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The European Payments Union (1950–58): the Post-War Episode of Keynes' Clearing Union

Adrien Faudot

CERAG, University of Grenoble-Alps, Grenoble, France

ABSTRACT
This article deals with the European Payments Union (EPU), which has garnered little academic interest to this day. The EPU operated from 1950 to 1958. It involved 18 countries and was hailed as a successful experience of European integration. Owing to the international clearing procedures that characterized the institution, the EPU is usually considered to be inspired by the Keynes plan, which was the ambitious reform that the British representative unsuccessfully upheld at Bretton Woods. This article seeks to determine signs of Keynesian thought in EPU rules and the operations of this clearing union. The article also provides an assessment of the Union's economic performance. Additionally, it aims to examine the process that resulted in dismantling the Union in 1958.

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1. Introduction

In the international monetary system, free convertibility of national currencies is the norm rather than the exception.[1] Such a state of affairs invariably leads to a currency competition to the point where only a handful of key national currencies – and their respective payments systems – are retained for the settlement of international trade. Oddly enough, the twentieth century saw a number of alternative monetary arrangements emerge. The 1931–58 period was characterized by restrictions on foreign exchanges across Europe (Battilossi 2000, p. 158), with European central banks channeling foreign exchange transactions. This paved the way for rethinking the international monetary system outside the classical box of currency convertibility, as Keynes did in 1941 when he formulated his *proposal for an International Clearing Union*. This article focuses on the final phase of this period – the European Payments Union (EPU), which operated between 1950 and 1958. The EPU was a unique episode of European integration, which is regularly considered as an application of the Keynes plan at the European scale (Mikesell 1954, p. 481; Strange 1971, p. 63; Lelart 1994, p. 542).

Initially, the EPU was comprised of the following eighteen countries: Austria, Belgium, Denmark, Eire, France, Germany, Greece, Iceland, Italy, Luxembourg, Netherlands,

CONTACT Adrien Faudot adrien.faudot@univ-grenoble-alpes.fr IUT Valence, 51 rue Barthélémy de Laffemas, 26000 Valence, France

[1]This article is based on the archives of the European Payments Union, which are located in the Marshall Building of the OECD, Paris. The author would like to thank the archives department for its services and kindness, as well as two anonymous referees for their comments.

Norway, Portugal, Sweden, Switzerland, Trieste, Turkey, and the United Kingdom.[2] Particular attention should be paid to the EPU for three different reasons. First, despite its economic significance, the EPU has been consistently overlooked in the economic literature. Second, it is a major episode of monetary and financial diplomacy of the twentieth century involving several national actors and international institutions that still exist and continue to shape the international economy to this day. This episode is of particular significance for researchers whose interests lie in the long-term trends of the European economy and European integration process since the EPU represents the formative years of the European integration. Third, as the paper will reveal, the Keynesian 'spirit of the age' inspired the European Payments Union (although the institution mainly focused on short-term strategic matters such as the reconstruction of the Western European capitalist bloc). It is nevertheless noteworthy to find, in the making of the EPU, discussions on a 'European Clearing Union' (the term employed in the early plans), whose principles can be traced back to Keynes' proposal for an International Clearing Union. The experience of the EPU should feature prominently in the research program of the proponents of Keynes' clearing union, which remains a timeless reform proposal (see Amato and Fantacci 2014).

This article investigates the degree to which the EPU reflects Keynes' vision of a clearing union by explaining its operations and rules. It argues that while the influence of Keynes cannot be denied, the EPU owes its existence much more to US dollar scarcity and the eagerness on both sides of the Atlantic to make the Marshall plan more efficient. However, it would be mistaken on the part of Keynesian economists to dismiss EPU as irrelevant. From a historical standpoint, no other international experiment ever gave more credence to the belief that reforming the system of international payments along Keynesian lines was realistic. The article also seeks to examine the process resulting in the dismantling of the EPU in 1958, although the consensus view at the time was that the institution was successful. The next section provides an outline of the Keynes plan. The following section describes the EPU, its historical origins, rules, and performances. The final goal of the article is to highlight the key factors that led to the EPU's termination.

2. A General Overview of the Keynes Plan

The Keynes plan is widely considered as a plan worthy of renewed consideration. Nevertheless, the plan is usually dismissed as unrealistic and impractical, which led a number of Keynesians supporters to relinquish it (King 2013, pp. 498–499). The Keynes Plan is the name given to the '*Proposals for an International Clearing Union*' defended by the British delegation during World War II and at the Bretton Woods Conference in 1944. The first version of the plan was created in 1941, when a great number of clearing arrangements concerning international trade were being debated among economists. Most post-Keynesian scholars endorsed the Keynes Plan, as they prized its blend of full-employment policy at home and international integration. The Keynes Plan is a consistent set of measures; their main points can be summarized as follows:

[2]Trieste, Luxembourg and Eire did not take part directly in the operations while they were members of the currency areas of Italy, Belgium, and United Kingdom, respectively.

(i) A supranational currency performs international payments. It is both a unit of account and a means of payment created by overdraft facilities. Keynes called the unit of account '*bancor*.' It is the only international means of payment, but has no use within national economies. Hence it is the means of payment used by central banks to settle debts to other central banks.

(ii) Alongside the supranational currency, national currencies still exist as the legal tender for payments, but only within a national territory. They have no purpose outside of their issuing economy. The establishment of the *bancor*, to which each participating country has agreed to a fixed but adjustable currency peg, puts an end to barter-like markets for national currencies. National currencies are, therefore, inconvertible, except through *bancor*.[3]

(iii) The supranational currency is issued by a supranational central bank, the International Clearing Bank (ICB), which can be considered as the central bank for national central banks. Each national central bank has an account with the ICB and represents its country.

