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The Global Economy is in Danger: On the Book of György Szakolczai through the Lens of Post-Keynesian School*

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György Szakolczai:
John Maynard Keynes, a nemzetközi gazdaság keynesi rendje és a Nemzetközi Valutaalap (*John Maynard Keynes, the International Economic Order and the International Monetary Fund*)
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1. Keynes' proposals: success or failure?

In addition to providing rich biographical details, *György Szakolczai's* book offers exciting insights into John Maynard Keynes's work in international finance. However, it is not a biography but much rather an impressive picture of the era, a story, containing worthy proposals and lessons which are highly relevant even today. In this paper, I compare Szakolczai's claims with today's post-Keynesian approach. Szakolczai does not refer to and does not express a shared view on post-Keynesian theories, however, by presenting Keynes's work he does a great service to the renaissance of Keynesian economics. In the light of global imbalances and the threat of a trade war, Keynes's proposals are highly topical even today. Szakolczai suggests a return to these proposals. The writer of this review hopes for more than that. He hopes that Keynes's work will not only be treated as economic policy proposals, but also considered as elements in the renewal of economic theory. In order to understand our current world, we need a completely new approach in economic theory. In order to renew economics, it is worth going back as far as Keynes.

Keynes always approached an issue in a manner that took into account not just the interests of one nation, but the global interests of mankind. Szakolczai states that this starting point could have been justified by the global trauma caused by World War II alone, but in the face of the bipolar world order that emerged after the cataclysm, such a viewpoint was condemned to failure from the outset.

* The papers in this issue contain the views of the authors which are not necessarily the same as the official views of the Magyar Nemzeti Bank.

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Keynes's greatness was not recognised in his time, but posterity discovered it. *Ann Pettifor* (*2018*), a well-known representative of the post-Keynesian school compares the genius of Keynes to that of Darwin. Darwin's theory of evolution is broadly recognised, but Keynes's work was not accepted by the economics profession, however much he was a well-known person. The revolutionary new ideas of both Darwin and Keynes met with huge opposition from their contemporaries. According to *Pettifor* (*2018*), Darwin was challenged by arguments in favour of the myth of creation, while resentments against Keynes's ideas fed the restoration of classical microeconomics through an obsession with creating microeconomic foundations for macroeconomics.

According to *Pettifor* (*2018*), we left the management of the global monetary system to the free will of speculators and capital markets. Crisis management is merely controlling the financial anarchy, often by putting a greater burden on tax payers. The fact that the 2007–2008 crisis hit developed regions which traditional economics considered as unquestionable models already implies an anomaly. György Szakolczai's book does not include such post-Keynesian statements, but he also points out that today we still fail to take those reasonable steps for prevention which already Keynes considered to be critically necessary.

According to the post-Keynesian school, the reason why we tackle the problem the wrong way lies in the traditional interpretation of monetary theory and the mainstream views of macroeconomics: "If we continue to fail to consider Keynes's warnings, and if we continue to fail to listen to his implications on monetary theory and macroeconomics, the occurrence of further severe crises will continue to be unavoidable in the future" (*Pettifor 2018*).

2. Long shadows of the very beginning

In 1919, Keynes attended the Paris Peace Conference that concluded World War I, and outlined a plan for credit and financing relief necessary for reconstruction. He put forward the idea that defeated powers could use the bond market to raise the funds necessary for the payment of reparations. The bonds would be guaranteed by the victorious powers, ensuring marketability. Keynes hoped that his proposal would constitute a general framework for an international financial system that would serve the development of individual countries, while also ensuring the stability of the global economy. Wilson, the American president, rejected his proposal on the grounds that the U.S. had already made major sacrifices, and therefore he did not think that Congress would support a European bond issue. Instead, he suggested the use of the usual market channels. *Pettifor* (*2018*) mentions that Wilson's rejection letter was drafted by a J.P. Morgan banker, Thomas Lamont, and thus it can be suspected that this suggestion for the usual market channels might have created a great business opportunity for the private bank.

