Why not bancor?
Keynes's currency plan as a solution to global imbalances

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[draft, please do not quote]

Abstract

Financial crises traditionally have at least one positive side-effect: a dramatic reduction of debts that have become unbearable. As a partial compensation for the damages they produce, financial crises usually reduce leverage and allow to restart economic activity on sounder grounds. By contrast, the crisis that broke out in 2007, and the countermeasures that have been adopted to contrast its effects, have left unaltered, if not increased, the overall debt exposure of businesses, banks, families and states. Therefore, as recent events have shown, the economic system has been made even more vulnerable to unanticipated contingencies, while the scope for further intervention has dramatically narrowed for governments and central banks that have already expanded their balance sheets on an unprecedented scale. The persistence of financial imbalances – public and private, national and international – appears to be, at the same time, a burdensome bequest of the last crisis and an ideal breeding ground for the next one.

In this paper, I focus on the role played by the monetary system in favoring or contrasting the buildup of financial imbalances. I argue that the seeds of the current situation were sown at Bretton Woods, with the establishment of the US dollar as a global unit of account, which paved the way to its use as a means of international payment and reserve, and hence to the eventual suspension of its convertibility and to the unrestricted expansion of capital movements worldwide. I then analyze the alternative plan for an International Clearing Union proposed by Keynes, and I suggest that it was expressly intended to avoid the accumulation of imbalances, in particular thanks to three distinctive features: an international unit of account, bancor, distinct from all national currencies; a system of money creation and destruction, that did not operate as a fiat money system, but through overdraft facilities and multilateral compensation; the symmetric distribution of the burden of adjustment between creditor and debtor countries. Finally, I suggest that the principles underlying Keynes's proposal could be adopted to address persisting imbalances at a global level and within the euro area.

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> The problem of maintaining equilibrium in the balance of payments between countries has never been solved, since methods of barter gave way to the use of money and bills of exchange. […] [T]he failure to solve this problem has been a major cause of impoverishment and social discontent and even of wars and revolutions.[1]

When John Maynard Keynes wrote these lines, in September 1941, he knew what he was talking about. The world was at war for the second time before one single generation had lapsed after the end of the Great War. And the issue of unsettled balances between countries had played no small part in the outbreak of the second global conflict.

Keynes had denounced the risk well before it eventually materialized. Already in 1919, in writing 'The Economic Consequences of the Peace', he had insisted on the need to reabsorb global imbalances in an equitable and orderly manner, so as to avoid the buildup of potentially explosive international tensions:

> The war has ended with everyone owing everyone else immense sums of money. Germany owes a large sum to the Allies; the Allies owe a large sum to Great Britain; and Great Britain owes a large sum to the United States. […] The whole position is in the highest degree artificial, misleading, and vexatious. We shall never be able to move again, unless we can free our limbs from these paper shackles. A general bonfire is so great a necessity that unless we can make of it an orderly and good-tempered affair in which no serious injustice is done to anyone, it will, when it comes at last, grow into a conflagration that may destroy much else as well.[2]

Unfortunately Keynes's appeals remained unheeded. Reparations imposed on Germany were seen by European Allies as a way, not only to humiliate the defeated enemy, but also to repay the war debts to the United States. The vindictive logic of the Versailles Treaty was to prove a shortsighted miscalculation, in both political and economic terms. Germany's capacity to pay had been grossly overestimated. As a consequence, European debts remained unpaid, and international capital markets were dried up by 'distressed borrowers' who demanded money only to pay back previous debts. This, in turn, caused interest rates to remain high, crowding out productive investments that would have been essential to boost postwar recovery and

[1] J. M. Keynes, 'Post-war currency policy' [8 September 1941], in *The Collected Writings of John Maynard Keynes*, 1971–89. London and Cambridge: Macmillan and Cambridge University Press [henceforth CWK], vol. 25, p. 21.
[2] J. M. Keynes, *The Economic Consequences of the Peace* [1919], in CWK, vol. 2, pp. 177-8.

alleviate 'social discontent'. Hence, not only did global imbalances persist, but they clearly failed to reflect an efficient allocation of capital, according to prospective returns on real investments. In other terms, they were not fresh funds to revitalize enterprise, but were on their way to becoming dead loans, 'as dead as mutton, and as distasteful as stale mutton'.[3]

Freedom from these 'paper shackles' was sought for, not by reducing all debts for them to be repaid, but rather by increasing the quantity of money for the debts to be refinanced – in other terms, by producing even more paper. This was made possible by the establishment of the gold exchange standard at the Genoa Conference in 1922. The international monetary base was duplicated by including not just gold, but also foreign exchange convertible into gold. The sudden abundance of credit finally managed to buttress growth, even beyond expectations. The duplication of international money allowed to finance investments on both sides of the Atlantic, fuelling, at the same time, the 'Roaring Twenties' in America and the 'Goldene Zwanziger' in Germany. However, this occurred at the price of producing ever larger imbalances that were reflected in the accumulation of foreign exchange reserves and other, mostly short-term, liabilities.

The sudden deleveraging caused by the stock market crash in 1929 found in these imbalances a channel of virulent contagion. In the words of Jacques Rueff: 'it was the collapse of the house of cards built on the gold-exchange standard in Europe that turned the recession of 1929 into a Great Depression'[4]. The repatriation of funds invested abroad caused a contraction of credit worldwide, a global deflation and, ultimately, a generalized resort to protectionist measures, retaliations and competitive devaluations. Trade wars, military expenditure and economic nationalism contributed together to exacerbating political tensions and to precipitating the outbreak of the Second World War.