(iv) The ICB is not only a clearing center which records transactions. It also enforces rules to better coordinate participating economies. It promotes both elasticity and discipline. Regarding the elasticity, *bancor* claims and liabilities can be created by overdraft to address the need for international trade and payments. Countries can temporarily find themselves in surplus or deficit. The whole structure tolerates the disequilibrium by providing overdraft facilities: it credits the surplus country's central bank and debits the deficit country's central bank simultaneously. To avoid excessive deficits and surplus between member countries, it charges interest to countries with balances above some threshold. Deficits countries must adjust by reducing the internal demand for imported goods. Surplus countries must also adjust their internal demand and promote investments and demand-led policies to balance their current account.

The Keynes plan was discussed considerably during the war. For several reasons, the British delegation failed to convince the other nations, and most of the decisions taken derived from the proposal from the US delegation led by Harry Dexter White. According to Randall Hinshaw's account, there were two reasons the American delegation did not accept the British plan. The fundamental objection lay in the fact that as a creditor country, the United States would not join an institution that gave them no control over the magnitude and direction of their financial transfers to debtor countries. The American delegation opted for a more conservative plan, which let the United States choose the direction of the financial assistance according to national political objectives. Hence 'the United States was able to maintain close control over the total amount of assistance, the rate of assistance, and the direction of assistance' (Hinshaw 1958, p. 7; see also Block 1977, p. 54ff.).

[3]Currency convertibility has evolved through time. The founding articles of the IMF define it as follows: 'Each member shall buy balances of its currency held by another member if the latter, in requesting the purchase, represents (i) that the balances to be bought have been recently acquired as a result of current transactions; or (ii) that their conversion is needed for making payments for current transactions. The buying member shall have the option to pay either in the currency of the member making the request or in gold' (article VIII). The articles of the IMF limited convertibility to current account transactions.

The other objection was technical: the United States participation in the Clearing Union might necessitate 'at least a centralization of foreign exchange transactions in order to be able to establish a periodic net position with the union', which would involve 'a great deal of form-filling for individuals and a large number of desk jobs for bureaucrats that could otherwise be avoided' (Hinshaw 1958, p. 7). The problem lay in the fact that, for the United States, 'the possibility of having to centralize foreign exchange transactions appeared to be a serious technical objection to the British proposal' (Hinshaw 1958, p. 7).

War-torn Europe did not raise the same objections. It was ruined and had already enforced an apparatus of exchange restrictions. Western European countries were linked by bilateral clearing agreements since the beginning of the 1930s, involving a machinery of exchange controls whose aim was to save gold and scarce currencies. The entire region was, therefore, a more appropriate field for implementing a sort of regional Keynes plan. Furthermore, after Bretton Woods the Keynes plan and more generally, Keynesian thought had gained influence on both sides of the Atlantic (Jones 1972). As we will see, several economists taking part in the making and administration of the EPU were influenced by the Bretton Woods discussions. The EPU, therefore, had several Keynesian characteristics, which owed much to the peculiar political and historical context of the time.

3. The European Payments Union: Historical Context, Purposes, and Rules

3.1. The International Context: Preparing for the Cold War

The EPU was a central piece to the US-sponsored post-war reconstruction program of Europe. Afraid of the Communist parties in Western Europe and expanding Soviet influence, the US financed the reconstruction of Europe through the Marshall Plan, formally the European Recovery Program (ERP). It was widely recognized that the promotion of full employment, interventionist policies, and high living standards were necessary to prevent the expansion of communism in Europe. Aid, in US dollars, was managed by the Economic Cooperation Administration (ECA), which summarize the rationale behind the EPU as follows:[4]

> To an increasing extent, particularly since 1931, governments have responded to the popular decision to pursue certain economic policies and maintain certain economic decisions at home regardless of developments abroad. In a sense, national states, particularly those most heavily dependent on foreign trade, have attempted to assert their independence of world economic forces. Since the war, the 'classical' automatic method of coordinating national economic policies with all other members of the trading world, no matter what their policies, or lack of policies, has obviously become too rigorous for existing social and political conditions. Governments which, like those of Western Europe, are under the compelling necessity of combatting the external and internal menace of communism, have committed themselves to a policy of reasonably full employment and rising living standards. The rising consumption expectations of their populations and the promises of their opponents impel these governments to insulate their economies from the disruptions generated in neighboring countries or in other parts of the world.

[4]OECD Archives, Economic Cooperation Administration, 'Proposal for the Establishment of a European Monetary Authority', Washington, D.C., December 5, 1949. Orc: 33/29, File EPU/EMA 4.

The European interventionist experiences of the 1930s and 1940s were not analyzed as complete failures or misleading policies. They were adequately justified by the existing material conditions of this age and by the increasing role of the state, which was called to conduct a variety of economic policies: 'Quantitative restrictions, exchange controls and other devices have proven highly effective and have permitted trading partners to exist side by side with widely divergent internal economic conditions.'[5]

It became obvious to the US government that the poor state of European payments after the war compromised the objectives of full employment, rising standards of living, and increased trade. From this point on, Keynesianism was opportunely mobilized to thwart communism, even though it involved concessions by European elites regarding the living standards of its people. The rapid restoration of capitalism in Europe resorted to a reform of the organization of European trade and payments.

3.2. The Previous Payments Schemes and Their Shortcomings

At the end of the war, European countries were linked by bilateral agreements. Europe was faced with two related issues: its dependence on US goods and its lack of US dollar for international payments. The only currency that was fully convertible, stable, and widely accepted as a means of payment was the US dollar. European economies fell short of US dollar supplies, which enticed governments to cut imports in an attempt to save dollars. Therefore, all European countries had a reasonable stake in restraining imports to save dollars. In 1947, 70 per cent of European trade deficits resulted from trade with the United States. Europe needed to expand intra-regional trade and avoid systematic recourse to US dollars. An aggravating factor of anguish for European governments was the official US policy not to extend the ERP beyond 1952.

