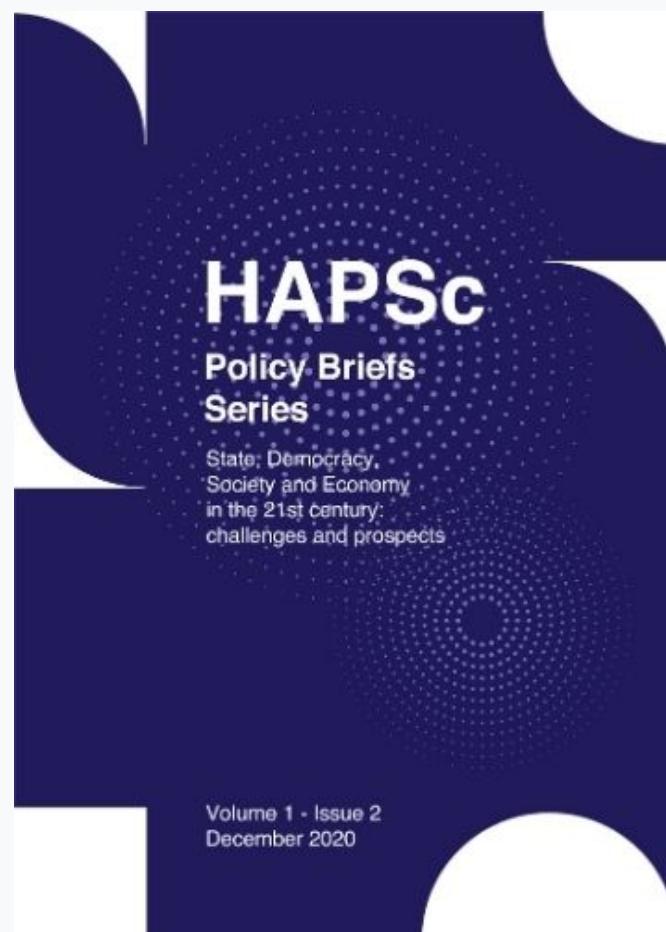


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**Revisiting the “Keynes Plan” for an International Clearing Union in a Eurozone Perspective**

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# Revisiting the “Keynes Plan” for an International Clearing Union in a Eurozone Perspective<sup>1</sup>

Alkinoos Emmanouil-Kalos<sup>2</sup>

## Abstract

The last decade has been turbulent for the EMU, with many structural weaknesses becoming apparent. While in a state of emergency, the European Central Bank has had to “reinvent” itself in order to stabilize the Eurozone, while the vital importance of the imbalances between the member states has been recognized, as the establishment of the Macroeconomic Imbalances Procedure (MIP) indicates. Yet, it is widely acknowledged that the architecture of the Eurozone needs structural reforms. This policy brief aims to present the case for the adoption of the core ideas of the “Keynes Plan” for an International Clearing Union, which could function as an important first step towards fighting intra-eurozone imbalances, hence strengthening the EMU. Given the existence of the European Central Bank and the common currency, a moderate version of such a plan could be implemented even without the need for any changes in the EU treaties, and could be the stepping stone for further economic integration.

**Keywords:** Eurozone; International Political Economy; Keynes Plan; Current Account Balance; International Trade; ECB; TARGET2; Euro; Bretton Woods.

## Introduction

Since the Global Financial Crisis erupted in 2007 and the chain reaction it caused – especially in the European economies – the criticism towards the accumulation of excessive trade surpluses by some countries has resurfaced. Countries such as China, Japan and Germany have been accused of creating severe imbalances in international trade, which spark recessionary effects on other countries due to rising unemployment and current account deficits. As Krugman, Obstfeld and Melitz (2018: 580) mention *“external balance is attained when a country’s current account is neither so deeply in deficit that the country may be unable to repay its foreign debts in the future nor so strongly in surplus that foreigners are put in that position”*. Although for years the idea that surplus countries should adjust their current account balance (just like the deficit countries) has been swept under the carpet, it is now once again gaining traction even among mainstream economists after a turbulent decade of economic uncertainty.

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Taking Germany as an example (as this policy brief focuses on the Eurozone), Bernanke (2015), ex-Chairman of the FED, has claimed that “Germany’s trade surplus is a problem”. In the same spirit, Gabriel Felbermayr (director of the Munich-based Ifo Center for International Economics) said in 2018 that *“(the trade surplus) is turning out to be an increasing issue, not just with the U.S. but with other trade partners as well, and also within the European Union [...] The surplus is becoming toxic, and also within Germany many argue now that we need to do something about it with the purpose of lowering it. It turns out to be a liability rather than an asset.”* (CNBC, 2018). Even the International Monetary Fund has joined the calls for Germany to reduce the excessive trade surplus (Reuters, 2018).