This failure did not put Keynes off, but rather inspired him to argue powerfully against the erroneous decisions of the Peace Agreement in his work *The Economic Consequences of the Peace* (*Keynes 1919/1971*). Keynes's book became a world-wide success. The Versailles negotiations had a lasting impact on Keynes. Szakolczai demonstrates that this was the place where international economic and financial issues became the focus of his attention for the rest of his life. According to *Pettifor* (*2018*), Keynes's views, expressed here, had a significant impact on and led to the success of the construction of the Bretton Woods system in 1944. However, this only happened after the 1928–1933 crisis and then the catastrophic war had caused the suffering of and claimed the lives of tens of millions of people. Szakolczai does not consider the establishment of the Bretton Woods system as Keynes's success, but as his fatal failure.

3. Keynes on the balance-of-payments problems following World War II

After the Second World War, loans to finance the large import volumes needed for rebuilding were not available. The majority of the world's gold reserves were in the USA. The United States accumulated large balance-of-payments surpluses due to US exports linked to reconstruction. European and Asian countries with balance-of-payments deficits faced US dollar shortages. Analysing the forces that correct imbalances, *Keynes* (*1946*) saw that as a result of the reconstruction, countries that previously had balance-of-payments deficits became able to achieve export surplus with the United States. This was also supported by domestic market demand in the USA. Keynes warned that these natural balancing mechanism should not be disturbed by levies or export incentives in the Unites States, because they would restrain growth in exports to the US.

However, there are no such balancing mechanisms correcting the current US–China balance-of-payments disequilibrium, because debt is denominated in USD, the currency of the debtor. If the creditor country (China) is willing to accumulate any amount of US dollar reserves, there is nothing that could force the debtor country (USA) to reduce its balance-of-payments deficit with China. As a direct consequence of the export-oriented development strategy of China and other emerging markets, these countries have no interest in an endeavour of the United States to reduce the balance-of-payments deficit with them.

According to the post-Keynesian argument (*Kregel 2015a, 2015b*), Keynes's proposal for setting up an international clearing union should be reconsidered in order to remedy this problem.[1] Szakolczai proposes the same and presents Keynes's proposal

[1] *Costabile* (*2009*) provides a very thorough analysis, examining the question from different aspects. She is also in favour of Keynes's proposal. There is a common element in the approaches of Costabile and Kregel: they both consider that the key currency status of the dollar can be terminated by adopting an international unit of account which is not the own national currency of any country.

in details. The proposal was elaborated for the Bretton Woods Conference in relation with the establishment of the International Monetary Fund (IMF) with the aim of setting up an international monetary system to release national economic policies from the constraints resulting from the international payment system. The purpose of Keynes's proposal was to introduce a supranational unit of accounting, the *bancor* to be used in international settlements. Balance-of-payments disequilibrium would have been recorded in bancor, and countries facing financing needs could have automatically taken loans in bancor within certain limits. If a country had exceeded these limits, correctional measures would have been applied. Within the given limitations, the system would have ensured autonomy for national economic policies in an integrated global economy, and it would have restored the stabilising function of capital flows.

4. Keynes's theoretical innovations: monetary theory and macroeconomics

Keynes's solution was facilitated by his new monetary theory. Instead of the theory of money which provided a framework for the gold standard system, he took an approach moving towards the modern theory of credit money or the theory of endogenous money often referred to as MMT (modern monetary theory). He clearly saw that money is created through lending, and loans allow investments to be made. With this view, he followed Joseph Schumpeter's approach.

