John Maynard Keynes, the Bancor, and an International Money Clearing Unit (ICU): from Bretton Woods to 21st Century International Trade

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Bretton Woods (New Hampshire). 1944.

44 countries organise a New World Economic Order

The two main antogonists are John Maynard Keynes, representing the UK, and John Dexter White, representing the USA

Prior to Bretton Woods currencies were fixed to gold (The Gold Standard) and hence to each other.

World War I saw the collapse of the system, and the interwar years 1918-1940 saw high fluctuations of currency values making international exchange very difficult and risky.

Jupiter Images, Getty Images

If the US devalues the $, then exports are easier (the goods now cost less in UK pounds and Deutchmarks) and imports cost more – therefore exports increase and Americans buy more homemade goods than more expensive imported goods. The economy and employment recover.

If several countries start doing the same thing, creating export or import contracts becomes very difficult.

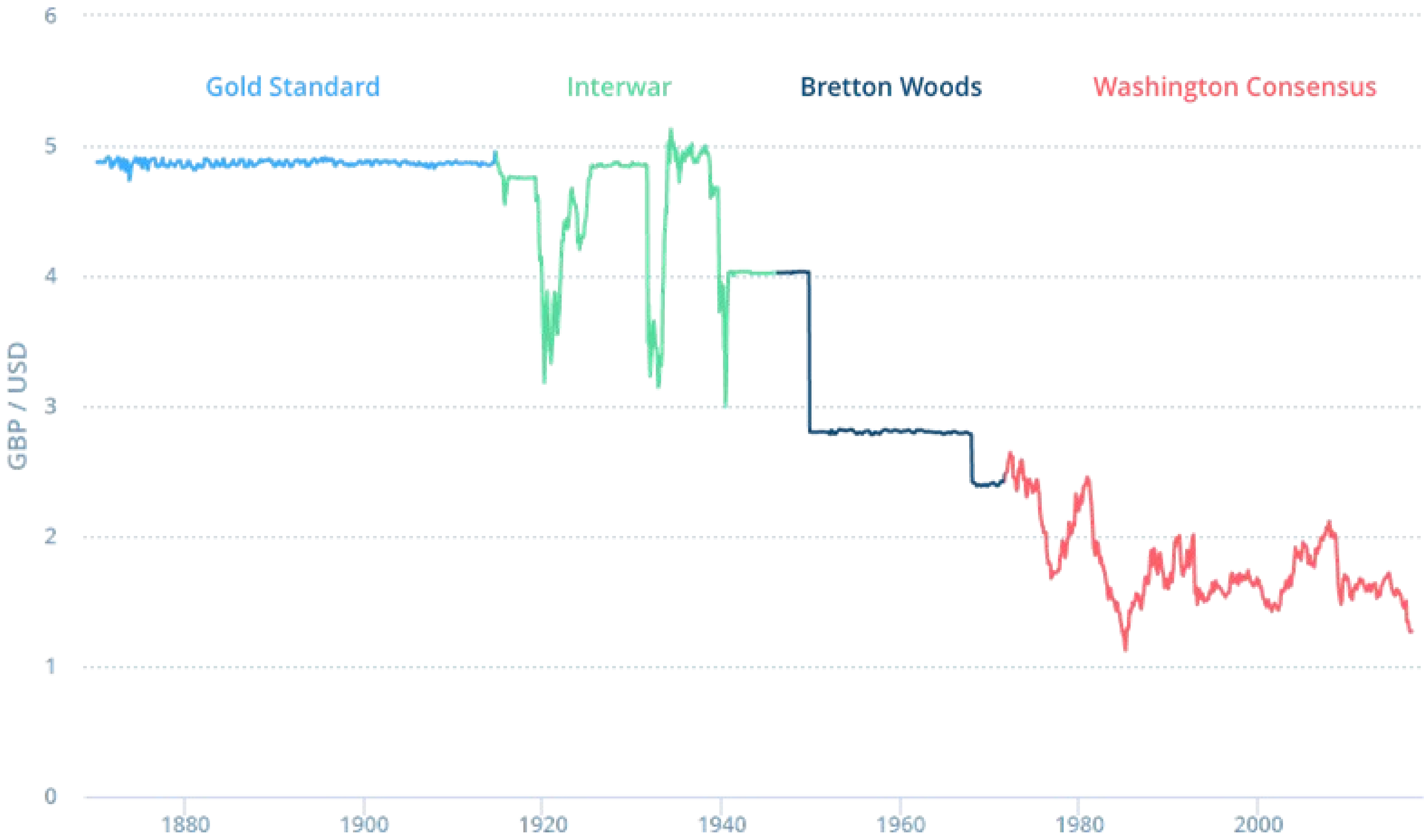


Figure 1. The currency-pair GBP/USD. Exchange rates were stable for decades under the gold standard, but became unsettled during the interwar period as Britain resumed and then ditched the gold standard. There were two more decades of stability under Bretton Woods (albeit with two steep devaluations) and then volatility after the 1971 Nixon Shock (ref. Winton.com)

If currencies are tied, what is flexible?

Exports

Imports

= Trade Balance

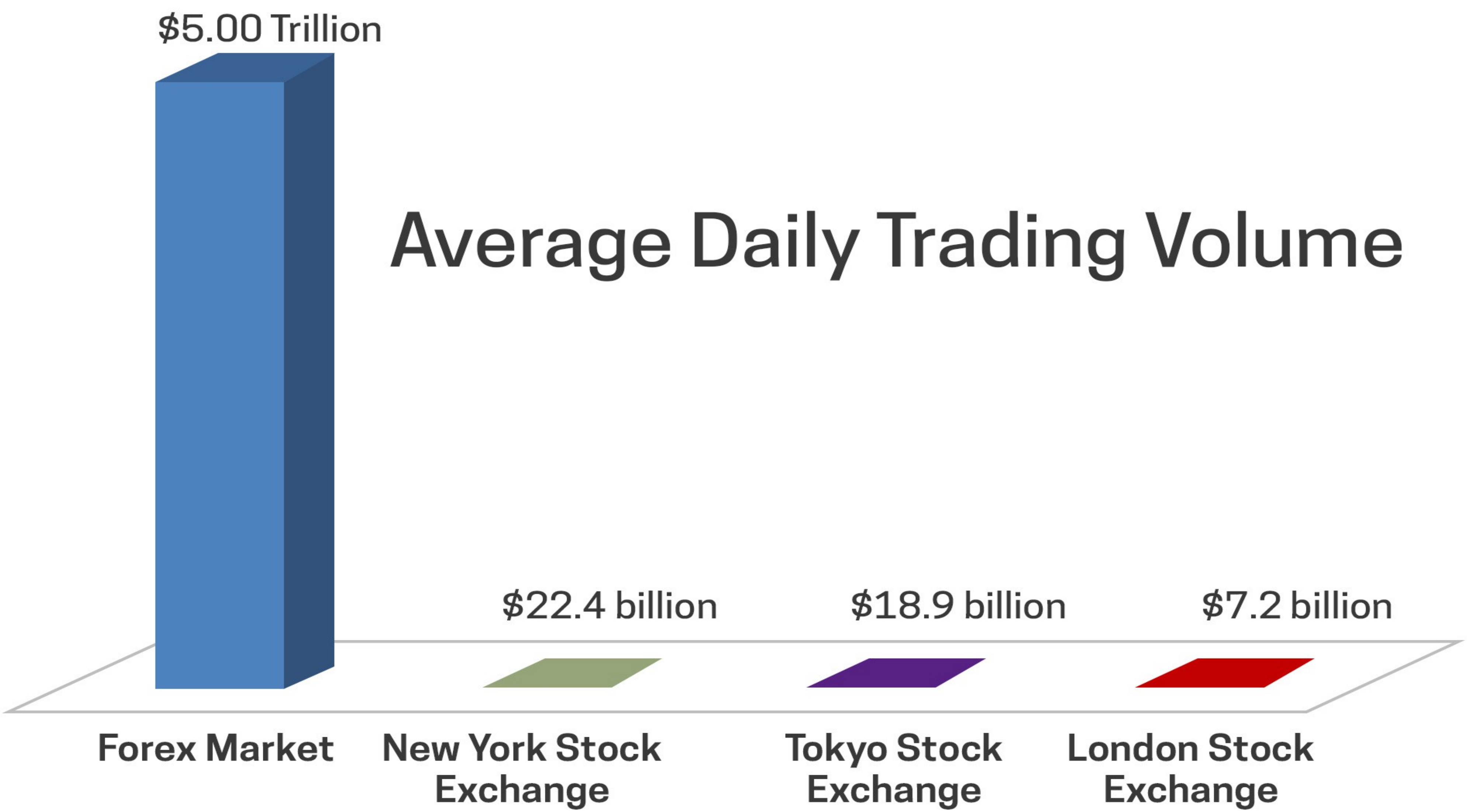
If the French Franc and US dollar **can float**, and if French imports are higher than their exports, the French will devalue (or lower IR) making French goods attractive again for export and US imports more expensive. Floating currencies allow currency speculation.

