

# **External Debt Duplication: Effect of a Payment System Aberration**

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This is not to say, of course, that individual or collective behaviour is altogether irrelevant. It is clear, for example, that consumers and producers' preferences as to present and future output have a direct impact on the economy. Yet, individual or collective decisions cannot modify the nature of the laws governing our economic systems, since not one of them is based on or influenced by economics agents' behaviour. Macroeconomic laws derive from the double-entry book-keeping nature of money and are concerned with the logical structure of payments relating to production and exchange. Far from being influenced by individual or collective behaviour, these laws set the structural framework within which economic agents are free to take their decisions and model their society in accordance with a set of ethical, juridical, sociological, and political rules that go far beyond the field of economics proper. (Cencini 2005: 279)

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## **Dedication**

*To Sofie Mélina*

*Thinking of you, as always*

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## Note

Quotes from informal sources (non-academic) are referenced directly in a bottom-of-page footnote such as to discern them from other quotes that originate from purely academic sources and that are identified in the Bibliography.

## Abstract

This work examines an existing anomaly within the system of international payments and shows how it lies at the core of a duplication occurrence that adversely compounds external debt.

It considers the case of the European monetary union. We explain why it would be in Member States' best economic interest, with respect to tackling their external debt and ultimately its sustainability, if efforts were concentrated first and foremost on correcting the faulty infrastructure that currently afflicts the process of international payments through lack of payment finality. We evidence how it would enable current member nations to regain their respective monetary sovereignties and thus all distinct tools of the trade essential to prosperous and sustainable growth, while simultaneously curbing their external debt. The approach advocated in this paper purports an alternative to the present status quo of trying to keep afloat a fragile monetary union despite its inherent problems and risks of irreversible negative impact.

Our analysis finds strong evidence to support the fact that it is primarily this payment anomaly that perversely affects economic growth through external debt duplication, in turn responsible for fuelling and escalating a worldwide financial crisis.

Finally, we bring forward the very fundamental chord responsible for undermining the European 'monetary union' in its current state – the delusion of an authentic single currency. We show how this revelation becomes undoubtedly evident when examining the procedural steps involved and currently in place at the level of international payments. Moreover we demonstrate how, in the presence of this deficient payment system, external debt duplication arises to further exacerbate the financial instability in Member States where the analysis is predominantly relevant. These countries are particularly vulnerable in their powerlessness to rectify the situation given the absence of respective monetary sovereignties that forms the basis of the Union. The ultimate implication is the inability of Member States to embark upon a path of recovery and sustainable long-term economic growth.

The paradox is that, having seemingly joined the European 'monetary union' in their quest for curtailing the unfavourable effects of exchange rate volatility, Member States have become even greater victims amidst the challenging course and devastating consequences of external debt duplication. Our research deliberates the alternative of a viable and positive resolve as could be achieved under the aegis of the Schmitt School's theoretical approach – quantum monetary macroeconomics – also known as the theory of money emissions.

## Introduction

In writing this thesis we endeavour to unveil the merits that permeate the fundamentals of a system of *absolute* exchange rates. We aim to impart its intrinsic virtue of stability in that it is essentially a system of distinct attributes that fosters *stable*<sup>1</sup> exchange rates. Moreover, were it adapted in conjunction with a comprehensive system of international payments all encompassing of a supranational currency that would carry out the payments through the systematic mediation of a supranational institution, this system of *absolute* exchange rates would yield optimal conditions for a propitious financial climate and sound economic evolution.

Still in these modern times, a system of *relative* exchange rates founds the basis of our current system of international payments despite its incompatibility with exchange rate stability and ultimately with the true nature of bank money, a unit of account emitted by banks – via the unique double-entry bookkeeping mechanism – as their acknowledgement of debt.

Unfortunately, it is in a very system of relative exchange rates that a currency is made to identify with a net asset and as such becomes the *object* of final payment, rather than a simple *means* of payment as it ought to be in keeping with the principles of banking money. It thus finds its way to the foreign exchange market, falling victim to speculation and consequent relentless pressures of erratic fluctuations. In fact, it is this resultant pressing environment that became the driving thrust behind countries eventually forsaking the regime of fixed exchange rates, given the otherwise necessary costly interventions of their respective governments. It even incited some to believe in the benefits of currency unions as a more permanent alternative to ensuring exchange rate stability, hence the 1992 Maastricht Treaty that later led to the creation of the Euro – the single European currency. Withal, our research undertakes to evidence the underlining paradox associated with the claim of having established such a currency union.

