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The Keynes Plan Today
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When John Maynard Keynes presented his ideas for an international clearings union for central banks he was insistent: “These advantages of the proposed International Clearings Union are surely so great that they overshadow most reasons of objection on lesser grounds.” (Keynes, 1980a, 47). Keynes wanted to set out what was best for the world in practical terms. Looking at the Keynes plan today, what remains fresh is the ethical principles he developed.

“The common love of truth, bred of scientific habit of mind is the closest of bonds between the representatives of divers (sic) nations” Keynes (1980b, p. 21) told the Lords in his famous speech supporting the Bretton Woods accords. In fact those thinking about world monetary problems are precisely divided between those who agree with Keynes that truth will win out from discretionary action by informed participants in a commonly agreed, just, and efficient arrangement; and those who prefer automatic mechanisms (such as foreign exchange currency

markets) to be obeyed in practice (Freidman, 1953). The editorial preface to his posthumous article in the *Economic Journal* (June, 1946) described Keynes as “one of the few” with the attributes needed to “restore civilization.” (Kafka, 1983). His plan was designed to do that and more: bring about a civilized approach to international monetary relations. He described it as financial disarmament (Keynes, 1980a, p. 131). At Bretton Woods his plan was rejected; but the world did get a financial cease fire: it turned out to be temporary.

This paper reviews the dream of a world currency, specifically, a world currency of the sort proposed by Keynes, a currency issued by an international agency. The first section looks broadly at what happened after Bretton Woods, the world since the Keynes plan was rejected; it reveals the limitations of gold, and the U.S. dollar as world monies. The second section looks at Keynes proposal for “bancor” in the light of what we know today. A third and concluding section reflects on what we can learn from Keynes in thinking about the projects for future world monetary co-operation in the era of the Euro. Throughout, an attempt is made to situate discussion of world monetary units in a historical context, without neglecting the common conceptual features.

The standard concepts of a monetary unit are as a unit of account, means of exchange and settlement, and storehouse of value. Not surprisingly, a world monetary unit has often been discussed in these terms. But, the conceptual issues treated here come under what is called the anchor problem: what shall constitute the main reference value for international transactions? (Mundell, 1982, 3) Or, to change the metaphor, what should be the pivot point for world finance? (Chesnais, 1997).

Keynes was used to thinking about a world where London was the financial centre and the pound offered features of a world money. In drafting his post-war proposals he was conscious that only a fully multilateral system would allow the sterling bloc to operate, and London to maintain its position in world finance, as restrictions would drive surplus members out of the bloc (Keynes, 1980a, 69-71,

93-4). Review of the much discussed current topic of globalization reveals that for most observers we already have one financial world characterized by integrated currency trading, money and securities markets, and massive capital movements across national boundaries (Davidson, 2003; Eatwell and Taylor, 2000). The extent to which one world implies one international currency is worth further consideration.

The brief survey undertaken here cannot address all aspects of how a world currency might work. It does not try and enumerate or examine the various attempts to think about a new world money or central bank (Smithin and Wolf; Blecker, 1999, 85-145). It does seek to assess whether a world monetary unit as conceptualized by Keynes makes sense in this era. Can we think about the world using his categorization of the international monetary problem, keeping in mind, as he did, that a utopian outlook can be useful if only to push the world a little closer to seeing itself differently?

The short answer is that when the Keynes project is discussed, and the issues that arise from postwar monetary arrangements through the IMF are highlighted, the vision contained in the bancor proposal has contemporary relevance. Indeed, the conceptual framework developed by Keynes can be used to look at the issues that were neglected, or inadequately dealt with, by the practices since World War II. The adoption of a fixed gold price, the dollar exchange standard, the SDR, the floating exchange rate system, and the Euro raise issues and questions similar to what did, and did not, figure in his thinking about a world currency. Thus, when we attempt to see what went wrong since the Keynes plan, and ask what could be done to put things right, the thinking of Keynes remains relevant.

