“Reshaping the International Monetary Architecture: Lessons from the Keynes Plan”

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Reshaping the international monetary architecture: lessons from the Keynes Plan

Abstract

As we witness profound turmoil in the global economy, and as it becomes apparent that the so-called "Revived Bretton Woods System" might be nothing more than a temporary non sustainable financing of the US structural imbalance favored by the global role of the dollar, which has increased the overall vulnerability of the global financial architecture, it's worth revisiting the origins of the Bretton Woods conference, and pointing out the relevance for today's framework of Keynes' original 1942 plan for an International Clearing Union. In this note we explore the main characteristics of Keynes' original plan, by revisiting his original writings between 1940 and 1944, and we outline its relevance to the current debate on the international financial architecture. We'll argue that reforms of the international financial architecture should include anchoring the international monetary system on sounder institutional ground.

Keywords: international financial architecture, Bretton Woods Institutions, Keynes Plan, international currency, global imbalances.
JEL Classification: E00, E12, E42, E50, E58, F02, F33, N20.

Introduction

In 1940 as World War II was still ravaging Europe, economists in both camps were at work to prepare the seeds of a new world monetary and financial order, which would have supported the post-war order. For Nazi Germany, which was still hoping for victory, the stakes were to provide a substitute to the sterling area they were so willing to annihilate. For the Allies, the stakes were to counter German propaganda, while also preparing to reconstitute on a sounder basis a new post-war world order, able to support renewed intensive flows of international trade. Lord Keynes was among the economists who would put his brilliant mind at work first to countering the German Funk-Schacht plan (1940-1942), the so called "German New Order", and subsequently in 1943-1944 to contribute to elaborating the basis of the post-war order, which led to the creation of the Bretton Woods Institutions in 1944. After an interwar period characterized by decreasing domination of the sterling and the increasing domination of the US dollar[1], Keynes conceived the post-war order as a multipolar international monetary system, centered around an international "clearing union". As it happened, the new world monetary order ended up centering on establishing the American dollar as the sole dominating currency instead – supported by the US excedentary current account – in a regime of fixed exchange rates with the dollar pegged to gold at $35 an ounce. The system was abandoned in 1971. As we witness profound changes in the global economy and the rise of a multipolar integrated global economy, and it appears clear that the so-called "Revived Bretton Woods System" (or "BW2") as described in the influential paper by Dooley, Folkerts-Landau and Garber (2003) (in which many countries, particularly in Asia, limit exchange rate fluctuation against the dollar, accumulating as a consequence enormous reserves in dollars) may have been nothing more than a temporary non sustainable financing of the US structural imbalance, which contributed to the overall instability of the global financial architecture, it's worth revisiting the origins of the Bretton Woods conference and pointing out the relevance for today's framework of Keynes' original 1942 plan for an International Clearing Union. In this note we explore the main characteristics of Keynes' original plan by revisiting his original 1940-1944 writings, and we briefly outline its relevance to today's current debate on the international financial architecture, stressing that reforms of the financial architecture should include reshaping the international monetary system.

Section 1 covers the origins of Keynes Plan, the 'secular problem' of international imbalances which had plagued the pre-war era of globalization, and Keynes' ambition to set the international trade on sound monetary basis. Section 2 provides a brief description of the key elements of Keynes Plan and the design of the International Clearing Union.

Section 3 addresses the relevance of Keynes Plan to the current debate on the international financial architecture and lists three reasons that justify a call for an inclusion of the renewal of the international monetary architecture:

1. Global imbalances have become an intrinsic feature of financial globalization, thereby increasing the risk of dramatic unwinding of the

These are the views of the author and need not reflect those of the World Bank or any affiliated organization.

[1] In their recent study, Eichengreen and Flandreau (2008) point out that the dominance of the US dollar started as recently as in the mid of the 1920s, anticipating the definitive fall of the influence of the Sterling. The interwar period was characterized by shifts between US dollars and Sterling.

imbalances. The global role of the dollar has acted both as underlying condition for the development of global imbalances accumulated between 2001 and 2007[1], and the 2007-2008 financial turmoil, with following contagion to Europe and the emerging markets.