Keynes (*1936*) outlined his theory of money and theory of the rate of interest in Chapters 13–15 of *The General Theory.* With these theories he went against the general opinion. Placing money and the rate of interest at the centre of the examination and challenging the arguments of classical economics, he demonstrated that a high level of unemployment is not caused by high wages, but by a high level of interest rate. According to the arguments of classical economists, the rate of interest is determined by the interaction between the demand for investment capital and the supply of savings, and therefore it is determined by economic activity, and not the other way around, i.e. it is not a factor that actively shapes economic activity.[2]

5. Global imbalances today

Szakolczai calls for a return to Keynes's proposals with a view to tackling global imbalances, however, his book does not deal with the applicability of these proposals to the current circumstances. For this, according to *Jan Kregel* (*2019*), first we have to identify the contemporary features of international finance and trade. The context around the establishment of the Bretton Woods system after World

[2] *Ábel et al.* (*2019*), *Chick – Tily* (*2014*), *Pettifor* (*2018*)

War II was very different from the one around us today. One of the main goals of the establishment of the International Monetary Fund (IMF) was to ensure a secure system and institutional stability for international payments, as a precondition for the normalisation of trade relations. The ultimate goal was to facilitate trade. Money and the monetary system were just tools for achieving this. Today we face the opposite of that. Money and capital flows have become major players (*Kregel 2019:4*).

The international monetary system which was set up to solve international payment problems hindering the expansion of trade became unsuitable for tackling the balance-of-payments disequilibrium. Following the collapse of the Bretton Woods system,[3] trade was smoothly financed by internationalised private banks. Global investment markets underwent a rapid expansion, which further fuelled the growth of imbalances and the persistence thereof.

Disequilibrium in the balance-of-payments within the Bretton Woods system was rather temporary and the magnitude of such imbalance remained limited, since there was a correcting mechanism acting as a balancing force. This mechanism involved both market automatisms and various forms of extra-market institutional intervention which were in interaction with each other.

In the period following the collapse of the Bretton Woods system, the US dollar continued to play a central role as the leading key currency, but with the changeover to floating currencies it lost its earlier stabilising role. Maintaining the exchange rate parity between gold and the US dollar would have required economic policy corrections in the United States aiming at reducing the trade deficit by restraining domestic consumption and controlling the budgetary deficit. However, the floating exchange rate of the US dollar generated an unfettered increase in the trade deficit, since that could be financed in the national currency (USD). This is the world of the Triffin dilemma, where there is no mechanism that would prompt the United States to reduce its domestic consumption or change the exchange rate so that it would support the correction of the imbalance.

6. China's trade surplus and the US deficit

The period following the 1970s when the US dollar played the role of the key currency is often described as Bretton Woods II (*Dooley et al. 2003, 2014*). China has now achieved a significant balance-of-payments surplus with a number of countries and has accumulated an exceptionally large surplus with the United States.

[3] The collapse of the Bretton Woods system was caused by the suspension of the US dollar's convertibility into gold in 1971, i.e. by the decision to make the US dollar a floating currency. Concurrently with this decision by Nixon, an import duty surcharge of 10 per cent was imposed.

China entered the global market as an emerging country, and it followed the typical path of emerging countries. The reason why traditional economics considers capital investments in emerging countries as especially advantageous is that utilising the resources available in these countries when entering the global market allows productivity advantages to be gained with the use of modern technologies. However, the improvement in productivity does not allow increases in wages because wages are suppressed not through productivity, but the global wage competition between assemblers. In many countries, the improvement of industry was not accompanied by an increase in the share of domestic value added in industrial exports which could have improved national prosperity. However, China was exceptionally successful[4] in this field. Experiences show that the share of domestic value added in exports contributes to growth in domestic income, but the basic tendency of global value chains shows an opposite direction, a decrease in domestic value added in exports. For that reason, income inequalities between developing and developed countries have been steadily increasing.