During the summer of 1947 the 'Conference of the sixteen' (also known as the Committee of European Economic Co-operation, which would then turn into the OEEC) was held in Paris and created the Payments Committee. Subsequently, several countries from Western Europe decided to implement a new organization for intra-European payments. Three schemes were successively implemented.

November 18, 1947 saw the ratification of the 'Agreement on Multilateral Monetary Compensation' between Belgium, the Netherlands, Luxembourg, France, the Bizone of Germany, and Italy. Other European countries had the status of occasional members and could retain the right 'to reject any of the Agent's propositions for compensations' (BIS 1949, p. 203). This agreement established two categories of compensation: automatic compensation and non-automatic compensation. The former was created to compensate debts between member states' existing balances; however, no new credit or overdraft facilities could be created under this category. The second category involved non-automatic compensation. It rested on a mutual agreement between member states to clear debts occasionally on a voluntary basis. The clearing was performed by the Bank for International Settlements (BIS), which would remain the clearing agent for future payment schemes, including the EPU. Its duties were purely technical (BIS 1949, p. 221). While the Bretton Woods agreements planned to terminate the Bank for International

[5]OECD Archives, Economic Cooperation Administration, 'Proposal for the Establishment of a European Monetary Authority', Washington, D.C., December 5, 1949. Orc: 33/29, File EPU/EMA 4.

Settlements due to its pro-Nazi leanings during the war[6], the Basel-based institution was resurrected for the needs of the Cold War.

According to Harry Travers, a European civil servant and member of the OEEC Secretariat, the payments scheme had very important psychological effects, because, for the first time in recent European history, several European countries established common rules for intra-European payments.[7] However, the payments agreement proved a failure, as only 10 per cent of the European debts were settled through its medium. From the standpoint of American civil servants, Europe was effectively wasting US aid, which inevitably led to a renegotiation of the compensation scheme.

A second agreement was signed on 16 October 1948 and labeled the *Agreement for Intra-European Payments and Compensation* (BIS 1949, p. 232). This new scheme covered all OEEC countries. Its key purpose was to facilitate trade through the creation of drawing rights associated with European transactions. However, these drawing rights were established on a strictly bilateral basis. They could not be used for transactions involving a third OEEC country. This limitation arose out of a general mistrust between OEEC member states which had a common insistence on abiding by the principle of maintaining a bilateral trade balance. This behavior stalled the growth of intra-European trade. The Economic Cooperation Administration was worried about the small progress made by Europeans. Europe still had a current account deficit vis-à-vis the dollar area and seemed unable to restore its competitiveness (Banque Nationale de Belgique 1952, p. 6).

The third scheme, which became later known as the *Agreement for Intra-European Payments and Compensation for 1949–50*, was signed on September 7, 1949. In line with Paul Hoffman's concerns[8], the agreement required that at least 25 per cent of all intra-European payments account for multilateral transferable drawing rights, which could in turn be used to settle any debt owed to an OEEC partner. In all other aspects, no significant alteration was made to the previous scheme.

Each new scheme marked an improvement relative to the previous state of affairs, but the result was still disappointing. The OEEC secretariat stated on November 14, 1949, that the scheme for intra-European payments which had just been signed – the third pre-EPU schemes – amounted to 'not more than a provisional system'.[9] This final pre-EPU intra-European payments scheme was set to remain in force until 1950, June 30. The OEEC paved the way for the launch of the institution to be created, this time envisioning all intra-European payments to become potentially transferable. The EPU came into existence in its wake a few months later (September the 19th) following tough negotiations, but covered retrospectively all intra-European payments having occurred between July 1st and September the 19th.

3.3. The Rules of the EPU

Contrary to previous intra-European payments schemes, the EPU made clear that participating countries were committed to accepting overdraft credit as means of settlement for their international trade, up to the limit scheduled with their allocated quotas.

[6]United Nations Monetary and Financial Conference, *Final Act*, Article V, 1944, p. 22.
[7]European University Institute Archives, OEEC-270, 1947-1958, Travers's book draft.
[8]Paul Hoffmann was the administrator of the Economic Cooperation Administration.
[9]OECD Archives, 'Memorandum Outlining a Scheme for Intra-European Payments to be applied in 1950–51 and Subsequent Years, 14th November 1949, SP/DI (49) 6. Orc: 33/26/1. File EPU/EMA 1.

The most Keynesian principle of the EPU was the automaticity of the overdraft provided by the institution to member countries in deficit. 'The Union worked upon the overdraft principle, member countries extending to the Union limited overdraft facilities in their currencies and receiving in return overdraft rights' (Scammel 1962, p. 291). Overdraft applied to international trade was indeed a major feature of the Keynes plan (Rossi 2007, p. 103), inspired by the 'banking principle' that Keynes analyzed in his writings on money and wanted to extend at the international level.

Debts were settled on a monthly basis. It meant that at the end of each month, calculations were made by the BIS. The credit granted by the Union as an overdraft was limited, and unsettled claims resulting from too large trade disequilibria needed to be settled outside the compensation scheme according to predefined rules. Once its quota was exhausted, a debtor country was supposed to settle its debts with gold, unless the EPU grants an outstanding extension of the quota. The quota marked the limit after which the EPU was inspired by the 'classical' adjustment principles of the gold standard. In that, it proves the limits of the Keynesian influence on the EPU. The quota was a disciplinary tool targeting 'fundamental disequilibria'.

