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| Is international monetary reform feasible or is the global economy trapped on the US dollar standard? |
| This paper examines the feasibility of implementing Keynes’s scheme for an international clearing union as proposed by the UN (2009) report. It concludes that although technically feasible, implementation faces formidable hurdles in the form of existing political and philosophical resistance. |
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**Introduction**

In a recent speech, Zhou Xiaochuan, (2009) President of the People’s Bank of China, called for reform of the international monetary system and made specific reference to Keynes’s international currency unit *bancor*. He expresses regret that Keynes’s proposals were not accepted at Bretton Woods. In a similar vein the report of the Commission of Experts to the President of the UN General Assembly (2009, p.93) suggests that Keynes’s proposal for a supranational currency and an international clearing union (ICU) is an idea whose time has come:

“This is a feasible proposal and it is imperative that the international community begins working on the creation of such a new global reserve system.”

There are, however, different, but not necessarily conflicting, objectives behind these two positions.

Xiaochaun is concerned largely with maintaining the purchasing power of China’s US dollar denominated reserve assets. A significant depreciation of the dollar or inflation in the United States would erode the value of those assets. Krugman (2009) and McKinnon (2006) suggest that this leaves countries holding US dollar assets trapped on the US dollar standard and provides an incentive for them to keep their exchange rate with the US dollar relatively stable.

By contrast it is apparent that the UN proposal has a more comprehensive objective. The central objective behind the UN proposals is aimed at sustaining global effective demand by implementing a global monetary system that will bring about the symmetrical adjustment of payments imbalances between deficit and surplus countries. This goes to the heart of Keynes’s proposals for the ICU and the Triffin problem that destroyed the Bretton Woods system. The post Bretton Woods (non) system has collapsed for the same reason – the lack of any adjustment mechanism between deficit and surplus countries on the *de facto* US dollar standard. The UN (2009) report concludes that: “This system has proven to be unstable, incompatible with global full employment, and inequitable.” The BIS Annual Report (2009) also concludes that global financial imbalances contributed to the severity of the recent financial crisis while Perelstein (2009) spells out the links between US trade deficits and the US dollar ‘glut’.

The crucial question facing international monetary reform is therefore not the adoption of a new international currency *per se* but the adoption of an adjustment mechanism along the lines of Keynes’s ICU that will maintain international payments balance without constraining global effective demand. The Keynes-UN (2009) proposals are intended to prevent the global economy from getting into the current disequilibrium state. They may not provide a roadmap for the way out! There will be costs to all parties in restoring a sustainable international monetary system and these raise obstacles to implementation of the ICU recommended by the UN that may leave the international monetary system languishing on the dysfunctional US dollar standard. The remainder of this paper considers the prospects for these two outcomes.

To that end, section II outlines Keynes’s (1980) proposals for an ICU together with Davidson’s (2002) reconsideration of the scheme to highlight the key roles of the global currency and the adjustment mechanism. Section III then examines the feasibility of implementing the Keynes-UN (2009) ICU proposal. Important issues here concern the role of SDRs as a potential global currency and the symmetrical adjustment mechanism built into the ICU system. Section IV then considers the obstacles that may keep the global economy on the dysfunctional US dollar standard despite the feasibility of the Keynes-UN proposals. Section V draws some conclusions.

II **Keynes’s proposal for an international clearing union**

To assess Keynes’s proposal it is important to understand what he was attempting to achieve. Post the *General Theory* Keynes was intent on developing an international payments system that permitted all countries to achieve full employment. He was particularly concerned to avoid the British interwar experience where employment and price stability were sacrificed on the altar of the gold standard. In addition he was concerned to limit what he thought was the inevitable destabilizing exchange rate and commodity speculation of the 1920’s and ‘30’s.

The following features of Keynes’s proposals for the ICU are taken from Keynes (1980 volume 25) and Skidelsky (2003, pp. 674-707) and they extend the analysis of the *General Theory* to the international economy.

(1) A fundamental property of Keynes’s scheme was the translation of the domestic banking principle to the international sphere in the form of an international clearing union (ICU). The banking principle to which Keynes is referring is the idea that the deposits held by a bank do not lie idle and deprive the community as a whole of purchasing power, but are lent to others.