In 1941, therefore, there were good reasons for Keynes to urge his country and its allies to plan ahead for a postwar economic order and to avoid the mistakes that had been made after World War I:

> The authors of the Peace Treaty of Versailles made the mistake of neglecting the economic reconstruction of Europe in their preoccupation with political frontiers and safeguards. Much misfortune to all of us has followed from this neglect. The British Government are determined not to make the same mistake again.[5]

Indeed, Keynes was entrusted by the Treasury with the task of drawing up a plan for a new international economic order to discuss with the Americans. The centerpiece of his plan was the International Clearing Union, a monetary system expressly designed to facilitate international trade and to avoid the creation of systematic balance of payments disequilibria. Keynes drafted seven different versions of the plan in over two years, in the attempt to meet

[3] J. M. Keynes, 'The Economic Prospects 1932', in CWK, vol. 21, p. 41.
[4] Rueff, *Le Péché monétaire de l'Occident*, Paris: Plon 1971, p. 31; English transl. *The Monetary Sin of the West*, London: Macmillan, 1972, p. 28.
[5] J. M. Keynes, 'Proposals to counter the German "New Order"', in CWK, vol. 25, p. 11.

criticisms at home and to win support abroad.[6] A compromise with the Americans was struck in April 1944 with the Joint Statement, that represented the point of departure for the Bretton Woods Conference held in July, where the foundations were laid of the postwar economic order.

Today, after almost seventy years, we still cannot claim to have solved the problem to which Keynes understandably assigned such great importance. Despite the ongoing crisis, global imbalances persist and net international credit and debit positions continue to accumulate, threatening to fuel diplomatic tensions. The issue has come back to the fore, both at the global level, where it has been put at the top of the agenda of the G-20 under the current French presidency, and within the eurozone, where it underlies the debt crises of peripheral countries.

In this paper, I intend to revisit Keynes's proposal, paying particular attention to the way in which the Clearing Union was designed to address global imbalances. I will show that, in this respect, the Bretton Woods system was based on principles and prescriptions that operated in a different, indeed in an opposite manner than what Keynes had proposed. Moreover, I will argue that the international monetary system inaugurated at Bretton Woods contributed decisively to broaden balance of payments disequilibria and that the Keynes plan would have been far more appropriate to avoid the buildup of global imbalances. Finally, I will suggest that the principles of the Clearing Union could be important to reform financial institutions today to face current imbalances globally, within the euro area, and at the local level.

The paper is divided in seven chapters that try to answer the following questions: (1) How are global imbalances related to the current crisis? (2) When are global imbalances good and when are they bad? (3) Where do global imbalances come from? (4) How did Keynes's plan cope with global imbalances? (5) Why was it not adopted? (6) What were the consequences? (7)What can be done today?

(1) How are global imbalances related to the current crisis?

The relationship between global imbalances and the current financial crisis is not obvious, and deserves to be discussed at the outset. My claim is that there is indeed a close relationship between the two phenomena, which however cannot be reduced to a univocal causal relation; that global imbalances are of a more structural character; that they have not caused the financial crisis, but they have made it possible as a global crisis; that, therefore, they should receive more attention than they have so far, because overcoming the crisis without reabsorbing global imbalances would mean leaving open the possibility of further crises in the future.

[6] All versions are collected in J. M. Keynes, *Activities 1940-1944. Shaping the post-war world: the Clearing Union*, CWK, vol. 25.

That global imbalances have a more structural character with respect to the contingent nature of the crisis is made clear enough by their sheer persistence: they started to accumulate well before the outbreak of the crisis and they have continued undisturbed until today – representing perhaps the only certitude in an age of uncertainties. It is by now widely acknowledged that large trade deficits, and corresponding massive capital inflows, preceded, and indeed contributed to fuel the 'irrational exuberance' on US asset markets (spanning from derivatives to real estate). What is less obvious is that the imbalances that inflated the bubble should persist, only on a slightly lower scale, even after the bubble has burst.

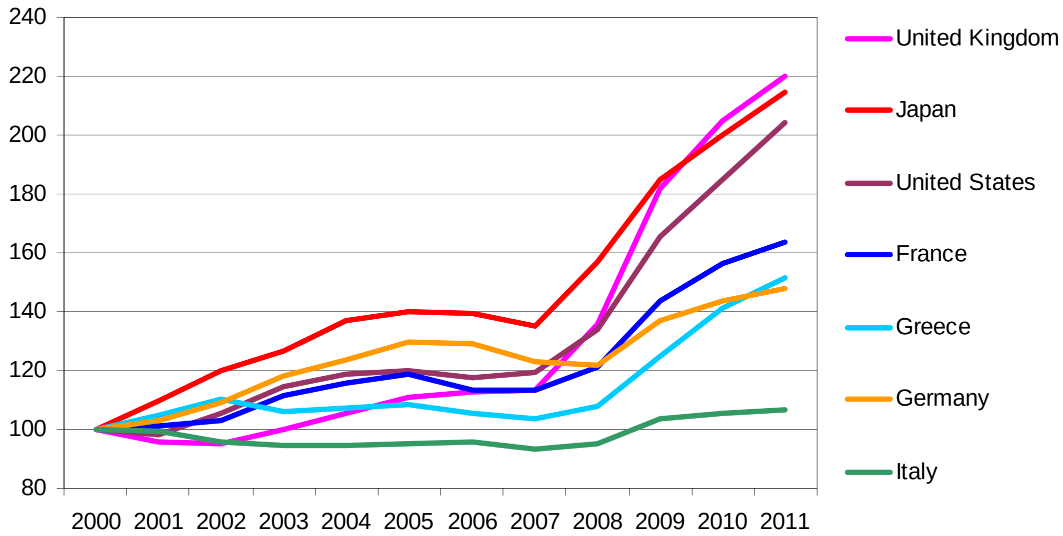
Traditionally, crises have at least the merit of reducing the overall level of indebtedness, since most bad loans are normally written down, cancelled or inflated away. Hence, crises have been viewed as a necessary evil, or as an 'unavoidable concomitant' of the ordinary functioning of financial markets.[7] They have acted as a sort of jubilee: however involuntary and accidental, they have appeared to reduce a debt burden that had become intolerable and to restore some sort of equilibrium, if not of justice. Something like a fever which is necessary, from time to time, to eliminate toxins and restore the health of the economic body. Unfortunately, it is difficult to hold this view in the face of the legacy of debts that the last crisis is leaving in its wake. What has occurred, since the summer of 2007, is not so much a cancellation or restructuring of non-performing loans, but a substitution of unpayable debts with other unpayable debts: from private debts, to public debts, to foreign debts. It is worth taking a closer look at this transformation since it can be seen as a gradual unveiling of the true nature of the debts on which the global economy is precariously floated.

