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Systemic Risk and New International Financial Architecture: Reconciling KEYNES and Neo-Liberalism?

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Abstract

Facing the systemic crisis which originated in Mexico and in Asia, and spread to all financial centers, the objective of the new international financial architecture is to master the international financial instability; this means improving the transparency and the regulation of markets, as well as arousing a greater responsibility of public and private actors in the prevention and management of crises. But many interrogations subsist concerning the contours of the new architecture. Does it simply mean improving the transparency of information in order to prompt better practices? Or is it desirable to introduce new constraining rules as far as the international mobility of capital is concerned? Does it call for allocating new responsibilities, and therefore new resources, to the International Monetary Fund, or should the Bank for International Settlements, or a central banks club, be entrusted with such a mission? In fact, these questions arise mainly because there is no theoretical consensus among economists and official experts. Paradoxically this leads us to revisit the thought and theoretical inheritance of KEYNES. The growing importance, in current debates, of concepts such as confidence, liquidity, imperfection of financial markets, mimetic contagions, is striking in that respect. Furthermore, discussions about the international financial institutions remind debates that KEYNES started, in his Treatise on Money as well as during the preparation of the conference of Bretton Woods. In a nutshell, cannot one see in this new international financial architecture the revenge of KEYNES? In section 1, one replaces the project of international financial architecture in the context of systemic crisis of the 90's. The basic principles of this architecture, as they appear in reports of the G 22 and the G7, are then reminded, in section 2. In section 3, one sheds a light on the keynesian foundations on which, according to us, this project partially rests, and draws some consequences on the responsibilities assigned to the International Financial Institutions.

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Introduction

The reconstruction of the *international financial system's architecture* is on the agenda. Faced with the seriousness of systemic crises which started in Mexico, and above all in Asia before becoming widespread to all financial centres, the objective is now to master international financial instability by improving the transparency and the supervision of the markets, and by inciting greater responsibility on the part of the players, whether they be private or public, in the prevention and management of such crises. The G22 technical reports and the common Statement of the G7 Finance Ministers in Cologne in June 1999 outline the framework of this new *architecture* and cover several areas such as exchange rate systems, determining factors and the management of banking and financial crises, prudential regulation and banking supervision, and the problem of international last resort lender. Nonetheless, we have not been able to achieve a *consensus* as regards the foundations of international financial instability and on the subject of new institutional or regulatory arrangements, let alone political economic rules which might nevertheless limit the risks. The stakes are no less considerable since it is a question of redefining the framework in which international investors operate on the capital markets, indeed of redrafting the *architecture* and the specific functions of the *International Financial Institutions* within the context of globalisation.

If the paths have been sketched out, numerous questions still remain as to the contours the new *architecture* will take on. First of all as a result of the method to be adopted. The reports from the three work groups set up by the G7 and G22 define a certain number of principles or options without settling the question of the institutional forms, and without really defining the political framework and the delegation of responsibilities which might implement them. Thus, faced with the errors committed by the IMF in dealing with the Asian crisis, some people propose the setting up of a *new* Bretton Woods, making it possible to look from all sides at the collection of mechanisms for financial and monetary adjustment and supervision of the markets which have progressively been put in place by the international community over the last fifty years. However, Michel CAMDESSUS felt it was much more a question of writing a new chapter to the Bretton Woods Charter without modifying the basic principles. Following on beyond a common objective which aims to avoid the excesses of international financial markets and neutralise the destabilising behaviour of certain players, resulting from the excessive use for example of the leverage effect attached to *hedge funds*, the answers brought to bear are often divergent.

Is it simply a question of improving the transparency of the information in order to incite *best practices*? Is it suitable to introduce much more restrictive new rules while accepting the principle of a limitation to the international circulation of capital? Is it a question of assigning to the IMF new last resort lender responsibilities, and therefore new resources that can be mobilised, or should such an assignment be entrusted to the BIS or to a *club* of central banks? Lastly, can we be sure that the analysis of recent crises which necessarily underlies such reforms would give rise to a minimal agreement?

If such questions are asked it is firstly because there is no theoretical consensus among economists and official *experts* relating to the observed malfunctions in the international financial markets in the 90's. Because of its violence and context, and because of the contagion effects it engendered, the Asian crisis has called into question a certain number of supposedly established principles regarding the foundations and efficiency of financial liberalisation. It is therefore on this ground that we should place ourselves. Paradoxically this leads us to *revisit* the theoretical work and legacy of J.M. KEYNES. It is striking to note the increasing place given in current debate to the notions of *confidence, liquidity*, financial market *imperfections*, and *mimetic contagion*. In the same way discussions carried on about the governance of international monetary or financial *institutions* reminds us of the debates which J.M. KEYNES had started up, as much in his *Treatise on Money* relating to the improvements to bring to the gold standard system, or as when he was preparing for the Bretton Woods conference. In a word, can we not see in this new *international financial architecture*, the revenge of J.M. KEYNES?

