

# KEYNES, INTERNATIONAL CREDIT MONEY AND EXCHANGE RATE EFFECTIVENESS

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‘At Bretton Woods, Keynes forgot everything he had learned in writing the *General Theory*’

(Marcello de Cecco, 2011)

# Paradox of Keynes' Monetary Thinking

(not unusual for a writer who traded in paradoxes: '... words ought to be a little wild for they are the assault of thought upon the unthinking'):

Clear (r)evolution of Keynes's thinking on **domestic** (closed economy) monetary ideas;

vs

**Stasis** in thinking on international monetary theory (fixed, but adjustable exchange rates).

# Post-Keynesian international monetary theory

Moves in two directions:

Vindication and modification of Keynes Plan at Bretton Woods (Davidson, Skidelsky)

Or

Application of Keynes's theoretical innovations in domestic money (e.g., liquidity preference) to international monetary theory (Bianca Orsi, Harvey, Prates, Kaltenbrunner, Gabor, Lavoie etc.)

# I will argue

1. Brief critique of Keynes' international monetary theory;
2. Recent innovations in international monetary practice;
3. Integration of theory of domestic money with international money through finance.

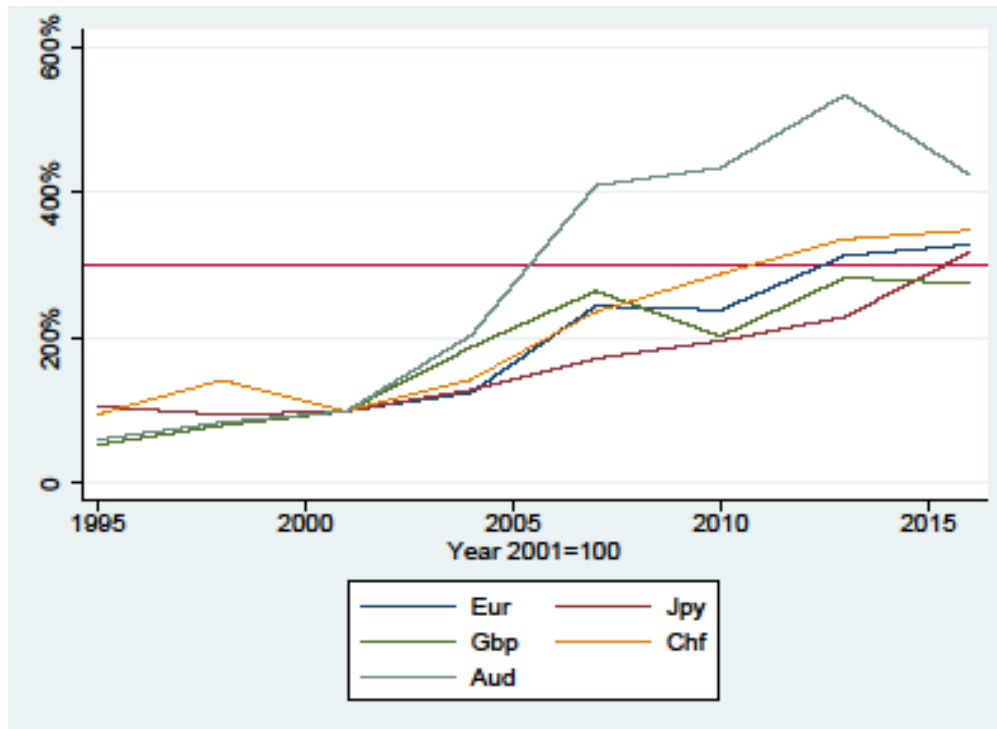
# 1. Keynes's international monetary theory

- 'Fixed but adjustable' exchange rates based on needs of trade;
- A 'monetary theory of credit' vs. a 'credit theory of money' (Schumpeter).
- Ignores international credit and debt, affected perversely by exchange rate flexibility.

## 2. Recent innovations in international monetary practice

- Internationalisation of money markets (from Euro-dollar markets to Foreign Currency Swaps) → new international monetary cycle
- Shifts between foreign currency indebtedness of private and public sector.

