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Policy Note

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KEYNES'S CLEARING UNION IS ALIVE AND WELL AND LIVING IN YOUR MOBILE PHONE

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It is generally accepted that Keynes's clearing union framework for the postwar international financial architecture was superior to the stabilization fund approach proposed by the United States and adopted at Bretton Woods. Yet, despite the inherent contradictions that have led to the collapse of that system, modern proposals continue to seek remedies rather than consider implementation of Keynes's original proposal. While governments may consider it too difficult to implement such radical change, the private sector has already produced a virtual equivalent of an international global monetary system.

This should not be surprising, since Keynes indicated that the inspiration for his proposal was to extend what he described as the "essential principle of banking as it is exhibited within any closed system," by which he meant the credit and debit transfers "by means of a clearing system" that provide the net settlement of the debits and credits among financial institutions in terms of some notional unit of account (Keynes 1980, 171). Keynes simply proposed extending this principle to the international stage, so that countries would undertake net settlement of their external accounts in terms of a notional unit of settlement—bancor was among the proposed names for this unit.

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Since every credit would be balanced by a debit, external deficits would be automatically financed, preventing undue pressure to adjust being placed on output and employment in the debtor nation. Coordination would thus be required to combine the policies of both creditor and debtor to limit the size of the credits created.

The role of the "banking principle" in replacing commodity currencies as a means of payment had been noted by Smith, Ricardo, and Jevons, as well as by Schumpeter, Mises, and Hayek. Clearing houses for settlement of accounts amongst private banks already existed in domestic monetary systems in the 18th century, so it should not be surprising that one might still exist today. What is more surprising is that it is employed as an extension of the international mobile telephone services provided by a private company rather than a financial institution.

Today, a client of Webtel.mobi (WM)—an existing company that operates as a specialized mobile provider (SMP) of telephony services—may load their account with stored credit/stored value via a bank transfer or card payment, or via a cash payment to its in-country affiliates (known as virtual specialized mobile providers [VSMPs]) as prepayment for mobile phone services. In addition, the company provides each member the possibility of transferring credit balances from their own prepaid account to the account of any other member via an internal system transfer (called an "inter closed loop member transfer" or "ICLM"). This reflects an internal adjustment by WM's system of a debit and a credit according to the banking principle. The same procedure can also be used to discharge a commercial purchase transaction. It is also possible for a member with a credit balance to execute a transfer to another member in exchange for a promise to repay at some future date along with a fee or charge—the equivalent of a borrow-lend transaction.

By executing debits and credits on members' accounts resulting from their transfer instructions, WM executes the role of bookkeeper in the "closed loop" clearing system. This is a bookkeeping account adjustment that is virtually instantaneous and thus much faster than a normal bank-to-bank transfer; since a banking relationship is not necessary, it also avoids bank charges. All member accounts and transactions, wherever in the world the member is situated, take place in the jurisdiction of the company's registration. Member accounts thus have a single geographical representation and may be in any international currency, although initial accounts are denominated in home currency. However, members may purchase or swap the home currency for other currencies from within their ICLM accounts via a conversion facility executed through global foreign exchange markets, or through a peer-to-peer (P2P) swap arrangement in which account holders exchange their national balances for foreign balances at conversion rates agreed to between the members. Members may thus hold balances in multiple foreign currencies within their accounts. The same advantages of increased execution speed and reduced costs, as in the ICLM transfers, are maintained. As in the operation of the banking principle for a domestic or international ICLM transfer, it is the account balances of nationally diverse members that adjust while the overall WM system balances remain stable.

All inward transfers, currency conversions, currency swaps, or member-to-member ICLM transfers are registered as a ledger entry in a member's account, bearing an Inter-TEL.mobi account number (ITAN) linked to the mobile number to be debited or credited according to the usage of services or transfer instructions. The system may thus be understood as one in which WM provides the clearing house mechanism for its clients, who are free to engage in global transactions in any currency, carried out in real time (in 1/100th of a second) at any time from anywhere in the world at zero cost.

Since the creation of a member's stored credit account results from a transfer from a nationally regulated bank or by a cash payment to one of WM's affiliates, it provides the equivalent of a 100 percent reserved regulated deposit banking system, something that a fractional-reserve-based private banking system cannot provide, except through the guarantee of a government deposit insurance scheme. This simply reflects Keynes's assessment that "the Union itself can never be in any difficulty" in executing payment (Keynes 1980, 171).

A further simplification of the system is that members do not require a sophisticated payments application—all that is required is a generic mobile phone. As such, it provides a cheaper, more rapid, and secure system for emigrant remittances in the same way that it provides these advantages for the entire range of retail or wholesale financial operations.

In Keynes's clearing union, one of the benefits was the possibility of shared adjustment costs, which resulted from the automatic creation of unit of account liquidity produced by the size of external balances. There were those who considered this a threat to price stability, and for this reason the formal proposal placed a limit, with penalty sanction, on the size of a country's external imbalance, positive or negative. In the WM system as currently configured, this problem does not arise, since all transfers into the system are sourced in a regulated banking system or in cash, creating an implicit limit on the size of the system as determined by the size of membership and the use of the system.

However, as was seen in the operation of private bank clearing houses, it was possible for them to create credit by simply writing up members' credit balances as needed to cover debits—as was the case with the New York Clearing House in the financial crisis during the outbreak of the war in 1914. The WM system thus has this ability inherent in its structure and provides full potential competition for existing private national credit systems.

While electronic or digital currency systems have been presented as a substitute for national monies, they have not been able to provide payments services because they are not governed by the banking principle, and thus have extremely volatile value.

On the other hand, central banks are considering the creation of their own electronic money accounts to maintain control of monetary policy but have hesitated because this would challenge the survival of private banks' major source of income. Implementation of such central bank electronic money would require a reformulation of the international system, raising the same problems faced in the original Bretton Woods system.

The WM clearing system provides an example of a possible solution that retains national currencies without requiring the substitution of the dollar with another national currency, such as the yuan, or a basket of national currencies such as the special drawing rights (SDR).

References

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