The need for a simultaneous adjustment of both excessive deficits and surpluses, as well as the way in which that could be accomplished, was already highlighted after the WWII and was debated at the United Nations Monetary and Financial Conference (best known as the Bretton Woods Conference). The British proposal for the regulation of the international economic system, led by John Maynard Keynes and known as the “Keynes Plan”, included the creation of an International Clearing Union, which would facilitate the correction of imbalances (both excessive deficits and excessive surpluses) and stabilize the international economic system as a whole. In the end, the British proposal was rejected by the USA, which came forth with a proposal that better suited its interests (known as the “White Plan”). The international monetary system that arose from the latter (the Bretton Woods System) collapsed in the early ‘70s, due to the same weaknesses that the “Keynes Plan” had foreseen and aimed to fix.

Although the implementation of the “Keynes Plan” at an international level still seems to be far from feasible, at a Eurozone level things seem more promising. The institutions and the tools that can support the implementation of such a plan have already been established (the European Central Bank and the Euro), and a decade-long economic turbulence, accompanied by a new post-pandemic economic challenge, has intensified the calls for a change in the European macroeconomic architecture and the role of the ECB. This policy brief aims to present the case for the implementation of (at least a version of) the “Keynes Plan” in the Eurozone, as has been proposed by the relative literature. In section 1, the main concept of the “Keynes Plan” is presented. In section 2, there is a brief review of the core similarities and differences between the “Keynes Plan” and the Eurozone architecture, as well as suggestions for possible reforms. Finally, the paper concludes with a brief discussion on the potential and the feasibility of such a plan.

## 1. The “Keynes Plan” for an International Clearing Union

Although an in-depth analysis of the “Keynes Plan” is beyond this policy brief’s scope, it is important to succinctly present the main concept of the British proposal for the post-WWII international economic order. By doing so, we can assess which parts of the proposal were not feasible back then but are feasible now, and vice versa, in order to adjust it in today’s Eurozone needs and capabilities.

First of all, the International Clearing Union proposed by Keynes would entail an international (supranational) Central Bank, in which the member states would hold reserves in an international currency.<sup>3</sup> The aim of the plan was to provide the international payments system with more flexibility, and avoid the shortcomings and the potential crash of a “gold standard” based system (as it happened in 1971). In essence, the plan aimed “[...] to generalize the essential principle of banking as it is exhibited within any closed system” (Keynes, 1943: 22). As Paus and Troost (2011: 9) point out, “under the gold standard system, the price of money in circulation had to be fixed in terms of a specified amount of gold. To increase money supply, gold had to be imported. Because gold was used as payment in international trade, gold imports could only result from a trade surplus”. Thus, a system like this actively creates incentives for the accumulation of surpluses. As Whyman (2014) notes, when the surpluses remain unused, as dictated by the mercantilist approach that such a system promotes, they are withdrawn from the global economy, leading to reduced aggregate demand, rising levels of unemployment and economic underperformance. The deficit countries can restore their current account balance through deflation and other adjustment programs, which will only augment the problem of the insufficient aggregate demand and its consequences (Piffaretti, 2009). At the same time, there is no pressure on the surplus countries to adjust their balance, an asymmetry that renders the system ineffective and problematic, with potentially dangerous side-effects.

The “recycling” of the surpluses and the balance in the global current accounts was a core element of the British proposal for an International Clearing Union. According to the White Paper of the proposal that the British Government published in 1943, “we need a system possessed of an internal stabilizing mechanism, by which pressure is exercised on any country whose balance of payments with the rest of the world is departing from equilibrium in either direction, so as to prevent movements which must create for its neighbours an equal but opposite want of balance” (Keynes, 1943: 20). As mentioned above, every member would hold reserves in this supranational Bank, through which the international payments would take place with the use of a supranational currency, the Bancor. The exchange rate between the national currencies and the Bancor would be fixed (to reduce uncertainty), with the

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<sup>3</sup> The proposed name was *Bancor*, from the French “*banque or*”, meaning “bank gold”.

possibility of adjustment of the exchange rate only after the approval of the Governing Board.<sup>4</sup> The key part of the plan was the provision that both the excessive deficits and the excessive surpluses would be charged with an interest rate, thus providing incentives to both creditors and debtors to balance their current accounts.