(2) The ICU was to have its own currency, *bancor*, to be created in terms of quotas allocated to each member derived from historical trade data. *Bancor* was to be traded only between central banks to make international payments and would not available to the public. Each member was to retain its domestic currency but guarantee convertibility into *bancor* for international transactions.

(3) The key element of the scheme was the symmetrical adjustment mechanism. The process of adjustment to maintain global equilibrium was intended to apply *symmetrically* to both deficit and surplus countries. Overdraft facilities were to be made available by the ICU (mobilising the surplus holdings according to the banking principle) and deficit countries would pay interest on borrowings of *bancor* and face a rule based approach to devaluing their currency against *bancor*. In the case of surplus countries they would earn no interest on surplus balances and in addition to the rules that required appreciation of the domestic currency in terms of *bancor*, any surplus that persisted beyond a pre-determined time frame was to be confiscated and redistributed to other members of the ICU. This threat was intended to ensure that surplus countries would take timely action to avoid confiscation. Keynes saw the symmetrical adjustment property of the system as an essential property of any system that was to avoid the deflationary bias inherent in previous systems such as the gold or gold exchange standards.

(4) Keynes (1980, Vol 25, p. 21) also placed considerable stress on the need for capital controls. The reason for these controls was to eliminate what he perceived as destabilizing speculation that was inevitable in a world where natural equilibrium exchange rates did not exist.

“To suppose that there exists some smoothly functioning automatic mechanism of adjustment which preserves equilibrium if only we trust the methods of *laissez-faire* is doctrinaire delusion which disregards the lessons of historical experience without having behind it the support of sound theory.”

This view is a direct extension of the conclusion of the *General Theory* that there is no unique natural rate of interest consistent with full employment that a *laissez-faire* policy could automatically locate. If there are no unique natural rates of interest generated by each economy then there can be no unique natural exchange rates linking those economies. In that environment destabilising speculation was inevitable. This explains why Friedman’s (1953) faith is stabilizing speculation failed and why Dornbusch’s (1976) analysis, although useful, is incomplete. Full employment and price stability required macroeconomic management at the national level and the same was true at the international level if the global economy was to avoid a deflationary bias.

Keynes’s proposal for the ICU is therefore intended to ensure that there is no constraint on effective demand in individual countries and therefore internationally. The objective was to replace a system with a deflationary bias, the gold or gold exchange standard, with one that had an expansionary and possible inflationary bias, the ICU.

(5) Exchange rates in terms of *bancor* were to be fixed initially in terms of gold but would be capable of adjustment (according to the rules) if over time it was apparent that any economy was running persistent deficits or surpluses. The link to gold was retained for psychological reasons but was not an essential requirement of the scheme.

(6) Finally, Keynes’s initial scheme required the ICU to be largely rule-based rather than discretionary with the rules agreed before establishment. However, the proposal moved towards increasing discretion as it evolved through each draft.

Davidson’s (2002) restatement of Keynes’s scheme has eight key proposals and he stresses that they do not rely on the creation of a supranational central bank even if that was thought desirable for other reasons. For example, to act as a global lender of last resort as Triffin (1961), Fisher (1999) or Winkler (2001) have suggested.

The eight elements of Davidson’s scheme are as follows:

1. The creation of an international monetary clearing unit (IMCU). IMCU’s to be held only by central banks and not available to the public.
2. All central banks to guarantee one-way convertibility of their domestic currency into IMCUs. All private sector international transactions clear between central banks on the books of the ICU. This one-way convertibility permits each country to implement controls on capital flows if necessary.
3. Domestic financial transactions continue in domestic currency.
4. The exchange rate of each currency in terms of the IMCU is set. That is the system is a fixed but adjustable rate system (see point 8 below).
5. An overdraft system would be built into the ICU rules to permit mobilization of any surplus IMCU balances.
6. A trigger mechanism based on predetermined rules would induce surplus economies to with surplus IMCU balances to spend or make universal transfers to deficit countries as a form of aid.
7. A system of stabilizing the purchasing power of IMCUs with any changes to exchange rates reflecting only permanent changes (improvements) in efficiency wages.
8. Running s structural trade deficit is *prima facie* evidence that a country is incapable of maintaining its standard of living. Rich countries would be required to devalue the exchange rate while developing countries may have a case for increased aid, e.g, unrequited transfer of IMCUs.