The crisis started from private debts: securitized mortgages, bank loans, corporate liabilities of various sorts. Governments were compelled to intervene through bail-outs, relief programs and outright nationalizations, supported by special facilities and massive liquidity injections of central banks. Thus private debts were substituted by public debts (figure 1).

But the reason why governments were forced to intervene is because those apparently private debts had in fact a public character from the very outset. This is quite evident in the case of the securitized mortgages that benefited from an implicit guarantee by the Government Sponsored Enterprises. It is less evident, but not less substantial, in the case of the liabilities of those institutions that were considered too big or too interconnected to fail. It was their systemic relevance that demanded state intervention as a way of defending national interests. The very liquidity of credit markets had assumed the character of a public good, for which no private institution could be held accountable and that ultimately required to be preserved by monetary authorities at all costs. Private debts became public because, in a sense, they were public from the very beginning.

[7] B. Eichengreen, *Financial Crises and What to Do about Them*. Oxford: Oxford University Press, 2002, p. 4.

Figure 1. Growth of public debt/GDP ratios (index 2000 = 100)



Source: extrapolations from IMF World Economic Outlook, October 2010: net government debt/GDP

Now the problem appears to be the sovereign debts of potentially insolvent states. Yet, even here there is a fundamental ambiguity. Since their invention, in the early modern era, public debts were never meant to be paid out, but merely floated on the secondary markets for Treasury bills and bonds. The issue is hence not of solvency, but of sustainability. And sustainability, unlike solvency, is not a matter of accountancy but of expectations. Any level of public debt is sustainable, as long as there are investors willing to purchase it on the market. Now, the possibility of selling their debts on liquid international markets, at stable or fixed exchange rates, is exactly what has allowed certain states to accumulate more debts than they could ever have dreamed of financing domestically. This is true for the US as it is for Greece. And this is what makes the sustainability of these debts not a domestic issue of public debts, involving considerations of intergenerational equity in view of dampening social tensions, but an international issue of foreign debts, involving international negotiation and coordination in an effort to stave off potential conflicts.

(2) When are global imbalances good and when are they bad?

At this point, a clarification is needed. I have hitherto referred to global imbalances as a major source of economic and political instability. This contrasts sharply with the established theory of the international economy that views global imbalances in a rather positive light, as a way of ensuring the efficient allocation of savings worldwide.

Indeed, there are situations in which it may make sense for a nation as whole, just as for an individual, to lend or to borrow. For example, according to whether it is 'old' or 'young' in both economic and demographic terms. If a nation has a mature economy and an aging population, it may wish to save, that is to earn more than it spends, and to invest the positive balance abroad, where it promises to yield higher returns, in the prospect of suffering a reduction in its productive capacity and an increase of its needs. On the contrary, if a nation has a young population and a developing economy, it may wish to invest more than it is capable saving, in the prospect of catching up, making innovations, increasing productivity and capacity, and eventually repaying capital and interest.

Now, as these examples show, global imbalances only make sense as long as they are temporary. If they are really for the sake of precaution and self-improvement, credits and debts necessarily have a limited time span. In strictly economic terms, just as for an individual, it makes sense for a nation to accumulate credits, only if, sooner or later, it intends to spend them; and it makes sense for a nation to negotiate a debt, only if, in due course, it expects to be able to repay it.