2. Structural vulnerability and failures in the interbank markets are leading to the re-evaluation of the centrality of central banks, and central clearing. While Central Banks are stepping up to their renewed role, the international system is dangerously left orphan.
3. The current "regulation" versus "laissez faire" debate should be extended to a more central question: the "adequacy" versus "inadequacy" of the institutional arrangements underlying international exchange in a globalized world.

Section 4 addresses current challenges in the global economy and the last Section concludes.

1. The "Secular International Problem" of balance of payment imbalances

Keynes' proposal for the establishment of a new World Order went beyond the need for managing post-war relations. It originated from Keynes' realization that the use of money in international trade had only "worked" for about "two periods of about fifty years each" in the past five hundred years (Keynes, 1940, p. 21). Contrary to common wisdom, Keynes' work didn't stem only from the need to overcome the limits of the interwar periods of unrestrained exchange rates flexibility. Keynes saw in the final break up during the war of the "international currency laissez-faire" not only a problem, but – in his own words – an *"opportunity"* to address a fundamental question of the institutional weaknesses of the first era of globalization, which had been brought to an end by the two World Wars and the Depression. Keynes saw in the dis-orderly international laissez-faire, based on the absence of a system of international payments, an institutional weakness. His work was first and foremost aimed at institution-building. By suggesting an international clearing union, he was proposing to introduce to international payments the same institutional arrangement ruling the payments within nations, and in particular the need for banking clearing system (operated by an international clearing bank).

Keynes plan originated from the *ambition to finally set international trade on a sound monetary basis* supporting the evolution toward an international division of labor and the exploitation of natural resources in foreign countries. Keynes considered such reform critical to the post-war world order. He blamed *"impoverishment, and social discontent and even wars and revolutions"* on the *"secular international problem"* of balance of payment imbalances (ibidem), pointing out that this failure can be traced to a *"single characteristic":* almost all the international monetary settings used in the past five hundred years *"throw the main burden of adjustment on the country which is in the debtor position on the international balance of payments"* (p. 27).

Keynes suggested a new institutional framework, in the form of a US-UK based system of international clearing, the operation of which would facilitate the re-equilibration of global imbalances, by stressing the need for a symmetric rebalancing which would involve countries in both debtor and creditor positions. "Symmetric rebalancing", which mimicked the action of Central Banks at national level on the interbank market, is the central feature of Keynes' framework, and the main element missing in the current regime of international exchange. The aim was to secure creditor adjustment while maintaining debtor discipline. *"The chief initiative"* would rest on the country which finds itself in a creditor position against the rest of the world, hereby avoiding the *"contractionist pressure against the world economy and, by repercussion, against the economy of the creditor country itself"* (p. 47). Following Keynesian logic, which was still very much influenced by the concern over avoiding spreading deflationary pressures, global imbalances should not lead to corrections through the contraction of imports, but would be better dealt with by expansion of the opportunities for exports.

The objective of Keynes analysis goes beyond the need to restore the international trade on a sound system of international payments and extends to the need for providing a growing world with opportunities of growing flows of international investments. A sound system will require the means to distinguish between "floating funds", and genuine investments for developing the world resources (p. 53) – on the one hand – and on the other hand, to distinguish between speculative movements of capital from deficient countries to surplus ones, and movements of capital favorable to the equilibrium, which would flow from surplus countries to deficiency countries.

2. The Keynes Plan

By the author's own admission the Keynes Plan was an *"ideal scheme", "complicated and novel and perhaps Utopian"* (p. 33). Nonetheless Keynes strongly believed it was *"right"*, and best corresponded to the new need of grounding international

[1] Reaching almost six percent of global GDP in 2007, this includes both deficits and surplus. It has been accompanied by a tripling of the total of foreign exchange holdings in US dollars (DECPG calculations).

trade on the spirit of trust and international cooperation. Suggestively, he described it *"as a measure of financial disarmament"* (p. 57).

The Plan rested on the fundamental idea of generalizing the principle of national banking to international transactions, i.e. *"the necessary equality of credits and debits, of assets and liabilities"* (p. 44), by creating an international clearing system. Central to this idea was the treatment of creditor countries. As Keynes puts it (p. 211) *"the problems of the debtors can only arise if creditors are not choosing to make use of the purchasing power they have obtained"*. Encouraging creditor countries to make use of this purchasing power will mitigate problems encountered by countries in a debtor position. On the other hand, the plan would have allowed surpluses to be borrowed by debtor countries[1].

