The Keynes-Davidson-Stiglitz plan: a summary

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In the world as a whole, trade deficits and surpluses cancel each other out. Over time, countries with trade surpluses tend to have savings surpluses, whereas countries with trade deficits tend to accumulate debt. The compositional fallacy occurs when it is assumed that what is possible for a single given actor at a given time is possible for all of them simultaneously. Therefore simultaneous attempts by all or most states to improve their trade balance can be contradictory. The likely overall result is a reduction in effective aggregate demand in the world economy as a whole.

Keynes' early 1940s plan for a Clearing Union involved an impartial system for the management of currencies, and a kind of world central bank responsible for a common world unit of currency, the *bancor*. Obligations would be made systemic and financial positions defined against the rest of the world, not against individual countries. At first Keynes proposed that surpluses beyond a given amount would be fully confiscated for a global fund. Also his later, more modest formulations included transferring resources from surplus to deficit countries. A key idea was to enable a "New Deal" within every country, including full employment.

The 1944 Bretton Woods agreement followed Keynes' proposals, at best, only partly. No world central bank or bancor or a system of taxing the surplus was established. Soon the International Monetary Fund (IMF) started to demand deflationary conditions on its loans. A mere few years after the end of the Bretton Woods era (1944-73), the Third World debt crisis erupted. Both the IMF and the World Bank started to apply structural adjustment policies to crisis countries. The burden of adjustment was shifted onto the deficit countries, frequently resulting in deep recession, high social costs and further accumulation of debt.

In this context, Keynes's original proposal was renewed and developed further by the Brandt Commission (1980) and, most notably, by Paul Davidson (1992–1993; 2002; 2004). Davidson updated Keynes´ plan to meet twenty-first-century circumstances with a more moderate version that requires neither a gold-based currency system nor a world central bank. Davidson's version is to some degree more nationally oriented than Keynes' original plan. According to Davidson (2002: 209), a supranational central bank is "at this stage of economic development and global economic integration, […] not politically feasible". He argues further that it is not necessary either.

The Davidson version involves a spectrum of different capital controls (as did Keynes' original). A country can only be living beyond its means if it is at full employment, but even then its deficit may be due to poverty, in which case richer countries are obliged to help it. The system is thus redistributive. If a member country accumulates excessive credit balances by running current account surpluses it has three options to spend its credits: "(1) on the products of any other member of the clearing union, (2) on new direct foreign investment projects, and/or (3) to provide unilateral transfers (foreign aid) to deficit members." (Davidson 2004: 600).

Also Joseph Stiglitz (2006: 245–268; based on earlier edition of Greenwald & Stiglitz 2010) has outlined a prominent version of the Clearance Union plan. Stiglitz (with Greenwald) proposes a Global Monetary Authority and "global greenbacks", an idea that comes much closer to Keynes' original proposal than Davidson's version of it. Stiglitz holds the current dollar-system partly responsible for the prevailing global financial instability. A jump to a new system based on an alternative national currency such as the *euro* or *yuan renminbi* would not solve the problem. A global system is needed. The new global reserve system could finance global public goods; and it could thus demonstrate a commitment by the world community to global social justice (Stiglitz 2006: 266). Hence the Stiglitz-Greenwald version introduces new ethical and political principles.

Sources

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