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WHAT WOULD KEYNES HAVE THOUGHT OF THE EUROPEAN CRISIS?

Jan Kregel *

ABSTRACT

Keynes died before the initiation of measures for economic and political union in Europe. However, he did have very clear views about the limitations on national policy space of an international standard which apply pari passu to the single European currency and to the problems created by international capital flows which have been part of the movement to a Single European market. At the same time, his proposal for an International Clearing Union, which was rejected in favour of the US proposl for a International Stabilisation Fund at Bretton Woods, provided the framework for one of the most important institutions in European Recovery proposed under the US Marshall Plan: the European Payments Union. Richard Kahn, one of Keynes collaborators put forward a regional version of the Keynes Plan, the 'Discount Scheme' which provides an indication of how Keynes might have evaluated the EPU. Based on Kahn's proposal, a possible modern application of Keynes's ideas on a sub-regional level is proposed as a means of avoiding the drawbacks Keynes noted of a single currency with open capital markets.

Keywords: Keynes Clearing Union, Kahn's Discount Scheme, European Payments Union, Regional Payments Systems, European Reconstruction.
JEL codes: F33, N24, N94.

1. What Would Keynes Have Thought of the European Crisis?

While Keynes was a sharp critic of the design for Europe shaped by the Treaty of Versailles, and a principal actor in the design of the post-World War II international financial architecture, he died in 1946 before the real political discussions on the shape of European political unification and economic reconstruction. His concerns in the former period were with the fea-

* Levy Economics Institute of Bard College. Address for correspondence: kregel@levy.org.

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sibility of the debt repayment and reparations conditions. The major theoretical implication that emerged from this concern was the elaboration of what came to be called the 'transfer problem'. From Skidelsky's biography we know that for the second period Keynes was more concerned with the design of a system that would allow Britain a viable post-war reconstruction, and thus with relations with the United States, more than with the rest of Europe. In this case his concern was the financing of imports for reconstruction in the presence of 'dollar scarcity'. The theoretical insight that emerged from this concern was the application of what Keynes called the "banking principle" on the international level in order to make the provision of liquidity more automatic and less dependent on external surpluses.

The basic problem facing Britain was the looming external imbalance which could only be achieved with US financial support; his negotiations for the American loan and his proposals for the post-war international financial system always kept this objective in the forefront. Keynes was less than fully successful in this endeavor to convince the Allied powers to implement his Clearing Union proposal, less through deficiency in his negotiating strategy than to the willingness of the US Congress to engage in a major lending programs to Europe after the experience of the 14-18 war.

Paradoxically, after Keynes's death the US did agree 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 overseen by the European Recovery Program (ERP). Assistance 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 under the Plan. 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.[1]

An even greater paradox was that the ERP, supported in a multilateral agreement on intra-European payments, that led to the creation in 1950 of the European Payments Union (EPU) that was broadly based on the Clearing Union proposals that were rejected at Bretton Woods. While it is

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1 "The OEEC and the EPU". Available at: http://www.cvce.eu/en/education/unit-content/-/unit/026961fe-0d57-4314-a40a-a4ac066a1801/22243aaf-3f7c-429e-b98c-283989b2b5e9/Resources#91fb1458-baac-497d-af6d-8b59f3ae4bf5_en&overlay (accessed July 14, 2017).

broadly 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 Britain refused to participate in a continuation of the plan in 1958 and embarked on a policy of special relations with the US rather than within Europe.[2]

2. 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, Europe, in the EPU. In this endeavour the proposals of Richard Kahn for an alternative multilateral European clearing arrangement provide insight into how Keynes might have approached the construction of a regionally limited clearing arrangement. And since Keynes's interest in the explanation of crisis in order to provide a theoretical basis to formulate policy, this conjecture on what Keynes might have thought will also require a speculation on what policy Keynes might have proposed to resolve the current European crisis.

Since the current Euro-based financial system in the EU 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 looked to 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 these are precisely the conditions that have been required for acceptance into the Euro system.

Keynes also noted that under these conditions it was the countries that were most in need of domestic policies to support growth and employment

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[2] As in the case of multiple regional integration proposals, the EPU was not the only regional payments union that was actually introduced based on the strike out experience of the EPU. 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 stop in trade integration.

that 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 lead to below-potential growth and employment for all members, as has generally been the case in Europe since the implementation of the Euro.

He thus favoured 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 diversity across countries and designed his proposals to retain them, while the current thrust in Europe is to impose common standards and to move to a more central political structure. It seems quite clear that the flexibility that he managed to introduce into the US proposal for a Stabilisation Fund which became the backbone of the Bretton Woods system is not present in the Single European Market and the Single Currency. In difference from his support of the IMF it is unlikely that he would have accepted participation in the EU in current form.

3. The Possible Alternative Financial System: Regional Clearing Unions

Impetus for a multilateral regional approach after the war 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 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 recovery programme dollar deficits of individual countries.

It was against this background, Richard Kahn (1949), one of Keynes's closest collaborators 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 in-

tra-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.

Since US funding was required for settlement within any multilateral clearing, the US became involved and the ERP supported the creation of the European Payments Union (EPU) built on a multilateral settlements system for Europe that would eliminate quantitative restrictions on intra-European trade and for providing 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 an ECA contribution of $350 million to be used whenever gold payments to creditor countries exceeded gold received from debtor countries.

Kahn noted the differences and similarities with 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.

Thus Kahn's criticism echoed Keynes's objection to the lack of asymmetry 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 possible difference between intraregional imbalance 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).