In section 1 we put the project of an *international financial architecture* back into the context of the systemic crises of the 90's. The basic principles of the new *architecture* are recalled in section 2 taken from an examination of the G22 and G7 reports. In section 3 we give prominence to *Keynesian* foundations on which in our opinion this project is partially based, before drawing conclusions from the point of view of the responsibilities assigned to the *International Financial Institutions*.

The new international financial architecture in a context of systemic crises

The Asian crisis of 1997-98 is scarcely similar to a simple financial turbulence such as the global economy encounters regularly. It is a *system crisis*. By its very magnitude and the degree of propagation that it initiated towards all the capital markets of the planet, this crisis brought about a real awareness of the risks which financial freedom brings to bear on the stability of the global economy. Moreover, the *systemic crises* multiply and spread on an international scale, and rarely in the course of history have international financial markets undergone such violent adjustments than over these last few years: for example, considerable bond markets tension in February 1994, the Mexican crisis between December 1994 and January 1995, Baring Brothers' failure to act in February 1995, the Asian *crash* in the autumn of 1997, Russia's financial difficulties from May to August of 1998, the Brazilian crisis from November 1998 to January 1999. On various occasions we were shown the fragility of the international financial systems, and how the protagonists' rationality could lead to a heightening of general insecurity and the rapid transformation of a local shock wave into a liquidity crisis on a global scale.

These *anomalies* are not attributable to financial competition *per se*, but to the fact that the free movement of capital most often finds expression in a strong increase of liquid asset commitments, notably of the short term currency debt through the intervention of the banks, a fact which has considerably accentuated the vulnerability of the economies concerned to a change as regards the state of confidence, and to a *backlash* in the assessment of risks on the part of international investors. The Asian crisis illustrates this type of scenario perfectly. In this way the international mobility of capital accentuates and multiplies the sources of turbulence and crisis, most particularly in emerging economies still marked by decades of *financial repression* and the stability of financing commitments which ensured very close ties between the bank and the State.

It is certain that the extreme brutality of opinion changes in financial markets rarely responds to irrational analysis of a country's situation or of a particular type of asset. Nevertheless the *overshooting* of the markets, other than the vulnerability which it induces for the traders themselves, very often shows the short-sightedness of market expectation and a real lack of judgement in its use. An element of anxiety only has to manifest itself in the marketplace, albeit considered short lived, even stripped of objective justification in the eyes of the traders themselves, and behold the market anticipation becomes polarised, spreading distrust towards other markets and onwards to other countries in the form of volatility swaps or cave-ins of asset values.

All this explains why, advocating as it did rapid modernisation of financial systems, the extension of securitization, the wider use of external currency convertibility, the freeing-up of the ways in which interest rates are fixed, the Washington *consensus* is today considered *outdated*, including at the World Bank and the IMF.

Moreover, since the financial crisis in the summer of 1997, the international community, the IMF and G7 have been getting down to the reconstruction of the *international monetary and financial system's architecture* on the basis of two types of argument, of theoretical construction and in an empirical manner. The plea for financial liberalisation rests on theories of financial market efficiency and on the postulate of perfect information. However, within a configuration of imperfect information and incomplete markets, unrestrained competition is no longer *Pareto-efficient* and government intervention must be maintained so as to curb several sources of inefficiency or fragility such as: adverse selection and unconsidered risk-taking in the presence of asymmetric information which itself accentuates the conviction in a last resort intervention, thereby giving rise to a moral hazard problem; doubts as to the efficiency of banking governance methods which are associated with the *short-sightedness* imposed by shareholders; the risks of sheep like behaviour provoking an *irrational* spread of speculation crises and banking crises. At the same time experience shows that the freeing-up of international capital movements significantly increases the risk of financial crises yet without being accompanied by a recognised correlation with the level of investment or the rate of growth.

It is this overall acknowledgement which today justifies that the *architecture of the international financial system* be placed on the agenda.

The official options of the new architecture

The notion of *international financial architecture* was launched at the beginning of 1997 by the State Secretary to the American Treasury R. RUBIN, and then taken up by M. CAMDESSUS following the Asian crisis; its status is ambiguous. It is not a question of designing, at least not for the moment, a set of rules of law a combination of which would emerge into a new *system* to be imposed on the international community in the image of the IMF's creation in 1944. However over time the term architecture necessarily covers the institutional framework within which international monetary and financial relations might be placed, and therefore the regulations, institutions and functionalities of global finance.