Keynes 1941 scheme suggests the creation by the US and the UK of a clearing institution, which would manage an international monetary unit (*bancor*), used in the settlement of international balances. The *bancor* would be based, as all other currencies at that time, on gold. The Clearing Union (C.U.) would entertain relations with all central banks of countries that wished to trade with members, and membership would be later opened to other countries. Clearance of balances between countries would be carried out by Central Banks through their accounts at the C.U. On the asset side of its balance-sheet the C.U. would have its reserves and loans to central banks of member countries, with deposits of central banks (defined in *bancor,* as international currency issued by the C.U.) on the liabilities side. The imbalances between nations would therefore be reflected in the C.U.'s account.

The Keynes Plan aimed at "multilateralizing" the national imbalances through their handling within an international banking institution.

The management of imbalances would be operated through the following mechanism. Countries would be allowed overdraft facilities up to a definite amount, to allow time for the country re-equilibrate its position. Every member state would be allowed a maximum debit balance determined by a quota related to its volume of trade. Members whose balance exceeded one quarter of the quota would be defined as Deficit/Surplus countries. The C.U. would discuss with Surplus countries that have exceeded half of the quota about measures to restore equilibrium (e.g., appreciation, expansion of domestic demand, reduction of barriers to import, loans to developing countries, payment of liquid reserves to a Reserve Fund)[2]. In the case of large debtors (for which the debit's balance exceeds three quarters of the quota) further measures could be discussed, including the possible suspension of membership.

The innovation of the plan consists in the treatment of Surplus Countries, and specifically in the following two features:

- Deficit countries would be allowed to borrow the balance of creditor countries.
- The C.U. would discuss with Surplus Countries that have exceeded half of the quota, about measures to restore equilibrium.

The centrality of this feature is also the key missing element of White's proposal for a Stabilization Fund (which, amended, gave rise to the IMF).

While in this note, we limit our discussion to the proposal for an international clearing union, the idea of an "International Bank" went beyond the clearing union, to become the financial core of the architecture of a system of global economic governance. According to Keynes 1941 proposal, the Institution would play many roles (p. 91):

- Finance an international body in charge of post-war relief and reconstruction, supplementing contributions from other donors. Overdraft facilities could be granted to this body, financed by countries having credit balances in their Clearing Accounts.
- The Bank might finance an international body in charge of preserving peace.
- It might set up an account in favor of international bodies charged with the management of commodities, and might finance stocks of commodities held by such bodies.
- The Bank might link with a Board of International Investment (or a Development Corporation) and be closely associated with an anti-depression board.

While visionary in many aspects, Keynes Plan never attracted support from the US Treasury, which was prepared for the Bretton Woods Conference in 1942 by producing an alternative plan prepared by Harry

[1] This provision, which implies that the C.U. provisions also cover the need for a financial intermediation between surplus and debtor countries, is often neglected in the recent analysis of the Keynes Plan. We believe that a correct application of this provision would prevent possible inflationary effects of the Keynes Plan as described in Rossi (2007).

[2] The provisions of the Keynes Plan might seem to be at odds with the management of chronically surplus countries like oil exporters. In reality, the mechanisms of the C.U. encourage countries to adjust and also contain provisions for the handling of persistent surplus, by requiring payments into reserve funds, which can be borrowed by debtor countries. This mechanism amounts to a "multilateralized" version of the current development of sovereign wealth funds. A key difference is that the surplus of oil exporters would be reserved in *bancors*, instead of US dollars. These funds would therefore be reserved to fund international trade. Note however, that other provisions of the C.U. like devaluation and increase of imports could be considered, with also possible useful results to minimize "Dutch disease" effects.

Dexter White. White's paper advocated the creation of an Exchange Rate Stabilization Fund, with the task of stabilizing exchange rates, and a Bank for Reconstruction. White's plan put the US dollar and its link to gold at the center of the international monetary system. The two plans were based on different concepts, and presented three key differences:

First, as highlighted above, White's plan did not require adjustments by creditor countries, leaving all the burden of adjustment to debtor countries.