We expound our reasoning as to why we advocate that a single European currency does not in fact exist. Moreover, we explain why restoring monetary sovereignty is crucially more important than striving to correct a faulty system of international payments such that it *could* deliver a proper single European currency, which currently it falls short of delivering. We demonstrate how European countries (whether Member States of the European ‘monetary union’ or non-members) or any other country in the world, would best progress towards sustainable economic growth were they to retain their own currencies and consort to rectify the anomaly of our current international payment system by adopting a supranational money

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<sup>1</sup> The system inherently prevents currencies from being available for trade on the monetary market. Hence, *by default*, exchange rate fluctuations are reduced (a complete halt would not only necessitate a more universal application but as well, a viable plan to re-absorb currencies which have *already made their way* to the foreign exchange market – on account of our current non-system of international payments which is based on a regime of *relative* exchange rates) without the need for a monetary authority’s costly intervention to otherwise ‘fix’ the exchange rate.

with which to carry out their international financial transactions, and this, via the intermediary of a central counterparty clearing house. We evidence how this undertaking, concurrently with enabling them to rein in their respective sovereign debt levels, would curb exchange rate instability.

The order with which we unfold the chapters of our subject reflects a dual focus. It attempts to parallel the sterling logic that pervades the reasoning of a theory constructed, evolved and continually advanced by economists Schmitt, Cencini et al., whilst staying abreast of the chaos that fuels an ongoing global financial crisis – within which state of affairs – this theory labours to vindicate the tenets of its doctrine.

## **Moving onwards and upwards from a current state of affairs...**

The system of international payments that we advocate is primarily illustrated through a scaled-down application that could easily befit the existing institutional infrastructures at the European Union level. Through tailored modifications of its current structural set-up of payment processes, the European Central Bank could readily take the lead with a new sound and exemplary system of payments at its helm that would serve well participant European countries.

### ***The Euro zone – On the horns of a trilemma***

But how is the current plight of Euro Member States truly envisioned? Is their state of quandary really at an impasse? Not necessarily, it would seem rather more about which of three options to choose from, that is, which has the most promise to lead Euro Land to the Promised Land.

***A first option*** – Feign mellowness and continue to muddle through as though all is sweetness and light.

Amid a deteriorating economic and financial environment, to all appearances this is surprisingly the course currently navigated – nation leaders desperately struggling to keep their respective ideals afloat despite gloomy forebodings that they might actually be riding a tsunami. In all fairness, perhaps they are simply affording the situation the benefit of the doubt in the absence of full and compelling evidence, that is, being unaware of a crucial and fundamental truth – the precarious situation that Member States find themselves in – in having seemingly joined a currency union when *in point of fact* analytical findings point to a very different reality. Put in a nutshell, the very fact that Member States – despite they're having adhered to a 'monetary union' – do not process the entirety of their international payment transactions via the intermediary of the ECB (European Central Bank), means that their inter-nations payments *do not* actually take place within a *unique* monetary system, the latter being devoid of monetary homogeneity. The lack of this homogeneous characteristic has serious implications for the servicing of external debt. 'Monetary homogeneity is what allows for a unique payment of debts; monetary heterogeneity, on the contrary, entails their double payment, since they require a transfer of income and the purchase of the vehicle necessary for the transfer in order to be effective' (Cencini 1995: 7).

In this state of affairs, particularly given the absence of a system of international payments based on a regime of absolute exchange rates<sup>2</sup> which guarantees the *vehicular* use of bank money, the double burden of external debt duplication negatively weighs on Member States' respective economies. Moreover, they find themselves in a tight situation with no individual tools<sup>3</sup> of retaliation with which to counter their parlous economic state, having waived their respective monetary sovereignties.