Overall his dream of a world money need to be understood in the context of the British empire, and recast again in the era of American hegemony, and European supranationality. Globalization does not mean that nations have accepted to live as if the world were one; a world currency would imply taking on that responsibility.

I: Bretton Woods and After: Why the Keynes Plan is Still Relevant

Bretton Woods enthroned gold, and the dollar as international money. By fixing the dollar price of gold, the gold exchange standard as envisaged by the Genoa conference of 1922 was made the operative mechanism for establishing the unit of account for world reserves: gold at \$35 dollars an ounce; or dollars. The latter earned interest and had liquidity. Dollars were also in short supply in 1944, and for more than a decade to come. This ensured their value and added to their attractiveness for private agents, financial institutions, and central banks.

What Bretton Woods did not do was make the IMF an operative lending institution. The IMF lent very little in its first years, and overall its resources were puny when compared to flows of international finance and credit. European monetary cooperation and Marshall plan and Dodge lending were at the centre of reestablishing international trade and finance, not IMF lending. American finance flowed bilaterally, outside the Fund. Ironically, magnitudes envisaged by Keynes in his plan were closer to what happened than those allowed for by the Americans at Bretton Woods.

For an adept of the monetary approach to the balance of payments such as Harry Johnson (Johnson, 1972) it was the fixed exchange rate regime which stood out when one looked back at what was agreed to in New Hampshire. In effect, to the extent that currencies traded against the dollar at rates established around a par value, the world could be said to have adopted a single currency. According to their analysis, the amount of liquidity in the system was set by the supply of new dollars flowing abroad. Thus, the U.S. balance of payments determined the potential rate of growth of reserves, and the amount of deflation or inflationary pressure in the world economy.

The U.S. was busy establishing a transnational empire based on direct foreign investment by U.S. controlled corporations. In a sense its publicly traded companies with their wholly owned foreign subsidiaries were the new British East India

Company, or Hudson Bay Co of a new post-colonial era of open markets announced in the Atlantic Charter that was to replace the European empires. The breadth and depth of the U.S. money market meant that the U.S. was a recipient of large sums of short-term capital. Much like Britain earlier, it was lending long and borrowing short. American investment abroad was very profitable. For most of the 20th century, inflows of interest, dividends, profits, and management fees outstripped outflows of new foreign direct investment (Levitt, 1970). The U.S. now finds itself in the debtor position. It makes no sense for the rest of the world to be lending money to the richest nation in the world but that is in fact what has been going in recent years. This indicates a “fundamental disequilibrium” not just in the U.S. balance of payments but in the flow of world finance.

To the extent the gold exchange standard was a dollar standard, the dollar was the world money (Rueff, 1971), but there were some important questions left hanging, about the bank of issue, or the lack there of, for example, and the amount of new liquidity available to finance world trade. And, it needed to be asked what about national policy to deal with inflation or deflation? In the the world outside the U.S. monetary policy could target the foreign exchange price of the currency, but only with difficulty if a country was also trying to control the quantity of money in order to target inflation, or stimulate the economy through deficit spending.

For the global monetary theorists (Johnson and Mundell), the role of the Federal Reserve was crucial to determining outcomes. As well, balance of payments flows depended on fiscal policy in the U.S. Mundell (1982) argued that by sterilizing gold outflows the U.S. Federal Reserve triggered the demise of the system. Gold became undervalued, the gold flow was going one way -- outward from the U.S. -- and it was irreversible.

Keynes was preoccupied by deflationary tendencies due to the surplus position of the U.S. These were addressed initially by post war lending bilateral lending policy, and U.S. military spending abroad. However, it was the growth of Euro dollar

deposits, and subsequent lending and creation of new dollar liquidity that rapidly changed the nature of world finance. Dollar shortage in the period before the movement to currency convertibility by the European nations in 1958, turned to dollar glut by 1968. In the wake of the establishment of U.S. multinational corporations abroad, U.S. financial institutions set up alongside European lenders. Centred in the city of London, the Euro markets privatized international credit creation. Prompted by American regulation Q (limits set on interest paid on domestic deposits) which made it profitable to bid on deposits in U.S. dollars, and still make profitable loans, the flow of finance out of the U.S. triggered a crisis of confidence in the gold market.