Thus according to the terms employed by M. CAMDESSUS in April 1998 the new architecture is similar to a schedule of international consultations involving a whole set of participants (the G7, G22, G30, the Financial Stability Forum, and also government or academic experts and practitioners) in order to examine questions relating to the stability of the international financial system and the efficient functioning of international capital markets. Under the aegis of the G22 *ad hoc* work groups were set up to formulate recommendations under three headings: reinforcement of transparency and responsibility; consolidation of financial systems; management of international financial crises.

Based on the technical reports submitted in October 1998 the Finance Ministers of the G7 came to an agreement over a common declaration during the Cologne summit meeting in June 1999 which specifies the principles likely to improve and reform the aforementioned *architecture*. We will use here the text of this declaration to characterise the options which gave rise to a political compromise amongst the most developed countries.

Faced with the observed malfunctions these past years the Finance Ministers of the most developed countries have identified the necessity for a set of reforms in six priority areas:

- *strengthening and reforming the arrangements and the International Financial Institutions;*
- *enhancing transparency and promoting best practices;*
- *reinforcing financial regulation in industrialised countries;*
- *strengthening macroeconomic policies and financial systems in emerging markets;*
- *improving crisis prevention and management and involving the private sector;*
- *promoting social policies to protect the poor and most vulnerable.*

We will not detail here the sixty points of the common declaration, certain of which are in any case laid out in the form of a set of options or possible measures in the area of exchange rate systems, IMF and World Bank action, or standards of prudence laid down for financial intermediaries. We will merely summarise the basic principles accepted either implicitly or in a more affirmative way by the G7.

From the outset the necessity to reduce the financial risks and to improve international cooperation was put forward as an imperative action in such a way as to maximise the advantages of the globalisation process and international financial integration. This acquired stability does not in any way require the creation of new international financial institutions, but does however demand increased governmental responsibility, as much in the micro-economic piloting as in the definition of more affirmative *rules of the game* which apply to markets and traders. In each of the priority areas the principles which should guide the reform are set out before formulating political recommendations capable of going as far as a definition of the tools required by the objective of financial stability. In spite of the formal and sometimes little agreed character of this type of declaration, we can nonetheless group together the basic options adopted by the G7 by drawing out four principles.

(i) It is important to reinforce the transparency and quality of the information so as to improve the functioning of the international financial markets.

This requirement as much concerns the data regarding the macro-economic situation of emerging countries in terms of short-term currency commitments or exchange reserves, as it does information relating to financial intermediaries or the private sector. This is where we find a necessary condition to ensuring *best practices*. Various types of international institutions should contribute to this objective: on the micro-economic level the IMF would contribute notably within the framework of the *Code of good practice regarding monetary and financial transparency* and the circulation policy for reports which was established after consultation on the grounds of Article IV; the Basle Committee for banks, the IOSCO[1] for stock markets and the IAIS[2] for insurance companies, they must all devote themselves to reinforcing the rules of centralisation and disclosure of information within a normalised accounting framework under the aegis of the IASC[3].

(ii) While reaffirming in fine the superiority of capital market liberalisation so as to maximise international savings allocations, growth financing and job creation, infringements are nevertheless foreseen and what is more, legitimised for emerging countries taking into account the malfunction observed in the markets in recent years.

This principle particularly concerns the preventive measures which aim to slow down excessive capital inflow, thereby mirroring the precautions adopted by Chile in the recent past. On the other hand the control of capital outflow is judged to be counterproductive and should never be used except in quite exceptional circumstances. At the same time in order to limit incentives for the inflow of currency capital in the short term and the excessive concentration of exposure to liquidity risk and foreign exchange risk, governments should reduce the scope of the guarantees provided on the national level for this type of external commitment, and should contribute to the development of national bond markets so as to

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1 International Organization of Securities Commissions.

2 International Association of Insurance Supervisors.

3 International Accounting Standards Commitee.

favour if necessary the long term debt policies in national currencies.

(iii) It is not a question of reconstructing a new international monetary and financial system, but rather of introducing in a pragmatic way a set of inducements, codes of conduct, indeed norms to be conformed to in order to ensure best practices as much among States in terms of international cooperation or foreign exchange systems, as in the matter above all of investors and financial intermediaries operating on an international scale.

