Reflections on the Prospects for the Introduction of a Clearing Union at the International Level

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Three Main Points

- 1. “Banking Principle” and Flying Money
- 2. Competition, Technology and Clearing
- 3. Can Technology do today what it could not in 1944?

1. Flying Money, Clearing and the Banking Principle

Lien-sheng Yang, Money and Credit in China: A Short History, Harvard University Press, 1952 p. 51-2

6.3 Chinese histories attribute the origin of *ch'ao-pi* or paper money to the *fei-ch'ien,* "flying money," of the T'ang period. The "flying money," also known as *pien-huan,* "credit exchange," was essentially a draft to transmit funds to distant places; hence it may be considered a credit instrument but not money. The history of paper money and that of other credit instruments, however, is so closely woven together that the **"flying money"** forms a logical starting point for our account.

6.4 The T'ang dynasty witnessed large-scale commercial activities, of which the most spectacular was the tea trade between south China and Ch'ang-an, the T'ang capital. The tea merchants wished to transfer profits realized from the sale of tea in north China back to the tea-producing south, but found the shipment of cash both cumbersome and perilous. The same problem of transfer faced the provincial authorities who were obliged to send monetary tribute and gifts to the imperial court. These authorities maintained in the capital liaison offices known as *chin-tsou yüan,* "memorial presenting courts," part of whose duties was to expedite presentation of these gifts. The transfer problem was solved by the institution **"flying money,"** whereby merchants deposited cash with the "memorial-presenting courts," in return for vouchers guaranteeing reimbursement in designated provinces. **Thereby a double transfer of cash was realized without an actual physical transfer**. Hence the picturesque name **"flying money."** Parties who used the device were not limited to tea merchants and the "memorial-presenting courts"; other merchants and officials could make similar arrangements between the two groups or within one group.

6.5 In 811, the government prohibited the use of **"flying money"** by private citizens and in the following year took over the system for its own purposes of forwarding taxes and revenues to the capital. Merchants were allowed to deposit cash with one of the three offices of government finance in the capital and to receive payments in the provinces.

WHAT IS HAWALA AND HOW DOES IT WORK?

Hawala, also known as hundi, is a traditional and informal system of money transfer that has been used for centuries in many parts of the world, particularly in the Middle East and South Asia. It is based on the principle of trust and the use of a network of agents, known as hawaladars, who facilitate the transfer of money between individuals or businesses.

The hawala system operates outside of the formal banking system and is not subject to the same regulations and oversight. To use the hawala system, a person who wants to transfer money, known as the sender, contacts a hawaladar in their local area and gives them the money to be transferred, along with the name and contact details of the recipient. The hawaladar then contacts a trusted hawaladar in the recipient's area and arranges for the money to be delivered to them.

The hawaladars involved in the transaction do not actually transfer the money physically. Instead, they record the transaction in their books and settle the balance at a later date through their own networks of hawaladars. This means that the money is effectively transferred without actually moving across borders.

Overall, hawala is a traditional and informal system of money transfer that has been used for centuries, and continues to be popular in many parts of the world. It is based on trust and personal relationships between hawaladars, and operates outside of the formal banking system. While it has been criticized for its potential to be used for money laundering and terrorist financing, it is also seen as an important and valuable service for those who do not have access to traditional banking services.

What is Netting Off and How Does It Work?

If Party A in Country A has to send Party B in Country B $100, and Party B in Country B has to send Party A in Country A $100, how is this transaction executed? This is a classical case of what could be netting-off. Netting off is a concept where you have two different book sets and one you know, or two accounting books and one, you know, accounting book owes the other person money and this book or this person money, but if they are both the same then you really don't have to do anything. You don't have to make a check to this person, and this person doesn't have to make a check to this person. He will say hey listen if you owe me a hundred and I owe you 100, we'll balance it off as paid and we assume you've paid me, and I've paid you, and everything is equal. So, netting off is basically an accounting trick if you will, its not even a trick, it's just a concept. And netting off is used in payments a lot. So let's say at the end of the day you know there's a money transfer company in Chicago and they have to send $10,000 to Manila. And there is a company in Manila that has to send the same $10,000 or other $10,000 or some other transactions back to this company in Chicago. Well it doesn't make sense for that company in Chicago to send $10,000 to Manila and the Manila company needs to send $10,000 back to Chicago. They can just net off.
There is no payment instrument issue. It's just an accounting balance that balances both entries. It is used heavily in the money transfer world and in the world of banking and payments in general.