Such a system would also provide the tools to control the international money supply according to the needs of the global economy, without the restrictions of a “gold standard” based system (that was indeed proved problematic later). As stated at the White Paper of the plan, there was a need for “*a quantum of international currency, which is neither determined in an unpredictable and irrelevant manner as, for example, by the technical progress of the gold industry, nor subject to large variations depending on the gold reserve policies of individual countries; but is governed by the actual current requirements of world commerce, and is also capable of deliberate expansion and contraction to offset deflationary and inflationary tendencies in effective world demand*” (Keynes, 1943: 20).

There have been many calls for the redesign of the international economic architecture throughout the years, many of which are inspired by the “Keynes Plan”. More recently, Davidson (2002), Greenwald and Stiglitz (2010) and Ocampo (2010) among others have proposed their own versions of a “Keynes Plan”, adjusted for the 21<sup>st</sup> century international environment and institutions. Still, the Global Financial Crisis doesn’t appear to have shifted the international economic system enough for the implementation of – what could be called “radical” – reforms. Time will show whether the post-pandemic global economy will lead to structural changes.

## 2. Eurozone and the “Keynes Plan”: Compatibility and Reforms

While such a plan seems hard to be implemented at a global level, the European integration (and, in particular, the monetary integration) could render it more easily applicable in the Eurozone. The core institutions that are essential for a version of the “Keynes Plan” to work have already been established in the Eurozone, with the European Central Bank assuming the role of the clearing agency and the Euro taking up the role of the Bancor. The clearing and settlement system, through which the payments among the members take place, is called TARGET2. Given the use of the Euro and its function as a closed system, the Eurozone (unavoidably) resembles Keynes’ idea for an International Clearing Union. Moreover, as stated by Lavoie (2015: 9), “*TARGET2 has no limits as to the size of the advances that can be taken by national central banks from the European Central Bank, [...] whereas Keynes’s Plan imposed a ceiling on the amounts that could be normally borrowed by the*

<sup>4</sup> The Governing Board would consist of the Central Bankers of the member – states, thus legitimizing the devaluations and prevent currency wars.

*national central banks from the International Clearing Bank, in addition to imposing limits on the length of time during which the ceiling could be exceeded*”, therefore rendering it even less constraining than the “Keynes Plan” in that perspective.

Still, issues such as the absence of national currencies and the need for protection against financial speculation require certain adjustments for compatibility within a Eurozone framework. The “Keynes Plan” was designed taking into consideration the existence of national currencies. The debate whether the monetary integration should have proceeded faster than the economic (and political) integration or not has been raging for decades, and it is not an issue this policy brief aims to address. Nevertheless, it is widely accepted that such a system reduces the flexibility that is needed at a domestic level for the adjustment of an economy (again, whether this is for better or for worse is beyond the scope of this paper). As Mr. Bini Smaghi (2011: 3), Member of the Executive Board of the European Central Bank at the time, admitted: *“the euro area is in fact the only area of the world where monetary and fiscal institutions are completely separate, in which the fiscal authority cannot count on the monetary authority, not only to prevent a solvency problem, but also a liquidity problem”*. Under the “Keynes Plan”, even though there would be a regime of fixed exchange rates between the Bancor and the national currencies, the Governing Board of the Supranational Bank could allow (or even demand) for the devaluation of a currency if deemed necessary. Accordingly, the national Central Banks could still act as “lenders of last resort”. Such tools are not available in the Eurozone.<sup>5</sup> Considering the political infeasibility of (re)introducing national currencies in the Eurozone members for domestic use, we are left with what Whyman (2014) calls “ICU-light” version.<sup>6</sup>

The symmetrical treatment of the excessive surpluses and deficits remains a core element in any version of the “Keynes Plan” that could be proposed. In 2011, as a result of the European debt crisis that started a couple of years before, the Macroeconomic Imbalance Procedure (MIP) was introduced as a tool to monitor the imbalances within the European Union as a whole. Excessive current account surpluses were recognized as an issue requiring attention, due to the adverse effects that they could have on the EU and the Eurozone economy among others, but even within this framework it is not

<sup>5</sup> Although the ECB is not permitted to purchase government bonds on the primary market, since 2015 it has included government bonds on its Quantitative Easing (QE) program, thus buying them on the secondary market. The QE program was further extended as a measure against the economic effects of the pandemic. Still, it's considered an *ad hoc* measure.