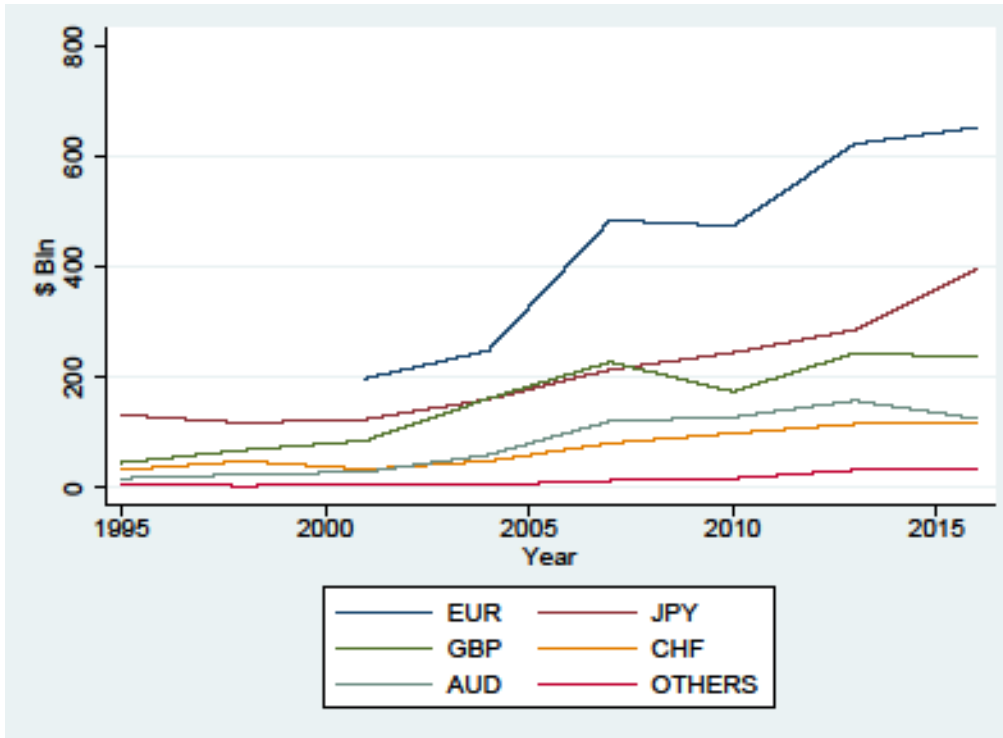
# Foreign exchange swaps



Source: BIS



# By value

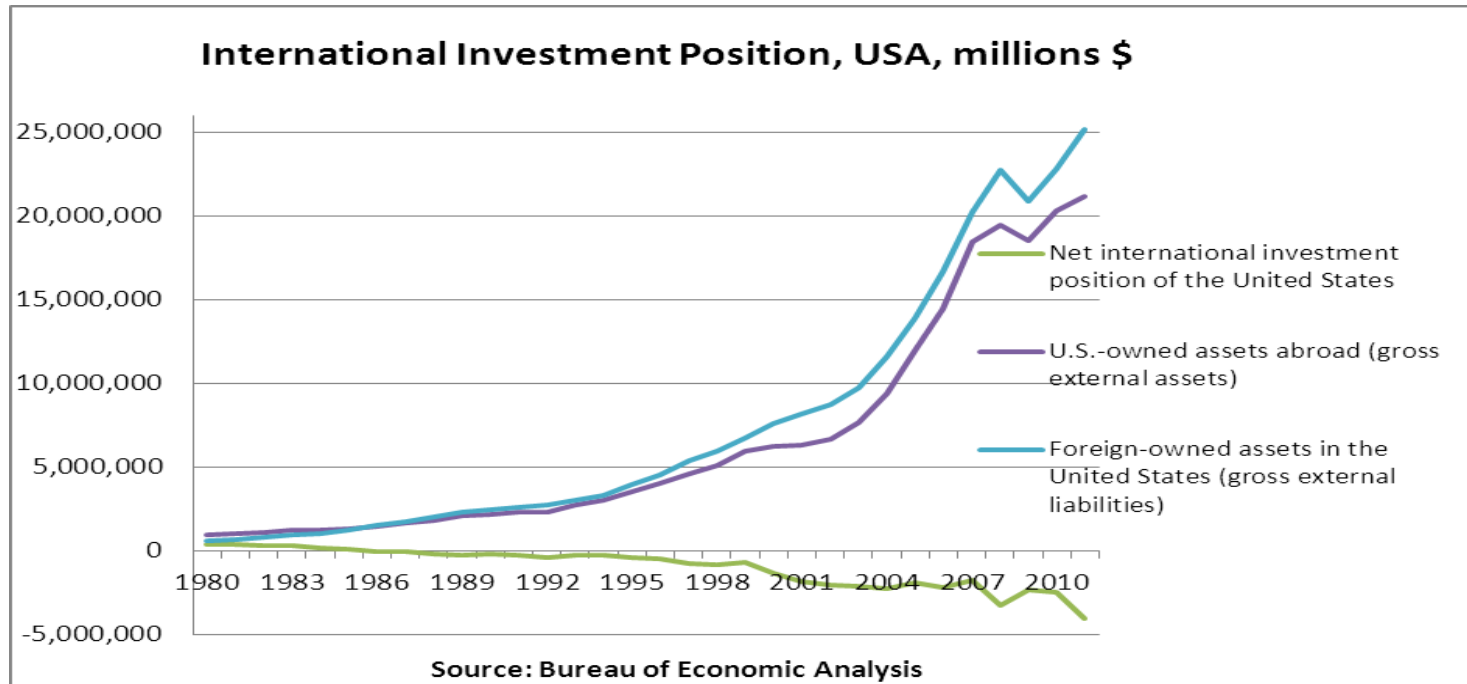


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