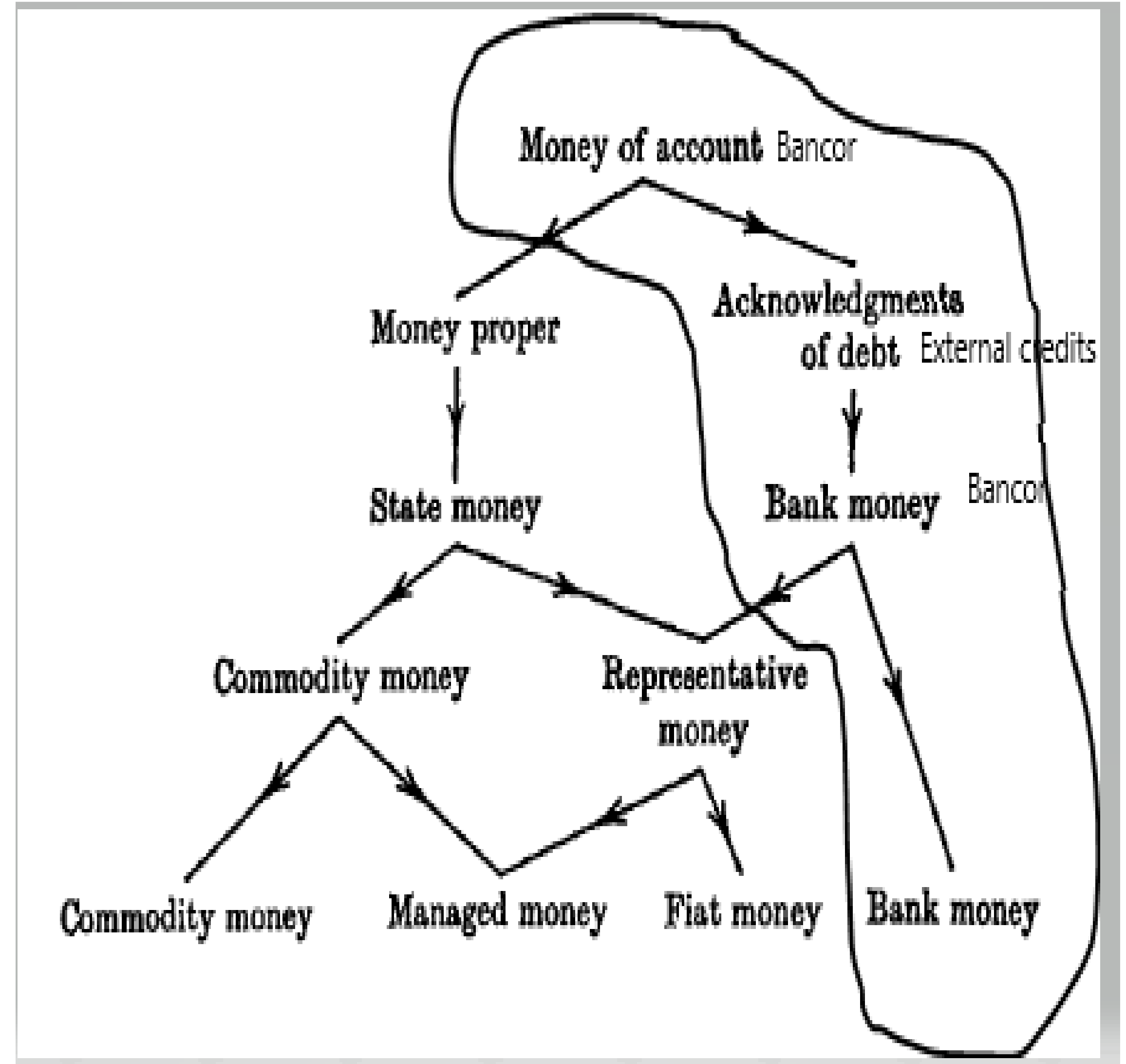
From Flying to Bank money: Imaginary Money and the Banking Principle

"The idea underlying such a Currency Union is simple, namely, to generalise the essential principle of banking, as it is exhibited within any closed system. This principle is the necessary equality of credits and debits, of assets and liabilities. If no credits can be removed outside the clearing system but only transferred within it, the Union *itself* can never be in difficulties. It can with safety make what advances it wishes to any of its members with the assurance that the proceeds can only be transferred to the clearing account of another member. Its problem is solely to see to it that its members keep the rules and that the advances made to each of them are prudent and advisable for the Union as a whole." (Horsefield, 3)

"In short, the analogy with a national banking system is complete. No depositor in a local bank suffers because the balances, which he leaves idle, are employed to finance the business of someone else. Just as the development of national banking systems served to offset a deflationary pressure which would have prevented otherwise the development of modern industry, so by extending the same principle into the international field we may hope to offset the contractionist pressure which might otherwise overwhelm in social disorder and disappointment the good hopes of our modern world." (Ibid., 4)