<sup>6</sup> Amato *et al.* (2016) present the case for the introduction of fiscal currencies in the framework of a “Keynes Plan” implementation in the Eurozone, claiming that this would work in favor of the European monetary system and speed up economic recovery. Such a plan, though, seems politically infeasible in the foreseeable future, and is not covered in this policy brief.

considered as urgent a matter as the deficits (European Commission, 2016).<sup>7</sup> This asymmetry in the treatment of excessive surpluses and deficits becomes more obvious when we take into consideration the indicative thresholds proposed for the current account imbalances, beyond which adjustment should take place: +6% of GDP (for excessive surpluses) and -4% of GDP (for excessive deficits), calculated as a 3-year backward moving average. If a version of a “Keynes Plan” was to be implemented in the Eurozone, the symmetrical treatment of the excessive surpluses and deficits would be vital, with both creditors and debtors paying a penalty when exceeding the set thresholds.

Consequently, the surplus countries would have to adjust their current account balance too in order to avoid the fines. It is now well known what an adjustment means for the deficit countries in the Eurozone. Internal devaluation (since there is no national currency to devalue), in an attempt to restore the competitiveness of the economy. The recessionary effects of such measures are unavoidable, and when used excessively they have shown to lead to extremely high and permanent unemployment, along with severe loss of output. Even the “successful” adjustment of the current account balance is not a result of higher competitiveness of the economy, but it is due to lower disposable income and therefore reduced imports.

The simultaneous adjustment of the surplus countries would “ease the blow”, since the spillovers of their expansionary effects would affect the economies of the deficit countries positively. As Whyman (2014) summarizes, there are two main ways that creditor countries can reduce their excessive surpluses in order to avoid the fines. One way is by boosting the domestic economy. As Bernanke (2015) explains (referring to the case of Germany), investments for public infrastructure, spending through targeted reforms and even a rise in the wages will reduce the excessive surplus while having positive effects on the economy. Another way (especially if the economy is already operating in near full employment and the danger of inflation arises), would be to use the resources for productive investments – especially in the deficit countries – in the form of Foreign Direct Investments (FDI). In both cases, the expansionary effects of the policies followed by the surplus countries would act (at least partly) as a counterweight to the contractionary effects of the policies implemented in the deficit countries, stabilizing the Eurozone economy as a whole. Such measures would have an important effect at political level too, as they would strengthen solidarity among the EU members and EU societies as well.

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<sup>7</sup> As the European Commission (2016: 51) states, “Against this background, both in the legislation and in practice it is clear that the MIP applies to both deficits and surpluses, although not necessarily with the same concerns in mind or with the same degree of urgency.”

Another issue concerning the implementation of a version of the “Keynes Plan” in the Eurozone stems from the fact that there needs to be protection against the adverse effects of financial speculation. When the “Keynes Plan” was written – and for the decades that followed – capital controls were normal, and they were effective in reducing financial speculation. In today’s world, and especially within the Eurozone, the implementation of capital controls is out of the agenda. That is not to say, however, that there are no concerns in the EU about financial speculation. In 2011 (and again in 2013) the European Commission proposed the introduction of an EU “Financial Transactions Tax”, which could serve as a tool to reduce financial speculation. Although discussions had been on hold for years, a joint statement by Germany and France in 2019 brought the proposal back for discussion (EUR-Lex, 2019). With the support of two of the most influential countries in the Eurozone, it is safe to assume that sooner or later a version of the European “Financial Transactions Tax” will be introduced. Whether this initiative suffices for the prevention of financial speculation remains to be seen.

## Conclusions

This policy brief aimed to present the core elements of the “Keynes Plan” and how it could work within the Eurozone framework. It is important to note that the proposal for the implementation of such a plan does not imply that the imbalances in the Eurozone or the structural weaknesses of some economies will suddenly disappear. It merely suggests how existing tools and institutions, as well as policies that are already under consideration, can function in a more stabilizing way for the Eurozone. A successful implementation of such a plan could pave the way for “EU-induced” growth and lead to a renewed trust to EU institutions and solidarity among the member states.

Concessions will have to be made even for a modest version of such a plan to be implemented, but it has become apparent that the way the Eurozone functions needs to change in order to cope with the challenges that arise. Both the European Central Bank and the European Commission have showed that they are ready to introduce flexibility in the system, in ways that ten years ago would have seemed unthinkable. It seems unavoidable that the economic impact of the Covid-19 pandemic will lead to major developments in the Eurozone and the EU as a whole. The “Keynes Plan” could be a step towards a symmetrical recovery and even further economic integration.

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