Levy Economics Institute of Bard College

Public Policy Brief

No. 144, 2017

A TWO-TIER EUROZONE OR A EURO OF REGIONS? A RADICAL PROPOSAL BASED ON KEYNES'S CLEARING UNION

JAN KREGEL

Contents

Editor: Michael Stephens
Text Editor: Elizabeth Dunn

The Public Policy Brief Series is a publication of the Levy Economics Institute of Bard College, Blithewood, PO Box 5000, Annandale-on-Hudson, NY 12504-5000.
For information about the Levy Institute, call 845-758-7700, e-mail info@levy.org, or visit the Levy Institute website at www.levyinstitute.org.

The Public Policy Brief Series is produced by the Bard Publications Office.

ISSN 1063-5297
ISBN 978-1-936192-56-4

Preface

For those concerned about the state of the eurozone project, the contributions of John Maynard Keynes and Richard Kahn to early debates over the design of the postwar international financial system yield valuable insights. Their engagement with the policy challenges associated with managing international settlements not only offers a perspective from which to analyze the flaws in the current euro-based financial system, but also suggests the elements of a solution.

At the broadest level, Keynes's view of the setup of the Economic and Monetary Union (EMU) would closely track his critique of the gold standard. The EMU strips countries of policy independence, imposing the same monetary and fiscal policies on nations experiencing dissimilar domestic economic challenges. Keynes also saw that a lack of symmetry in the adjustment mechanism supporting a fixed exchange rate—much like a single currency—would mean that countries in need of using domestic policy tools to address employment and growth crises would be unduly burdened. For Keynes, currency flexibility and the ability to control cross-border capital flows—both lacking under the euro system—were crucial.

The seeds of an alternative to the current system can be found in Keynes's early clearing union proposal. The idea would be to establish a clearing system in which members use a common unit of account in order to register debits and credits for the purpose of settlement. Kahn, a close associate of Keynes, lived to see the creation in 1950 of the European Payments Union (EPU), an arrangement loosely based on the clearing union scheme. His critiques of the short-lived EPU help flesh out the idea of a clearing union approach that might improve on the status quo. From the premise that a successful clearing arrangement depends upon creating incentives to avoid excessive imbalances, Kahn conceived of a multilateral arrangement under which the members of the clearing union would see their debit and credit balances liquidated at the end of a given period. Settlement of balances resulting from intra-European trade would be made on the basis of a "discount" established at the beginning of each settlement period, such that surplus countries would have an incentive to increase their imports from the deficit countries. This arrangement would enable a symmetric adjustment process—something still lacking both within the eurozone and between the eurozone and the rest of the world—and would address the problem of euro exchange rates exacerbating internal and external imbalances.

An alternative along the lines of a Keynes-Kahn plan could take two possible forms. The first would be a multilateral clearing union among member-states using the euro for clearing purposes and applying Kahn's "discount." The other emerges from Keynes's suggestion of the creation of regional groupings sharing certain economic and cultural characteristics. Each regional grouping would make up a currency union with its own unit of account and internal settlements system. At the same time, the regional groupings would take part in a European-level clearing union, using a common, Europe-wide unit of account. This European federation of regions would then participate in a wider clearing union with other such federations around the world.

Cultural and economic diversity would be better preserved under this structure than under the status quo, with policy and exchange rate flexibility enhanced for each regional unit. This would implicitly create the sort of limitations on cross-border capital flows within the European federation that Keynes thought necessary. Finally, the arrangement would preserve domestic policy independence, allowing members to pursue full employment—an objective of particular importance to Keynes, but which has been badly neglected due to the flaws of the current system.

As always, I welcome your comments.

Jan Kregel, *Director of Research*
September 2017

What Would Keynes Have Thought of the European Crisis?

Although John Maynard Keynes died in 1946, before the real political discussions on the shape of European political unification and economic reconstruction took place, two episodes provide an entry point to understanding how Keynes might have analyzed the flaws embedded in the structure of the eurozone.