Exports

Imports

= Trade Balance

If the French Franc and US dollar **are fixed**, and if imports are higher than exports, the value of the FF cannot devalue. There is no currency speculation. The French must either decrease labour costs (wages) or increase productivity.

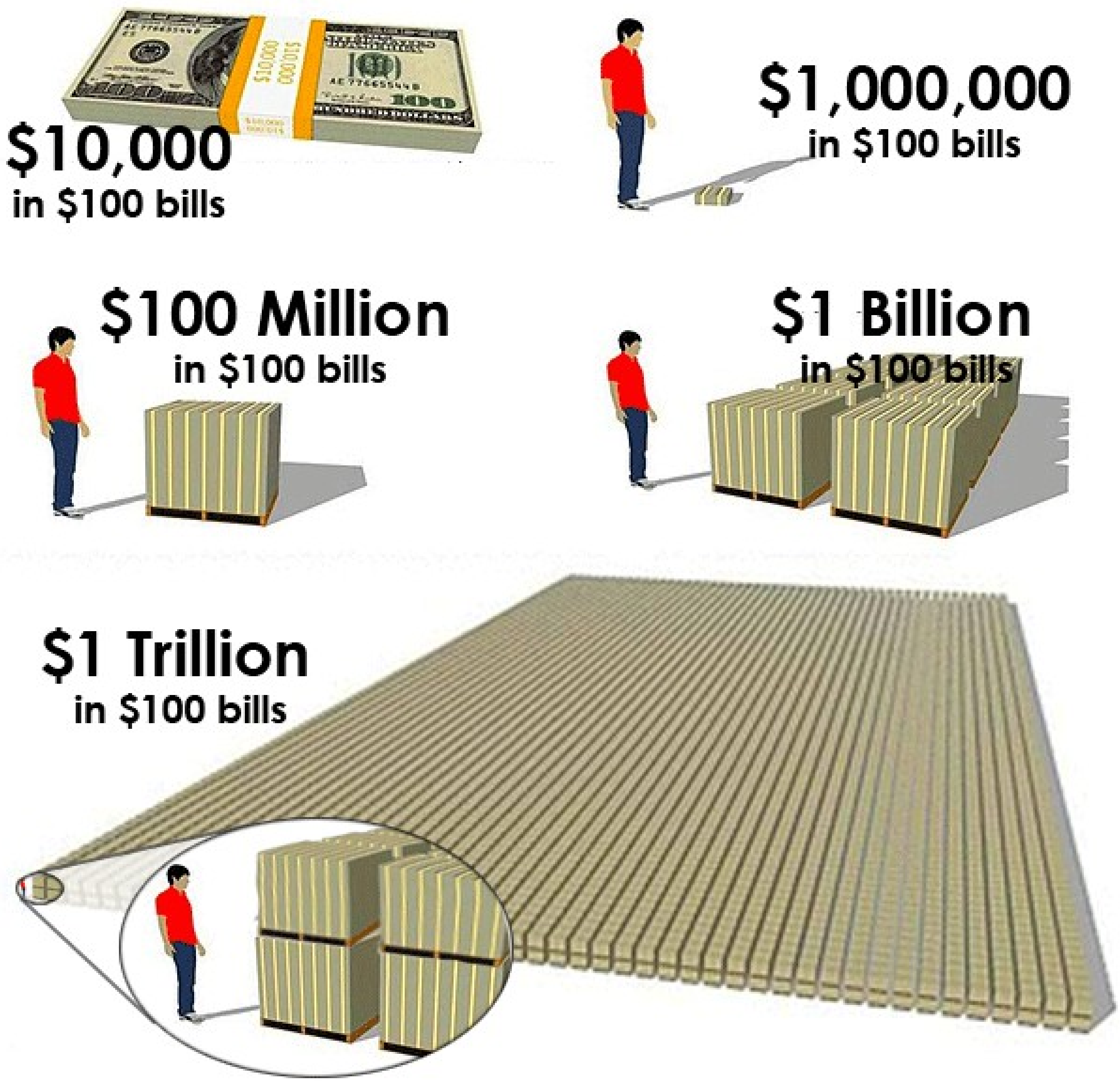


Source: Forex

Forex trading : $5 trillion **a day** = 5x365 = 1,825 trillion **per year**

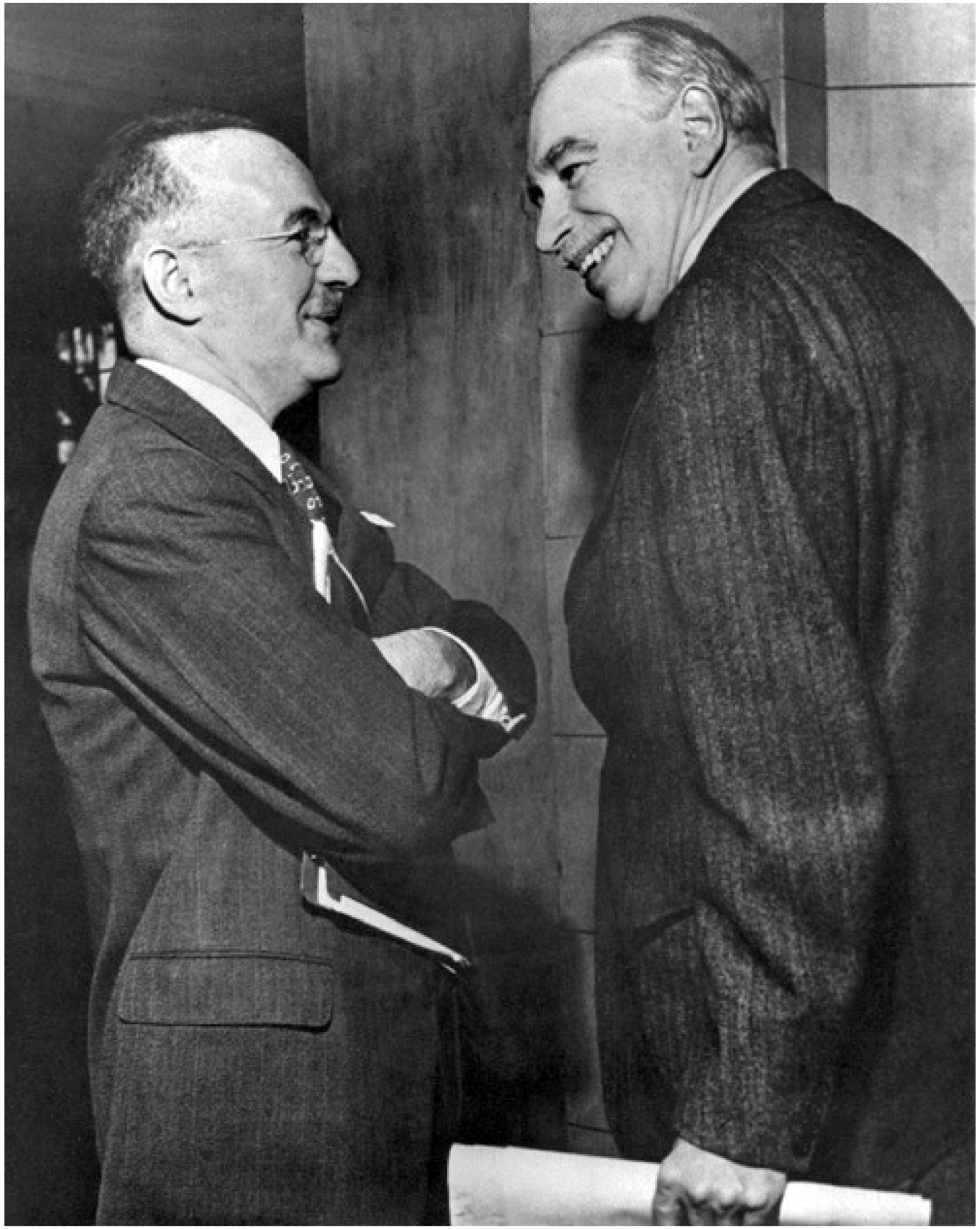
The **annual** GDP of France is about 2.5 trillion.

