



Keynes' Obsession

The worry over global imbalances.

BY TYLER BECK GOODSPEED

There is a whiff of necrophilia in the air where old theories are exhumed for use in waging contemporary policy wars, with the economics of John Maynard Keynes seeming often to comprise the weapon of choice. It is a weapon which should be wielded more knowledgeably. Keynes was notorious for relentless revision during his “long struggle to escape” from a classical paradigm to which even he, in his “unregenerate days,” once subscribed. According to one close friend and colleague, no sooner had *The General Theory of Employment, Interest, and Money* hit the printing press than Keynes was already planning an edition of “footnotes” to modify and amend his magnum opus. Indeed, shortly before his death in 1946, Keynes lamented the state of “Keynesian” economics, “gone wrong and turned sour and silly.” The scrupulous student of Keynes is left pleading: “Would the real Mr. Keynes please stand up?”

But we can be certain of one thing: Keynes was nothing if not a monetary economist. The lone theme coursing through all his work, surviving that “immense lot of muddling and many drafts” which accompanied the journey from his first article, on the Indian exchange rate, to his last, “The Balance of Payments of the United States,” is a long-abiding apprehension toward global trade imbalances, coupled with an exhausting, at times pedantic, quest for an international monetary system to restrain them. As global imbalances increasingly assume center stage in the debate over the Financial Crisis of 2007–10, Keynes’ protracted attention to what he termed the “secular international problem” is a topic about which pedantry is again well worth the while.

Keynes’ obsession with this problem began early. His 1919 bombshell, *The Economic Consequences of the Peace*, strenuously protested German indemnification on the grounds that it would inevitably inflict massive and sustained current account deficits upon the Allied economies. An entire chapter of his 1923 *Tract on Monetary Reform*

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is dedicated to the “balance of payments” question, while his 1930 *Treatise on Money* features lengthy discussions on squaring “internal” asset price stability with “external” exchange rate stability. Even *The General Theory* concludes, tellingly, not with some paean to deficit spending, but rather with a provocative reflection on how domestic economic policy can and must be reconciled with international monetary stability, lest international trade devolve into no more than a futile mercantilist ploy to export unemployment.

While Keynes would continue to grapple with the “international problem” until his death, the fundamental dilemma, he eventually concluded, came to this: nearly every international monetary system of the modern era has cast the burden of adjustment to global imbalances overwhelmingly onto the debtor country. Insofar as creditor countries refuse to make use of their increased purchasing power, adjustment must come via deflation by the debtors, thereby generating a potentially contractionary impulse within the world economy. Keynes’ paramount objective, therefore, was to devise a new international monetary regime in which global imbalances, should they arise,

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might be primarily resolved not through a contraction of imports on the part of the debtors, but rather also via an expansion of imports by creditors.

To this end, Keynes called for the creation of an international monetary clearing union to facilitate “symmetric” rebalancing. Under his plan, exchange rates would be fixed in accordance with nominal pegs of each national currency to a single, international monetary unit, “bancor,” which would in turn be tied to a basket of some thirty commodities. Clearance of multilateral trade balances would then occur through accounts

held by individual central banks with the clearing union; central banks of surplus countries would accumulate bancors, while deficit countries would have to draw down balances, with each member state entitled to overdraft facilities not exceeding half a rolling average of its overall volume of trade.

To put teeth into the system, Keynes proposed that any deficit country—a country tapping more than one-quarter of its maximum overdraft allowance—would be charged interest. Of countries whose overdraft withdrawals exceeded 50 percent of quota, devaluation and capital controls would be required. The clincher, however, was that penalties would apply symmetrically to surplus countries, with any country accumulating positive bancor balances likewise subject to interest charges and, in the event of an excess balance running 50 percent over quota, mandatory revaluation. Surplus countries failing to comply would find their balances confiscated altogether.

Keynes’ plan would thus go some way toward obviating two particularly pernicious perversities of the past twenty years, both of which stem from the fundamentally asymmetric nature of our current dollar-centric reserve currency system: First, the ability of the United States to rack up colossal deficits with seeming impunity; and second, the ability of China and other compulsively surplus countries to cavalierly export deflation via the accumulation of trillions in dollar reserves. Under the “Keynes Plan,” with the supply of bancors being highly elastic with respect to international trade, persistent U.S. deficits would no longer be necessary to provide the world with sufficient liquidity, and, moreover, China would no longer be able to suck that liquidity from the system without penalty.

Keynes, to be sure, was keenly aware that his proposal risked political indigestion. By his own admission, it constituted an “ideal scheme,” “complicated and novel and perhaps Utopian.” As it was, it was also wholly unpalatable to American negotiators at Bretton Woods, who, as creditors nonpareil, were not about to sign on to a system of symmetric rebalancing. One suspects Beijing would exhibit similar reluctance today. But as the deflationary pressure of global imbalances must invariably redound upon surplus and deficit country alike, we must ask, like Keynes, “If not this, what then?”

In 2004, Larry Summers described the warped relationship between the U.S. and Chinese current accounts as “a balance of financial terror.” Keynes’ plan, in his own words, was designed to offer “a measure of financial disarmament.” As so-called “Keynesian” economics are once again hauled out of cyclical ignominy to justify all manner of fiscal indulgence, the one issue which actually was of longtime signature concern to Keynes—the need to place the international balance of payments on sounder footing—deserves at least passing notice. We may, in the process, discover that Keynes the tedious monetary economist is of greater contemporary relevance, and offers a more effective contemporary remedy even, than the Keynes of “Keynesian” legend. ◆