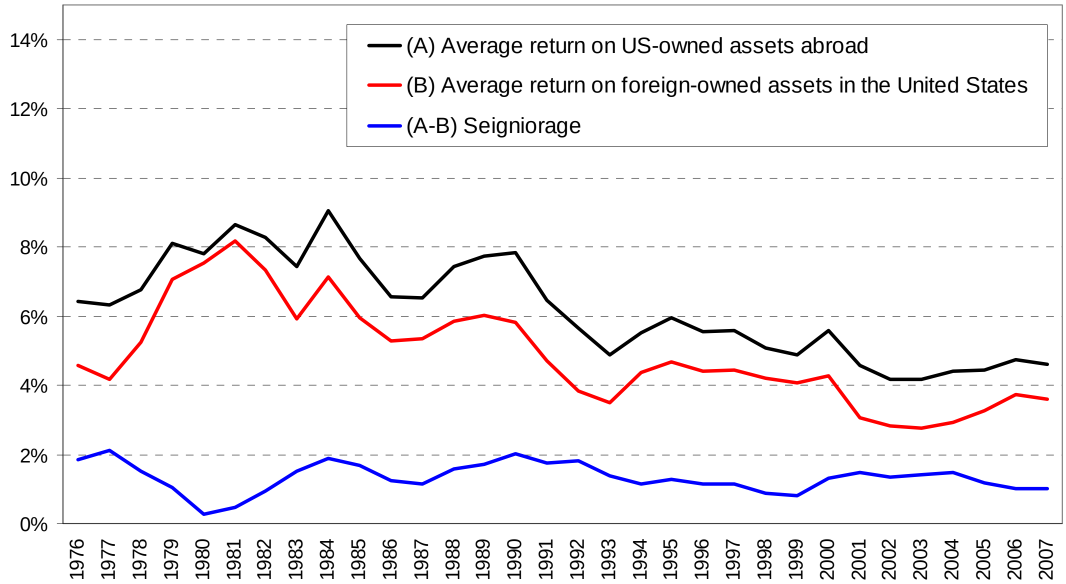
In actual fact, however, we observe that global imbalances tend to acquire a permanent character: credits and debts are accumulated, without any connection with real investments and beyond all prospect of repayment. International reserves are hoarded without ever being spent, international debts are granted without any possibility of being repaid from the proceeds of actual investments.

Chinese foreign exchange, and particularly dollar reserves exceed any reasonable amount that can be justified on the grounds of the economic motives for the demand for money: they are not held for the purpose of transactions, since the US balance of trade towards China has now been negative for decades; they are not held for the purpose of precaution, since their amount is greater than any conceivable capital outflow against which they should provide protection; they are not even held for the purpose of speculation, since it is difficult to imagine that such a long position in dollars is held in anticipation of a prospective appreciation. Hence, we are left with the assumption that dollar accumulation on the part of China is intended merely to counter a potential dollar depreciation. Which amounts to saying that China has to continue to buy dollars, because she bought dollars in the past. Rather tautological…

On the other hand, it is difficult to explain the massive amounts of savings flowing towards the US in terms of a greater profitability of American investments. Foreign assets in the US have yielded systematically less that US assets abroad over the past ten years (figure 2). And this has not withheld huge amounts of capital from seeking to be invested in the US (figure 3). What attracted them was clearly not the returns on American assets, but their liquidity. Which, however, is once again quite self-referential.

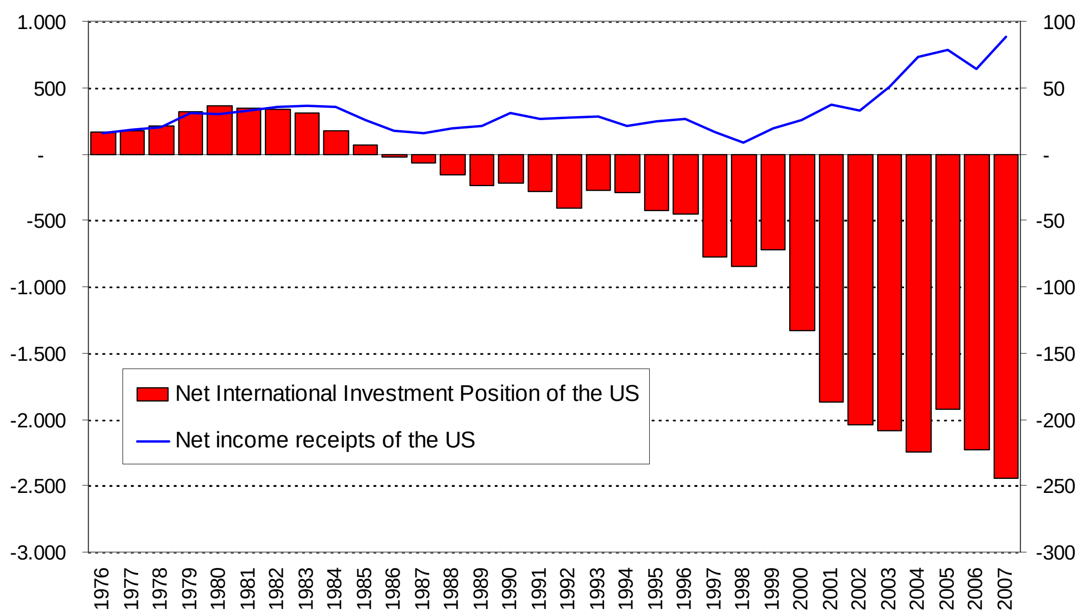
We may conclude, therefore, that global imbalances are good when they are temporary, and bad when they are permanent. The distinction between ‘good’ and ‘bad’ here is not drawn on moral, but on strictly economic grounds. Permanent imbalances are ‘bad’ because it is impossible to explain them on the basis of an economic criterion of convenience.

Figure 2. Returns on foreign assets



Source: Extrapolations from US Department of Commerce, Bureau of Economic Analysis, *U.S. International Investment Position* (version released 27 June 2008) and *US International Transactions Account Data* (version released 17 September 2008). Data available online at: http://www.bea.gov/international/index.htm (accessed 15 May 2011).

Figure 3. US foreign indebtedness



Source: Extrapolations from US Department of Commerce, Bureau of Economic Analysis, *U.S. International Investment Position* (version released 27 June 2008) and *US International Transactions Account Data* (version released 17 September 2008). Data available online at: http://www.bea.gov/international/index.htm (accessed 15 May 2011).

(3) Where do persistent global imbalances come from?