> Since liquidity is an essential feature of this Fund, particular care will have to be taken that it is not used for the financing of fundamental disequilibria. However, in practice it is nearly impossible to ascertain what part of the monthly deficits of the European countries vis-à-vis one another is due to short-term fluctuations that are liable to be reversed and what part is a sign of more lasting disequilibria.[10]

The quota accounted for 15 per cent of the visible and invisible trade of the country's international trade. The quota was divided into tranches. When a country recorded a deficit vis-à-vis the Union, no issues arose as long as the deficit was kept below 20 per cent of the quotas (i.e., the first tranche). In this case, the creditor country was credited by the clearing agent on its account without resorting to gold (Table 1). The surpluses beyond this threshold were required to be settled partly in gold.[11] Extra quota surpluses (i.e. beyond the 15 per cent of visible trade) and deficits involved 100 per cent gold settlements. In order to make up for a mismatch between debtor liabilities in gold or dollar and creditor receipts, the United States provided the EPU with a fund of 350 million US dollars. It was a sort of working fund (Bank for International Settlements 1950, p. 242).

With regard to the EPU's unit of account, the BIS had to cope with the various national currencies of the participating countries. The calculations of monthly debts and settlement were made by using the official parities of the national currencies with respect to the US dollar – the 'IMF parities'. Since the conference of Bretton Woods, each national currency had a fixed parity with the US dollar, which was itself tied to gold. For the sake of convenience, the BIS used, for the entire clearing union, a unit of account with a gold content

[10] OECD Archives, 'Memorandum outlining a scheme for intra-European payments to be applied in 1950–51 and subsequent years, 14th November 1949, SP/DI (49) 6, p. 6. Orc: 33/26/1. File EPU/EMA 1.

[11] For example, in the case of a country recording a deficit of up to 60% of its quota, it should compensate the BIS in gold for 12% worth of its quota; the remainder to be settled at a later stage. A creditor country recording a surplus of 60% of its quota would receive 20% of its quota in gold from the BIS; the remaining 40% being turned into credit to be used as purchasing power within the Union. For both creditors and debtors the share of gold in the settlement would increase in proportion to the extent of the trade imbalance. As summarized by US economist Raymond Vernon, 'The underlying principles were clear; there was to be a free credit swing, and then a little bit of pain, and then a little more pain, and then a lot more pain.' Retrieved from 'Oral History Interview with Dr Raymond Vernon, https://www.trumanlibrary.gov/library/oral-histories/vernonr.

Table 1. Share of gold and credit in the settlement of bilateral positions.

	Creditors		Debtors	
Tranche of the qu otas (%)	Gold received from the Union	Credits granted to the Union	Gold paid to the Union	Credits received from the Union
0–20	0	20	0	20
20–40	10	10	4	16
40–60	10	10	8	12
60–80	10	10	12	8
80–100	10	10	16	4
Total	40	60	40	60

Source: the author, adapted from EPU (1951, p. 15).

equivalent to the US dollar. Noteworthy, the EPU's unit of account had no proper name and was simply mentioned in the tables of the official reports as the 'unit of account'. Owing to Triffin's commitment to supporting the nascent European integration, 'it was not considered opportune in 1950 to introduce the dollar sign into European trade' (Bruppacher 1954, p. 417).

3.4. The EPU's top Priority: Facing Liquidity Issues

The EPU addressed the issue of international payments, the main European issue in 1949 (Hirschman 1951, p. 49). The main purpose of the EPU was to avoid the use of US dollars for intra-European transactions and facilitate the growth of intra-European trade. Europe benefited from US aid and, at the same time, needed to discriminate against the US economy. As Hinshaw (1958, p. 12) explained, the EPU would be discriminatory in the sense that 'an effort would be made to remove intra-European quantitative restrictions without simultaneous effort to remove such restrictions against the outside world'. It is noteworthy that the United States authorized – even encouraged – discrimination against the US dollar for maximizing the efficiency of the US dollar aid. The Economic Cooperation Administration had informed the secretary of the OECE that it would prefer that intra-European transactions were conducted in European currencies.[12]

The membership of the EPU involves specific rules regarding the settlement of trade. For example, a creditor country was not entitled to require gold or US dollar for the purpose of a settlement but should accept the currency of other countries. 'Each Contracting Party shall make amounts of its currency requested by any other Contracting Party available to that other Contracting Party, without requiring a settlement in gold or in the currency of any third country'.[13] This constraint was not perceived favorably by the surplus countries. It was nevertheless a crucial pro-growth bias of the Union.

Table 2 shows the relative success of the EPU: 70 per cent of trade was settled through the compensation mechanisms, whether multilateral or through time. Multilateral compensation meant clearing multilateral deficits and surpluses within a month. Compensation through time meant using a current surplus to clear debts accumulated in the past, or a past surplus used to settle the debt of the current month. Only 23 per cent of debts were

[12]OECD Archives, letter from Milton Katz to Robert Marjolin, 22nd June 1949, 'ECA financing of dollar sales within Europe'. File EPU/EMA-90.
[13]Article 8, Agreement for the Establishment of a European Payments Union, 19th September 1950, OECE, Paris, pp. 8-9.

Table 2. Bilateral positions and settlements within the EPU, 1950–58, in millions of units of account.

		Deficits	Surplus	%
Bilateral positions		*23323*	*23323*	*100*
Compensations (multilateral and through time)		16282	16282	70
Effect of interest payments, initial balances as grants, existing resources, etc.		283	184	1
Balances settled in gold and credit, including:		6658	6757	29
Gold	- Settlement of monthly accounting positions	4306	4144	23
	- Repayment of credit	1050	1180	
Credit	- Ordinary (in quotas and extensions)	1117	1315	6
	- Initial balance loans	35	Ø	
	- Special gold credits	150	118	

Source: The author, adapted from EPU (1959, p. 51).

settled with gold. The high level of trade settled through the compensation mechanism suggests that the EPU reached its objectives.