First, Keynes was a sharp critic of the design for Europe shaped by the Treaty of Versailles. In this case, his criticisms were directed at the feasibility of the debt repayment and German reparations. The major theoretical implication that emerged from that critique was the elaboration of what came to be called the "transfer problem." Second, Keynes was a principal actor in the design of the post–World War II international financial architecture. From Robert Skidelsky's biography (Skidelsky 2001) we know that in this period Keynes was more concerned with the design of a system that would allow the United Kingdom a viable postwar reconstruction—and thus with relations with the United States rather than the rest of Europe. In this case, he was focused on the financing of imports for reconstruction in the presence of "dollar scarcity." The theoretical insight that emerged from this concern was the application on the international level of what Keynes called the "banking principle," in order to make the provision of liquidity more automatic and less dependent on external surpluses (see Kregel 2015).

The basic problem facing the United Kingdom in the immediate postwar years was financing the looming external imbalance, which could only be remedied with US financial support; accordingly, Keynes's negotiations for the American loan and his proposals for the postwar international financial system always kept this objective in the forefront. Keynes was not fully successful in this endeavor to convince the Allied powers to implement his clearing union proposal, less due to deficiencies in his negotiating strategy than to the refusal of the US Congress to engage in a major lending program to Europe after the experience of the 1914–18 war.

Ironically, it was only after Keynes's death that the United States agreed to such funding. In June 1947, the US Secretary of State George C. Marshall proposed the granting of economic and financial assistance to all the countries of Europe, subject to implementation of closer European political cooperation and overseen by the European Recovery Program (ERP). Assistance under the plan was accepted by Austria, Belgium, Denmark (with the Faroe Islands and Greenland), France, Greece, Iceland, Ireland, Italy (and San Marino), Luxembourg, the Netherlands, Norway, Portugal (with Madeira and the Azores), Sweden, Switzerland (with Liechtenstein), Turkey, and the United Kingdom. A Committee of European Economic Cooperation (CEEC) drew up a report establishing the priorities of the recipients and a permanent agency for the implementation was created in Paris in 1948: the Organisation for European Economic Cooperation (OEEC). West Germany and the territory of Trieste joined in 1949 (CVCE 2016a).

An even greater irony was that the ERP supported a multilateral agreement on intra-European payments, which led to the creation in 1950 of the European Payments Union (EPU) that was broadly based on Keynes's clearing union proposals rejected at Bretton Woods. While it is widely accepted that the EPU was a success in restoring multilateral trade and payments, it was soon eclipsed as the basis for economic and political unification in Europe by the Schuman Plan in 1950, and was eventually scuttled when the United Kingdom refused to participate in a continuation of the plan in 1958 and embarked on a policy of special relations with the United States rather than the rest of Europe.[1]

Drawbacks of the Current EU Economic and Financial Structure

Thus, if we are to envisage what Keynes might have thought of the current conditions in Europe, we are restricted to his indirect, posthumous contribution to European reconstruction via the application of the clearing union principle to a region, in the form of the EPU. In this endeavor, the contemporaneous proposals of Richard Kahn—one of Keynes's closest collaborators—for an alternative multilateral European clearing arrangement also provide insight into how Keynes might have approached the construction of a regionally limited clearing arrangement. And since Keynes sought an explanation of the 1930s crisis in order to establish a theoretical basis from which to formulate policy, this conjecture on what Keynes might have thought will also require speculation about what policy Keynes might have proposed to resolve the current European crisis.

Since the current euro-based financial system in the European Union closely resembles the reimposition of the gold standard, in the form of a single currency that is exogenous to all participants in the system, it is not difficult to surmise the types of criticism Keynes would have made. First of all, since he would have emphasized the objective of maximizing employment, domestic policy independence would have been paramount. His basic objection to the gold standard—equivalent to a single currency system—was that it imposed the same monetary and fiscal policies on countries facing different domestic conditions. But this imposition of policy uniformity is precisely the condition that has been required for acceptance into the euro system. Keynes also noted that the countries most in need of domestic policies to support growth and employment would be penalized under what is called "asymmetric adjustment" in support of a fixed exchange rate, which is equivalent to the single currency. The result of this condition would be below-potential growth and employment for all members, as has generally been the case in Europe since the implementation of the euro. He thus favored currency flexibility and believed that its successful operation would require strict controls over cross-border capital flows, while the basis of the EU single market has been to facilitate such flows.

Finally, Keynes believed in the benefits of cultural and economic diversity across countries and designed his proposals to retain such diversity, while the current thrust in Europe is to impose common standards and to move to a more centralized political structure. It seems quite clear that the flexibility that he managed to introduce into the US proposal for a Stabilization Fund (which became the backbone of the Bretton Woods system) is not present in the Single European Market and the Single Currency. In contrast with his support of the International Monetary Fund, it is unlikely that he would have accepted participation in the EU in its current form.