The reinforcement of international consultation should imperatively extend to emerging markets while taking on a largely informal shape by relying notably on the Interim Committee of the IMF which has seen itself given a permanent standing after its transformation into the International Financial and Monetary Committee. Should it not be possible to establish the absolute superiority of such and such foreign exchange rate systems, then monetary stability and the sustainability of anchor base rate systems requires prudent budgetary policies and above all the limitation of short term sovereign currency debt policies. In this way external financing on a large scale would not on a long-term basis be able to sustain an excessively rigid exchange rate. However, it is above all regarding the private sector that the need is felt for more restricting rules to the game. This necessity to reinforce the financial regulations is linked to the recognised underestimation of the risks run by international creditors particularly during periods on the markets termed as *euphoric*. According to the G7 statement such shortcomings respond to the taking into account of *inadequate* information and also *adverse incentives* leading to excessive risk-taking. From which comes the need to reinforce the arrangements for supervision, surveillance and prudential regulations in order to reduce this type of exposure. This leads to approval of the steps defined in January 1999 by the Basle Committee relating to the assessment of credit risk and the limitation of bank commitments to *Highly Leveraged Financial Institutions*. Where it seems essential to define *codes of best practices* in particular for financial conglomerates, it is the banks who are object to real preoccupations whether it is a question of keeping better to prudential equity ratios, or of better evaluating and mastering contingency risks and foreign exchange balances. Thus we come back to the first principle since the checking for these best practices requires real progress in the exchange of information between national supervisors or the different professional organisations such as the IOSCO or IAIS and, what is more, necessitating an extension of the field of application to tax havens in particular which also have certain similarities to *prudential havens*.

(iv) The triggering of international financial crises is not seen as a low probability event as the defenders of financial market efficiency asserted, but as an endogenous phenomenon which should indeed be forecast, and which we should above all be prepared to manage by foreseeing intervention rules to ensure a more balanced sharing of responsibility between creditor countries and debtor countries, and necessitating the involvement of the private sector.

If the application of the three preceding principles should enable an improvement in the prevention of crises *ex ante* then from now on it is advisable to prepare for the management of international crises in order to limit the risks of contagion. At the same time this presumes a strengthened international cooperation in order to very quickly bring about concerted solutions and also the increased involvement of the private traders. The IMF's new *Contingent Credit Line* answers to this objective but should be added to *private contingent credit lines* in order to forewarn of liquidity risks. If the outcome of crises is not to result in the reduction of debtors' obligation to repay the whole of their financial commitments, then at the same time it is important that creditors bear the consequences of the risks they have accepted and without any guarantee *ex ante* of automatic intervention by the official sector. In the event of a crisis the transitory reduction of net repayments might be envisaged, but no category of creditor should be privileged and in particular bondholders should not benefit from a sort of precedence over bank creditors. More generally the international community should equip itself with a wide panoply of intervention tools and sources of crisis financing by directly involving the private sector from now on, even before the International Financial Institutions appear on the scene.

These principles such as they can be identified from the Cologne statement have not been formalised in such a way as to enable an operational application following an explicit timetable. We shall later come back to the status of such recommendations and the risks of sticking with matters which simply beg the question. All the same an examination of the theoretical foundations which implicitly underlie the G7 position reveals a very clear shift in the *official doctrine* and marks the end of the *Washington consensus*. It is in this sense that can be seen, *post mortem*, the revenge of J.M. KEYNES.

The theoretical foundations of the international financial architecture project: the revenge of keynes or neo-liberalism?

It is easily acknowledged that a common statement by the G7 Finance Ministers could not refer to the theoretical substructures likely to justify the proposals. One can however identify a set of implicit foundations which underlie the options adopted and which in our opinion respond to an intrinsically Keynesian reading of international financial instability. But in what way is it legitimate, in terms of the *architectural* project, to talk about J.M. KEYNES' revenge? Certainly not in the sense of a return to exactly the same conditions of the *Clearing Union* in the Keynes Plan which was drawn up as early as 1941. It is more in the domain of the principles of international financial and monetary governance that a Keynesian connection can be made.

Challenging the rationality of international investors

Compared to the G7 statement, it is impossible at first to find that errors in macro-economic control are the cause of financial instability, although this does not mean that these errors do not happen in a *crisis context.* But, above all, it is the irrational behaviour of private agents, influenced as they are by the herd instinct and changes of opinion, that can be blamed. The G7 Finance Ministers now recognise that markets can, in A. GREENSPAN'S words, be subject to the effects of exuberance or, conversely, irrational wariness. The G7 declaration, while focusing on the requirements for transparency and accurate information, also questions the omniscience of investors in their assessment of individual risk or the international allocation of assets. It is easy to discern the traces of the principles of *imperfect information* or *adverse selection* which Neo-Keynesians popularised. From this point of view, the implicit analysis of financial crises in terms of contagion, multiple equilibria and self-fulfilling expectation sends us, once again, back to J.M. KEYNES. In fact, the individual investor trying to optimise his or her portfolio is in conflict with the interaction between heterogeneous agents who have access to limited information and are subject to mimetic contagion. Complex economic processes, marked by discontinuities and undetermined outcomes, respond to stable economic laws, known by all and subject to probabilistic perturbations. Multiple equilibria and the possibility of divergent, chaotic, even explosive processes oppose the general equilibrium which ensures the efficient allocation of global finance. When the instability of markets is no longer necessarily due to fundamental crises, but changes in *dominant opinion*, when volatility propagates from market to market without any real discrimination, and everyone involved feels vulnerable even to a local problem, then these anomalies put the ability of markets to efficiently assign funds and to manage individual risk into question.