3.5. Keynes' Shadow and EPU Officials

In all likelihood, the particular organizational design of the EPU, as well as the conception of its compensation scheme owe much to Keynesian ideas. In their seminal narrative of the EPU, Kaplan and Schleiminger (1989), who were themselves EPU officials, cautiously hinted at the similarities between the Keynes plan and the EPU design. Several economists and civil servants who took part in the design of the EPU and held a decision-making position within it were, in no small extent, seduced by Keynesian ideas.

Mention should be made of one of the architects of the EPU, Robert Triffin, who was seen as a 'progressive Keynesian' (Maes and Bussière 2016, p. 33) and a 'New Dealer'. Triffin worked for the Federal Reserve, advising Latin American countries between 1941 and 1946, where he became a proponent of contra-cyclical central banking policies as well as exchange controls where required (Triffin 1946, p. 66; see also Caldentey and Vernengo 2018). As of 1947, he devoted his time to the payments schemes to implement in Europe, as he was an employee of the IMF. He was appointed the official head of the newly created Economic Cooperation Administration (ECA) in 1949. Triffin was considered the 'father' of the EPU (Bouvier 1964, p. 179; Triffin 1989, pp. 14–15). He left the ECA in 1951 for an academic career at Yale. Nevertheless, he continued to support projects of regional clearing integration and used the EPU clearing agreement as an example worth following by other regions of the world, such as Asia and the Far East (Triffin 1968, p. 37). Triffin (1960) also advocated implementation of an amended Keynes plan on a global scale.

Two other important protagonists of the EPU were Robert Marjolin and Guido Carli. Marjolin was unofficially the secretary of the conference of the sixteen in 1947. His task was facilitated by the 'Keynesian outlook' that he shared with US and British economists (Seidel 2016, p. 53). In 1948 he became the First General Secretary of the OEEC, a position he held until 1955. An analysis of the EPU would be incomplete without a reference to Guido Carli. Carli was sent to Bretton Woods by the Italian government. He became the Chairman of the EPU Managing Board from 1950 until Von Mangoldt's takeover in October 1952. He remained nevertheless on the Managing Board until the end of the Union (Roselli 2008, p. 99). Carli had a Keynesian reading of the contradictions of the international monetary system. He was continuously preoccupied with the issue of financing trade disequilibrium and he supported the EPU for its ability to offer steady credit facilities, whatever the vagaries of international trade had been (Carli 1953, p. 156; 1978, pp. 413–414).

Hence this period (1950–58) is sometimes regarded as the Golden Age of Keynesianism. In spite of these influences, European economic policies were neither informed nor animated by Keynesian ideas. As policymakers aimed to promote, as early as possible, full-employment and regional integration, they might be judged Keynesian only from the narrow perspective of the expected effects of their policies. It would be erroneous to consider that all the parties involved in the making of the EPU were sympathetic to Keynesian ideas. Keynesianism across nations, as Bateman (2006, p. 274) notes, is 'a more complex phenomenon than the simple triumph of Keynes's ideas over economists and policy-makers'. Faced with either approving a pro-growth, unbalanced public budget or tightening fiscal and monetary policy, most members of the Managing Board felt closer philosophically to the second option (Kaplan and Schleiminger 1989, p. 149). Many economists were concerned about the institutional design of the EPU and its inflationary risks. These individuals could hardly be regarded as Keynesians. The view of these economists was given a great deal of attention in creditor countries, where the credit facilities granted by the EPU caused widespread anguish. Also, we find these criticisms at the US Federal Reserve. Menc Szymczak, a Fed Governor, was concerned about the 'softness' of the first EPU proposal,[14] meaning the possibility that debtor countries would postpone adjustment by using overdraft facilities. Yet, this was the main innovation of the new payment scheme.

3.6. A Neglected Aspect: the Arbitrage Between Rules vs Discretion in the EPU

A groundbreaking feature of the Keynes proposal was that it planned to entrust a supranational institution with disciplinary power over member states. The International Clearing Bank would have been legally entitled to impose charging interest on the debtor as well as on creditor countries. It is one of the main reasons the US derailed the plan during the negotiations, considering it an impingement on national sovereignty. According to Keynes, the high degree of rules over discretion was an important feature of its proposal for an international clearing union, 'perhaps the most difficult question' to settle (Keynes 1980a, p. 116). The final texts adopted at Bretton Woods created institutions (the World Bank and IMF) that were designed according to US needs, not that of Britain. Unlike these institutions, the EPU shared similarities with the Keynes plan: 'In its automaticity the EPU contrasted with the IMF whose working depends upon the discretionary powers of the governing body and in the last resort upon difficult analysis of particular situations' (Scammel 1962, p. 309).

Interestingly, the EPU was an international organization endowed with a prerogative to establish common rules (Eichengreen 1994, p. 887). The EPU set the trend of European technocracy. In 1949, November 14, the OEEC secretariat' memorandum outlining the EPU's mission read the following:

[14]Szymczak, Letter to Hoffman (June 26, 1950) Annex III, Federal Reserve Bank of St Louis.

> The working of a payments system based on the principles outlined above would be a simple matter. … However, for psychological reasons it may be as well to assign to a new institution, which might be affiliated to the OEEC, the functions which would be normally undertaken by the latter. The creation of a separate institution entirely devoted to the problem of intra-European payments, would emphasize the autonomous nature of the system. Moreover, such an institution would perhaps be better able to act as a centre of information, contacts and negotiations, which is of primary importance. This would be particularly the case if it were one of the functions of the institution to make recommendations and to coordinate matters of monetary policy affecting member countries.[15]

Several episodes between 1950 and 1958 gave the EPU Board the opportunity to intervene in national government policies, sometimes opposing the national government in place. This was the case for the first crisis that the EPU had to deal with, the German crisis. Germany was ruined following the war. During the first months of the EPU, it recorded huge deficits with other European countries, and its quota was quickly exhausted. The OEEC secretary opposed the restrictions over import licenses that the German government threatened to impose on German businesses.