Second, while the Stabilization Fund made loans out of the subscribed capital (as the current IMF) in national currencies, the ICU had the ability to create overdrafts in Bancor, acting if needed as lender of last resort.

Third, while 1941 Keynes Plan was not a truly multilateral arrangement (the ICU would have first be created by the US and UK only, with possible extension to other countries at a later point), Bancor provided a system for multilateral clearing. White's 1944 plan, while having the clear advantage of being based on a truly multilateral agreement, was designed for a world of bilateral payments arrangements: a country could borrow from the Stabilization Fund only to cover a deficit with the country whose currency is being borrowed. White had not yet understood the need for a multilateral mean of settlement, and the role the dollar was going to play in this respect in the postwar world.

In the frenetic months that preceded the Bretton Woods Conference, White's proposal came to dominate the discussions. The negotiations took a so that pragmatic turn, so that much of the visionary work of Keynes wasn't reflected in the final discussions in Bretton Woods, New Hampshire. Nonetheless Keynes' support for the new Bretton Woods institutions was clear and vocal, as he clearly saw in them the seeds of the new order. As it happened, these seeds never grew into an international monetary system, which was left into the "non-system" system depicted by Robert Triffin (1960), in which provision of international liquidity ended up depending on the US carrying current account deficits.

The reasons for Keynes' failures were not only rooted in the fundamental antithesis between a "visionary plan", and the pragmatic political approach that dominated the international debate. Keynes also failed as his "market pessimistic views", as expressed by Skidelsky (2005), which were based on belief of a superiority of rules versus discretion, were simply going against the renewed "esprit du temps". Keynes' plan was simultaneously too much ahead of his time, and behind the times The market oriented approach to economic institutions was back in fashion, after more than two decades of pessimism. Keynes Plan was stillborn.

3. Relevance of the CU's proposal in the current international financial context

3.1. The instability of the current international monetary architecture. In contrast to Keynes' idea of an international clearing union, the current design of the international financial architecture is shaped by the concept of "key currencies", structured into a core (the US), and a periphery (EU, Japan, and more recently Asia). As currently operated the system allows for international imbalances to continued build up so long as the periphery supports the accumulation of US dollar denominated debt, while placing the burden of adjustment on debtor countries. The apparent stability of this arrangement prompted Dooley, Folkerts-Landau and Garber (2003) to claim the existence of an implicit "Bretton Woods 2" (BW2) regime. According to the proponents, the system reflects a mutually beneficial relationship among deficit and surplus countries. It allows the US to enjoy very low long-term interest rates while also accommodating successful development strategies in emerging countries. While "BW2" developed since the early nineties, in the last few years it has come to symbolize the relation between US and China. The role of the dollar supports the employment of chronic excess labor supply in Asian countries, by redirecting it to export-oriented production. Asian countries compensate the chronic surplus of the current account by becoming a chronic surplus buyer of US securities. Other authors voiced greater skepticism and various degrees of concern, with Lawrence Summers depicting the system as "balance of financial terror", and Gourinchas and Rey (2005) pointing out that the "exorbitant privilege" of issuing international currency has led, since the break up of the Bretton Woods System in 1971, to a transformation of the US from the World Central Banker, to the World Venture Capitalist, with high return risky investments on the assets side, and a considerably increased leverage ratio on the liability side, hereby increasing the likelihood of abrupt adjustment. Caballero and Krishnamurthy (2008) offer a compelling analysis of the role of capital inflows in the US in facilitating the securitization boom, and rising leveraging: excessive capital inflows in the US being mostly non speculative and addressed to risk-free assets, the US financial system has increasingly intermediated domestic saving into assets that carries a higher cash-flow risk, with the result that the *"US increasingly specializes in holding 'toxic waste'"*.