The Possible Alternative Financial System: Regional Clearing Unions

The impetus for a multilateral regional approach after World War II came from the limitations of the initial bilateral payments agreements. In November 1947, an Agreement on Multilateral Monetary Compensation proposed by the CEEC was agreed to by France, Italy, the Netherlands, Belgium, and Luxembourg. But it became increasingly evident that reserves in convertible currencies were required. The only possibility was to appropriate ERP funds, a proposal that met with US resistance, since Congress had only approved funding to cover the recovery program dollar deficits of individual countries.

It was against this background that Richard Kahn proposed what he called a "Discount Scheme," which provides an indication of how Keynes himself might have approached the operation of a regional multilateral clearing union. Kahn proposed that members' credit and debit balances with the other participants

> would be liquidated in dollars (or gold) . . . But instead of such liquidation taking place at exchange parity . . . it would take place on the basis of reckoning the European currencies at a discount in terms of the dollar. This discount, the same of course for all the European currencies involved, I shall call the "European Discount." It would be altered from period to period according to need, but it would be fixed at the beginning of each settlement period (or, perhaps better, a couple of months before) for the whole of that period, so that the authorities of each country could operate their economies with full knowledge of the value of intra-European exports, and of the cost of intra-European imports, passing between their own country and the other participants. The European Discount would not of course in any way apply to the rates of exchange at which transactions were effected between traders in the various countries. It would apply only to the settlement of net balances arising from intra-European trade. And such settlement would be definitive—the liquidation in dollars, on the basis of the Discount, would be complete. (Kahn 1949, 297)

Since US funding was required for settlement within any multilateral clearing, the United States became involved and the ERP supported the creation of the EPU, built on a multilateral settlements system for Europe that would eliminate quantitative restrictions on intra-European trade and provide a framework for dealing with balance of payments crises. Bilateral imbalances were funded by an EPU clearing balance, which had to be settled in gold on a sliding scale when a country's credit or debit surpassed a certain threshold. The dollar liquidity of the EPU was supplied by a contribution of Marshall funds of $350 million, to be used whenever gold payments to creditor countries exceeded gold received from debtor countries.

Kahn noted the differences and similarities between the EPU and his original scheme for multilateral payments, in which

> at regular intervals the balances of each participant with the other participants taken together (which must add up algebraically to zero) would be settled by transfers of dollars (or gold), after they had been reduced in value by the amount of the "European Discount," which could be altered from time to time. This settlement would be definitive—the liquidation in dollars, on the basis of the Discount, would completely discharge the outstanding credit and debit balances. Under the EPU, the members will extend lines of credit to the Union and have lines of credit extended to them by the Union. The extent to which these credits are to be utilised is determined by the accrued credit or debit balance of each member with the other members taken together, reckoned cumulatively from the date at which the EPU begins to function. The first tranche of credit or debit balances will carry with it no payment in gold. Of the subsequent tranches of credit balances, it appears that 50 per cent will be settled by the Union in gold as they accrue to a member. A member which has a growing debit balance with the Union will have to settle in gold 20, 40, 60 and 80 per cent of each successive tranche. It appears that an accrued debit balance which outstrips all the tranches will, if it grows any bigger, involve 100 per cent gold payments to the Union, but that no decision has been reached about the position of credit balances beyond the point at which all the tranches have been exhausted. (Kahn 1950, 306–7)

Kahn's criticism echoed Keynes's objection to the lack of symmetry in international adjustment mechanisms, noting that the system might converge to a gold standard if intraregional imbalances became large enough. His own proposal, he noted, sought to meet the difficulties of a regional scheme couched in an international trading framework, due to the possible difference between intraregional imbalances and international imbalances:

> My main quarrel with the EPU arises from the concept of "creditor" and of "debtor" countries. A "creditor" country is a country which has a favourable balance of payments with the other members, even though its over-all balance is adverse. A "debtor" country has an unfavourable balance with other members, but might conceivably have an over-all favourable balance. The philosophy of the EPU is based on the view that there is something wrong—in the sense of departure from equilibrium—in a country being either in a "creditor" or in a "debtor" position with the rest of Western Europe. The latitude which the Union will provide in either direction is represented by an aggregate lump sum, the amount of which is fixed irrespective of the period of time over which the Union has operated. If this ceiling had been conceded as an annual rate, the amounts of the possible credits and debits being renewed year by year, much of my objection would have disappeared, since a "departure from equilibrium" in the EPU sense could then be financed under conditions which could remain steady through time. But the ceiling is a cumulative aggregate and not an annual rate. Once the ceiling has been reached the Union can offer no further help however much time is allowed to elapse. For this reason alone its days are probably numbered, but that is a poor consolation for the unsuitability of the arrangements, particularly as the dimensions of the maximum credits and debits are generous, thus rendering it probable that the Union will run for two or three years before revision becomes essential. (Kahn 1950, 307)

The essence of Kahn's scheme was to wipe the books clean every period—he suggested six months—so that cumulative debit balances would not make carrying them more onerous in terms of foreign reserves. It also raised the question of a creditor country financing its dollar-denominated imports with the reserves of its European partners. Thus, the European Discount was meant to create symmetry through the incentive it would provide for creditor countries, since their dollar balances would be reduced in terms of the sale of their exports within Europe and their purchasing power over hard currency imports would thereby be diminished. Obviously, Kahn was looking at the operation of the EPU from the point of view of the United Kingdom, which would have been very likely to have quickly exhausted its cumulative debit balance limits and thus faced full settlement in gold to European creditor countries. The latter would then have an advantage in importing dollar-denominated goods from outside Europe. And as Kahn notes, the EPU proposal provided little incentive for creditors to participate in the elimination of their credit balances.

In this regard, Raymond Mikesell observed that

> in any regional or group multilateral payments mechanism there are three general problems to be solved: (1) the multilateral offsetting of net surpluses and net deficits arising out of bilateral trade between individual members of the group; (2) the settlement of net surpluses and net deficits of individual members with the group as a whole; and (3) the settlement of the net deficits or surpluses of the group as a whole with nonmembers. Although the clearing operation per se is confined solely to the first of these three problems, all three are closely inter-related and must be dealt with, if intragroup clearing is to be successful. (Mikesell 1948, 503)

Albert O. Hirschman provided a similar assessment: "As was true of all similar previous plans for multilateral clearing, the EPU project consisted of two distinct parts: (1) an offsetting mechanism and (2) a settlement mechanism" (Hirschman 1951, 49). However, he noted the divergence of views between the United Kingdom and the rest of the recovering economies with respect to the operation of the system:

> The EPU project ran into serious trouble as the result of British opposition. During the session of the OEEC Council in January, Sir Stafford Cripps declared that the United Kingdom would be unable to accept substitution of the proposed clearing mechanism for the bilateral agreements involving sterling. He refused to accept an EPU that would supersede the existing bilateral agreements; rather, he favoured one that would function only after exhaustion of bilateral credit lines and would thus be superimposed upon the bilateral agreements as a "lender of last resort." At the same time, Sir Stafford declared that the United Kingdom could not agree to restrict its freedom of action with respect to quantitative restrictions on trade. (Hirschman 1951, 50–1)

These problems soon became evident in the EPU with respect to the limits placed on the size and method of settlement balances. The success of any clearing scheme depends on a relative balance in each member's trade with the other members, since an excessive imbalance in any one country compromises the value of the outstanding credits of the others. It is in these conditions that the ability of such schemes to provide adjustment credit becomes evident.

The Possible Alternative Political System: Regional Agreements

In working out his initial proposals for a clearing union, Keynes was conscious that national sovereignty would have to be given up under such a scheme. At the same time, he was also concerned about preserving national cultural characteristics under a multilateral payments system. Presumably, his experience at Versailles had impressed upon him the difficulties these national idiosyncracies would create in achieving rational solutions to economic problems. In an April 1943 white paper, Keynes noted that

> in preparing these proposals [for the clearing union] care has been taken to regard certain conditions, which the groundwork of an international economic system to be set up after the war should satisfy, if it is to prove durable: (i) There should be the least possible interference with internal national policies, and the plan should not wander from the international terrain. Since such policies may have important repercussions on international relations, they cannot be left out of account. . . . (ii) The technique of the plan must be capable of application, irrespective of the type and principle of government and economic policy existing in the prospective member States. (Horsefield 1969, 19)

While this is often considered an acknowledgement of the difficulties of including planned economies in the system, it is most certainly an attempt to carve out space for a British policy of protected trade to support full employment recovery in the presence of US insistence on more restrictive expenditure and more open trade policies. After the war, it would be Germany that took on the role of economic policy opposition against both the United Kingdom and the United States.