The OEEC appointed two experts to assess the problems of Germany within the EPU – Per Jacobson (from the BIS) and Alec Cairncross (chief economist of the OEEC). These experts recommended that Germany be granted an additional credit and in exchange be put through 'a comprehensive stabilization program'. It was considered a success: during spring 1951, Germany became a net creditor vis-à-vis the Union and was able to repay its debt.

4. Why end it There?

Currency convertibility was reestablished on December 27, 1958.[16] Given the success of the EPU regarding its economic performance, why end it? This decision was largely anticipated since EPU was from the beginning conceived as a transitory device for liberalizing European trade and payments. The currency convertibility marked a turning point in European monetary integration and the end of the EPU.

4.1. The Obsession of Convertibility

The EPU rules meant suspending convertibility for participating countries' currencies. However, even before the agreement on the EPU, all protagonists had in mind the medium-term objective of a return to convertibility. As IMF members, EPU countries were committed to complying with article VIII, and implement currency convertibility for residents and non-residents, and for all current account transactions. The EPU was only conceived as a temporary, second-best device. In 1951, Frederick G. Conolly, who represented the BIS, stated that 'The alternative at the present moment is not between

[15]OECD Archives, 'Memorandum Outlining a Scheme for Intra-European Payments to be applied in 1950–51 and Subsequent Years, SP/DI (49) 6, p. 8. Orc: 33/26/1. File EPU/EMA 1.

[16]The European Monetary Agreement (EMA) was signed in 1955 by the OEEC countries and came into effect in 1959 in place of the EPU. A European Fund was attached to the EMA to grant credit to deficit countries to withstand balance of payment difficulties. Unlike the EPU and its automatic rules, credits were entirely discretionary. The monthly settlement institution of the EPU was renewed in the EMA, but became a last-resort clearing system – due to the prominent role of private channels for settlements. For a comparison of the EPU and the EMA, see Jones (1957). See also Triffin (1960).

EPU and convertibility but between EPU and the worst form of bilateralism. But, although universal convertibility may still be postponed for some little time ahead, yet it remains the only goal and objective of all the endeavours in Paris.'[17]

From the beginning, returning to convertibility has been a continuous obsession of the EPU Managing Board. It was a shared objective of all participating countries although some countries came closer to implementing it than others (EPU 1951, p. 38).[18] At the beginning of the 1950s most debtor countries, like France, were not ready for convertibility (Schwaag 1997, p. 45; see also Eichengreen 1993). Even creditor countries within the EPU were concerned about the effect of currency convertibility on trade with the dollar area. In 1953, the question was openly raised at the initiative of Britain. Convertibility raised many practical questions. For example,

> What is meant by convertibility? Can convertibility be reconciled with the maintenance of quantitative import restrictions? Is it possible and does it make sense to limit currency convertibility to current transactions only? Is currency convertibility conceptually linked to fixed rates of exchange? … How would the EPU clearing operate if some countries introduced fluctuating exchange rates? (Kaplan and Schleiminger 1989, pp. 186–188)

Under the EPU scheme, European currencies' transferability was automatically granted within the clearing area thanks to unequivocally fixed exchange rates. The automatic transferability between national currencies is, in principle, opposed to their market convertibility which involves the bartering of currencies on foreign exchange markets. The EPU had likewise created a unique regime of European social accounting. As emphasized in the EPU's first annual report, 'The Union functions as though the currencies of all members can be treated as equally valuable; indeed a payments system based on such an assumption is essential for any multilateral trade system' (EPU 1951, p. 37). To paraphrase Schumacher (1943, p. 154) – a close war-time collaborator of Keynes, every national currency was made into a regional currency. The main issue regarding fixed exchange rates and inconvertible currencies is that exchange rates do not adjust to shifting economic fundamentals. They fail to reflect the country's economic competitiveness. For the same reason, convertibility only begins to make sense with fluctuating exchange rates. The Managing Board's concerns were indeed justified: convertibility makes clearing within EPU rules impossible since it involves perpetual recalculations of the rate at which currencies from different monetary areas are exchangeable.

A first step towards convertibility within existing EPU rules was the gradual 'hardening' of the EPU through the increase of the gold ratio in intra-European settlements. 'Gradually increasing the ratio would lower the brick wall between the EPU and the dollar area, layer by layer' (Kaplan and Schleiminger 1989, p. 191). Any country legally bound to use gold as debt settlement would invariably be pressured into implementing austerity measures in an effort to acquire gold (or US dollar) from another trade surplus – e.g., with the US dollar area – or from international loans (Schwaag 1997, p. 35). The EPU gold settlement ratio was raised to 50 per cent in June 1954, and to 75 per cent as of July 1955. As the gold ratio increased, EPU countries neared closer to free convertibility.

[17]OECD Archives, 'European Payments Union. Address by F.G. Conolly', Oct-Nov 1951, p. 17. File EPU-EMA-88.
[18]OECD Archives, 'Convertibility and Fluctuating Rates', Mr. Rooth's Luncheon Meeting, September 13, 1953, Orc: 43/70. File EPU/EMA-39.