Forex trading is about **730 times bigger than the entire French economy**.



The average time a share or purchase is held is **22 seconds!**

Bretton Woods, 1944

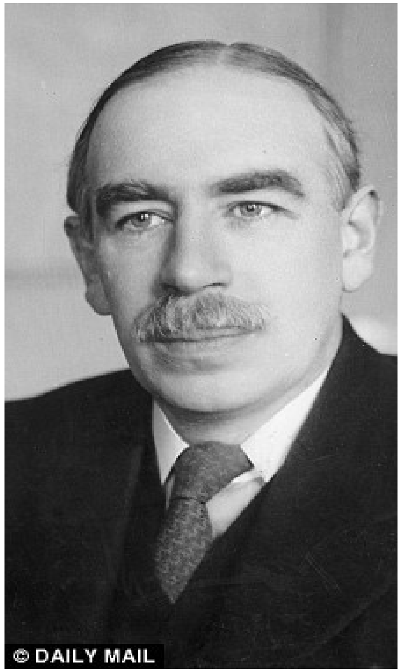


Both John Maynard Keynes (UK, right) and Harry Dexter White (USA, left) have the same overall objectives:

- Stabilised or fixed exchange rates to increase trading security and stop currency speculation
- International institutions to control the rules of international trade
- A debt-relief program and massive investment to rebuild countries damaged by World War II

However, there are also big differences:

Keynes



- The Institutions (General Agreement on Tariffs and Trade, World Bank, International Monetary Fund) should be **Democratic and International**
- Currencies should be **linked to a virtual currency, the Bancor**
- Trade balances should be controlled by an **International Clearing Union** which would use balance of trade credits and deficits to change currency values or force countries to find ways of **balancing their international trade account**.