In March of 1968, a two price system for gold was set up, and effectively the link between the dollar and gold was broken, though this was not officially recognized until August 15, 1971 when Nixon officially devalued the dollar -- a default in essence -- and closed the gold window. At that point, with the U.S. no longer selling monetary gold, the next step was for others, the European central banks mainly, to cease buying dollars (Mundell, 200a, 2000b).

The balance of payments adjustment process was fingered as the villain in the play that killed the Bretton Woods order (Triffin, 1988). There was no way for the U.S. to change its par value without defaulting on its pledge to redeem in gold -- at the fixed \$35 price -- official holdings of dollars. This left the onus on surplus countries to revalue or to load up on surplus dollars. In effect, the Europeans, and Japan had done both. At the end of a futile search for new par values, generalized floating, accompanied by new efforts at European monetary co-operation ended the par value system, and the gold exchange standard (Williamson, 1977; De Vries, 1976). But, though the world was no longer on a single currency system, the dollar was still the main world money. The unit of account for most of world trade was the dollar, and most payments were made in dollars, though some diversification of official reserves was taking place.

If floating rates addressed the adjustment question, the use of a national currency as the world money was still a major outstanding issue. The SDR was conceived as a supplementary reserve asset at a time when the dollar looked to be in short supply. Based on a currency basket it came into being when an inflationary crisis was brewing that would disrupt not only financial flows, but the very thinking known as Keynesian, and, eventually call into question macroeconomic policy itself (Beaud and Dostaler, 1993). SDRs were allocated in proportion to IMF quotas. As Triffin pointed out, the rich countries looked after themselves. As a result the countries that could have used the drawing rights, the poor, deficit countries, went without, and the SDR failed to circulate to any great extent. But it did become the unit of account for the IMF, and it provided a standard against which the values of the currencies in the basket can be measured with respect to each other (De Vries, 1976).

The creation of the Euro adds yet another new currency to the mix. Unlike the SDR, purely central bank money, the Euro circulates replacing domestic monetary units. Internationally it represents a challenge to the supremacy of the dollar in international finance.

Domestically it represents an innovation: Euroland has a new central bank, but not an elected government to oversee its actions. Does the ECB incorporate a deflationary or anti-expansionist bias? To the extent it does, it is far from respecting Keynesian principles. But, in some respects, once the age of the Euro dawned others made themselves ready for negotiations on the dollar, and future international co-operation (Council on Foreign Relations 1999; International Financial Institutions Commission, 2000; IMF, 2000; Mack 1999, 2000; UN, 1999; U.S.Treasury, 1998).

Though not all agreed, the logic underlying the Keynes plan was sound, as will be seen. But the Bretton Woods conference was not an exercise in logic or philosophy. Politics, not public reason, was to prevail. National interests, not ideas, would win out. While Keynes favoured unit – bancor -- was not to be, the idea of a

world monetary unit remains an intriguing possibility, or at least worthy of further thought, reflection, and discussion. A UN Commission has recently pronounced on the need to update the SDR, and the Chinese Central Bank has been heard from on the subject of creating an international reserve unit. The successful launch of the Euro suggests that some monetary schemes of an over-arching nature can be realized. However, past experience with bancor and the SDR suggests currency reform schemes carry with them the limitations of any utopian project.

II: The Clearings Union Proposal

More of the Keynes plan subsists in the IMF than is always acknowledged, including the name, which was suggested by him when the “draft statement of experts” (Keynes, 1980a, pp.469-77) was being prepared in 1943. Keynes thought of his clearing union as being made up of quotas for drawings by members. The IMF established such quotas, and introduced drawing rights into the daily language of international finance. Keynes (1980a, p.127) foresaw bancor being defined by its gold weight, and currencies being defined by their relation to bancor; thus currencies were to be defined to each other in relation to gold, as well as in bancor. Similarly the IMF declaration of par values by members suggested currencies defined in gold, and subsequently in dollars.