4.2. The Restoration of Foreign Exchange Markets

The demise of the EPU in 1958 gave greater prominence to foreign exchange markets. A step toward their liberalization had nevertheless already been taken with the restoration of the foreign exchange market within the EPU. In 1953, on May 18th, eight countries launched a new 'arbitrage' mechanism of foreign exchange dealings. It was then possible for a (private) foreign exchange dealer to trade currencies as long as they were part of the EPU basket (Balogh 1960, p. 370–371). Under this new scheme, authorized banks in eight member countries 'were permitted to arbitrage with each other for spot transactions in any of the eight currencies' (EPU 1959, p. 20). In October 1953, the permission was extended to forward transactions. Progressively, all EPU countries followed suit (except Greece and Turkey). Most of the compensation has since been carried out through private channels: it enabled the foreign exchange markets 'to reclaim from the central banks much of their own clearing functions' (Kaplan and Schleiminger 1989, p. 348).

The new scheme allowing currency trading was not yet extended to the dollar area (European currencies were still not convertible to US dollars) (EPU 1959, p. 20). This reform from 1953 nevertheless contributed greatly to a smooth transition toward convertibility and modified the European Payments Union, making 'it possible for EPU member countries completely to dismantle their exchange control apparatus so far as non-dollar transactions are concerned' (Hinshaw 1958, p. 24). The central banks' clearing system became an ancillary clearing system, that is, a sort of last-resort clearing system (EPU 1954, pp. 80–2).

Such a restoration of the foreign exchange markets signaled a step backward from the Keynesian perspective opened by the EPU. As of 1941, Keynes championed the channelling of foreign exchange by central banks, such a device being necessary to record transactions and perform the compensation. In May 1944, Keynes (1980b, p. 123) wrote:

> I think the Americans were always rather confused as to whether they wanted central banks to support the private market in exchanges, or whether they wished to concentrate transactions in the hands of the respective central banks. In my view the former is mere conservatism and cuts right across the philosophy of the Fund. With the other alternative, the general structure of the Fund begins to make sense.

The British government eventually pushed for restoration of convertibility. Although the UK was the country of the Keynes Plan, it precipitated the end of the EPU. As Schwaag (1997) emphasized, the case for reestablishing convertibility was not unanimously approved in Britain. However, the City and the Bank of England lobbied for it. In London, the City hailed 'the first revival of the almost lost art of foreign exchange arbitrage' (Brown 1953, p. 75). The Conservatives, who won the 1951 and 1955 general elections, were prone to reestablish Sterling convertibility. Under the new system, Hinshaw (1958, p. 27) added, 'the British could see no need for a clearing union with systematic settlements, since clearing would be effected on a continuous basis through arbitrage transactions, while 'settlement' could be effected at any time in the market by selling surplus holdings of sterling or other convertible currencies for dollars'. The time had come to shut down the clearing union.

4.3. Shortcomings of the Union and National Mismatches

As Harry Travers noted, 'the EPU system was to some extent demolished from within.'[19] Not surprisingly, the Union experienced several crises and was continuously subject to disagreements. Already before the 1950 agreement on the EPU, several disagreements threatened to jeopardize the launch of the Union, especially because of Belgian and British interests. Belgium, was by far the largest creditor nation in 1949 (its surplus with other OEEC countries was estimated at $400 million on the eve of the EPU, according to Scammel 1962, p. 287), due to its steel and coal exports, and was reluctant to enter into a system which would compel it to accept payments in rights to acquire goods from European partners rather than gold or US dollar (Kaplan and Schleiminger 1989, p. 79). Furthermore, Belgium was in deficit with the United States and could not use its inconvertible EPU surpluses to settle its imports from the dollar area.

National interests and international economic divergences evolved over the years (see Table 3). The UK and Germany were pushing to end the Union for different reasons:

> the Bank of England had opposed the EPU since its inception because in the EPU it saw the status of the sterling differing little from that of any other member country. Rightly or wrongly the Bank of England considered that times were ripe for making sterling convertible for non-residents and for terminating participation in the EPU. The German authorities wanted the D.M. to become convertible as the conclusion of their economic 'miracle' and the free market policies to which they attributed the miracle. At the end of 1958 the EPU was precipitously liquidated. Carli (1988, p. 532)

In 1950, Germany had become by far the Union's most indebted country and required urgent action from other EPU member states. However, as of 1951, it became a net creditor and remained one until the end of the Union (see Tables 3 and 4). Germany over time pushed for further liberalization of trade and payments. Kaplan and Schleiminger (1989, p. 320) gives an account of Germans and British being satisfied with the EPU's liquidation. Taking further steps towards the end of exchange restrictions, the time had come for the Deutsche Bundesbank (1959, p. 45) to put an end to 'a chapter of external monetary policy which had begun in 1931 crisis'.

National mismatches were also deepened by current account imbalances. As a matter of fact, the Union was deprived of any mechanism to restore equilibrium between creditor and debtor countries (Kregel 2017, p. 6). Several countries, such as Portugal, Turkey, the United Kingdom and France frequently found themselves in deficit towards the Union, while Belgium and Germany remained on the creditor side (Table 4). Under these conditions, the mismatches made the clearing union unsustainable in the long run, as creditor countries eventually claimed for the final settlement of their account and the termination of the Union. Although, as mentioned previously, the EPU may have appointed experts to advise the governments of member states, it remained powerless in dealing with structural surplus countries. For instance, from 1955 onwards, Germany consistently opposed both inflationary policies and currency revaluations, which would have reduced its surplus towards the Union (Cesaratto and Stirati 2010, pp. 70–71). The balance of payments adjustment was therefore asymmetrical.

[19]European University Institute Archives, OEEC-270, 1947-1958, Travers's book draft, p. 47.

Table 3. Yearly position vis-à-vis the Union, net deficits or surpluses, 1950–58, in millions of units of accounts.