Inspection of Davidson’s proposals reveals that they are largely a restatement of Keynes’s scheme but with a concession that exchange controls remain at the discretion of each member country. In Keynes’s ICU scheme exchange controls were mandatory as they were thought to be essential to eliminate the destabilizing speculation that was inevitable under both flexible and fixed but adjustable exchange rates. We now know the free capital mobility and fixed exchange rates can be a deadly cocktail. Any system with fixed or adjustable exchange rates will therefore require some degree of capital controls. But such controls are often rejected on the grounds that they restrict efficient market forces and the allocation of capital – See the introduction to Tirole (2002). In particular, classical theory suggests that capital should flow from capital-abundant rich countries to capital–scarce developing countries. However, as Tirole (2002) outlines, general concerns about the banking and financial crises that have occurred over the past three decades following such liberalizations of capital flows, and the particular experience with the Asian crisis of 1997, has shattered consensus on this issue. Flows of foreign direct investment have usually been beneficial but the same cannot be said of portfolio flows. Portfolio capital flight has often precipitated and/or aggravated financial and currency crises in developing economies.

Thus although the use of capital controls would have been controversial in the past it is much less so today. There is now a well developed crisis literature where asymmetrical information and moral hazard is introduced even into real Fisherian models such as in McKinnon and Pill (1999). In addition, the question of capital controls overlaps with current proposals to coordinate global regulation and supervision of financial markets and institutions to control tax evasion and money laudnering. In that respect the previous Basel, I and II, approaches now appear to be grossly inadequate. If anything, they contributed to macroeconomic or systemic instability by inducing pro- rather than counter-cyclical behaviour in financial markets. See also the BIS 79th Annual report (2009).

The role of capital controls, particularly in emerging economies, is therefore something that can no longer be summarily dismissed and needs to be looked at afresh in the light of recent events. Of particular concern is the fact that allowing free access to private international capital markets allows trade imbalances to grow and to create the pre-conditions for currency and financial crises. It also impairs the effectiveness of domestic monetary policies.

**III- The UN (2009) report: Is international monetary reform feasible?**

Reading the UN (2009) report may come as a shock to many international monetary economists because it rejects the economic philosophy that has dominated the macroeconomics profession over the past three decades. In that respect it reflects a revival of Keynes and the brand of Keynesian economics based on externalities and incomplete, asymmetric information rather than wage and price rigidities. In other words, it raises issues that are not included in the consensus approach to macroeconomics and monetary policy.

The two key elements necessary to implement an ICU along the lines proposed by the Keynes-UN (2009) proposals are: (i) the creation of an international currency that is used for all international transactions between central banks through an international clearing house; and, (ii) the symmetrical rules imposed by the clearing house to restrain trading imbalances. These two key features are prominent in the UN (2009) report, particularly chapter 5 and as Kregel (2009) stresses the report should be read as a coherent whole.

*A new global currency*

First, as a practical matter the UN (2009) report suggests that the SDR could become the new international currency. The SDR as it currently exists is defined in terms of a basket of currencies consisting of the euro, yen, pound sterling and the US dollar. The weights in the basket are reviewed every five years and adjusted according to value of exports and imports of goods and services and the amount of reserves held by members of the IMF. As it currently exists the SDR is therefore not an international currency but acts as only as a *numeraire* and international reserve asset. According to the IMF fact sheet of February 2009 (emphasis added):

“*The SDR is not a currency* or a claim on the IMF. It is a potential claim on the freely usable currencies of IMF members. Holders of SDRs can obtain these currencies in exchange for their SDRs in two ways: first, through the arrangement of voluntary exchanges between members; and second, by the IMF designating members with strong external positions to purchase SDRs from members with weak external positions.”