Recent years have seen an increasing number of authors detecting in the build up of global economic

imbalances the seeds for a progressive change of the international currency regime, with the end of the sole domination of the dollar as global payment and reserve currency. The early debate (2003-2008) has been dominated by divergent views on the modalities and pace of progressive substitution of the dollar by other key currencies. Some authors, who see global imbalances as the natural result of real and financial globalization, predicted a very long "soft landing" process are not bound to cause any sudden change in the dollar status, which would orderly and progressively lead to a multipolar currency system (Lipsky 2008). Others[1] warned of the increased likelihood of an abrupt adjustment through a possible collapse of the value of US dollar.

Among the most vocal authors, Roubini (2007a) warned that the economic and financial model behind the "revived Bretton Woods" arrangement was leading to *"excessive monetary and credit growth, asset bubbles in stock markets, housing markets and other financial markets that will eventually lead to a build up of financial vulnerabilities"*. Other authors, like Canzoneri, Cumby, Diba and Lopez-Salido (2008), pointed out to the existence of a systemic risk: a key currency system heightens the inner vulnerability of the global financial architecture, as shocks emanating from the key currency country have the potential to lead to a global shock and can be a greater source of instability. Goldberg and Tille (2008), on the other hand, had shown that the conduct of monetary policy in the center has substantial impact on countries at the periphery, even when direct trade links are absent.

While both optimistic and pessimistic authors pointed to the inherent vulnerability of the global financial architecture, few expected an unwinding of macro-imbalances through a deep global financial turmoil of the kind the world economy has been experiencing since late 2008. Whereas there is widespread agreement that global imbalances have been playing the role of underlying condition, and broad support for a call to review the international financial architecture, no far reaching overhaul of the international architecture has been so far put forward.

3.2. The current international monetary architecture as one of the factors underlying the 2007-2009 global financial turmoil. The macro roots of the current crisis can be traced back to the widening global imbalances, which highlight the existence of a *multilateral* imbalance that cannot be simplistically reduced to a *bilateral* imbalance between US and China. China's bilateral trade surplus with the US accounts for only about one-third of the US current account deficit, and by 2006 the financing of the US current account deficit absorbed more than three fifths of all cross-border savings of the sixty-seven countries that run surpluses that year. As Asian economies accumulated huge reserves by partially applying "mercantilist" policies that kept their exchange rate underevaluated, boosting exports, they submitted themselves to the risk of contagion: with gross flows of trade remaining unchanged, the exposure to impact from international troubles was also substantially unchanged, and the generation of a substantive net outflow just entertained the illusion of protection against an international financial crisis. At the same time, excessive dependence on export led growth made emerging countries vulnerable to trade shocks.

While today's crisis is inextricably intertwined with a process of disorderly unwinding of global imbalances, we are just beginning to understand the full extent of the imbalances in US domestic financial sector. The US dollar status as the world's foremost reserve currency played a significant role in enabling the financing of the US external deficit beyond normally sustainable levels. The build up of external imbalances in the US is a story of domestic financial imbalances that spilled out across sovereign borders starting in the early 1990s.

The growing imbalances have helped sustain a lower interest rate in the US economy, indirectly helping create the conditions that fed the housing boom. In a deregulated financial environment, low interest rates and abundant credit have a tendency to spill over into non-traded goods sectors, including property markets. Recent evidence suggests that international capital inflows to the U.S. have enabled long-term lower interest rates, offsetting the effect of factors pointing toward higher long-term rates like the fiscal deficit and the tightening of monetary policy: Warnock and Warnock (2006) estimated that there had been no foreign official flow into US government bonds from 1984 to 2005, the 10 year yield would have been 90 points higher in 1996. On the other side, the high demand for US dollars in the 2005-2007 period, which kept increasing despite the ongoing deficit and the evident imbalances, helped delay the need for the US to adjust to the internal saving-investment imbalance, increasing the likelihood of a sharper adjustment and the risk of a more severe crisis. The flow of funds from emerging markets hinged on the willingness of both central banks and private financial intermediaries to take on the risks which were being generated in both the external position of the US and the internal financing of indebted households. Quite ironi-

[1] See Obstfeld and Rogoff (2004), Eichengreen (2004), Godley (2005), Goldstein and Lardy (2005), Krugman (2006), Summers (2006), Roubini (2007b).

cally, the mid-September 2008 collapse of the core financial institutions in the US has not stopped the process, but seems to have accelerated it, causing a strengthening of the dollar (which we believe might end up being as short-lived as powerful).