	1950/1	1951/2	1952/3	1953/4	1954/5	1955/6	1956/7	1957/8	1958[a]
Austria	−104	−38	42	106	−103	−6	23	−4	24
Belgium-Lux.	236	509	−33	−55	80	222	14	153	66
Denmark	−68	46	−17	−92	−94	4	−43	10	−1
France	194	−602	−417	−149	115	−180	−969	−576	−317
Germany	−281	584	260	518	296	584	1336	826	350
Greece	−140	−83	−28	−40	−27	40	5	7	−49
Iceland	−7	−6	−4	−5	−2	−4	−3	−3	−9
Italy	−30	194	−223	−210	−225	−125	−94	219	73
Netherlands	−270	477	139	−42	84	−62	−36	86	181
Norway	−80	21	−59	−61	−70	−27	41	−78	−30
Portugal	59	28	−23	−19	−59	−33	−38	−54	−37
Sweden	−59	284	−44	−37	−104	6	111	−30	11
Switzerland	11	158	85	73	10	−66	−83	−189	20
Turkey	−64	−96	−50	−94	−38	−27	−36	−50	−14
United Kingdom	604	−1476	371	107	136	−327	−225	−317	−267

[a]From 1st Jul. 1958 to 27th Dec. 1958. Each financial year started on July 1st. Source: EPU (1959, p. 36).

4.4. The International Context

The shortage of international liquidity was a key factor accounting for the EPU's inception. Throughout the 1950s, Europe successfully handled its problem of international liquidity. The end of the dollar shortage greatly undermined the EPU's *raison d'être*, which precipitated the dismantlement of the institution.

There are two reasons that explain the end of the dollar shortage in Europe. In 1958 Europe had recovered and was regarded as competitive, to the point where it could achieve liberalizing trade and payments with the dollar area. For many European leaders, the EPU had transformed Europe into a fortress, and it was henceforth time to dismantle it. The gradual liberalization of trade – including with the dollar area – further indicated that the European competitiveness was restored. EPU member states were seen as capable of settling payments in gold – as requested by the successive increases of the gold ratio – or in US dollar, the latter being considered 'as good as gold'.

The second reason was linked to the availability of international liquidity and the ever-growing outpour of the US dollar on the international stage, facilitated by the US balance of payments deficits. Scammel (1962, p. 310) wrote that 'the EPU was looked upon as an institution which would wither away once dollar balance was achieved.' US official lending programs and the Marshall plan had allowed immediate postwar reconstruction. This role

Table 4. Debtor and creditor positions at the end of the EPU, in January 1959 (millions of US dollar).

Debtor countries		Creditor countries	
France	484.5	Germany	871.6
Great-Britain	378.5	Belgium and Lux.	130.6
Norway	87.1	Netherlands	102.8
Denmark	65.5	Italy	6.0
Portugal	36.4	Austria	4.6
Turkey	33.7	Sweden	1
Greece	11.9		
Switzerland	11.8		
Iceland	7.2		
Total	1116.6	total	1116.6

Source: The author, adapted from Penglaou (1959, p. 760).

was then taken by the Eurodollar market (Carli 2003, p. 295). 1958 marked the rise of the Eurodollar markets in Europe, especially in London. Since then, US dollars have been abundant and available in Europe. The scarcity of the US currency which had characterized the post-war years vanished.

Concluding Remarks

This paper traces the Keynesian roots of the European Payments Union. At first glance, it is facile to surmise that the British master influenced European policies. Keynes' proposal for an International Clearing Union emphasized the necessity of a *multilateral* union, backed by fixed exchange rates, common rules, regulated foreign exchange, and the coordination of central banks. All these crucial elements were brought within the EPU's scope. The intra-EPU trade was accounted for and compensated through operations of the Bank for International Settlements which also prevented member states from recourse to the currency of a member state. The Keynesian influence on the organization of the EPU should, however, be qualified, as several political threats urged Western Europe to resort to a European clearing union. The main driver of the EPU was the struggle against the deflationary biases of the balance of payments adjustments to avoid a shift of several European countries towards the Soviet camp. Furthermore, it also worth noting that the clearing union was only a short interlude of the twentieth century, rapidly having to make way for trade liberalization, free foreign exchange markets, and a much more classical regime of free convertibility.

The article highlights that the principle of international clearing union was tested with the EPU, with conclusive results. The underlying purpose of this article is to emphasize the clearing union as a source of social and economic progress, which dampens exchange rate instability, liquidity shortage and deflationary adjustments due to the balance of payments constraints. These are still ongoing issues, especially in developing countries. The establishment of regional clearing unions may address the structural shortcomings of the international payments system while promoting regional integration.

The EPU can be compared with the recent experience of regional monetary integration of the Euro – which uses the TARGET2 payments system (Barredo-Zuriarrain and Cerezal-Callizo 2019). As a currency union, the Eurozone is certainly based on a regional clearing system that to the extent insulates Europe from the US dollar's global hegemony – arguably one of its most appealing features. The euro area is nevertheless affected by fundamental flaws. The currency union took no action when it recorded a dangerous level of intra-European disequilibrium in the 2000s. An additional problem has been raised regarding the acceptable policy tools to solve the issue of disequilibrium after the burst of the Euro crisis. On this matter, both the EPU and Eurozone failed to implement non-deflationary and symmetrical adjustment rules. However, the Eurozone proved to be much worse: it has been invariably leaning towards austerity measures borne by deficit countries, as devaluing domestic currency is impossible and fiscal federalism seems to be an elusive goal.

As a rule, a sound regional clearing integration should involve a machinery of oversight on intra-regional payments flows, as well as some degree of government planning to prevent international disequilibrium. In spite of its limitations, the EPU was the result of a fortunate chain of circumstances which draw our attention on this neglected aspect. Reappraising the EPU historical role should encourage us to shed new light on today's European Monetary Union, to say little of the chaotic international monetary system.

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