What's Monetary Sovereignty Worth? A Case Study

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States' control over their domestic monetary and financial systems is a critical, and generally under-appreciated, part of the measure of their sovereignty. In recent years, the literature on monetary sovereignty has surveyed how, for most states, it is generally weak.[1] Yet few writers have addressed the underlying consequences and significance of diminishing monetary sovereignty. Exceptional in this regard, Katarina Pistor's article, *From Territorial to Monetary Sovereignty*,[2] argues forcefully that "if the question of sovereignty was tied not to effective control over territory and people but to effective control over money, including state and private moneys, most states in this world would fail the test of sovereignty."[3] Only a very few countries are "sovereign in monetary terms" – the US, the UK, Canada, Japan, Switzerland, Australia, and China.[4]

According to her account, only states that issue their own currencies can retain such control.[5] States that issue their own currency may yet effectively cede or lose control over their monetary and financial systems to the influence and impacts of private actors and financial markets. This is especially true where domestic monetary and financial policymaking is heavily dependent on external forces through capital flows or external debt in foreign currencies. For Pistor, the consequences of such constraints on sovereignty are most apparent and dire during times of crisis, when states are unable to independently respond to systemic financial and economic vulnerabilities:[6]

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[1] *See infra* notes ___.

[2] Katharina Pistor, *From Territorial to Monetary Sovereignty*, 18 THEORETICAL INQUIRIES IN LAW, 491 (2017).

[3] *Id.* at 2.

[4] *Id.* at 4

[5] *Id.* at 2.

[6] *Id.* at 4 ("Every crisis puts to a test the ability of states to rescue the domestic money system without recourse to external help. Some countries can help themselves and others can't. External help always comes with strings attached and constrains autonomous decision making.").

> Every crisis puts to a test the ability of states to rescue the domestic money system without recourse to external help. Some countries can help themselves and others can't. External help always comes with strings attached and constrains autonomous decision making. …. It is an inherently hierarchical system that links assets, intermediaries, and countries in ways that predetermine winners and losers in times of crisis.[7]

At such times, "[o]nly countries that house intermediaries in the business of exporting money can maintain basic principles of democratic self-governance …."[8]

This article critically examines Pistor's account of monetary sovereignty and the relevance of its strength or diminishment through a case study of India. While India is not among the countries that Pistor identifies as enjoying monetary sovereignty, its circumstances are quite different than those states she assigns to the periphery, or lower in the hierarchy, of the international monetary and financial system. The country arguably retains more sovereignty in this regard than Pistor's account would ascribe to it.

In its first decades of independence, India's economy was very insular and controlled. Since the 1990's, the country has embraced a wide range of gradually liberalizing reforms, yet it has deliberately and carefully maintained a significant amount of state control over its economy, including its monetary and financial systems. In particular, the country still exercises a high degree of control over the factors that generally erode monetary sovereignty – *e.g.*, private money creation, cross-border capital flows, and levels of external debt. While the country has opened its capital account in important ways in recent decades, it still actively manages a wide-ranging array of de jure and de facto limits on capital flows, both inward and outward. Private external debt in India has been steadily increasing since the financial reforms of the 1990's, yet India has less external debt as a percentage of GDP than many other emerging economies, and much of it is owed in rupees. Furthermore, a large portion of that external debt is held in domestic bank accounts payable to non-resident Indians. Relatively little of it is owed to other sovereigns or international financial institutions. None of its public external debt is owed in

[7] "[M]onetary and financial systems are hierarchical. States that control their money enjoy power over those that don't. Generally, states enjoy power over private entities that make private money, but sometimes foreign or domestic private entities can effectively drive the monetary behavior of sovereigns." *Id.* at 4.

[8] *Id.* at 22.

foreign currency. Finally, India's sovereignty over private domestic money creation is quite robust as elements of shadow banking ubiquitous in other jurisdictions are highly constrained there.

India thus appears to enjoy a meaningful quantum of monetary sovereignty. Pistor does not exclude the possibility that there are degrees of monetary and financial sovereignty, yet her account strongly suggests otherwise, emphasizing the hierarchical nature of monetary and financial systems, in which certain economies enjoy full sovereignty and others, on the periphery, do not. The case of India complicates this claim, suggesting that countries may not enjoy full monetary sovereignty but can reduce the extent of this vulnerability and also maintain a robust degree of democratic self-governance and control over their monetary and financial systems.

But at what cost? Maintaining or ceding monetary sovereignty involves tradeoffs between control on the one hand and liberalization and integration on the other. Understanding various macroeconomic policies in India as defining the extent of its monetary sovereignty provides a useful frame for evaluating the development of such policies to date and into the future. The direction of policymaking in the country has, across different governments, continued to be one of cautious, managed, and fitful liberalization. Policymakers have viewed such liberalization as a pathway for improving financial markets and increasing economic development in the country, thereby improving social welfare. But it appears they have consistently weighed these benefits against those of maintaining a significant degree of state control over the economy, the government's ability to manage the country's economy to promote stability and other social goals in the course of integration with the global financial system. In this context, monetary sovereignty is valued only partially because it insulates the country from external factors that may cause or exacerbate financial crises; it is also, perhaps primarily, a crucial component of the country's commitment to exercising meaningful central control over its economy and financial system, at least compared to other large modern market-based economies.

In other words, the degree of India's monetary and financial sovereignty at any particular point in time is a function of the balance among and between policies aimed at control, stability, and development. The policies that support India's sovereignty in this regard have been widely

credited for enabling the country to weather the global financial crisis of 2008-09 better than many other jurisdictions. And they may have reserved for India more space for routine, non-crisis economic and financial policymaking. Yet such policies have been controversial among domestic and international observers, and it is possible that the generally cautious approach of government stewards of the domestic economic and its financial system has unnecessarily slowed the country's growth and development. Maintaining India's degree of monetary and financial sovereignty may have effectively served to limit the availability of financial resources in the country as well as the potentially disciplining force of external assessments.

This Article aims emphasizes these trade-offs between financial liberalization and monetary sovereignty by examining a set of policies and practices that are central to both and that define the balance between them. It proceeds as follows. Part I elaborates on the concept of monetary sovereignty and describes the contemporary literature on the topic, arguing that Pistor's recent contribution provides an opportunity to operationalize the concept. Part II briefly surveys relevant aspects of India's economic and financial history and then examines some of the core policies that determine the degree of its monetary and financial sovereignty: management of its capital account; the amount and composition of its public and private external debt; and the extent of domestic private money creation. It concludes that India enjoys a greater degree of monetary sovereignty than Pistor's account anticipates. Part III then employs the mapping of these policies to questions of sovereignty to reframe recurring debates over them. It embraces Pistor's critical insight that the tradeoffs related to such discrete policies determine the scope of a state's autonomy and independence and, thereby, the space for democratic self-governance. Above all else, it means that the stakes of domestic policymaking over financial liberalization and integration with global monetary and financial systems are even higher than generally appreciated.