The Keynes plan was conceived in a short week at Tilton where John Maynard Keynes kept a summer residence (Skidelsky, 2000). This “was the job of putting on paper my ideas about future currency arrangements” previously announced in a letter to Richard Kahn (1980a, p. 20). His initial draft of September 8, 1941 was divided into two memorandum (Keynes1980a, p. 21-40).

In the Post-War Currency Policy, the first paper, he wrote that history had shown what had not worked in the inter war period, which, he famously suggested, had served as a laboratory for ideas that now needed to be discarded. This paper contains his assessment of the “secular” international problem, as well as the British problem, followed by his analysis of “the problem,” and then his statement

of “the Alternative Before Us.” His second paper he entitled Proposals For an International Currency Union, and was designed to be used in approaching the United States. It was the rational utopia, reflecting his analysis.

Though the plan for an international clearings union, as devised by Keynes, went through various versions, at its heart was the idea of a central bank lending to deficit countries under specific banking conditions. The world money was not in the first draft and first appeared named Grammor in the “Appendix” to his second draft of November 18, 1941 (Keynes, 1980a, p. 61). Bancor appears first in the important third draft of December 15, 1941 (Keynes, 1980a, p. 68-94). Bancor accounts would be created in the form of over-draft facilities. Gold could be exchanged for bancor, but not bancor for gold. Interest would be charged to those who drew on their account, and in a innovation worthy of emulation today, surplus countries would also pay interest once they had “overaccumulated” bancor.

In his plan Keynes (1980a, p. 127) recognized the role of gold as a unit of account, even if in responding to cabinet questions on the fourth draft, he (1980a, p. 274-5) expressed the view that credit created in the union would vastly overshadow the role of gold. And, obviously, as was well known to all concerned, Keynes was no fan of gold species flow adjustment because of its deflationary bias. But he (1980b, p. 17-9) pointed out in an important speech to the Lords that demonetization of gold was not being called for by anyone. Not by the Americans who held so much of it, and not by the British Commonwealth who produced so much of it. Gold was a convenient way of setting an initial par value for a currency that could be subsequently be adjusted, meaning the value of the currency would be set by internal policies, not imposed under compulsion by external commitments as under the gold standard.

The Keynes plan expected that daily financial business in member countries would go on as usual, but that central banks would deal with each other in a new way through the creation of the union (Keynes, 1980a, pp. 125-6). Instead of

outstanding balances being settled by gold shipments, or currency holding being redeemed for gold (or gold accounts being adjusted) overdrafts would be debited and credited with the clearings bank.

Keynes saw national central banks in his international clearings union as in a similar position to British clearings banks with the Bank of England. Central banks would relate to each other through their own central bank. This clearings union for central banks could settle outstanding balances, and lend out surpluses to deficit central banks.

In his thinking Keynes made the point that the clearings bank could not itself get into financial difficulty, credits equaled debits within the bank, assets equaled liabilities: it was a closed system (Keynes, 1980a, p. 112). The advantage was that countries were in a deficit or surplus position to the union as a whole, not to each other. Multilateralism would replace bilateralism. Lending by surplus countries did not affect their capacity to produce or consume.

The important difference between a purely domestic banking system, and the proposed international clearings union was that domestic banks dealt firstly in a single national currency while the members of the clearing union each had their own monetary unit.

As it was gaily announced by Dennis Robertson (1952, p. 173) in a celebrated ditty, the role of a common currency in the currency union was not obvious. Was it to be accumulated, or spent quickly? Was it a reward or a punishment? How nations were to see it was not evident, and though it went unsaid, for those who wanted to bring bancor into being, like with any new endeavor, the intent of the creators, and the results in operation, were not necessarily going to be the same. Keynes wanted the world trading system to eliminate its contractionist pressures (Keynes, 1980a, p. 112-14). A nation in surplus was accumulating gold, idling resources in the process. In the domestic banking system the equivalent was deposits which would generate loans. An international clearings union could serve the same end by lending to deficit countries. Within the international clearings

bank, the use of overdraft facilities by deficit countries was a “relief” to them, but did not create a “real burden” for the surplus countries. Keynes thus gives international cooperation a definition: benefits arise without creating offsetting burdens for others (Keynes, 1980a, p. 112).