As it currently operates the SDR is therefore not performing the function of *bancor* as envisaged by the Keynes-UN (2009) scheme. To be consistent with the ICU scheme the SDR would need to become a currency with all international transactions made only in terms of SDRs, and all cleared through the IMF acting as a clearing- house.

The transformation of the SDR into an international currency would therefore seem to be straightforward in principle. The devil would be in the detail of the weights and currencies to include but that does not seem to be an insurmountable obstacle. The more difficult task is the implementation of the symmetrical adjustment mechanism.

Currently, under existing arrangements, there is no private access to SDRs but all international transactions are cleared through domestic central banks using bi-lateral exchange rates and national currencies. There is therefore no mechanism such as required under the ICU to impose symmetric adjustment on deficit and surplus countries. The IMF notes that it has the power to direct surplus members to purchase SDRs from deficit members but I am not aware that it has ever made such a request. In fact the current operating procedures of the IMF reinforce the *asymmetrical adjustment* that has resulted in the gross global trading and financial imbalances. This happens because the IMF has no influence over surplus countries but is able to impose restrictions on deficit countries. The difficulties that this causes are well known but reached a head during the Asian crisis as documented by Stiglitz (2002) and the UN (2009) report. The weight of adjustment under current operating practices therefore falls largely on deficit countries. This was the fundamental problem that Keynes’ s was seeking to avoid.

In addition to this structural flaw it is apparent that the IMF lost its way when it came to implementing its own Articles of Agreement. This sorry episode has been well documented by the economists at the Petersen Institute of International Economics, particularly Michael Mussa, in the book by Goldstein and Lardy (2007). The review of this book by Kenen (2009) is also revealing. The consequence of this operational failure by the IMF is now well understood if not always acknowledged. In response to IMF policies during the Asian crisis, Asian economies took defensive action that involved running trade surpluses based on undervalued exchange rates. In following this export-led growth strategy they followed China’s earlier lead but contributed to an excessive build-up in US dollar and other reserves. The re-cycling of this build-up in US dollar reserves as a form of self-insurance against exchange risk and speculative attack no doubt played a part in creating Mr Greenspan’s ‘conundrum’ that pushed US monetary policy off-track. The BIS Annual Report (2009) outlines this process and the e UN (2009) report pretty much endorses the Petersen Institute assessment of the IMF culture and policy implementation. In their view, IMF policy has been pro-rather than counter-cyclical.

*The ICU and symmetrical adjustment*

This brings us to the second key element of the scheme. The need for symmetrical adjustment through the rules of the ICU. Here the UN (2009) report also suggests that the IMF needs a change in culture and perspective. To assist with that, it proposes a Global Coordination Council to oversee the activities of the IMF and the World Bank. This Coordination Council would allow for political consultation at the highest level to ensure that the economic philosophy and principles underlying the need for *symmetrica*l adjustmet is built into the rules of the ICU. The potential difficulty with this proposal is that it seems to be an attempt to circumvent the structural and operational flaws in the current IMF by adding an additional ‘overseeing’ role in the new monetary order. This may be the only politically practical way to proceed but is not essential to the implementation of the new ICU. In particular, if the symmetrical adjustment is built into the rules of the ICU there is little need for such and oversight function.

In that respect, with the creation of the new SDR and the clearing union the IMF seems to be ideally placed to manage the system under a ‘new view’ of the Articles of Agreement based on the principles already embodied in the existing Articles. The ghost of Keynes still haunts many of the existing Articles and all members have already agreed to them so little more than a change in economic philosophy is required to implement them.

The importance of symmetrical adjustment is evident in the UN (2009, p. 95, emphasis added) report:

“ A global reserve currency whose creation was not limited to the external position of a national economy could provide a better system to manage the deflationary bias that the system faces during a crisis, as well as the broader problem of instability analyzed above. It would be possible to regulate the creation of global liquidity, and reduce the ability of a reserve currency country to create excessive liquidity. And the system can be designed in ways to put *pressure on countries to reduce their surplus and this reduce their contribution to the insufficiency of global aggregate demand*.”

The UN (2009, p. 99, emphasis added) report goes on to note that:

The allocation [of the new international currency] *can and should have built into it incentives and/or penalties against maintaining surpluses*. Countries that maintained surpluses would lose all or part of their quota allocation if they are not utilized in a timely manner to increase global demand.”