BUT

The UK was heavily indebted to the USA

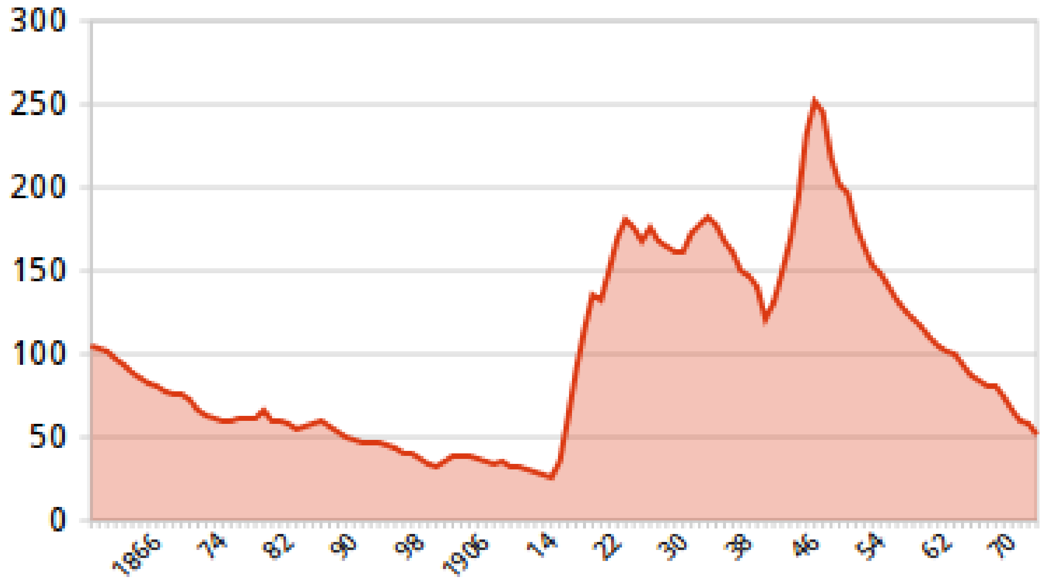
The UK had lost its pound trading zone

The UK had used up its gold reserves

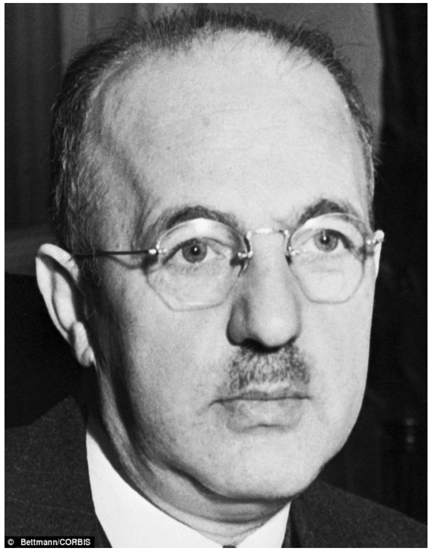
The UK badly needed the Marshall Fund

The UK badly needed debt relief following the war (and Lend Lease)

UK debt % to GDP from 1850 - 1975



Dexter White



- The Institutions (General Agreement on Tarifs and Trade, World Bank, International Monetary Fund) should be **run by the US**.
- Currencies should be **linked to the dollar (the dollar linked to gold)**
- Trade balances should **not be controlled** and **countries should not be allowed to create import barriers (GATT)**
- The **Marshall Plan** should be **tied to acceptance of the US BW proposition**

AND

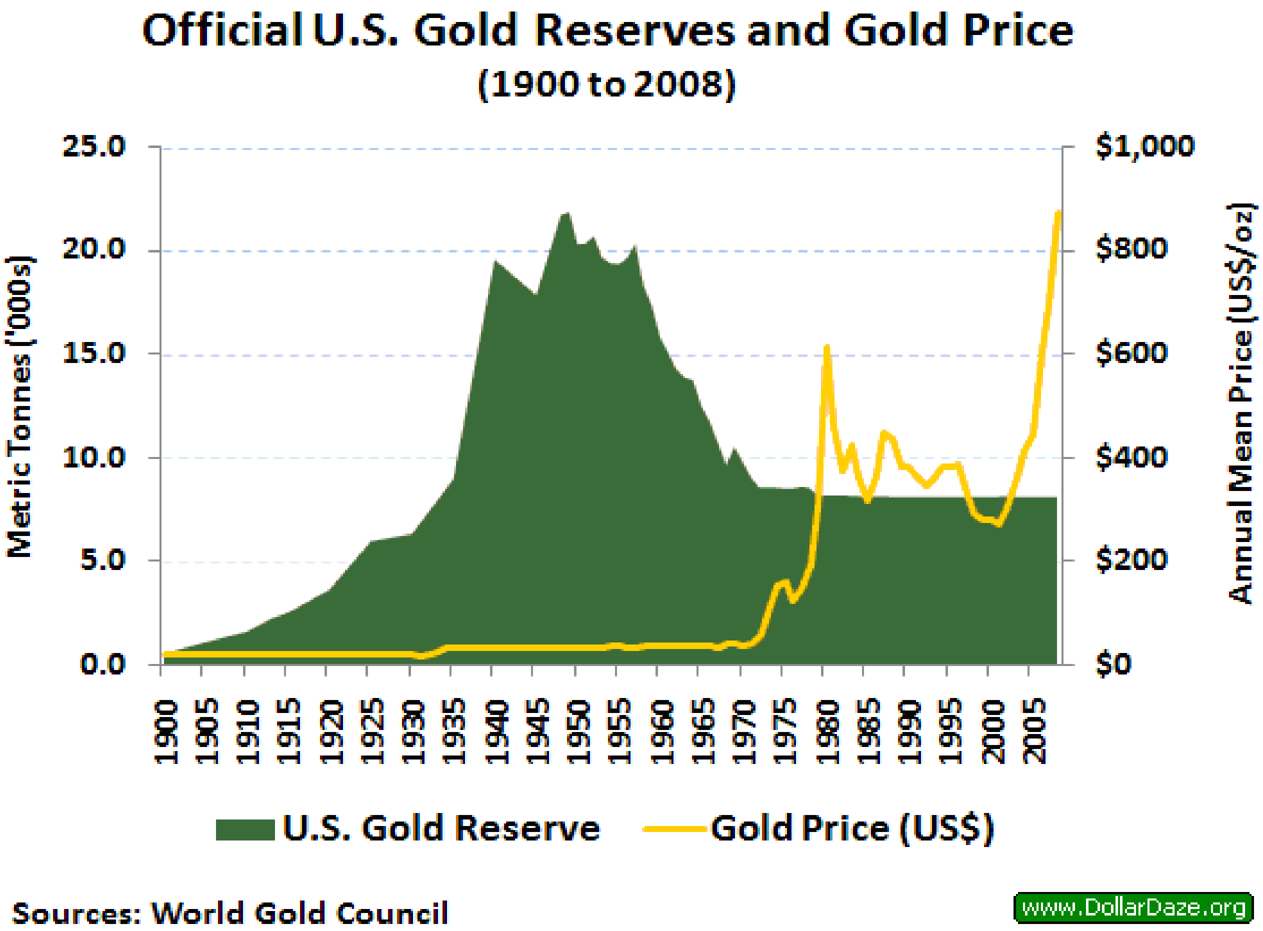
The USA held the world's gold (+/- 70%)