This being so, we come back to J.M. KEYNES' *General Theory :* firstly with the distinction made between investors and speculators, the latter being concerned only with *forecasting changes in the conventional basis of valuation a short time ahead of the general public* (*General Theory*, 1936, p. 170); and secondly with the importance of the state of confidence, that is *on how highly we rate the likelihood of our best forecast turning out quite wrong* (*ibid.*, 1936, p. 164), which is the origin of violent swings of opinion. J.M. KEYNES also made reference to changes in the climate or context which provoke *waves of irrational psychology* (*ibid.*, p. 169) so that, what predominates is not an anticipation based on reason which today we would qualify as rational, but on the contrary, *a conventional valuation which is established as the outcome of the mass psychology of a large number of ignorant individuals is liable to change violently as the result of a sudden fluctuation of opinion due to factors which do not really make much difference to the prospective yield* (*ibid.*, p. 164).

The first J.M. KEYNES, in the *Tract on Monetary Reform*, was not so pessimistic. In this, the exchange rate depended on three fundamental factors, *the internal price level, the volume of trade and the ability to borrow on foreign markets* (1923, p. 92), and speculators played a balancing role : *Speculators, indeed, by anticipating the movements tend to make them occur a little earlier than they would occur otherwise, but by thus spreading the pressure more evenly through the year their influence is to diminish the absolute amount of the fluctuation (ibid.).*

Yet J.M. KEYNES soon changed his mind. In the *Treatise on Money* he laid less stress on speculation as such than on the disadvantages which result from dependence on foreign investments : *A mere change in the demand schedule of borrowers abroad,* he wrote, *is capable, without any change in the monetary situation proper, of setting up a disequilibrium in the existing level of money income at home* (1930, p. 311). Of course, the consequences of this established fact are more serious in a system of fixed exchange rates, like the gold standard, which Great Britain had adopted at the time J.M. KEYNES was writing the *Treatise.* In this case, in a situation of a free trade system, the adjustment can only be based on two instruments: varying the gold reserves which are not inexhaustible, or raising the interest rate. This is even more difficult when a country's salaries and exports are more rigid, foreign capital less elastic and domestic investment more elastic than the interest rate. Consequently, *the transition from one position of internal equilibrium to an-*

other required by the necessity for preserving external equilibrium may be difficult, dilatory and painful (*Treatise on Money,* Vol. 1, p. 314).

The KEYNES Plan, which appeared later than the *General Theory*, reveals the writer's final stance regarding movements of capital. Written by KEYNES himself and published in 1943, it conveys the British government's official position in the negotiations with the Americans to reconstruct the post-war international monetary system. This system, as it would emerge from the Bretton Woods Conference, was strictly closer to the American proposal defended by H. WHITE of setting up an international stabilising fund than that of J.M. KEYNES which consisted, notably, of creating a supranational bank and currency. Nevertheless, the way the IMF operated in the 1960s and 1970s and its subsequent development, show that it was not as far as one would have thought in 1945 from the original position held by J.M. KEYNES.

The KEYNES Plan contains a forceful denunciation of the risks to the host country of what he called then *fugitive funds* or *floating funds*: *There is no country which can, in future, safely allow the flight of funds for political reasons or to evade taxation or in anticipation of the owner turning refugee. Equally there is no country that can safely receive fugitive funds which cannot safely be used for fixed investment and might turn into a surplus country against its will and contrary to the real facts* (*Collected Writings,* Vol. 25, p. 30).

Furthermore, the possibility that the G7 now envisages of introducing measures to slow down international movements of capital was explicitly taken into account in the KEYNES Plan. In this, J.M. KEYNES counted on maintaining permanent control over capital movements after the war. He considered that to be effective, such a system of control required the surveillance of all international transactions both by the transmitting country and by the receiving country, realising that the goal to achieve was not to forbid all capital movements but only the *floating funds.* On the contrary, *compensatory financial flows* of the movements of goods and capital flows corresponding to *genuine new investment for developing the world's resources* should be encouraged.