These features are clearly a restatement of Keynes’s proposals and it is therefore not surprising that the UN (2009) report is also critical of the view that freely floating exchange rates and liberalization of capital accounts can automatically and inevitably produce desirable results. But it also notes that fixing exchange rates in a world with free capital mobility would be a daunting task. Experience over the past three decades illustrates all these concerns but does not resolve the debate between exponents of fixed and freely floating exchange rates. A complete assessment of this issue is beyond this paper but several general conclusions are now possible.

First, despite what theory may claim, all international monetary and exchange rate regimes have been managed systems. Countries on freely floating exchange rate regimes both intervene from time to time to prevent what are perceived to be excessive movements in their exchange rate and/or engage in cooperative intervention to prevent what they perceive to be fundamental misalignments of exchange rates. The question to be addressed by exponents of international monetary reform is therefore what the rules of adjustment should be rather than the narrow question of fixed vs freely floating exchange rates. Neither of these two corner solutions is feasible. However, that does not rule out the possibility that countries may peg their exchange rate for a time so long as doing so does not disrupt the international monetary system as specified by the Articles of Agreement of the IMF. The rules of symmetrical adjustment built into the ICU structure would automatically prevent any excessive build up in SDR reserves.

Second, the UN (2009) report also makes it clear that the IMF Articles of Agreement do not prohibit the use of exchange controls. Both China and Malaysia recently followed this route but the IMF failed to implement its mandate and warn of the danger if this strategy was adhered to for too long. It may well have been oblivious to the dangers if its economic philosophy was as ingrained and distorting as the UN (2009) report suggests or it may simply have been negligence or incompetence as Mussa (2007) charges. But more importantly, the global economy got into this state because there was no symmetrical adjustment system in place to head–off the massive global trading and financial imbalances that resulted. Clearly, over the period 2000-2008 too much capital was flowing in the wrong direction; from developing to developed economies in the form of a low interest loan. Classical theory does not explain this paradox. See the BIS Annual Report (2009).

This pegging exchange rates and employing capital controls are all options that countries could employ under a revived ICU that had built into it an adjustment mechanism that fell symmetrically on deficit and surplus countries. The UN (2009) proposals leave the choice of exchange controls to individual countries but they would need to be compatible with the new international financial regulations and a Global Financial Authority to coordinate global financial regulation as proposed by the UN (2009, chapter 4) report.

Although many of these issues may strike the reader as utopian the fact is that the problems they confront have been dealt with on an *ad hoc* basis for the last century at least – Eichengreen (1990, 1998). The shock of the current economic crisis may provide the opportunity to take them seriously. And although the transformation of the SDR into a new international currency is relatively straightforward, the role of the ICU with a symmetrical adjustment mechanism requires additional changes to the economic philosophy that drives the IMF.

This means that there are many additional obstacles to implementation of the Keynes-UN (2009) proposals.

**IV Obstacles to implementation of a new ICU: is the global economy trapped on the US dollar standard?**

The conceptual and practical aspects of the proposed ICU seem to be relatively straightforward. The political economy dimensions pose, as always, the greatest hurdles. In particular, major hurdles include the following:

(i) The significant disequilibrium state in which the global economy finds inself means that all those holding US dollar securities face a significant loss when moving to the exchange rates implied by a new ICU scheme. Current estimates of the misalignment of the renminbi, for example, suggest that a revaluation in the order of 25% is required. This may not be what Mr Xiaochuan has in mind.

(ii) Similarly, there is opposition in the United States to any expansion of the role of international institutions such as the UN, IMF and World Bank. The practical implication of this view changes with the colour of US adminstrations as is evident from the plight of the IMF which went from laying off staff one year to a windfall increase in allocations the next. International organizations cannot operate effectively in such an environment. There is also likely to be opposition from this quarter to the loss of reserve currency status for the US dollar.