The structural weaknesses of the current international monetary architecture might also play a negative role in the unwinding of the 2007-2009 financial turmoil, by intensifying problems rather than helping mitigate them. On the one hand, by putting the burden of adjustment on the debtor country, unwinding of global imbalances might generate the same deflationary effects on demand and international trade that lead Keynes to suggest a "symmetric" system, and that we've addressed in Section 1. Secondly, the global role of the dollar might fuel a continued flight to quality of capital into the US, which is increasingly seen as demander of last resort. Finally, the crisis might encourage emerging markets to prevent future vulnerabilities by building up even more substantive reserves, leaving the global economy vulnerable to possible future crisis involving a sudden stop of inflows of capital to the US.

3.3. The need to re-establish the importance of central banking functions at both national and international levels. Internal structural vulnerability and failures in the inter-bank markets are leading to a necessary re-evaluation of the centrality of central banks in the national financial architecture. While Central Banks are carving for themselves a new role, the international system has been so far left out of current discussions.

Keynes' pivotal idea of a clearing union consists in adopting for the international exchanges the same principles of two-tier banking that ruled most of the national systems. The originality of Keynes' approach stems in his theoretical works on the nature of money and banking: Keynes' works are first of all a search for understanding of the mechanics of the economic system, representing a superb example of the kind of "system analysis" that has fallen out of fashion in the last decades. Keynes' central idea was that international exchanges should rely on the same sound banking structure that was ruling exchanges within nations. History moved in the opposite direction. Not only the idea of grounding international trade on an international banking system never went beyond the level of debate among academics, but banking systems shifted away from the centrality of central banks, as large banking conglomerates and interbank markets developed in the last decades. It is interesting to observe that this disengagement of the central banks from the clearing activity contributed to propagate the sub-prime crisis to a generalized crisis: as recent evidence by Peydo and Iyer (2005) shows, the interbank market not only transmits, but also amplifies shocks, increasing the fragility of the whole system over and above the initial shock. Acharya, Gromb and Yorulmazer (2008) documented this intrinsic vulnerability of the interbank market, by finding that in time of crisis surplus banks can strategically exert market power and exploit banks in difficulty – starting a "silent bank run' – unless a discount window is available at the Central Bank. The stigma attached to the FED's discount window, and the following bank's very high reluctance to access it, might have caused the FED to lose its balancing influence over the interbank market (despite the FED's effort to issue new discount windows during the 2007-2008 period). Rochet and Tirole (1996) concluded that the systemic risk in interbank market could be offset by centralized liquidity management, where the central bank acts as counterpart and guarantees finality of payments.

An international clearing union could assume the same role of crisis prevention and management which clearing houses[1] assumed from mid-1800s (by functioning as "last resort" and issuing certificates which amounted to a form of deposit insurance) before the establishment of the FED in 1914.

In 1963, the IMF started moving timidly toward a multilateral scheme for international exchanges by suggesting the introduction of Special Drawing Rights (SDRs). Unlike the Bancor, SDRs were not meant to be chiefly a vehicle of payment settlement but to supplement the availability of international reserves. By the time of their first allocation (1970), however, the "Bretton Woods System" was already crumbling. The global shortage of reserves that the SDR were supposed to address never materialized, and the SDR never managed to gain significance. The following widespread development of lending to sovereign debtors by commercial banks ended up steering the evolution in a quite different direction, and the SDR were left with the potential role of "a safety net for [improbable] future contingencies"[2]. As lending takes place more and more across national boundaries, involving different national regulations, the need for an international lender of last resort appears to be essential. While the introduction of the SDR has mitigated the risk of shortage of international reserve currency, the international monetary system was left vulnerable to systemic coordination failures of commercial banks[3], which

[1] Clearing houses would clear payments among banks during normal times, and helped sustain bank's liquidity and solvency during crisis (Gorton and Huang, 2002).
[2] Report of the Deputies of the Group of Ten, 1985, quoted in Polak (1998).
[3] Rochet and Vives (2004).