Central banks had their own monetary units, and their financial positions reflected national policies. To lend to them was to support those policies. Automatic lending amounted to approval in advance. This was why Keynes had carefully thought out the terms of access to bancor. He argued that in international finance rules had to be thought out and agreed to in advance much more than in domestic banking where the individual lending practices of the banks could be counted upon to screen reckless borrowers (Keynes, 1980a, pp.45). Not wishing to hand money over to insolvent clients sharpened the attention of high street bankers. How could the international community agree to finance automatically the policies of say a quasi-fascist, or racist state?

Policy trumps Bancor

The demise of the Keynes plan as an operative mechanism for putting a world currency into play went through three stages, none of them related to economic reasoning. First the internal workings of His Majesty's Government (not to mention his natural opponents, and self-proclaimed adversaries) had a way of interfering with his ideas. The national interest of Britain was the presumed basis for policy-making. Within the British civil service, and the Bank of England, the vigilance of internal critics to utopian ideas represented an obstacle that could only partially be overcome. Tradeoffs had to be made between the British request for an American loan and ensuing negotiations, plans for commercial policy and buffer stocks, and the clearings union. Which was to get priority? The role of sterling and the British balance of payments weighed on Keynes himself as well as being the main preoccupation of Ministers, the Treasury knights, and the Bank of England (Horsefield, 1969).

Secondly, Keynes (1980b) himself under pressure from all sides, changed his own outlook on what it was he wanted to accomplish. Policy debate inevitably slid towards the notion of what most needed to be done. His own priority became ending the dangers associated with American isolationism; Americans needed to think of themselves as owners of the post war order; nothing of value could be accomplished without them; therefore the price elasticity of meeting their demands was high.

Finally, the American negotiators fell under the influence of their own assembled interests. These were, principally, foreign exchange dealers from Wall St. Having central banks settle up outstanding balances amongst themselves in bancor through overdrafts facilities established by the IMF, was not the vision New York bankers wanted to support. Lucrative commissions on foreign exchange trading were of greater interest.

It will be remembered that Keynes foresaw a much weakened Britain emerging from the successful war effort, and that he was not alone in seeing this. His great task was to put forward a plan that was in the interest of Britain and of the world, and to still make it a plan the Americans would take as their own (Harrod, 1972a, 1972b). His views of British interests were subject to debate and discussion at the highest levels in HMG. But, decisions were made by others than himself, obviously. His views of the interests of the world are what make the plan still interesting today as shall be seen further below. As for the Americans, it seems most of the main players were prepared to believe that anything in the British interest would be turned down flat in Congress, even if it could be shown that the Americans would benefit as well (Horsefield, 1969; Skidelsky, 2000; Moggridge, 1992). In short international cooperation on a scale envisaged by Keynes was not on.

Shortly after Bretton Woods, the U.S. administration made several moves to bring the IMF under American control including situating the Fund and the Bank in Washington (Keynes, 1980b). In the bid to obtain congressional support the U.S.

established a cabinet level committee to oversee the Bretton Woods institutions and protect U.S. interests. Keynes had envisaged a joint Anglo-American run clearings banks with other nations to come in later. In fact the IMF is now so closely identified with the U.S. Government that it seems incapable of acting with impartiality. John Eatwell (Eatwell and Taylor, 2000) has proposed using the B.I.S. in Basle as a new world central bank perhaps for this reason. Restoring the IMF to international control is a prerequisite for any world currency centred on the SDR.