From ICF to Notes on Ancient Currency to Tract to Treatise

- Keynes worked on International Monetary Reform his entire career from Versailles to Bretton Woods
- He also worked on an alternative to the Quantity theory of Money from the Tract to the General Theory
- JMK in ToM "the introduction of a money of account gives rise to two derived categories—offers of contracts, and acknowledgments of debt, which are in terms of it, and money proper, answering to it, delivery of which will discharge the contract or the debt."
- This leads to "the discovery that for many purposes the acknowledgments of debt are themselves **a serviceable substitute for money proper in the settlement of transactions**. When acknowledgments of debt are used in this way, **we may call them bank money**—not forgetting, however, that they are not money proper. Bank money is simply an acknowledgment of a private debt, expressed in the money of account, which is used by passing from one hand to another, **alternatively with money proper, to settle a transaction.**"



Keynes was not alone

Walras: Theory of Money pp. 80-81

Paper money and compensations

10. The following two complications should be taken into account:

1 The idea arose of representing a part of the entrepreneurs's capital by deeds of property, bills of exchange or banknotes, namely that part which consists of raw materials and products in stock, and to use these titles instead and in place of money. This is *paper money* as opposed to *metallic money*.

2 Furthermore, there arose the idea of settling a certain number of daily exchanges by means of the following procedure. People who have a credit account at a bank buy and sell commodities all day long to or from each other, just paying by means of receipts on their bank called *cheques*.

Between 5.00 p.m. and 6.00 p.m. the bankers meet and *compensate* their clients' debts and credits and each of them supplies in money only the surplus of cheques written over those he received, or obtains in money only the excess of the cheques he received over those he wrote.

Purchases and sales are also made by credit, that is to say, settling them only later on in paper or metallic money. We shall not deal with this type of exchange.

We only notice that the ensuing request for money will be carried out when maturity is reached, whatever the case may be. As for settlements by compensation let us notice that: (1) to pay by cheque one must have provision in the bank arising from a credit account and represented by metallic money or banknotes or by bills of exchange rediscountable in the portfolio; (2) the compensation of cheques between banks, in *clearing houses*, has as a result that **things take place as if all exchangers had the same bank,** in the sense that, where a cheque is brought to the credit of one client and at the same time to the debit of another**, its handing over does not bring any transfer of money with it;**

Commodity Money v. Credit Money

- JMK: Bank Money can become money proper and discharge a debt
  - Imaginary money: Unit of account- from Petty to Einaudi to Schumpeter
  - Clearing Union: netting based on "imaginary" units of account
  - Credits are capable of discharging debt
  - Debts and credits always balance – no need for reserves clearing credits discharge foreign debts
- Walras: You need to settle "only later on in paper or metallic money"
  - Quantity theory from Smith to Jevons to Marshall to Fisher
  - Bretton Woods is a commodity reserve system based on commodity money or national currency based on commodity reserves
  - You need an external surplus to discharge a foreign debt

2. Historical Experience of Clearing

- 1. Private Clearing Systems are ubiquitous in history
  - In the single bank: prehistory
  - Amongst local banks: medieval
  - Across regions of a nation: modern
  - In Nations: Private systems difficult/ Central banks
- 2. International Private Systems also ubiquitous
  - Trade Fairs, bills of exchange, letters of credit, derivative contracts
  - In National Currency Systems:
    - Domestic currency credits do not discharge foreign currency debts
  - Solution: Global denomination of debits and credits
    - Commodity settlement: Gold standard
      - Settlement via external account balance
      - Commercial account solution
    - Credit Creation: Clearing Union
      - Settlement via netting in notional unit of account
      - Automatic Credit Creation: Capital market solution

3. Impediments: competition and Technology

- Quantity theory: transactions costs of bilateral exchange
  - Matching supply and demand
  - Solutions: Walrasian Auction Market/Edgeworth recontracting/Broker dealers
  - Competitive Price adjustment
- Clearing House: transactions costs of multilateral netting
  - Matching debits and credits
    - Technically difficult globally
    - Private/Public interface
  - Global Balance/National Imbalances
    - Automatic Borrowing and lending
    - Global Investment/Development policy

We now have the technology for global netting

- Digital currency
- Will it be public or private?
- Public: CBDC
  - Retail accounts held by central banks – domestic automatic netting
  - Central banks automatic global netting
  - Do we need the central banks?
    - They provide prudent regulation of private bank liabilities and bank reserves
    - If CBDC replace private bank liabilities no need for Central Banks
    - Could be done by National Treasury/Finance Ministries
    - They all hold clearing accounts with the Clearing Union
    - Fits with Keynes/Schumacher/Kalecki proposals
      - Preserves national currencies
      - Allows global investment policies
  - Problems are still political and failure to understand Clearing