(iii) The dominant economic philosophy that the UN refport refers to is a major obstacle to reform of the international monetary system largely because that philosophy can see no coherent role for national institutions let alone international institutions. The consensus economic doctrine in macroeconomics and monetary theory embedded in current DSGE models employed by national institutions is biased against any role for policy or macroeconomic management apart from that of inflation control. The UN (2009) report notes that this philosophy permeates most national and international institutions.

There are solutions to all these obstacles but they need to be considered and understood if they are to be overcome. Consider each in turn.

*Escaping the US dollar trap?*

The is no doubt that those countries with large holdings of US dollar securities are trapped on the US dollar as Krugman (2009) explains. They will inevitably suffer a loss if the US dollar depreciates significantly relative to their currency so they have a vested interest in exchange rate stability. But as the ICU is needed to prevent future trading and financial imbalances from occurring, it cannot resolve the implied paper losses from current holdings of US dollar securities. In fact, as significant exchange rare realignment between the US dollar and the renminbi is certainly required as part of the implementation of an ICU such paper losses are inevitable. However, they should not be seen as a reason for rejecting the ICU.

Holders of US dollar securities are indeed trapped in the short term by the lack of US dollar liquidity and in the long term if the ICU imposes exchange rate realignments and/or confiscation of SDR reserves. The sensible response to this situation is to diversify the US dollar portfolio to generate a longer-term income stream and rebalance the growth drivers of the domestic economy away from export-led growth. The latter is if fact what the ICU adjustment mechanism would induce through real effective exchange rate adjustment and changes in domestic policy settings; the restoration of internal and external balance.

Thus although many Asian economies holding US dollar reserve assets will face paper losses and reduced income streams with the introduction of an ICU any short-term pain should be offset against the long-term gain. As many have now recognised, the current global growth path was unsustainable. Growth driven by debt fuelled consumer spending in the west pulled Asian and other economies into an export led growth strategy. This worked well while it lasted but once the debt bubble burst in the west export-led growth collapsed in the east. Now is the time to grasp the opportunity to put the global economy on a sustainable growth path. The ICU can make a significant contribution to that objective as the UN (2009) report outlines.

*The politics of laissez faire capitalism*?

The most strenuous opposition to the implementation of the ICU is likely to come from those in the United States. There are two sources of opposition here. First, are those in the financial sector who have benefited from the massive growth in that sector over the last two decades. Second, there are those who oppose any role for international institutions such as the UN and IMF.

The influence of the first group has been well documented by Johnson (2009) who outlines what many had noticed – that US economic management had become economic management by Wall Street. In terms of older doctrines, it seems that in the US the financial circulation has come to dominate the industrial circulation – the servant has become the master.

On the question of international institutions there are many examples of mal- and misfeasance in these institutions to point to. But that is not a reason to cut off your nose to spite your face! The US has much to gain from participation in international institutions and in particular the implementation of an ICU that would the US dollar from its role as the reserve currency.

To begin with it resolves the Triffin dilemma. The US will no longer find itself running continuous trade and current account deficits with an over-valued real effective exchange rate to feed the growing global demand for US dollars as the global currency. The US, along with other countries will be free to allow its exchange rate to adjust to restore trade balance. This will remove an important constraint on US growth in the post crisis period. In this respect the US has been suffering from a form of the Japanese disease as outlined by McKinnon (2006) under the rubric of the ever appreciating yen.

The strong dollar policy initiated by Mr Rubin has not only contributed to the growing global trade and financial imbalances but has also undermined the competitiveness of US industry. Those who look for similarities between Japan and the US in the current crises should look at the impact of undervalued Asian exchange rates on the return on investment in Japan rather than the failure of Japan to restructure its banking system. Japan’s liquidity trap was caused by a collapse in the return on investment in Japan relative to the rest of Asia and there is no fiscal policy that can solve that problem.

Those who advocate the benefits of *laissez faire* financial capitalism therefore need to explain how maintaining the *status quo* will allow the US economy to compete successfully on world markets. For the US to return to strong and sustainable growth it must be able to at least run a structural trade balance. That will not be possible with an overvalued real effective exchange rate dictated by the US dollar’s role as the *de facto* reserve currency.

*Changing economic philosophy*?