III: Learning From the Keynes Plan

Though individual nations in financial trouble struggle to meet requirements for external debt repayment, viewed from perspective of the world as a whole, international financial flows are equal: world exports equal world imports, cross border outflows equal cross border inflows. The world cannot have a balance of payments deficit, though individual countries can get themselves in plenty of trouble. This state of affairs provides the basis for conceptual thinking about a world currency in the spirit of the Keynes plan. Not in the past practices of the IMF however. Through its structural adjustment programmes, the IMF has been implanting a market model in which seemingly all states will simultaneously have export surpluses, in order to make payments on foreign owned assets (Williamson 1990, 1997).

Under the international gold standard, it was expected individual countries would have balanced trade, exports equaling imports, thanks to the movement of prices engendered by gold outflows or inflows. As Joan Robinson (1978, p. 213-4) noted, this equilibrium was assumed by the model, and those that propounded it as well. It was not how the world actually worked: income and expenditures on current account did diverge. Since these included payments and receipts of interest, dividends and profits on foreign borrowings and investments, as well as for goods and services, there was no reason for them to be equal. Flows of capital could either compensate for an income deficit or accentuate it; they would not

necessarily equilibrate the income account.

Some countries could accumulate positive balances in a financial centre such as London. Others could contract foreign loans. Gold could be moved around in bank vaults as well, but there was no automatic balancing of income and expenditure accounts. Keynes (1980a, 21) pointed out: "The problem of maintaining equilibrium in the balance of payments between countries has never been solved, since method of barter gave way to the use of money and bills of exchange."

In his thinking about the world, Keynes (1980a, p.123) was used to seeing Britain and the city of London as being at the centre of an empire. The dominions and other members of the sterling area left deposits in London that were transformed into investments reaping interest and dividends abroad. In his own analysis Keynes (1973) resented these capital exports, especially in the slump that followed the first world war, and affected Britain greatly, though not as much the rest of the world. This led to him writing about how finance should be national above all, goods should be homespun and ideas cosmopolitan and international (Beaud and Dostaler, 1993). Keynes was an opponent of laissez-faire. He understood the banking function of key currencies. Though he often appeared to favour the imperial view of the issues that arose, he was quick to show overall benefits to be gained from bringing the world together.

In his model of international cooperation each nation could stand on its feet, and would not be swept away by international forces. Keynes wanted to see a large clearings facility, a major commitment of resources to international co-operation. Ample access to resources meant that countries did not have to deflate or devalue at every cyclical downturn (Keynes, 1980b). Exchange rates did not have to be adjusted as frequently, if the surplus countries were recycling finance to the deficit countries.

The IMF has never been successful in dealing with the big, rich members that control its activities. From the Keynes plan we need to retain the main idea: first, and most importantly, it is the rich countries that should adjust their policies to

those of the poor (Keynes, 1980a, p. 27-31). The surplus countries need to expand; it is not the deficit countries that need to deflate. This is in sharp contrast to IMF policies that promote a “deflate and depreciate” solution to countries in balance of payments difficulties.

Much that makes the Keynes plan look outdated today has to do with his view of central bank operations; some of his basic assumptions no longer hold. Settlement of deficits and surpluses through central bank bilateral transfers is not the issue it was when Keynes devised his plan. Money flows through foreign exchange markets that run through bank networks around the world, not from domestic banks through central banks, and then on to other central banks. The combination of floating exchange rates, and the use of the dollar as world money now define the practice of international finance (Mundell, 2000a).

It is hard to see how the role (a tyrannical one) of FX markets could be contained by reverting to having domestic banks deal in foreign exchange only with their central bank, when there is hardly such a thing as a large domestic bank-- most important financial institutions now being transnational in character. Though, should a further crisis occur, similar to the one sparked by the failure of Lehman Bros. that imperiled the dollar itself, the advantage of reverting to nationally regulated banking systems with commercial banks settling with their central banks, and central banks with each through a clearings union would be obvious to many.

Keynes saw fixed exchange rates as basic financial practice (Keynes, 1980a, p117-8). Central banks held accounts with each other, and accumulated balances of foreign exchange through exchange market intervention to maintain the gold value of the currency. The foreign exchange (convertible currency) could then be kept on account, or be converted into gold, as the authorities decided. But private foreign exchange markets have grown, and the importance of national central bank reserves has diminished.