caused the current global dry up of liquidity. On October 29, 2008 both the FED and the IMF resorted to new instruments, the FED expanding swap arrangements with countries outside the G10 group, and the IMF introducing a new short-term financing facility. Both schemes do not, however, apply to more vulnerable developing countries. Additionally, recent efforts include a possible renewal of the SDRs' role: the G20-lead effort for a coordinated answer to the global financial crisis is exploring the possibility of a new SDR allocation in 2009, which would provide unconditional liquidity to member countries by supplementing reserves[1]. While such an allocation would be a very welcome confidence-building response, a renewal of the role of SDRs would not directly address the core issues that the Keynes Plan was meant to address through the introduction of a third tier international central bank function: preventing the building of balance of payment imbalances and the deflationary adjustments, and the absence of lender of a last resort function at international level.

While the current financial turmoil has led to the recognition that the development of the interbank market has not made redundant the need for a lender of last resort institution in national economies, little consideration has been given so far to the international monetary system. Attention should now turn to the vulnerabilities of the international (non-) system: probably too much emphasis (and hope) is currently being put on the effectiveness of coordinated action by Central banks. In the absence of a sounder global institutional grounding, and with currencies, including the US dollar, being left dangerously exposed to very strong fluctuations, the global monetary architecture is being left vulnerable to chaotic unwinding of global imbalances.

In the past, there has been much debate about a possible support function of last resort by the IMF (see, for instance, Mishkin, 2007) to certain emerging markets. In a world with the C.U., if a domestic central bank lacks the resources to conduct emergency liquidity assistance to stop a financial crisis or promote a recovery when one occurs, overdraft facilities could be granted to this institution, financed by countries having credit balances in their clearing accounts at the C.U. Compared to the IMF, the overdraft facilities offered by the C.U. could allow to easily step in even extremely exceptional situations, when needs could dwarf the resources that can be mustered by an institution like the IMF, in particular when in comes to support to the largest countries.

4. A renewal of the international monetary architecture

Since the presentation of Keynes Plan in 1941, there have been many suggestions for a renewal of the International Monetary Architecture based on Keynes' blueprint, most notably by Triffin (1960), Bernstein, Grubel (1963), Machlup (1966), Horsefield (1969), Schmitt (1973), and Cencini (1995). More recently by Rossi (2007), and by Alessandrini and Fratianni (2008) who argue for the establishment of a supranational bank money.

While the current financial and economic turmoil is profoundly transforming the structure of the global financial system, the role of the dollar, the so-called "renewed Bretton Woods" system (BW2) and the euro zone are so far the only key structures of the global financial system that have remained intact. As Dooley, Folkerts-Laundau and Garber (2009) point out in their most recent analysis, the incentives driving the durability of BW2 are still in place, despite the crisis. It indeed seems, at the time of this writing, that the appetite for accumulating dollars and US securities might never come to an end. The current financial and economic crisis has, however, intensified the debate around the sustainability of the BW2 arrangement. There are some reasons to believe that US securities – as one of the few assets still perceived as risk-free – might keep their attractiveness throughout the crisis, and that emerging markets are bound to approach the post-crisis world by an ever increasing appetite for US reserves, to minimize vulnerabilities to future crisis. Other scenarios are, however, plausible: the intensity of the crisis and the following US fiscal expansions will might set the stage for a true "twin deficits" scenario, where the assets accumulated by surplus countries (typically US Treasuries) will be the very same assets that sustain US excess of consumption. Bibow (2009) describes this scenario as "BW3".

The current arrangements bear some substantive risks. The increasing dependence of Asian countries on trade has made them very vulnerable to economic shocks of the type the global economy is currently experiencing. While the current crisis is not the crisis of BW2 system that many predicted in the past few years – a sudden stop of flows of capital to the US, and the free fall of the dollar (accompanied by a substantive loss on securities in emerging markets) – *that* crisis is still possible. Dooley, Folkerts-Laundau and Garber (2008) claim that these risks might have been overestimated, and that *"this scenario remains a forecast that is no more credible today than it has been in the past several*

[1] The G20 proposal explores the possibility of ratifying the 1997 suggested SDR allocation, which never became effective as only 78% of the IMF shareholders have ratified the 1997 decision so far. The idea of building on the 1997 resolution could guarantee a rapid achievement of the required 85% of voting rights, and a rapid allocation.

years". Still, the possibility could materialize at any moment in the future. BW2 still holding might be the signal that the worst is still yet to come. As the global economy lives through a turmoil of historical proportion it is necessary to ask whether the willing to bear this risk is justified.