7. Contradictions in today's international monetary system

Elimination of the US trade balance deficit could trigger a global recession. According to the calculation of *Truman* (*2005*), the deficit of the US had a positive impact on economic growth in other countries between 1999 and 2004, contributing 1.7 percentage points to global GDP growth. The deficit was financed by capital inflows from less advanced countries to the more advanced United States. This is the paradox of capital flow pointed out by *Prasad – Rajan – Subramanian* (*2007*), since preferably capital should flow towards capital-poor countries, contributing to global growth. The inflow of foreign savings which finance the US deficit could be eliminated by a shift of direction of capital flow which could trigger a depreciation of the US dollar and an increase of interest rates in the US. However, a brake on the rate of economic growth in the US would also put a brake on global growth. These unsustainable balances do persist and their persistence is supported by a threatening alternative, the financial terror, using the expression of *Larry Summers* (*2004*). Before handling this delicate imbalance, the global financial crisis broke out in 2007–2008, which threatened the collapse of the American and European banking system. A number of analysts saw a link between the operation of the global monetary system, the imbalances and the crisis; and several recommendations were

[4] According the data of UNCTAD (2018), China's domestic value added in exports increased by 12 percentage points between 1995 and 2014, while the increase was only 6 percentage points in 27 other developing countries where, in addition, the base was significantly lower.

made on reforming the system.[5] Various elements of these ideas practically revived Keynes's proposal for an international clearing union.[6]

8. The topicality of Keynes

Several parts of Szakolczai's book address the need to update the Keynes Plan. Keynes's proposal includes many important elements, but in order to implement them we should analyse the actual situation as a starting point. Szakolczai's book is an excellent work if it were to be understood as a logical experiment, just as *Costabile* (*2009*) also addressed the topicality of Keynes's proposals. It would be misleading to draw economic policy conclusions from these proposals without taking into account the technical and practical context. *Costabile* (*2009*) highlights that Keynes's proposal for *bancor* substitutes the key currency role, and since bancor is not the national currency of any country, it eliminates unilateral advantages and disadvantages entailed by the key currency role.

In the current era, among the global imbalances, the main problem has been the deficit of the United States and the surplus of China, for almost decades now. Therefore, this wording in Szakolczai's book is ambiguous: "It has been virtually the main aim of the International Monetary Fund to impose the full burden of correction on debtors and to exempt creditors from the consequences of irresponsible lending, thus causing enormous moral risk" (*p. 94*). This criticism might be justified in the case of many of the debtors, but not in the case of the true big debtor, the United States. In the last 75 years, the IMF has witnessed a lot of success, but even more failures. In line with the changes, the IMF itself has also changed. One could imagine a lot about the economic and political role of many creditors, including China, and in general about the motifs of international capital. However, it is unthinkable that the IMF would want to pick China for the purpose of exemption in respect of irresponsible lending. Referring to Keynes or to his proposals with such and similar statements is not appropriate, not least because his wordings were associated with the problems topical at the time. In view of the current trends, he would obviously use a different wording. It is worth learning from the analytical framework that Keynes applied and the theoretical approaches that he proposed, advancing towards a new theoretical system on the path he embarked on. Szakolczai's book is a great work on Keynes's life and struggles, and his objectives

[5] The proposal of the Governor of the People's Bank of China to use the SDR created by IMF as Keynes's bancor in international settlements instead of key currencies attracted a high level of response (*Zhou 2009*).

[6] The clearing union and the bancor, an international unit of accounting are central issues of Szakolczai's book. The details of some versions of the plan are presented in Chapters 7 and 8 (pp. *101–141*). The plan for a clearing union also played an important role in the negotiations at Bretton Woods aimed at preparing the establishment of the International Monetary Fund, of which a true picture is provided in Chapters 10 and 11 (*pp. 173–210*). Bancor would play a supranational role in the settlement of international payments, but it would not be a national currency of any country. In contrast to the US dollar, bancor would not be issued by a central bank of a nation, and therefore its operation and its effect are fundamentally different from those of national currencies used in international payments today.

and proposals. It is undisputable that Keynes' theories are still relevant today, but they should be interpreted in the light of the circumstances prevailing today. And this is exactly what post-Keynesian economics wants to do. One of the conclusions of this approach is that the exploration of technical and practical questions requires a renewal not only in economic policy but also in economic theory.

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