Today currency values fluctuate, sometimes widely. Interest rate adjustments, not

exchange market intervention, influence international financial flows: countries allow currencies to vary, or attempt to affect markets through monetary policy. Competitive devaluation is common practice. National monetary sovereignty is still an important basis for economic policy making in much of the world (Smithin and Wolf). Floating exchange rates are seen as enhancing national policy autonomy. Not everybody appreciates this state of affairs. After the second amendments to its articles of agreement (1976) favouring exchange rate flexibility, Robert Mundell (1997b) referred to IMF policy as “destabilizing” economies such as Mexico. Keynes (1980a, p.149) pointed out that if the full employment rate of interest in Britain was below the prevailing rate in Australia, it was hardly acceptable for money to flow abroad creating unemployment at home. Importantly, for Keynes the idea of capital controls was central, and it was the capital controls that were practiced in Britain than he had in mind when he wrote that “it is widely held” (Keynes, 1980a, p. 113) that capital movements both inward and outward had to be regulated. He thought the clearing union would facilitate this greatly at both ends. In essence, Keynes thought it was possible to discriminate between movements of “floating funds” and genuine new investment, between capital movements that compensated for trade imbalances, and those that promoted further imbalances (Keynes, 1980a, p.53). His plan envisaged an international board approving investment flows.

In the years since his death, liberalized capital movements have become the basis of international economic policy, with flows of international trade being dwarfed by speculative flows of finance. International currency markets were estimated to do \$1.2 trillion dollars of trading a day by 1995 (Smith, 1999), representing about four months of total international exports. By 2007, the BIS estimated currency trading at \$3.2 trillion a day.

Of course, Britain herself had been at the centre of a great age of global finance, and the Keynes (1930) of the Treatise has foreseen the need to include capital flows and trade flows in his analysis of the macro economy. Once currency

convertibility had been well established in the 1960s, the Mundell-Fleming analysis of the small open economy was standardized by textbook use (Mundell, 1997a). However the impact of the capital liberalized flows is far from being straightforward or uncontroversial. The rôle of foreign direct investment requires careful scrutiny from the perspective of sustainable development in the Third World (Levitt, 1970). And the influence of hot money has led some to argue for Chilean style roles to control short-term capital movements (Blecker, 1999, p. 99-100). Now, it is generally held that for most countries capital flows, not trade flows, drive the exchange rate, and determine the balance of payments. In the absence of exchange controls, trade flows are of course affected by exchange rate variations.

The Tobin tax, to be applied at a tiny rate on all foreign exchange transactions, an idea of the 1970s, became a proposal with some support in the late 1990s (Blecker, 1999, p. 96-8; Frankman, 2002). However, thinking about measures to control capital movements has lagged accounts of their importance. From the point of view of encouraging currency flight from the Third World, the removal of the withholding tax on interest paid to foreign purchases of U.S. securities by the Reagan administration was arguably the worst public policy measure to be enacted. While it allowed American authorities to increase their borrowing from the rest of the world, it reduced the ability of other nations to track offshore capital leaks. International coordination in the use of withholding taxes to control flows of hot money into securities markets would have the effect of reducing exchange rate volatility.

What Keynes did not incorporate when in his British centric thinking mode, was the world when looked at from outside Britain, from the end of the borrower, from the Argentine, Australia, South Africa or India. When he did look at the world in his clearings union plan, he was not able to include both the British case of a debtor faced with liquidating its overseas investments, and the case of overseas borrowers of loan capital with deposits on account in London. In a sense the

current account surpluses were to be separated out and addressed in the union, with the capital account issues being addressed in the bank. In his well known characterization Bretton Woods created a fund that it called a bank, and a bank that it called a fund. What is needed is an institution that can be both a fund and a bank, that can integrate the short-term deposit, and long term loan functions. That argues for the establishment of a world central bank able to issue securities, and make loans at both the long and short ends of the market.