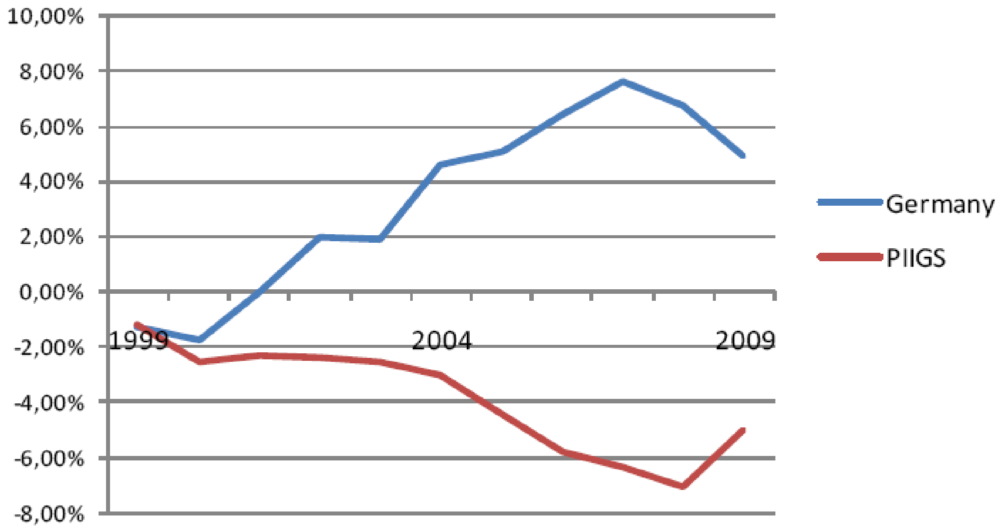
Why, then, do permanent imbalances arise? Why don't international capital markets work as we would expect them to, at least in the long run? Three main reasons have been indicated to give account of present and past imbalances: only the first has to do with an obstruction in the smooth functioning of market forces, while the second depends on a peculiar configuration of the international monetary system, and the third follows from the very existence of capital markets as such. Let us review them in turn.

One popular explanation (particularly in the US) traces the cause of global imbalances (specifically of the US trade deficit) in maladjustments of the exchange rates (namely between the dollar and the renminbi) that are impeded to fluctuate freely (by Chinese monetary authorities). According to a theory of international trade that goes back at least to David Hume, any disequilibrium is doomed to be reabsorbed by automatic adjustment mechanisms.[8] In a system of freely fluctuating exchange rates, a trade surplus ought to determine an appreciation of the currency of the surplus country, thus reducing its competitiveness and contributing to rebalance its foreign trade. If a country throws sand in the mechanism, for example by piling up foreign exchange reserves in order to keep its exchange rate low, this will obviously hinder the correction and perpetuate the imbalance (at least until a rebalancing is achieved, more slowly and indirectly, by a greater inflation in the surplus country, or by a greater deflation in the deficit country, so as to eventually devalue the currency of the latter in real terms, if not in nominal terms).

Another reason for maladjustments derives not from the violation of the rules of the game within a system of flexible exchange rates, but from the application of the rules of the game within a system of fixed exchange rates. Perhaps for this very reason, fixed exchanges have enjoyed a decreasing popularity, both in theory and in practice, over the past few decades. And yet, there are two instances of huge practical importance that go exactly in the direction of stabilizing rates – in fact, even more strongly than in a regime of fixed exchange rates. This occurs when an international currency is used as a national currency (as in the eurozone or in developing countries that have opted for dollarization, eurization or currency boards) and when a national currency is used as an international currency (as in the case of the dollar ever since Bretton Woods). Indeed, when nominal exchange rates are fixed, or indeed when two areas use the same currency, the only possible adjustment is in real exchange rates, through different price dynamics. This can be very painful, particularly for the deficit country that is forced to deflate, and hence it can be delayed. The identification of national and international currency is thus another, perhaps even more important factor of structural global imbalances, as paradigmatically described by the Triffin dilemma in relation to the role of the US dollar as a global currency. The argument finds strong support in the data that shows how global imbalances have exploded in the world since the adoption of the dollar as the international standard (figure 3) and in Europe since the introduction of the euro (figure 4).

[8] D. Hume, 'On the Balance of Trade', in *Political Discourses*, Edinburgh, 1752.

Figure 4. Trade imbalances in EMU (current account as percent of GDP), 1999-2009



Source: C. Altomonte and A. Villafranca, "Not only Public Debt: towards a new Pact on the Euro", ISPI Policy Brief, N. 198, October 2010

A third reason for persistent imbalances is of a completely different nature, and has to do with the functioning of international capital markets *as markets*. The very fact that imbalances are funded by surplus countries at a cost, in the form of credits that have to be remunerated, puts the whole burden of adjustment on the shoulders of the deficit country, which is in most cases the weakest party and the least capable of bearing the weight. The relationship between creditor and debtor countries is greatly asymmetric: the debtor pays an interest on its debts, while the creditor earns a return on its investments; the debtor may be forced to borrow, while the creditor is never compelled to lend; the debtor faces a limit on the sustainability of its liabilities, while the creditor can go on indefinitely accumulating reserves and assets; the adjustment is more painful for the debtor, who is forced to enforce restrictive monetary and fiscal policies, than for the creditor, who is asked to adopt expansionary policies. Clearly, all these asymmetries play against a conversion of international positions and contribute to the perpetuation of imbalances.[9]

(4) How did Keynes propose to counter global imbalances?