***A second option*** – Embrace the reality that Member States of the Euro zone are *not* actually part of a currency union and aim to modify the existing anomalous payment system *such as to render* the Euro zone a truly homogeneous monetary area.

This course might appeal the most even if beguilingly. European nation leaders may find it more viable to their idealistic endeavours and less daring than the immediate challenge of ceding monetary sovereignty back to the current Member States.

Though in the short-term the proposal has some remedial aspects<sup>4</sup>, in the long-term it is not without its consequential reverses<sup>5</sup>.

Essentially they would be setting themselves up as a United States of Europe and all reciprocal payment transactions amongst Member States of the Euro zone would be processed in a same manner as it currently is within any national payment system. This in itself would solve their external debt problem and thus greatly improve their long-term prospect for economic growth.

Still, the general state of things would not yield the optimum conditions for nurturing *sustainable* economic progress and sound financial stability that could otherwise be attained if Member States were to brave taking over the reins of their respective monetary sovereignties,

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<sup>2</sup> Our current *non-system* of international payments is based on a regime of relative exchange rates in which each national currency is exchanged against another nation's currency. In this regime, bank money is considered to have intrinsic value, of being an asset per se versus being a simple *means* of payment. Specifically, a system of *relative* exchange rates inherently lends itself to a process of duplication that transforms bank money from a mere *means* of payment into an *object* of payment on account of the fact that this system does not enable a *vehicular* use of bank money. 'The circular use of money requires international payments to be carried out in such a way that no foreign currency is ever entered on the assets side of a net exporting country's balance sheet as the final counterpart of its net commercial exports' (Cencini 2000: 19).

<sup>3</sup> Despite each country's unique individual make-up, the fact is that Member States have given up their respective monetary sovereignties to the central governing of the ECB and hence have lost essential monetary tools with which to govern their economic and financial policies as per their specific needs, e.g. setting their own interest rates.

<sup>4</sup> If the Eurozone *were* an authentic homogeneous monetary zone, the entirety of its inter-nations' (Member States) payment transactions would be carried out through the systematic mediation of the ECB and as such Member States would avoid the double charge of external debt servicing.

<sup>5</sup> Securing the Euro by rectifying the anomaly within the current payment system does not avoid the detrimental effects that some features inherent to a currency union may have. For example, the specific make-up of the union may be conducive to *capital movement* that may – in the long-term – increase the disparity that much more amongst Members States (if we recall the negative consequences that *capital movement* could have on employment) and as such fuel an interdependency that may be unwelcomed, if not unsustainable, by some.

as they once have in the past. The difference with now and then is that they could do so simultaneously with adopting a new payment system<sup>6</sup> that would utilize the Euro solely to process the entirety of the member participants' reciprocal payment transactions – through the mediation of a third counter party institution<sup>7</sup> – whilst all of their intra-nation payments would be carried out in their respective currencies.

***A third option*** – Aim for the sky and go the full nine yards. Restore monetary sovereignty in each of the current Member States and, together with any new European member participant, embark upon a path of sustainable financial stability and long-term economic growth.

This course has veritable potential for nurturing a viable European bond, more realistically than a mere currency union<sup>8</sup> could ever hope to accomplish. European nations would *naturally* draw closer together towards a sound and prosperous union of strong commercial affiliation with mutually reciprocal economic ties, enabling them to build upon an integrated structural framework more conducive to financial and economic stability.

Moreover, Nations would regain the powers of their respective monetary sovereignties along with its associated diversified advantages *without* the destabilizing effect of fluctuations of exchange rates<sup>9</sup>.

Of course, the endeavour that we hereby advocate could not be successively achieved without an accompanying reform of the current payment system at the European level. The current regime of relative exchange rates will have to be replaced with one of *absolute* exchange rates that would assuredly yield monetary *homogeneity* through the issuance of a common currency for member participants' use *in all of and solely for* their reciprocal payment transactions<sup>10</sup>.