Current Financial Concerns

Keynes was acutely aware that in the 1930s the emergence of competition between the sterling area and the dollar zone was a factor in setting protectionist measure against protectionist measure, culminating in making a bad situation worse. He was worried about how Britain could restore its balance of payments after the war, and he was attuned to the development needs of the countries in the sterling area (Moggridge, 1992, p. 670-5). His thinking about a clearings bank can be applied to the problem of sustainable development.

Smaller nations are going to be the losers in the emerging competition between the Euro and the dollar. International competition in the form of competitive devaluations by the Euro against the dollar, and then the dollar against the Euro is not only wasteful, the smaller countries are side-swiped. In 2003 some 50 nations had their currencies fixed to the U.S. dollar. For central banks of these and other countries with currencies that are not widely traded, the establishment of a multilateral clearings facility through the IMF would make sense at this stage. In the world of the Twenty-First century, the anchor problem remains. In establishing a value for a world central bank fiat money, gold would no longer find much favour, even within conventional thought. Of course, Keynes was as fierce an adversary of convention as the financial establishment encountered. He would have no doubt approved of the extent to which gold is being demonetized, even if it did not figure in his plan. The SDR is defined in relation to a basket of currencies

(Yen, dollar, Euro, pound); the Euro was created using a basket based on exchange market values; the U.S. dollar is a fiat currency, as is the Yen, and the pound. Even the Swiss franc is no longer convertible into gold. So, if not gold, what can serve as a pivot point other than a national currency like the dollar or even a supranational currency like the Euro?

The SDR represents an attractive prospect. It exists, it can be reformed, and adjusted. Despite difficulties surrounding its distribution, allocation, and circulation, the SDR bears some of the genes of bancor.

There have been proposals to tie the value of an international currency unit to a basket of goods, and to make it adjustable to changes in those prices. Keynes thought along similar lines working on the Treatise in the 1930s.

Establishing a fiat money for use by central banks among themselves based on the value of other monies (a basket), letting the money work its way into consciousness through judicious practices, based on enlightened thought, that would seem to incorporate the spirit of Keynes. In a short article in the *Economic Journal*, Keynes (1980b, p. 30) spoke of the ability to expand the volume of money available for transactions as being tied to hoarding, meeting contingencies and spanning lags between expenditure and income. He was commenting on international price stability in the light of a contribution by Hayek in the same issue arguing for a basket of commodities standard. Rather than control its quantity Keynes, preferred to see the velocity of money accelerate. He spoke to the banking principle of using idle balances to back new loans, and the overdraft allowing for contingencies and obviating the need for hoarding. The important point here is that credit money was created from the fiat money. That would seem to point the way towards thinking about the role of a world currency today. In a world made up of colonies and imperial centres the number of currencies used in international trade and finance was limited. After decolonization, national monetary units, and their relationships to other currencies, have led to persistent and widespread deficits that have to be financed through acquisition of

internationally acceptable money or foreign exchange. The balance of payments adjustment process routinely overwhelms democratic governance in weak or emerging economies. The efforts to meet human development goals (Sen, 1999) or even basic human needs are thwarted by a hostile world monetary order overseen by the International Monetary Fund (Traoré, 2002; Soederberg, 2002)). Could we not get closer to meeting the millennium development goals of the United Nations by adopting a world monetary unit?

Of course, it would be of some inconvenience to transnational financial players to be forced to settle their foreign exchange dealing through a national central bank rather than with each other. Market participants would certainly resent having to pay a Tobin tax on the foreign exchange commission charged for transactions or on the transaction itself. No bondholders or dealers would appreciate having to pay withholding taxes on interest payments made to them as holders of securities. But, surely, these inconveniences and annoyances have to be set against the cost to humanity of the existing financial order. Keynes claimed he used the calm of war to prepare for the turbulence of peace (Skidelsky, 2000, p.264). Perhaps, in the aftermath of the sub-prime crisis, it is time for the world to dream again, and to reflect about what it would mean to pursue global justice.

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