Today the G7 has also expressed a marked concern about liquidity problems by proposing to limit incentives, in actual fact the guarantees, for capital inflows or for short-term bank commitments. It is the same for the method of crisis management and the necessity of suppressing at an early stage the propagation of the risk of liquidity. This is where J.M. KEYNES can be acknowledged in that international financial markets are not only founded on ensuring the optimal allocation of shares but also on regulating the preference for liquidity, the Achilles' heel of finance. In this way international financial stability has something in common with a public good, as a bearer of externalities which justify setting up international financial governance. This could take several different forms: inducing *best practices;* introducing certain controls on capital movements; reinforcing and extending standards of prudence to counter the excessive risk-taking of certain agents; making the function of last resort lender official from now on by mobilising additional credit lines from private sources…

Although, from now on the necessity of a statutory or prudential infrastructure, or indeed the hypothesis of controls over short-term capital received by emerging economies, has been affirmed, nevertheless the Finance Ministers have not settled the issue so that we can ascertain whether it concerns a short *pause*, a transitional phase which should lead to a more robust domestic financial system before returning to the principle of liberalisation required for savings transfers or, conversely, if it is a question of a long-term option which will respond to endogenous imperfections in international financial markets. In the latter case this would mean, as J. BHAGWATI (1998) maintains, that there would not be one single principle ensuring global well-being, so free trade would have to be combined with restricted exchange in the field of financial assets.

A more balanced share of constraints between debtors and creditors?

The objective of a reinforcement of international consultations involving from now on emerging economies, and above all a concern for a more balanced share of the responsibilities between creditor countries and debtor countries remind us once again of J.M. KEYNES' position on the necessary symmetry of adjustments. Thus we find in his Plan that excessive creditor countries would be subjected to negative interest rates on their assets in *bancors* and would have to undertake an expansionist monetary policy or re-evaluate their exchange rate. In actual fact, J.M. KEYNES wanted to extend the principle of internal banking systems to the international level: a hierarchical system with a central world bank at its head, the *Clearing Union*, which would issue the *bancor,* the currency of international credit circulating between national central banks. As bancors would circulate solely through transfers between central bank accounts to the *Clearing Union*, the latter would run no risk to its solvency. The amount of the maximum possible overdraft, or *quota*, for each country would be fixed according to its share of global trade. More precisely, J.M. KEYNES envisaged that the initial *quota* would be equal to the average trade figure of the country (imports plus exports) for the three years preceding the war.

As each country would be able to increase the debit side of its bancor account by a quarter each year for three following years, the leverage effect resulting from the introduction of the international currency would be considerable. A country continuing to export after the war as it had done before would have the possibility of importing more than before the war after three years. And this would be at the lowest cost since debtor countries would have to pay 1% interest each year on the average remaining balance on their account for up to half the quota and 2% beyond that.

Yet J.M. KEYNES did not wish to encourage the outbreak of structural disequilibrium in balances of payments, especially not for high amounts. Firstly a country should not increase its debit balance with the *Clearing Union* in the course of a year by more than a quarter of its *quota* without authorisation from the *Clearing Union*. It would be free, therefore, to devalue its currency vis-à-vis the bancor up to a limit of 5% if it saw fit. When the increase in the debit balance exceeded 50% of the quota, the *Clearing Union* would have the right to impose measures to restore equilibrium to the account: the devaluation of the currency but also the installation or reinforcement of currency controls, or even the repayment in gold of that part of the deficit which exceeded the authorised overdraft. Finally when the debit balance and not its increase exceeded 75% of the quota, even more draconian measures would be able to put into place which could go as far as a notification of *declared in default* and the exclusion from any further funds.

Such measures would only slow down the increase in disequilibria. They would not be able to prevent deficits reaching tendentiously 75% of the quota for a number of countries representing about half the world's trade. One of the most original ideas in the KEYNES Plan would intervene in this situation with the aim of forcing countries with a surplus to reabsorb their excess surpluses. First the countries in credit would be subject to negative interest rates on their bancor assets under the same conditions, the necessary changes having been made, as countries with a surplus: 1% beyond a quarter of the quota, 2% beyond half. And above all, countries whose credit balance exceeded 50% of its quota over one year would have to negotiate with the *Clearing Union* the measures to take to restore equilibrium to its balance of payments, amongst which could be *appropriate measures to increase credit and domestic demand, re-evaluation of the currency or an increase in salaries, the reduction of customs duties and quantitative import restrictions, loans to late developing countries.* In the case of disagreement between the *Clearing Union* and a country with a surplus, the latter would, however, have the final word.