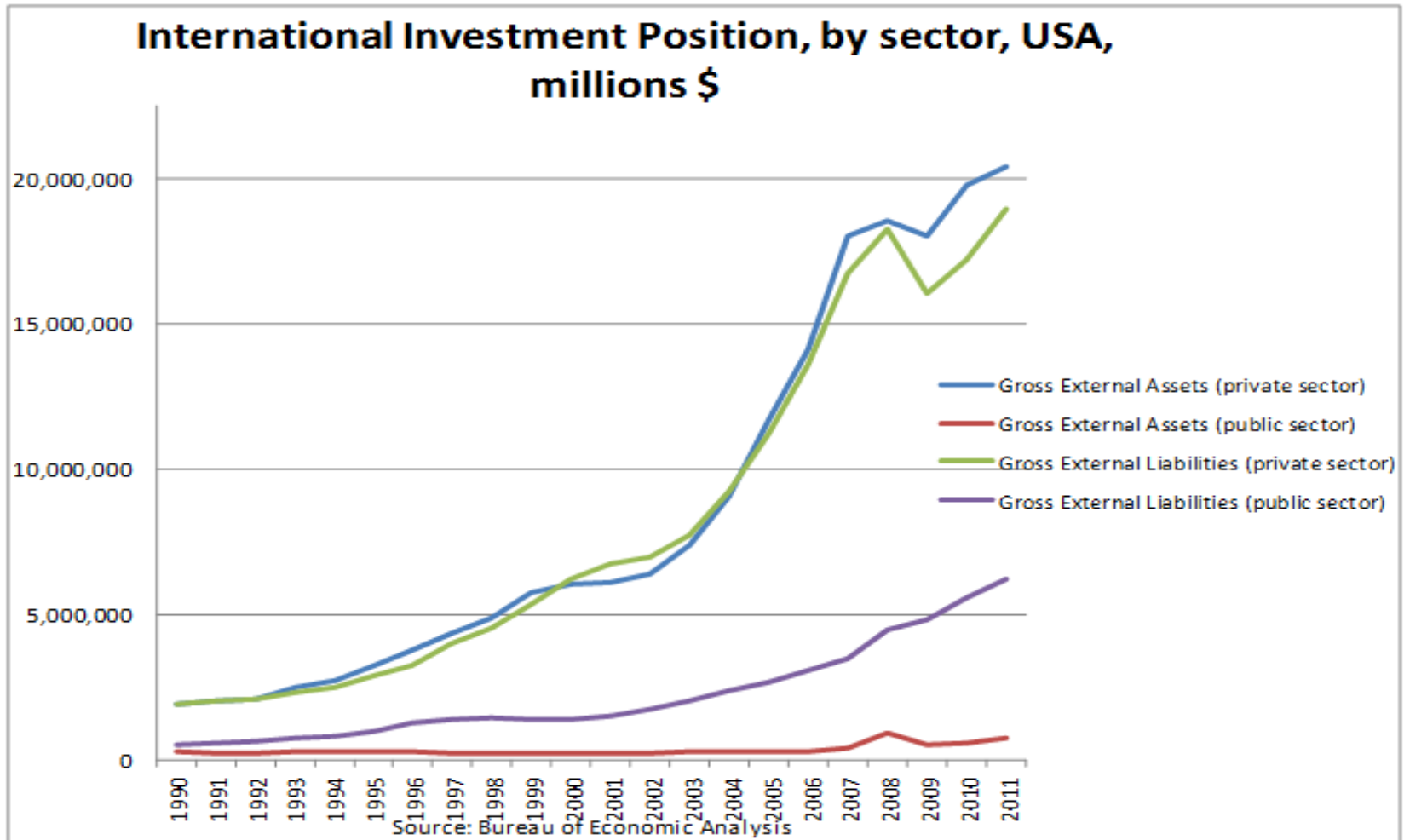
# New International Monetary Cycle

- Central banks no longer 'have' or even control their own money markets.
- Global system depends on US dollar market liquidity