Thus, the essence of Kahn's scheme was to wipe the books clean every period – he suggested six months, so that cumulative debit balances should not make carrying them more onerous in terms of foreign reserves. It also raised the question of a creditor country financing its imports of dollar-denominated imports with the reserves of its European partners. Thus the discount was meant to create symmetry through the incentive the European discount would have for creditor countries since their dollar balances would be reduced in terms of the sale of their exports within Europe and thus reduce their purchasing power over hard currency imports. Obviously Kahn was looking at the operation of the EPU from the point of view of the UK which would have been very likely to have exhausted quickly its cumulative debit balance limits, and thus face full settlement in gold to European creditor countries which 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 its credit balance.

In this regard Raymond Mikesell (1948: 503) observed that:

> [I]n 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 non-members. Although the clearing operation per se is confined solely to the first of these three problems, all three are closely interrelated and must be dealt with, if intra-group clearing is to be successful.

Hirschman (1951: 49) provided a similar assessment: "As was true of all similar previous plans for multilateral clearing, the EPU project consisted of two distinct parts: (i) an offsetting mechanism and (2) a settlement mechanism". However, he notes the divergence of views on the operation of the system between the UK and the rest of the recovering economies:

> [T]he 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: 50-51).

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 such conditions that the ability of such schemes to provide adjustment credit becomes evident.

4. 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 to preserve national cultural characteristics under a multilateral payments system. Presumably his experience at Versailles had impressed upon him the difficulties these would create in achieving rational solutions to economic problems. Keynes thus 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 (April 1943 White Paper, reproduced in Horsefied 1969: 19).

While this is often considered as being 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 more restrictive and open US policies. After the war, it would be Germany that took on the role of economic policy opposition now in contrast to both the UK and the US.

It is thus of interest that in one of the earlier redrafts of his proposal for an international clearing union Keynes (1980: 55-56) 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 (See also, Keynes 1980: 182).

In this vein, Keynes goes on to propose groupings, which for European context were The Germanic countries (Switzerland, Holland, 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 presumable 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 European Union.

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 more or less represent similar economic structures and cultural patterns and that it would be supposed that they would represent possibilities for fuller economic integration. We 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 with a pan-European unit of account — and then conceivably that unit would enter into a Super Clearing with other regions. Keynes's proposed list includes, North America, South and Central America, Sterling Area, USSR, Central Europe, Balkan Union, Middle East and 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, the Oslo Convention proposed the elimination of trade barriers for the three Scandinavian countries and Belgium, 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.[3]

It is thus perhaps not surprising that the initial patterns for post-war European integration were all regional arrangements similar to those that had been suggested by Keynes. Building on pre-war 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 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 Benelux.[4] The Benelux Union created two elements: a) the coordination of economic, financial and social policy, and b) the acceptance and conducting 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 European Union, as well as worldwide as far as import and export are concerned.

The Benelux experiment was accompanied by a series of less-successful regional proposals which 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.[5]

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3 From "The European Federalist Papers". Available at: http://www.europeanfederalistpapers.eu/index.php/en/component/content/article/9-papers-uk/51-nr-13-jadoul-october-2012 (accessed: July 14, 2017).

4 *Centre Virtuel de la Connaissance sur l'Europe*. Available at: http://www.cvce.eu/en/education/unit-content/-/unit/02bb76df-d066-4c08-a58a-d4686a3e68ff/02d476c7-815d-4d85-8f88-9a2f0e559bb4 (accessed: July 14, 2017).

5 "Customs Union Projects". Available at: http://www.cvce.eu/en/education/unit-content/-/unit/02bb76df-d066-4c08-a58a-d4686a3e68ff/18f901e3-62ce-47a9-a917-db8d4dccda96 (accessed: July 14, 2017).

5. The Possible Alternative Policy Proposal

There are thus two elements that Keynes would have found inappropriate in the current European context and could have formed the basis for an alternative policy. The first is its application across all European countries, and the second is the lack of symmetry in the adjustment process which results from the imposition of the single currency which prevents the preservation of national diversity. From Richard Kahn comes the third element, the absence of any mechanism for external adjustment between the EU and the rest of the world.

There are two possibilities. The Kahn Discount proposal could be applied to a payments union for all members of the Euro zone. This would be a relatively straightforward procedure in which say Germany would receive its surplus balance from say Greece reduced by the Kahn Discount. Its accumulation of Euro credits would then be reduced and the incentive to import from deficit countries increased.

The second would follow 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; 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.[6]

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.

Would such a move be feasible in the current European context? The cessation of powers to a federal structure was written into the Belgian

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[6] "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).

Constitution which 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) preserved these rights 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 also appears 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.[7]

6. The Regional Application of the Kahn Proposal

It would thus be possible to conceive of a system in which regional federations employed 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 intra-regional imbalances would be small. These regional federations would remain members of the EU and participate in a European-level clearing using the Euro, with their regional monetary authorities represented in the ESCB. The regional currencies would thus have a fixed parity with

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[7] European Federalist Papers. Available at: http://www.europeanfederalistpapers.eu/index.php/en/component/content/article/9-papers-uk/51-nr-13-jadoul-october-2012 (accessed July 14, 2017).

the Euro. According to the Kahn proposal the settlements across regions would be made after calculation of the a 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 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 also had a surplus with the rest of the world and the Euro area thus also had a surplus, which is the current case, then it is likely that the Euro would appreciate, which would also 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 Euro zone.

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.[8] 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, supporting 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.[9]

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[8] The International Bank responsible for keeping the clearing accounts "might be closely linked up with a Board for International Investment …. It might act as 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).

[9] Holm provides another method for applying the clearing union principle to the EU. See https://www.omfif.org/analysis/the-bulletin/2011/january/keynes-clearing-union-in-europe/ (accessed: July 14, 2017).

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