Without restating all the provisions laid out in the KEYNES Plan, the IMF's statutes partially endorse the Keynesian idea of the symmetry of adjustments. During the negotiations which preceded Bretton Woods, the British negotiators, facing the reticence of the Americans who feared they were being led into financing world trade beyond the point they were prepared to go, persuaded them to accept the *apportionment of scarce currencies* which constitutes article VII-3 of the statutes. This clause authorises member countries to restrict their normal business transactions with a country which has a surplus and whose currency therefore has been declared as *scarce* by the Funds because it has disappeared from its reserves. However the scarce currency clause has never been applied.

We can add another point related to Keynes concerning the dangers of exchange rates which are too rigidly fixed. Regarding developing countries, the idea that a large amount of external financing would not be able to durably maintain an excessively rigid exchange rate and, above all, that a policy of prohibitive interest rates is not the most appropriate solution in a debtor country subject to a speculative attack, contrary to the policies imposed by the IMF right at the beginning of the Asian crisis – all of this brings us back to J.M. KEYNES. In a speech made in May 1944 before the House of Lords in which he defended the compromise which had just been drawn up between H. WHITE and himself, he declared: *We are determined that, in future, the external value of sterling shall conform to its internal value as set by our own domestic policies, and not the other way round. Secondly, we intend to retain control of our domestic rate of interest, so that we can keep it as low as suits our own purposes, without interference from the ebb and flow of international capital movements of flights of hot money. Thirdly, whilst we intend to prevent inflation at home, we will not accept deflation at the dictate of influences from outside* (*Collected Writings*, Vol. 265, p. 16).

International Financial Institutions: the *statu quo*?

None of the provisions envisaged by the G7 Finance Ministers tackle the question of institutional forms or delegations with the responsibility of setting them up. Yet it is difficult to see how the architecture of the international financial system could be consolidated without an institutional framework which specifies both how it should be run and the jurisdiction to be respected. Otherwise this *agenda* will never see the light of day. The question therefore arises of a new architecture for international financial institutions in charge of managing this collective good which is financial and monetary stability. This is an issue which J.M. KEYNES had clearly foreseen.

In fact, both in the *Treatise on Money* and at the time of preparing for the Bretton Woods conference, J.M. KEYNES had put forward several principles for this plan: firstly by expressing his opposition to the creation of new international organisations which are the source of bureaucratic misdirection, and his very clear preference for what would be called today a network of national institutions, and secondly by underlining his preference that such responsibilities should be entrusted to central bankers rather than government representatives. In the *Treatise on Money*, J.M. KEYNES tackled the question of adjusting the gold standard to respond more effectively to the needs of the economy and he suggested two models. Firstly, what he qualifies as *minimal*, with the transition to a gold exchange regime and the creation of a *committee of central banks*, responsible particularly for modifying the hedging rate of participating currencies in order to avoid a shortage of currency and deflationary consequences. But his preference was for the *maximal* model which already involved the creation of a supranational currency and bank. The new currency would be convertible to gold at a fixed rate, but it would be destined to take the place of the precious metal in most international transactions. Above all, it could be created by the supranational bank in the form of *discount credit* granted to member national central banks in the system. All this would achieve two related objectives: stabilise the purchasing power of the supranational currency, and therefore also gold, with reference to a price index of basic goods traded at an international level and, consequently, prevent the outbreak of all inflationary processes or deflation originating from abroad.

As for the means he envisaged, they combine centralised action and coordination of the central bank. *Its methods of attaining these ends would be partly by means of its bank rate, its discount quota and its open-market policy, but largely by consultation and joint action with and between its adherent central banks who would be expected to discuss their own credit policies at monthly meetings of the board of the supranational bank and to act, so far as possible, on lines jointly agreed* (*Treatise*, Vol. 2, p. 360).

The *Clearing Union* project resumed the main features of the system described above, specifically a network of central banks. Moreover, J.M. KEYNES fought hard to impose this model at the time when the IMF was being set up. Apart from the choice of headquarters which J.M. KEYNES wished to be New York, the most important financial centre in the world, rather than Washington, the liveliest part of the discussion concerned the management components of the Funds. J.M. KEYNES categorically wanted the operational responsibility of the IMF to be entrusted to a body of international civil servants, granted, but under the mandatory authority of an *intermittent executive board* composed of members who retained their national positions in the national central banks. However, in March 1946 at the Savannah Conference on the operational setting up of the Bretton Woods agreement, J.M. KEYNES found himself face to face with an American delegation that was determined to impose another type of organisation where power lay principally with full-time executive directors who remained representatives of their respective governments. This was what was voted at Savannah and J.M. KEYNES, reflecting *a posteriori* on what could have been the Americans' real intentions, concluded that they had wanted to *politicise* the decision-making processes of the two Bretton Woods institutions in order to establish greater control over the economic reconstruction process of the *free world.*