The plan drawn up by Keynes for the postwar monetary system aimed expressly at contrasting the creation of permanent disequilibria in the balance of payments between countries. To be sure, it shared this goal with the plan concocted by Harry Dexter White on behalf of the US Treasury, and indeed with the institutions that were eventually set up at Bretton Woods. The Articles of Agreement that were signed at the Conference clearly indicated as one of the main

[9] The argument is clearly spelled out by J. M. Keynes, 'Post-war currency problem', in CWK, vol. 25, pp. 27-8.

goals of the International Monetary Fund (IMF) "to shorten the duration and lessen the degree of disequilibrium in the international balances of payments of members".[10] That the Bretton Woods system failed to accomplish this task is quite evident from the situation of persistent and widening disequilibrium that has characterized the 65 years since its inception. My claim is that the Clearing Union proposed by Keynes would have been more appropriate and more effective in achieving the desired purpose. This claim is based on the fact that the international monetary system envisaged by Keynes, unlike the one that was established at Bretton Woods, radically overturned the causes of structural imbalance outlined in the previous chapter. This stands out clearly from the distinctive features of the Clearing Union: an international unit of account, distinct from all national currencies; a symmetric distribution of the burden of readjustment between debtor and creditor countries; a criterion to detect chronic disequilibria and to correct exchange rates accordingly. Let us see what kind of international monetary architecture Keynes planned to build on these three pillars.

The Clearing Union was conceived as a bank with the task of financing temporary disequilibria in the balance of trade between countries. In this respect, it shared the same purpose of the IMF. Yet, unlike the IMF or an ordinary commercial bank, it would not grant credit on the basis of deposits or capital previously entrusted to it by its members. Member countries would not be required to commit any amount of money in any form to the Clearing Union. They would be simply assigned a current account denominated in a new, international unit of account called 'bancor'. Not having deposited anything into its account, the initial balance of each country would be equal to zero. The par value of the currency of each member would be expressed in terms of bancor.

The Clearing Union would grant credit in the form of overdraft facilities. In other terms, each member would have the possibility of financing a trade deficit simply by entering a negative balance on its account. Symmetrically, a country with a trade surplus would have a positive balance credited to its account. Hence, for example, an export from country A to country B financed by the Clearing Union would give rise to the simultaneous registration of two entries of equal amount: a credit to the account of A and a debit to the account of B. Thanks to the centralization of all accounts at the Clearing Union, however, the credit and debit would not be bilateral, but multilateral positions, of each country vis-à-vis all the other members as a whole. In other terms, the surplus country A could spend its credit in bancor not only with B, but with any other member country; and B could reduce its debit by exporting towards any other country. In this way, the Clearing Union would be able, in principle, to finance international trade and its expansion, without the need of any given amount of money.

For this reason, Keynes's proposal has been accused of being inflationary. However, this criticism depends on a misunderstanding of its logic and functioning. Bancor is not a fiat money. To be sure, it is created ex nihilo. And yet its creation does not depend on the decision

[10] 'Articles of Agreement of the International Monetary Fund, December 27, 1945', in A. J. Peaslee, *International Governmental Organizations. Constitutional Documents*, The Hague: M. Nijhoff, 1956, pp. 259-87, at p. 259.

of a central authority. The amount of bancor balances is not decided by the Clearing Union. Bancor can only be created in conjunction with the transfer of real goods from a surplus country to a deficit country. Moreover – and this is a second difference with respect to a fiat money – bancor does not only come from nothing, but it also goes back to nothing; it is not only created, but it is also destroyed, every time a transfer of goods occurs in the opposite direction, from a deficit to a surplus country. Hence, bancor really is made to comply with the definition of money that Keynes had given twenty years before in his *Tract on monetary reform*:

> a mere intermediary, without significance in itself, which flows from one hand to another, is received and is dispensed, and disappears when its work is done from the sum of a nation's wealth.[11]

The destruction of bancor reflects a reabsorption of imbalances. The ideal situation is one in which all bancor balances have returned to zero, since this would imply that each country would have given to other countries an amount of goods exactly equivalent to those received in return. Of course, however, this outcome is not guaranteed. For this reason, Keynes introduced in his scheme a series of corrective mechanisms. This leads us to the second distinctive feature of the plan: the burden of adjustment is distributed symmetrically between debtors and creditors. In fact, exactly the same rules would apply to positive and negative balances with the Clearing Union. First, both would be subject to maximum levels of imbalance (or 'quotas'), so that it would be impossible to increase a country's debt indefinitely, but also to indefinitely accumulate credits. Second, and even more significantly, both debtors and creditors would be subject to the payment of a charge, in proportion to their imbalance. It is as if, in this sort of international bank designed by Keynes, not only debtors would have to pay an interest on their debts, but also creditors would have to pay an interest on their credits.

This might appear startling and vexatious towards creditors, since we are used to seeing them as virtuous savers that deserve to be rewarded. Yet, this is contrary to the logic of Keynes's plan, and on strictly economic, not moral, grounds. First of all, the creditors within the Clearing Union have not deposited any money, and hence do not have to be compensated for not spending it. In fact, their credit remains perfectly liquid, and they are free to spend it, in any direction and at any moment they please. So, if they refrain from doing so, it is only for their free decision not to spend. This is perhaps enough to explain why creditors do not earn anything. But why do they have to pay? Because, indeed, they receive a benefit from the possibility of running credits with the Clearing Union that it is worth paying for. Just as the Clearing Union allows deficit countries to purchase goods that they otherwise would not have been able to afford, in exactly the same way and in the same measure it allows surplus countries to sell goods that they would have otherwise not have been able to sell. Hence, the creditors may be happy to pay a charge for the opportunity of gaining access to a wider market, especially in economic systems that are chronically affected by overproduction, where demand is often the most difficult good to find.