It is therefore of interest that in one of the earlier redrafts of his proposal for an international clearing union, Keynes raised this issue and proposed an alternative solution to the problem of policy diversity within the union:

> An important matter for decision is whether and how far there should be currency unions *within* the international system, or whether individual countries should be accepted for membership. Either system is possible, but there is much to be said in favour of currency unions within the general framework. One view of the post-war world which I find sympathetic and attractive and fruitful of good consequences is that we should encourage small political and cultural units, combined into larger, and more or less closely knit, economic units. It would be a fine thing to have thirty or forty capital cities in Europe, each the centre of a self-governing country entirely free from national minorities (who would be dealt with by migrations where necessary) and the seat of a government and parliament and a cultural and university centre, each with their own pride and glory and their own characteristics and excellent gifts. But it would be ruinous to have thirty or forty entirely independent economic and currency units. Therefore I would encourage customs unions and customs preferences covering groups of political and geographical units, and also currency unions, railway unions and the like. Thus it would be preferable, if it were possible, that the members should, in some cases at least, be groups of countries rather than separate units. (Keynes 1980, 55–6; see also 182)

In this vein, Keynes goes on to propose groupings, which in the European context were the Germanic countries (Switzerland, the Netherlands, Austria, and the constituents of the former Reich), the Scandinavian countries (Norway, Sweden, Denmark, Finland, and the Baltic States—if there be such), and the Latin Union (France, Belgium, Italy, Spain, and Portugal). Greece and Luxembourg are not mentioned but presumably the latter would have been included in the Germanic group and the former in the Latin Union. It is interesting that, with the exception of Belgium and Norway, these groupings come very close to the divergences across groupings of countries that exist in the present EU.

I interpret Keynes's proposal as implying that each of these groupings would comprise a currency union, as well as the trade, rail, and other unions mentioned. It is to be noted that they represent more or less similar economic structures and cultural patterns, and that it would be supposed that there would be possibilities for fuller economic integration. I note in passing that the Schuman Plan represented an integration of the dominant economies in two different groupings, the result of political rather than economic decisions.

The presumption is that each of the groupings would comprise a "mini" clearing union with its own unit of account and that each of the groupings would participate in a European-level "maxi" clearing union with a pan-European unit of account—and then conceivably that unit would enter into a "super" clearing union with other regions. Keynes's proposed list includes North America, South and Central America, the Sterling Area, the USSR, Central Europe, the Balkan Union, the Middle East, and the Far East (China and Japan), each with its own regional unit of account and settlements system.

This approach was far from revolutionary at the time. The push for closer European integration after the Treaty of Versailles had been based on a series of proposals for regional arrangements within the League of Nations. In 1931, a Conference on European Union, intended to lead to a Federal Union of Europe within the League of Nations, was held in Brussels without success. The 1930 Oslo Convention proposed the elimination of trade barriers for the three Scandinavian countries and Belgium, the Netherlands, and Luxembourg. This was followed in 1931 by a Nordic Monetary Union of Denmark, Norway, Sweden, Iceland, Finland, and Estonia, and the creation of the Nordic Association in 1934, while in 1932 the Benelux countries signed the Lausanne-Ouchy Treaty. This represented a reversal of the process that had been started in 1830 to sanction separation of the Netherlands, Belgium, and Luxembourg. In 1841, the request by Luxembourg for a treaty with Belgium, supplemented with an economic union with the Netherlands, was a first step in the creation of what would become the Belgium-Luxembourg Economic Union (BLEU), which also became a monetary union (Jadoul 2012).

It is thus not surprising that the initial patterns for postwar European integration were all regional arrangements similar to those that had been suggested by Keynes. Building on prewar efforts, in October 1943 an agreement to fix exchange rates between the Belgian and Luxembourg franc and the Dutch guilder led to a customs convention that was agreed upon in September 1944 to establish a tariff community and a subsequent economic union that included a common external tariff and eliminated customs duties on trade within the Benelux (CVCE 2016b). The Benelux Union created two elements: (1) the coordination of economic, financial, and social policy; and (2) the acceptance and conduct of a common policy with respect to economic relations with other countries. This economic and financial dimension was gradually supplemented in the areas of transport, physical planning, environment, policing, and justice. The success of the Benelux is evident: with respect to economic potential it occupies the fourth position in the EU, as well as worldwide as far as imports and exports are concerned.