# US Foreign Assets and Liabilities



# By sector



# Data reflects

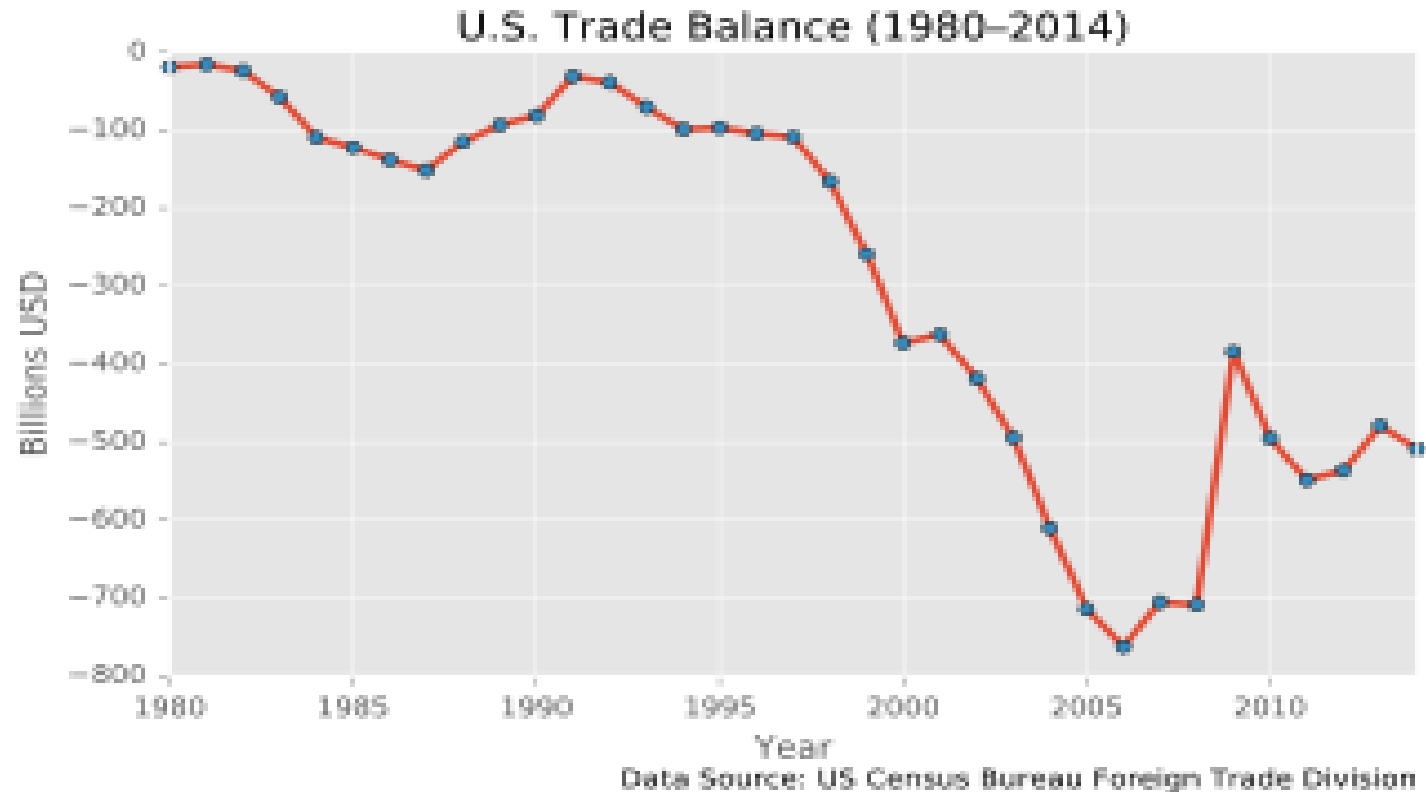
- Corporate sector has small surplus: public sector is in deficit.
- Foreign liabilities are in US\$ (US government and corporate stocks and shares held abroad) that are reserves of international monetary system;
- ‘Off-shoring’ of US corporate balance sheets.

# International monetary operations

Involve international debt management (not monetary issuance) through:

Trade deficit of country whose currency is denominated for trade deficit

# US Trade deficit



# International debt management

Through refinancing of Government debt by  
private banks (no longer done) or IMF/World  
Bank



# Or refinancing from Government to private sector

Portfolio capital inflow → \$ deposits in banking system;

Government issues local currency bonds to buy \$ to repay \$ borrowing;

Foreign currency exposure shifted from Government to private sector (e.g., Mexico 1990)

# But Government also (partially) liable for private sector foreign borrowing

- Through central bank management of exchange rate;
- Government residual responsibility for larger national businesses

# Conclusion

- Debt drives monetary circulation in the international monetary system (trade plays minor role)
- Debt management vs. exchange rate management is the challenge of international monetary policy.

So what is Post-Keynesian about this?

The liquidity of (long-term) international debt is  
the key to debt management.