[11] J. M. Keynes, *A Tract on Monetary Reform* [1923], in CWK, vol. 4, p. 124.

The symmetric charges would have the further benefit of facilitating the return to a balanced position for all members. Insofar as creditors have an incentive to spend their positive balances, it will be easier for deficit countries to reduce their negative balances. This would facilitate the repayment of debts and the reduction of global imbalances in the interest of all, and hence the achievement of the main purpose of the Clearing Union. In the words of Dennis Robertson:

> It is arguable that the proudest day in the life of the Manager of the Clearing Union would be that on which, as a result of the smooth functioning of the correctives set in motion by the Plan, there were no holders of international money – on which he was able to show a balance sheet on both sides of the account.[12]

Despite the incentives to converge towards a clearing of all balances (whence the name of the Union), it may occur that a country still experiences a persistent imbalance. Here comes into play the third distinctive feature of Keynes's proposal: the correction of exchange rate misalignments. In case a country should have a systematic deficit (or surplus), its currency would be devalued (or revalued) accordingly, in order to increase (or reduce) its competitiveness and hence to restore the equilibrium of its foreign trade. The fact of restricting the possibility of devaluating to deficit countries is sufficient to rule out 'competitive devaluations', that is, the indiscriminate recourse to this sort of measure as a way to boost exports. In fact, the disequilibria that would justify such corrections would be clearly defined in terms of a certain proportion of the quota for a certain number of years.

(5) Why was the Keynes Plan not adopted?

If the light of this analysis, however sketchy, it appears that the Keynes Plan contained measures that would have presumably allowed it to pursue much more effectively the goal of containing global imbalances, on which there was general consent. It is therefore only natural to ask why the proposal was eventually set aside, in favor of the American proposal.

The most immediate answer would seem to be that it failed to reflect existing power relations. After all, by the end of World War II, the United States were by far the leading industrial power of the world, they had accumulated massive credits towards their European allies, and they were the owners of almost all the official gold reserves of the entire world. Why should they have been willing to enter a plan on a level of parity with all the other countries? It might seem obvious that no reason at all could induce the Americans to enter the Clearing Union. And yet, at a closer look, there were indeed good reasons. First of all, Keynes was not so naïf to believe that the world economy could restart from scratch after the war. He envisaged the possibility that the wealth previously accumulated in the form of gold could be paid into the Clearing Union and credited to the account of the owner. However, this was conceived by Keynes as a

[12] D. H. Robertson, 'The Post-War Monetary Plans', *Economic Journal*, December 1943, p. 359; quoted in F. Cesarano, *Monetary Theory and Bretton Woods. The Construction of an International Monetary Order*, Cambridge: Cambridge University Press, 2006, p. 150.

one-way convertibility: gold would be convertible into bancor, but bancor could not be converted back into gold. The rationale for this provision, in the logic of Keynes's proposal, is quite evident: the possibility of taking positive balances out of the Clearing Union would have allowed creditor countries to escape the charge, and to refrain from reducing their position. Keynes was convinced that such behavior was to be avoided, in the interest even of the creditor countries, since it would have exerted a contractionist pressure on world trade, to their own detriment. Of course, one might argue that the United States might not have subscribed to this view. However, the scale of US aid, particularly under the Marshall plan, testifies that indeed the Americans did share the belief that a substantial redistribution of wealth was necessary, and in their own interest.

It is then perhaps more accurate to say that the true aim of the American government was not to preserve the existing distribution of power and money, but to maintain control of the source of money and power, by establishing the use of their national currency as an international means of payment. Indeed, this endowed the US with 'the secret of a deficit without tears', which, as shown by Jacques Rueff, 'allowed the countr[y] in possession of a currency benefiting from international prestige to give without taking, to lend without borrowing, and to acquire without paying'.[13]

To be sure, the gold dollar standard that was established at Bretton Woods as the new international monetary system provided an invaluable thrust to the political and financial power of the United States, supporting it with a potentially unlimited purchasing power. And yet, the dollars flowing conspicuously out of the United States into the rest of the world also served, more broadly, the purpose of defending the interests of capitalist democracies in the confrontation with the Soviet bloc, and of promoting the steady expansion of international trade and investment that was to prove even more strategic than open military conflict in winning that confrontation. Hence it cannot be stated that such system was imposed unilaterally by the United States as a means of preserving power. Rather it was willingly accepted by all Western powers, as the most effective means of pursuing an indefinite increase of power, where productive and destructive capacity are inextricable, and where economic growth and military escalation are just two equally essential and mutually enforcing faces of the mobilization of resources.

(6) What were the consequences of the Bretton Woods system?

The system established at Bretton Woods owes its strength and its resilience to its apparent capacity of serving simultaneously all purposes and all nations in their quest for growth and empowerment. It is apparently a win-win game for all participants. And, yet, we might ask: Is it true that nothing is lost in the process? What are the actual consequences of the Bretton Woods system? What are its costs? The most important one, on which this whole paper is

[13] Rueff, *Péché monétaire de l'Occident*, p. 24 ; English transl. *Monetary Sin*, p. 23.

focused, is indeed the chronic buildup of global imbalances, together with the financial, economic and political instability that they entail. And, if we compare the International Monetary Fund with the Clearing Union it is not difficult to understand why: the statute of the Fund failed to adopt all three distinctive features that Keynes had designed as mainstay of his proposal and as bulwark against the formation of persistent imbalances.