In conclusion, the passage from a regime of relative to one of absolute exchange rates would mark a radical change for the European monetary system. Without depriving EU countries of their national currencies, the new structure of payments will gather the different countries together in a common area where transactions among them will all be settled by the use of a common money: the euro. While protecting themselves from capital flight, EU countries will benefit from a mechanism guaranteeing exchange rate stability and will, in the meantime, create the sound premises for an increasing economic integration. This would be achieved, let us say it once again, through the monetary and financial *intermediation* of the ECB, and would invest the ECB

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<sup>6</sup> The idea would be to base this new system of inter-nations payments, for member participants, on a regime of absolute exchange rates.

<sup>7</sup> Ideally, the ECB would assume the role.

<sup>8</sup> Or, any specific *compulsory* unified set of rules or directive forming the basis of any other pertinent future alliances or unions, e.g. fiscal/banking union, which may be even self-defeating in the long run, for certain nations.

<sup>9</sup> That is, amongst European participating members – ridding our economies, universally, of exchange rate erratic fluctuations would warrant a more comprehensive reform of ecumenical applicability. Later on in the paper, we will return and elucidate this ultimate 'sonata' that could potentially be played out in the fullness of time.

<sup>10</sup> Specifically, we intend 'a system of payments in which money is used only 'vehicularly''(Cencini 2000: 18) and through the intermediation of a third counter party institution, a role that the ECB could readily embrace.

with the tasks of creating the euro as a European vehicular money, managing the system of inter-European (gross) settlements, and providing extra investments to less developed countries.  
(Cencini 2001: 18–19)

In the ensuing sections, we advance the arguments pertinent to the thesis's mission via a top-down approach that will deviate intermittently from the intended course such as to reveal the essence of key components and principles fundamental to the theory and various concepts.

The first chapter (Part I) focuses on the principle of monetary homogeneity versus heterogeneity through which it introduces fundamental concepts pertinent to a monetary economy. We evidence the lack of payment finality within the EMU's current payment regime and the resulting payment imbalances, amongst Member States, that fuel an ongoing crisis. We emphasize the *raison d'être* of Central Banks in affording monetary homogeneity at the national payment level and demonstrate how, contrarily, this lacks at the international level. We show how our current non-system of international payments, being based on a regime of relative exchange rates, is unable to solve the problem of monetary heterogeneity at the international level of payments. We explain how this leads to serious payment anomalies with self-defeating effects. Finally, we expose the current sentiment with respect to the very latest state of the alliances be it the EMU or the EU. We advocate a backward step onto a path of 'sustainable retreat' versus continuing on a quest for the Holy Grail – the 'sustainable development'<sup>11</sup> of the EMU. In this regard, we close with an enlightened reflection from Lovelock.

The second chapter (Part II) evokes a macroeconomic approach to our analysis, overall. It recalls the 'template' of bank-money and explains the appearance of money-income into our capitalist systems. The analysis emphasizes the fundamentals of double-entry bookkeeping from which the macroeconomic laws of logical identities are derived. It stresses the importance of recognizing the existence of nations as macroeconomic entities. It elaborates on the concept of double-entry bookkeeping such as to distinguish it from that of double double-entry bookkeeping, which elaboration more clearly evidences the vehicular aspect of bank-money. Finally, it explains the interrelatedness of the balance-of-payments identity to that of double double-entry bookkeeping. In closing we remind of the persistent payment imbalances as revealed in the statistical data covering both the global current and, capital and financial accounts despite the strict adherence to double-entry recording. We suggest that a thorough analysis of international payment flows may help us understand the mystery behind the imbalances.

Chapter three (Part II) revisits Schmitt's (1975) fundamental macroeconomic law of the identity between each economic agent's sales and purchases and considers how it all plays out in an international context by examining the evolvment of international payment flows between countries. That is, given the defective infrastructure of our current international payment 'system'. We evidence a pathological malfunction of the monetary flows implicated in a nation's net foreign borrowing, an impairment that leads to a costly *net* monetary outflow for these nations *whose gain is more often than not, less than its expenditures, in foreign money*.

Chapter four (Part II) provides a brief history on the progress realized to date in understanding world accounting discrepancies. It sets out to unveil them whilst exposing its unique source-cause: external debt servicing. In so doing, it highlights the essence of nations as

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<sup>11</sup> Both expressions 'sustainable retreat' and 'sustainable development' derive from Lovelock 2006: 7.