The economic philosophy to which the UN (2009) report refers is deeply ingrained in the current macroeconomic DSGE models and thinking of many national and international institutions. In effect it is a philosophy that aligns well with the politics of *laissez faire* capitalism because it embodies the belief in the rapidly self-adjusting behaviour of economies. The consensus between new Keynesian and new Classical economics that travels under the heading of the new neoclassical synthesis, and is embedded in the consensus DSGE macroeconomic models, presents a vision of an equilibrium business cycle. In this context fiscal policy has no traditional role but taxes influence effort and profits and therefore influence the profile of the equilibrium cycle. This is a significant change in perspective from old Keynesian slow adjustment to full employment equilibrium, as embedded in disequilibrium models of the business cycle, where fiscal spending and taxing could speed-up adjustment and compensate for the existence of sticky prices and wages that would otherwise slow the process of adjustment back to a unique (not constant) full employment equilibrium.

Thus Keynesians old and new see a limited role for macroeconomic management of what is otherwise a self-adjusting system that can be left to *laissez faire* market forces. Their versions of the current equilibrium DSGE models therefore have a limited role for fiscal policy by construction and focus almost exclusively on inflation targeting as sufficient to ensure macroeconomic stability. Consequently it is not surprising to see that they have come in for criticism for failing to anticipate the current global crisis or for offering and insights on what might be done about it.

By contrast the economic philosophy underpinning the UN (2009) report reflects the economic philosophy of Keynes augmented by more recent developments in the economics of information. This philosophy provides a much broader foundation for the concept of managed capitalism and is based directly on the theoretical structure of Keynes’s *General Theory*. There is no unique full employment equilibrium in Keynes’s model that can be attained by *laissez faire* market forces alone. There are structural flaws in *laissez faire* capitalism emanating from the monetary architecture that often keep the interest rate too high and unless special factors keep the return on capital higher, the monetary and financial architecture produces a cost of capital that restrains affective demand.

As explained in Rogers (2008) Keynesians have in general misunderstood the theoretical arguments underpinning that conclusion and therefore failed to understand the implications of the two policy recommendations in the *General Theory*: the role of government in ‘socializing investment’ and the role of a central bank acting in the public interest. The failure by most Keynesians to grasp the theoretical structure of the *General Theory* also largely explains why many economists mistake the influence of transitory favourable factors and government intervention for the self adjusting nature of the economy. The support for Keynes’s ideas in the UN (2009) report therefore offers another opportunity to assess those ideas as the basis for managed capitalism both domestically and internationally. In that respect it should not be forgotten that Keynes’s clear intention was to put in place structural changes to *laissez faire* capitalism, to transform it into managed capitalism to escape the central planners on the left and the right.

I can see no reason why all macro and monetary economists would not want to take that perspective on board.

**V Concluding remarks**

It is now apparent to all that the current international monetary system not only contributed to the current global economic crisis but is dysfunctional and inequitable. If allowed to persist the existing system will either constrain world growth in the medium and long term or if a bout of unsustainable growth returns, it will aggravate the consequences of the collapse of the next bubble.

The cost of the current crises in terms of declining living standards and incomes, particularly in emerging economies, is not something that any governments want to see repeated in future. A feasible way to avoid that outcome has been presented by the UN (2009) report but the political and economic philosophy issues are the major hurdles to overcome.

The political opposition seems to be akin to that of a religious belief that is never to be questioned. It is unlikely that those beliefs are open to persuasion by rational debate. They must be resolved by the political process and there is no guarantee in any democracy that they will.

The question of economic philosophy is more intriguing. On the one hand there has been little evidence over the past 70 years that Keynes’s *General Theory* has been widely understood. On the other hand, the current crisis has shaken confidence in many aspects of received wisdom and as the UN (2009) report reveals, Keynes’s vision is again up for debate. If it will succeed in promoting sustainable reform of the international monetary system only time will tell. Using odds based on Keynes’s success rate in achieving reforms while he was alive the prognosis is not good. During his life-time Keynes had little success in the art of persuasion. Perhaps the ghost of Keynes will have more luck.

Without it, the global economy may well remain trapped on the dysfunctional dollar standard for some time yet.

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