The Benelux experiment was accompanied by a series of less-successful regional proposals that preceded the discussions of fuller European unification:

> In 1947, Denmark, Sweden, Norway and Iceland, … considered the creation of a Scandinavian customs union. In 1949, Denmark, Norway, Sweden and the United Kingdom also began negotiations for a regional economic union to be dubbed Uniscan. At the same time, France and Italy negotiated a tariff union treaty that was never ratified. In January 1948, France … proposed the creation of a customs union to Italy and the Benelux countries. This economic association for the liberalisation of trade and exchange rates was first called Fritalux, which was later changed to Finebel (France-Italy-Netherlands-Belgium-Luxembourg). In September 1947, a plan for a customs union between Greece and Turkey was also announced. However, none of these projects advanced beyond the exploratory stage, and they all appeared too limited compared to the generalised liberalisation of trade advocated by the OEEC and the planned creation of a European Payments Union (EPU), which was actively supported by the United States. (CVCE 2016c)

The Possible Alternative Policy Proposal

There are thus two elements that Keynes would have found inappropriate in the current European context. The first is the application of uniform monetary and fiscal policies across all European countries, and the second is the lack of symmetry in the adjustment process that results from the imposition of the single currency, which impedes the preservation of national diversity. From Richard Kahn comes a third element: the absence of any mechanism for external adjustment between the EU and the rest of the world.

These problematic elements can be addressed by alternative clearing arrangements. There are two possibilities. First, the Kahn Discount proposal could be applied to a payments union for all members of the eurozone. This would be a relatively straightforward procedure in which, say, Germany would receive its surplus balance from, say, Greece, reduced by the Kahn Discount. Germany's accumulation of euro credits would then be reduced and the incentive to import from deficit countries increased.

The second possibility would adhere to Keynes's suggestion of creating smaller, more cohesive regional groupings, following the example of Benelux, making it politically easier to introduce federal governance structures in each one. One might envisage a grouping of Germany-Austria, Scandinavia-Finland-Baltics-Benelux, France-Italy-UK, and Spain-Portugal-Greece, each regional grouping with its own currency and clearing, linked through a European clearing with the euro as the clearing unit of account. Implicitly, this would introduce limitations on capital flows across the EU.[2]

Here, instead of imposing similarity across all economies in the EU by means of economic policies to bring inflation, debt, and deficit positions into equality (in order for them to participate in a common currency), similar conditions would have been implicit in the choice of the country groupings. On the superficial level, this would have eliminated the conflicts in policy objectives between Germany and France, for example, that have plagued European unification. It would also have prevented the resulting recurrent currency crises. But most importantly, it would have eliminated the need for similar monetary and fiscal policies across countries and the detrimental impact of those policies on domestic demand.[3]

The Regional Application of the Kahn Proposal

It would thus be possible to conceive of a system of regional federations employing a clearing system in which members either retained their own currency or used a common currency as a unit of account in registering debits and credits for settlement purposes. It would be presumed that the degree of similarity across members would be such that the intraregional imbalances would be small. These regional federations would remain members of the EU and participate in European-level clearing using the euro, with their regional monetary authorities represented in the European System of Central Banks. The regional currencies would have a fixed parity with the euro. According to the Kahn proposal, the settlements across regions would be made after calculation of the Discount, with surplus federations receiving a discounted payment of euros from the deficit units. This should create an incentive for the surplus federations to increase their imports from the deficits units

As Kahn pointed out, there is no necessity for a surplus federation in the European clearing union to have a surplus in its trade with the rest of the world. This would then raise the question of the parity of the euro with other currencies, such as the US dollar or the Chinese yuan. If the surplus federations had a surplus with the rest of the world and the euro area thus also had a surplus—which is currently the case—then it is likely that the euro would appreciate, which would create an incentive for intra-European trade and reduce the overall EU surplus as well as the individual federation surpluses. This would eliminate the current difficulties in the system, in which exchange rates for the euro seem to aggravate the internal and external surpluses of individual members of the eurozone.

