and when ruling administrations were closely allied with it (1893-94; 1929-32); and when the United States was a financial hegemon (1929) as well as when its membership in the international financial system was controversial at home and abroad (1884-85; 1893-96). In every instance, and at least temporarily, the crisis reshaped the existing balance of power between the American government and financial elites to the advantage of the latter, and this development produced a shift in existing national security policies towards major prudence. Accordingly, the administrations of Chester Arthur and Teddy Roosevelt were reminded that they were not, respectively, in LA–LE but rather in LA–HE, while the administrations of Grover Cleveland and Herbert Hoover, both of them highly exposed to

¹⁵³ By “normal” here I mean “financial-crisis free.”

high finance *after* crisis outbreak, were enthused to take conciliatory military spending, threat assessment, and war prospects to further extremes in an attempt to solve the financial crisis.

Interestingly, as a result of every single financial-crisis episode, the enhancement of the pre-crisis national security agenda by the crisis-hit government did not outlast the financial crisis—a clear difference with the Japanese case.

Confirming the framework, cautious national security policies were pushed to new prudent extremes when the exposure to high finance of crisis-hit governments was high (1893-94; 1929-32). Also confirming the framework, assertive, crisis-hit governments reacted by inflating—or attempting to inflate—their assertive national security agendas (1884; 1907). Both in the financial crisis of 1884 and in that of 1907-08, the crucial role of high finance in the process of financial crisis resolution eventually undermined an assertive national security agenda, moving American security policies onto a more cautionary course. Much more indeterminate was the shift in security posture of cosmopolitan, crisis-hit governments having, or better, developing, throughout the crisis, a low exposure to high finance (1895-96; 1933-36). The national financial and security policies of the second Cleveland administration, as well as those of McKinley, and Franklin Roosevelt, all released significant pre-crisis constraints to the exercise of greater ambition.

As expected, presidential races and congressional majorities stand out as the two main channels through which high finance exerted or failed to exert cautionary pressures in American national security policies—and the two channels through which American governments, after financial crisis outbreak, resisted or conceded to high finance in the formulation of national financial and security policies.

The findings of the chapter also show that American governments' incentive, from LA–HE or HA–HE, to embrace greater national security caution in order to solve financial crisis decreased when high finance and international financial cooperation failed to improve national economic conditions and encountered profound domestic and Congressional opposition. The scarce power of high finance to solve the financial crisis became a fact between 1895 and 1896, and 1931 and 1933, setting the stage for a scenario-HA–LE kind of influence of the crisis on national security policies.

The inflation or curbing of pre-crisis national security policies following financial crisis outbreak (or the release of constraints to pursue greater assertiveness) did not always affect the whole spectrum of national security policies to the same extent. In the 1930s, for instance, structural factors other than the financial crisis kept war prospects close to zero. As a result, the influence of the financial crisis of 1929-1936 remained limited to military spending and threat assessment. Similarly, as the Cleveland administration embarked on a more cautionary assessment of the British threat between 1893 and 1895, military spending, for instance, remained shielded from cuts in 1893-95. A “protected” defense spending policy, however, did not cushion the administration’s decision to undertake most radical measures of military withdrawal from the Pacific.

More notably, the chapter suggests that pushing cautiousness to new conciliatory extremes (HA–HE) to signal the respect of international financial cooperation, quell business anxieties, and abide by the prescriptions of high finance in the attempt to resolve the crisis might not be the most “prudent” or farsighted measure. Also, when more cautious national security policies were undertaken, it was difficult to stop them, placing national security policies on an uncomfortable slippery slope. American leaders’ financial-crisis responses that “glorified”

national security caution were often overturned because of the repercussions on national interests and national honor. Moreover, financial crisis responses that promoted an overly dovish security stance were often only fictitiously prudent, paving the way for increased international financial competition to the detriment and security of other states. This occurred during the financial crisis of 1893-1895 and Cleveland's exceedingly cautionary assessment of the British threat in the Caribbean and the Pacific. Hawaii and Venezuela were the victims. It also ensued soon after the financial crisis of 1907-08, and its influence on American Asian policy. This time it was China who suffered the consequences. Finally, it occurred in 1931-32, with the "honest" scarification of American military power to save the power of high finance and the international gold standard. Ambitious national security policies were then domestically intolerable, but Franklin Roosevelt's heterodox response to the financial crisis and the collapse of the international financial system opened a new chapter for American national security agenda.