Today the new *international financial architecture* only concerns the *technical rules* which help to master international financial instability more successfully by improving the transparency and surveillance of markets and by encouraging greater responsibility amongst the players involved, both private and public, in the prevention and management of crises. The stakes are also political and the question of a new *architecture* of international financial institutions has now arisen in a new context where a number of issues have joined together: doubts about the *Washington agreement*, the recurrence of systemic crises, the appearance of a second international currency with the Euro and the legitimate claim on the part of emerging economies to participate in international financial regulations. This collection of factors which argue in favour of a new neo-liberal compromise could well mark the beginning of J.M. KEYNES' revenge.

The defenders of the international political economy, and amongst them theorists of international regimes, focus on a distinction between two types of rules of a nature to govern relations between states: on the one hand, *substantive rules* defining in a precise way the behavioural norms which participation in the international game imposes; and on the other hand *procedural rules* specifying managing principles and incentives whose application is not imperative, as well as *good practices* which comply with behavioural norms judged to be desirable in the interests of everyone. If this interpretative framework is applied to the questions of international finance and monetary governance, it appears that the official architecture project clearly depends on the *procedural rules* without redefining the *list* of functions and jurisdictions relative to national and international financial institutions. The recent creation of the Financial Stability Forum confirms this option as does the informal mobilisation of multiple professional organisations of international finance ((IOSCO, IAIS, IASCS). But there is a legitimate question as to the limits of such an option if we really want to endow the global economy with the measures required for monetary and financial governance.

This is the debate now taking place. C. WYPLOSZ and the International Center for Monetary and Banking Studies in Geneva (1999) suggest a radical reform of the IMF's statutes giving the organisation greater responsibility and autonomy vis-à-vis governments. Concerning the issue of last resort lender, IMF experts and chiefly S. FISCHER (1999) have drawn up the conditions required so that the IMF, in the name of governments, can carry out such a function under redefined conditions. M. AGLIETTA and C. DE BOISSIEU (1999) judge that the BIS and the central banks which have a seat on it are better able to assume this role, coupled with international banking supervision and surveillance of payment systems. More radically, post-Keynesian economists like J. EATWELL & R. TAYLOR (1998), suggest replacing all the current institutions (IMF, World Bank, BIS) with a *World Financial Authority.*

The debate has therefore moved to the institutions in charge of ensuring the permanence of the new architecture, and the political stakes today are combined with specifically economic issues. But how would J.M. KEYNES have contributed to this debate? Doubtless he would have underlined the fact that the first role of financial institutions is to fuel the expansion of *business* and to ensure confidence and liquidity in the markets, without serious damage on a systemic level. When these two functions, which are, moreover, inseparably linked, are compromised the question of the efficiency of the allocation of resources and of the transparency of information takes on a very secondary character. On the domestic level, that is what justifies the irreplaceable role of the central banks in the management of payment systems and the exercise of monetary policies. In this sense it is almost certain that J.M. KEYNES would have entrusted the responsibility of managing international financial crises and therefore the role of last resort lender to central bankers rather than governments or the IMF. From this point of view M. AGLIETTA and C. DE BOISSIEU'S proposition (1999) of creating a *contingency network of co-operation* between central banks under the aegis of the *Federal Reserve Board* and the ECB follows exactly the same path of reasoning. It is doubtful, however, if states would be prepared to give up such a prerogative, so eminently political, to central bankers who are becoming more and more independent.

Conclusion

The exercise of researching Keynesian sources for the *international finance architecture* could not have been pushed so far had it not been for the serious economic upheavals that the global economy has suffered during the last half century and therefore the new context in which the problem of international financial regulation has arisen. It would have been even less so if J.M. KEYNES as from the 1930s had not formulated most of the principles which are the basis for the aforementioned *architecture*. But such a reconstruction marking, in a way, the revenge of J. M. KEYNES and Keynesian theorists over the defenders of efficiency and the unfettered liberalisation of international financial markets does not solely depend on arguments put forward by economists whoever they may be. The *embedded liberalism* that J.M. KEYNES, the heterodox, called for during the Bretton Woods Conference was already very convincing but it was not adopted. The emergence of a new *world governance* on the economic level puts into play new relations of power not only between America, Europe and the emerging economies in Asia but also between markets and states.

In these conditions, the new international financial architecture could not unfortunately mark the revenge of Keynes. It has been reduced to a compromise, more neo-liberal than neo-Keynesian, which seems ambiguous and unfinished. Meanwhile, in 2001, we are witnessing the outbreak of new financial crises in Argentina, in Turkey...

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