While the US are battling low consumption, and the Asian countries face the daunting task of redirecting the free falling external demand into internal demand, it is tempting to see in the continuation of the BW2 arrangement a way out of the current economic crisis. Capital inflows to the US are bound to increase the current global imbalances. On the other side of BW2, countries are experiencing sudden drop of exports, accompanied by a drop in imports (as production and consumption are also reduced as a result of the economic slump), without substantial regression in the accumulation of surplus.

As the US faces excess capacity, it is unlikely that increased capital inflows will generate any improvement in the US economy, where production and consumption would still be lagging: at best, the continuation of BW2 will allow the US to export part of its problems to emerging countries. This is a far cry from the idealized "mutually beneficial relationship" of BW2.

All this leads to the need of a deeper discussion about the best international monetary arrangement. The Keynes Plan is a blueprint for the institution of a multilateral international clearing that would avoid most of the shortcomings of the dollar-based system. Keynes' aversion to the secular problem of imbalances stemmed from the contraction of imports caused by adjustment through the debtor. To avoid this dampening effect on trade he advocated a system that would put the burden of adjustment on both surplus and credit countries, focusing on expansion of opportunities for exports. This focus of Keynes should not be surprising, as in the early forties he was still very much worried by possible deflationary effects of adjustments of global imbalances (between the US and Europe at that time).

Conclusion: Keynes' legacy

The 2007-2009 global financial turmoil has prompted a renewed interest in the need to review the global financial architecture, and the role of the Bretton Woods Institutions in such a renewed framework. The Group of 20 has taken on this debate and planned to address it through working groups, which might echoe (at some level) the kind of preparatory works that led to the 1944 Bretton Woods Conference, which had seen Keynes supporting the works of the UK treasury (through his plan) to counter the plans of the US Treasury. Surprisingly, this work does not include at the moment any analysis of the future of global imbalances, on their desirability, sustainability and compatibility with a less vulnerable international financial architecture. Failure to address at technical level this politically sensitive issue could lead to potentially incomplete reforms.

At another level, the current global financial turmoil and its initial policy responses have spurred a debate on the need of more regulation, the role of the State and the Central Bank in managing the financial sector, and on the level at which the financial turmoil should lead to a review of the tenets of the "laissez faire" approach in the financial sector[1]. It is not doubtful that the crisis will give rise to a new body of research, some of which might lead to the rethinking of some of the received common wisdom. In this respect, we believe that the current "regulation" versus "laissez faire" debate should be extended to a central question: the "adequacy" versus "inadequacy" of the institutional arrangements underlying the monetary and financial architecture of the global economy, both at national and international levels. While Keynes has sometimes been described as "market pessimist", not least by one of his prominent biographers like Skidelsky (2005), Keynes' approach is rooted in much more than the skepticism generated by the depression in the 30s: Keynes' work is a response to the institutional weaknesses at international level that have characterized the first era of globalization, and his work is foremost aimed at international institution-building. Keynes monetary thought was elaborated in the 1920s, preceding the depression, and was chiefly devoted to understanding the nature of bank money (which proved to be very different than metallic money) and of modern banking activity. Keynes' main legacy lays in his analysis of the adequacy of the institutional arrangements underlying both the national and international system of exchanges. The Keynes Plan is an attempt to ground the international system of trade in a sound monetary institutional framework. More than sixty years after this failed attempt, Keynes Plan remains the chief blueprint for any further attempt.

There is finally a very important lesson to be learned from Keynes 1940-1944 activities. By putting his mind at work on the details of a post-war monetary order in the early days of 1940 already, when victory was still far away from being acquired, he stressed the need for adequate advanced preparations for the new order. Tomorrow's international monetary order shall start to be designed today.

[1] Demirguc-Kunt and Serven (2009), and Caprio, Demirguc-Kunt and Kane (2009) offer an excellent overview of these discussions, while also stressing the need for balanced and evidence-based approach to this, at times, heated debate.

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