This proposal would introduce a degree of policy and exchange rate flexibility into the system. It would remain possible for the ECB to arrange for currency adjustments across the regional clearing systems. In addition, as Keynes's original proposal had envisaged an international investment board, the EU might replace its regional assistance programs with a more directed control of capital flows to distribute investment across regions in relation to the clearing imbalances.[4] Keynes himself went beyond this limited scope, suggesting that it might be used for countercyclical policy in the guise of an anti-depression board.

In summary, Keynes clearly would not have approved of the current thrust of European integration or financial reform, and would instead have supported greater regional independence and diversity. An extension of his clearing principle to regions provides the possibility of greater political integration through political federations that retain regional diversity.[5]

Notes

1. The EPU was not the only regional payments union based on Keynes's clearing union proposal. The framework for a clearing arrangement was established at the end of 1965 by the central banks of the member countries (Argentina, Brazil, Chile, Colombia, Ecuador, Mexico, Peru, and Uruguay) of the Latin American Free Trade Association (LAFTA). In addition, Bhatt (1969) reports proposals for clearing arrangements and monetary unions in Africa, Asia, and the Middle East. The basic thrust of these proposals was as an adjunct to free trade areas and as a substitute or first step toward a common currency, thought to be necessary as a next step in trade integration.
2. "I share the view that central control of capital movements, both inward and outward, should be a permanent feature of the post-war system. If this is to be effective, it involves the machinery of exchange control for all transactions, even though a general open license is given for all remittances in respect of current trade." (Keynes 1980, 52)
3. Would such a move be feasible in the current European context? As Jadoul explains, the ceding of powers to a federal structure was written into the constitutions of the Benelux states:

   > The Belgian Constitution states: "The execution of certain powers can be transferred to international institutions by treaty or agreement" (article 34). The Dutch Constitution mentions the same: "Taking into account—if necessary—article 91, section 3, legislative, executive and judicial powers can be transferred by treaty to international organizations" (article 92). The Luxembourg Constitution states: "The execution of legislative, executive and judicial powers may temporarily be transferred to international institutions" (article 49bis). Thus, the constitutions of the Benelux countries allow them to create a Federation because the transfer of stately powers, in other words sovereignty, is constitutionally possible. The Treaty of Rome (1957) contained in article 306 the so-called "enabling clause" . . . : "The provisions of this treaty do not prevent the existence and the completion of the regional unions between Belgium and Luxembourg, as well as between Belgium, Luxembourg and the Netherlands, as far as the goals of these regional unions have not

> been met with this treaty." . . . This text is also found in article 350 of the Treaty of Lisbon (2007/2009). . . . Due to the fact that Article 50, section 1 of the Treaty relating to the European Union (which is one of the two treaties within the Treaty of Lisbon), allows Member States to leave the European Union, it will be no problem if Belgium, Luxembourg and the Netherlands leave the intergovernmental system individually, in order to enter that system again as one Federation of three countries—as long as this intergovernmental system is still alive. (Jadoul 2012)

4. The international bank responsible for keeping the clearing accounts

> might be closely linked up with a Board for International Investment . . . It might act as the bankers of this Board and collect for them the annual service of their loans by automatically debiting the Clearing Account of the country concerned. . . . It might be provided that Surplus Banks of countries which were indebted to the Board should automatically use their surplus to discharge such indebtedness, and that Surplus Banks accumulating credits beyond a stipulated percentage of their quota should advance such surplus to the Board for further investment by them. (Keynes 1980, 59–60)

5. Holm (2011) provides another method for applying the clearing union principle to the EU.

References

Bhatt, V. V. 1969. "A Payments Union for Developing Countries." *Economic and Political Weekly* 4 (1/2), January: 103–14.

CVCE (Centre Virtuel de la Connaissance de l'Europe). 2016a. "The OEEC and the EPU." Last updated July 7, 2016. https://www.cvce.eu/obj/the_oeec_and_the_epu-en-91fb1458-baac-497d-af6d-8b59f3ae4bf5.html

———. 2016b. "Benelux." Last updated August 7, 2016. http://www.cvce.eu/en/education/unit-content/-/unit/02bb76df-d066-4c08-a58a-d4686a3e68ff/02d476c7-815d-4d85-8f88-9a2f0e559bb4

———. 2016c. "Customs Union Projects." Last updated August 7, 2016. http://www.cvce.eu/en/education/unit-content/-/unit/02bb76df-d066-4c08-a58a-d4686a3e68ff/18f901e3-62ce-47a9-a917-db8d4dccda96

Hirschman, A. O. 1951. "Negotiations and the Issues." *Review of Economics and Statistics* 33 (1): 49–55.