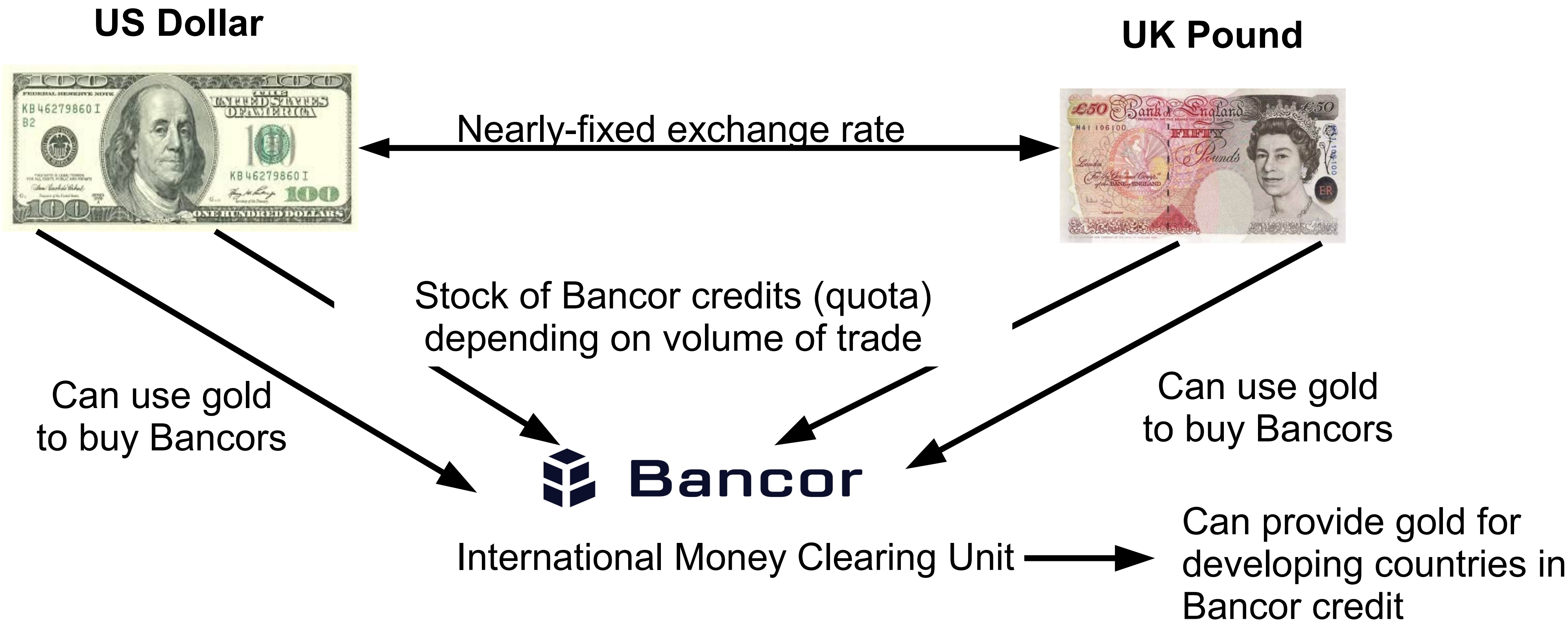
The USA held much of the world's debt

The USA had productive capacity

The USA was the lender of the Marshall Plan ($13 billion – equivalent to $130 today)