First, the treatment of creditor and debtor countries by the Fund was greatly asymmetric. Deficit countries faced severe limits, charges and interest payments on their debts towards the Fund. On the contrary, surplus countries did not have to pay any charges whatsoever, and could go on accumulating surpluses indefinitely. In fact, the systematic surplus of a country would imply that, as the other countries would be purchasing its currency from the Fund for the purpose of funding their deficits, the currency of the surplus country would eventually be declared by the Fund to be scarce. In that case, the 'scarce currency' clause would come into effect. It has often been said that the reason why surplus countries did not share the burden of readjustment within the Bretton Woods system was because that clause was not applied. Considering its provisions, it might as well not have been written. In face of persisting surpluses, in fact, all it states is that the Fund can borrow or purchase the scarce currency from the surplus country. Far from putting surplus and deficit countries on an equal footing, therefore, the Articles of Agreement of 1944 actually give an advantage to surplus countries, not only with respect to deficit countries, but in relation to the Fund itself, since the latter may be forced to borrow the currency of the surplus country at an interest.

Second, the statute of the Fund did not present adequate measures to correct exchange rate misalignments. In principle, the Bretton Woods system established a regime of adjustable pegs, just as the one envisaged by the Keynes plan. And yet, the conditions at which the exchange rates were to be adjusted were not equally clear. The Articles of Agreement stated that 'A member shall not propose a change in the par value of its currency except to correct a fundamental disequilibrium'. And yet nowhere in the entire document was a definition of 'fundamental disequilibrium' to be found. In the absence of a definite and agreed criterion according to which exchange rates ought to be adjusted, the adjustment did not take place, the Bretton Woods system came to be seen as a system of fixed exchange rates, and the ensuing imbalances couldn't but persist.

Third, and most important, the Bretton Woods adopted a national currency as international money. Systematic balance of payments deficits for the country issuing the international money were an inevitable consequence of this arrangement. Those deficits became essential as a source of money supply for the rest of the world, and as a means to finance the expansion of international trade and investments. And, as Triffin has pointed out in formulating the dilemma that goes under his name, running deficits in the interest of growth can only jeopardize stability.

(7) What can be done today?

The Triffin dilemma has been recently quoted as a reason of major concern in a paper by the governor of the People's Bank of China, Zhou Xiaochuan. If it is read between the lines, the remark also seems to suggest thy reason why China might not be so eager to take over America's dubious privilege of issuing the global currency. The paper indicates the identification of the international money with a national currency as the main cause of the global imbalances, in which the People's Bank of China is in up to the neck under the weight of its foreign reserves (figure). The governor, then, sets out to propose a way of overcoming the dilemma. The proposal consists in '[t]he creation of an international currency unit, based on the Keynesian proposal'.[14]

The explicit reference to Keynes's plan, as a model for reforming the international monetary system, is all the more significant and encouraging as it comes not from a large debtor country, as was Britain in 1944, but from the greatest creditor country worldwide. Unfortunately, however, the Chinese proposal only maintains one of the three distinctive features of the Clearing Union: the international currency. And it misinterprets it as a reserve currency, whereas bancor was a pure unit of account. As a consequence, the other pillars of the Clearing Union fall. The Chinese proposal consists in extending the use of Special Drawing Rights (SDRs), issued by the IMF, as a means of international settlement and as a reserve asset. This would definitely alleviate the pressure on the US balance of payments to provide international liquidity, but it would transfer the entire burden on the frail shoulders of the IMF. Moreover, SDRs are created as a fiat money by the IMF, and they are lent out at interest, thus producing a clear dissymmetry between debtors and creditors. The use of SDRs as a global currency, in lieu of the dollar, may not require global imbalances, but it certainly also does nothing to reabsorb them.

What, then, can be done? One option could be to transform the SDR in a pure unit of account (or to establish another monetary unit), to be used by a special department of the IMF (or by another international financial institution created ad hoc) to grant overdraft facilities to states for the settlement of their international payments on current account, according to the principles of multilateral and intertemporal compensation devised by Keynes for the Clearing Union.

A similar clearing system could be set up in Europe to face the current sovereign debt problems. As I have already observed, the whole debate concerning the so-called 'sovereign debts' is biased by an obsessive concern for public debts, whereas the problem really concerns that part of public and private debts which is financed abroad. In other terms, the real problem of the euro today is the persistent disequilibrium in the balance of payments of participating countries. And the European monetary unification bears itself a responsibility for the buildup of such imbalances, since it has encouraged international capital movements to expand at bay

[14] Z. Xiaochuan, 'Reform the International Monetary System', Speech by the Governor of the People's Bank of China, 23 March 2009, available at http://www.bis.org/review/r090402c.pdf (accessed 11 May 2011).

from exchange risk, in fact inhibiting the correction of exchange rate misalignments. The ensuing economic and political tensions have been exacerbated by a consolidated expert and public opinion that views a trade surplus as a virtue and a deficit as a vice, whereas they are in fact the two sides of the same medal. The imbalances within the eurozone would be more appropriately and effectively tackled if they were financed through a clearing system, with a more balanced distribution of the burden of adjustment between debtor and creditor countries. Such institution could be drawn up along the lines of the European Payments Union, that actually allowed Europe to clear 75 percent of its trade in the 1950s and that, in turn, was largely inspired by Keynes's plan for an International Clearing Union.[15]

[15] See M. Amato and L. Fantacci, *The End of Finance*, Cambridge, Polity Press, 2011 (forthcoming), part 2, chapter 5, 'The European Payments Union'.