Holm, E. 2011. "Keynes' Clearing Union in Europe." *The Bulletin*, The Official Monetary and Financial Institutions Forum, January. https://www.omfif.org/analysis/the-bulletin/2011/january/keynes-clearing-union-in-europe/

Horsefield, J. K., ed. 1969. *The International Monetary Fund, 1945–1965: Twenty Years of International Monetary Cooperation*, Volume 3. Washington, D.C.: International Monetary Fund.

Jadoul, F. 2012. "European Federalist Papers, Nr. 13." http://www.europeanfederalistpapers.eu/index.php/en/papers/separate-papers/51-nr-13-jadoul-october-2012

Kahn, R. F. 1949. "A Possible Intra-European Payments Scheme." *Economica*, New Series, 16 (64): 293–304.

———. 1950. "The European Payments Union." *Economica*, New Series, 17 (67): 306–16.

Kaplan, J., and G. Schleiminger. 1989. *The European Union: Financial Diplomacy in the 1950s*. Oxford: Clarendon Press.

Keynes, J. M. 1980. *The Collected Writings of John Maynard Keynes*. Edited by D. E. Moggridge. Vol. 25. *Activities 1940–1944. Shaping the Post-war World: The Clearing Union*. London: Macmillan.

Kregel, J. 2015. *Emerging Market Economies and the Reform of the International Financial Architecture: Back to the Future*. Public Policy Brief No. 139. Annandale-on-Hudson, N.Y.: Levy Economics Institute of Bard College. February.

Mikesell, R. F. 1948. "Regional Multilateral Payments Arrangements." *The Quarterly Journal of Economics* 62 (4): 500–18.

Skidelsky, R. 2001. *John Maynard Keynes Fighting for Freedom, 1937–1946*. New York: Viking.

About the Author

JAN KREGEL is director of research at the Levy Economics Institute of Bard College and head of its Monetary Policy and Financial Structure program. He also holds the position of professor of development finance at Tallinn University of Technology. In 2009, Kregel served as Rapporteur of the President of the UN General Assembly's Commission on Reform of the International Financial System. He previously directed the Policy Analysis and Development Branch of the UN Financing for Development Office and was deputy secretary of the UN Committee of Experts on International Cooperation in Tax Matters. He is a former professor of political economy at the Università degli Studi di Bologna and a past professor of international economics at Johns Hopkins University's Paul Nitze School of Advanced International Studies, where he was also associate director of its Bologna Center from 1987 to 1990. Kregel has published extensively, contributing over 200 articles to edited volumes and scholarly journals, including the *Economic Journal, American Economic Review, Journal of Economic Literature, Journal of Post Keynesian Economics, Economie Appliquée,* and *Giornale degli Economisti*. His major works include a series of books on economic theory, among them, *Rate of Profit, Distribution and Growth: Two Views*, 1971; *The Theory of Economic Growth*, 1972; *Theory of Capital*, 1976; and *Origini e sviluppo dei mercati finanziari*, 1996. His most recent book is *Ragnar Nurkse: Trade and Development* (with R. Kattel and E. S. Reinert), 2009.

In 2011, Kregel was elected to the Accademia Nazionale dei Lincei, also known as the Lincean Academy, the oldest honorific scientific organization in the world. Founded in 1603, the academy counts Galileo Galilei among its original members. It has remained an elite organization of only 540 members, with only 180 of those from outside Italy. Although the academy covers all scientific and literary fields, Kregel is a member of the division for moral, historical, and philological sciences; specifically, the social and political sciences. Robert Solow, Amartya Sen, the late Paul Samuelson, and fellow Levy Senior Scholar James K. Galbraith are among the other American economists who have been elected foreign members of the academy.

Kregel studied under Joan Robinson and Nicholas Kaldor at the University of Cambridge, and received his Ph.D. from Rutgers University under the chairmanship of Paul Davidson. He is a life fellow of the Royal Economic Society (UK) and an elected member of the Società Italiana degli Economisti. In 2010, he was awarded the prestigious Veblen-Commons Award by the Association for Evolutionary Economics for his many contributions to the economics field.