The USA wanted to break UK dominance of world trade (ex N°1 before WW1)





- Annual excess of trade deficit or credit by 25% will be charged 1%. Debtors can borrow from creditors to avoid this.
- Long-term annual deficit of >25% should devalue their currency in terms of Bancor by not more than 5% per year
- A country with persistent surplus (> 50% of quota) should a) increase domestic credit and demand, b) appreciate its currency or increase wages (minimum salary) c) reduce import tariffs, d) provide international loans for developing countries.
- No need to maintain trade balance with another country, just with the ICU

USA

Exports
$116 billion*

Imports
$463 billion*

China

Trade deficit = $347 billion (of a total of $586)

China needs to export, so it buys US bonds

US debt to China (10 year bonds) = $1.2 trillion

Ref. thebalance.com October 2017. See:
'Why America's trade deficit with China is so high'

And if we used Keynes's ICU system today?

USA

Bancor

International Money Clearing Unit

USA would need to:

- create internal demand with low IR (already exists at 1.25%)
- devalue the $ by 5% each year
- buy Bancor credits with gold

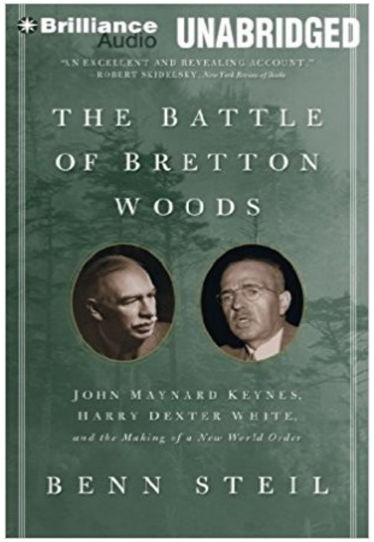
China would need to:

- appreciate its currency by 5% per year
- increase national demand and remove import barriers
- increase wages
- lend to developing countries

China

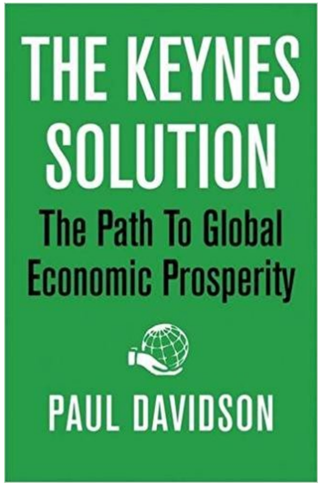
***Ref. thebalance.com October 2017. See:**
'Why America's trade deficit with China is so high'

<u>Recommended Reading</u>



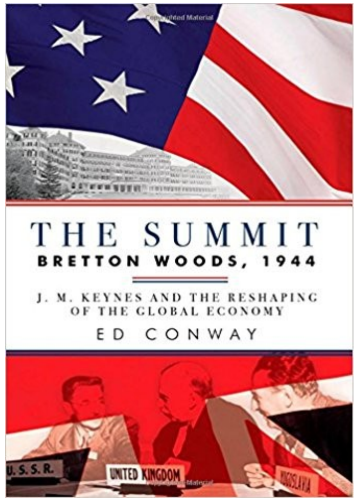
The Battle of Bretton Woods. Benn Steil. 2013.

A detailed description of the 2 years of debates and intrigue before the signing of the Bretton Woods agreement. Written mostly from an American point of view.



The Keynes Solution: The Path to Global Economic Prosperity. Paul Davidson. 2009.

An analysis of how to adapt Keynes's Bancor and International Money Clearing Unit to today's world. One of the world's experts on Keynes.



The Summit. Bretton Woods, 1944. J. M. Keynes and the Reshaping of the Global Economy. Ed Conway. 2014

The story of the Bretton Woods conference and Keynes's role and dilemmas. Written from a Keynesian, British point of view.