*macroeconomic entities*, reflected in the very macroeconomic element that characterizes international payment transactions. The ‘missing surplus’ is ultimately exposed followed by the ‘missing capital outflow’. We end with closing remarks regarding the *double* charge of net interest payments.

In chapter five (Part II) we concentrate on Schmitt’s (2014) double charge claim with regard to countries’ external debts. We examine his various, versatile and all in all compatible proofs that undeniably demonstrate the pathological formation of a sovereign debt that adds to that of an ‘ordinary’ debt, the result being that it duplicates a deficit nation’s external debt. We emphasize the importance of net imports’ distinctive payment. We study some of Schmitt’s double-loan arguments starting with his demonstration that net imports are paid both in real and in money terms. Moreover, we consider the fact that they are paid by an income originating from the domestic production of the rest of the world. We observe the additive lien that links the two distinct debts: the ‘ordinary’ and sovereign debts. We then consider Schmitt’s single-loan argument and conclude this last section with a sub-section dedicated to the compatibility of Schmitt’s varied proofs, whether single or double-loan.

Chapter six (Part III) introduces the reform. In particular, we focus on Schmitt’s (2014) single-country reform. The chapter’s first section puts it forward through yet another specifically pertinent demonstration of Schmitt’s *double* charge claim. The second section of the chapter gives a thorough overview of this distinctly independent reform. Several sub-sections ensue, three of which concentrate on the ‘Bureau’, a core internal country department to be established by any reforming country: first introducing the idea or, principle behind it; secondly, its essential functions; thirdly, a brief summary of its mechanism. A next sub-section covers the governing rule that underlines the basis of international exchanges, that of the necessary reciprocal parity of expenditures between trading countries. Two other relevant sub-sections follow: the first lays bare the *double* charge by unmasking the very method by which the parity of reciprocal imports is, today, attained; the second compares today’s method with tomorrow’s method of attaining it, that is, as the single-country reform would accomplish. Finally, we bring the chapter to a close through a final sub-section that provides some correlating evidence and concluding observations.

In chapter seven (Part III) we put forward a conceptual framework that could form the basis of a more elaborate reform – the multi-country reform. We present the fundamental mechanics of a partial system of international payments, based on absolute exchange rates and operating multilaterally with a real-time gross settlement mechanism. The reform that we advocate is illustrated through a scale-down version of a more comprehensive reform that could, ultimately, encompass all world countries. Its initial application at the European level could, admittedly, easily benefit the institutional infrastructure the likes of the ECB, if tailored modifications of its current payment system were undertaken. Still, our study-module consists rather of a diligently chosen group of seven European countries, non-Euro zone members that could potentially more willingly embrace the multi-country reform, as well as realistically deliver a successful result from their endeavour. The reform that we elaborate aims at achieving the same beneficial results, for participant member countries, as would be obtained through Schmitt’s single-country reform. It implies, however, the need for a decisive political will to create a world/European intermediary settlement institution that would be complemented with its own currency standard with which to mediate the new system’s overall payment transactions.

Finally, in chapter eight (Part III) we conclude our study with a retrospective view on the state of affairs and reflect on how countries could choose, or not, to move it along on a more progressive and sustainable path.

## **Part I    Anent monetary macroeconomics**

# 1 Some specifics on the realities and effects of a monetary economy – a monetary economy of production within a nation’s boundary, a monetary economy of exchange across it’s borders

## Introduction

We introduce in generalities and on the whole, fundamental concepts of a monetary economy that we will later elaborate more specifically in ensuing chapters.

## Fundamentals underlying the mechanics and settlement of intra-national economic transactions

Let us consider the underlying principles governing the general scheme of a payment system as it currently operates within nations, and as it would likely happen for Member States were they to actually form a one-nation Confederacy.

Starting with *bank* money we remind of its capacity for providing ‘the objective numerical measure of economic transactions’ (Rossi 1997: abstract) and of its distinctive nature as a virtual means of transport essential for distributing national output amongst a vast array of economic agents (national agents). The modern paradigm of money facilitates a clear and logical understanding of the genesis of money’s purchasing power ‘by relating it to the production process’ (ibidem) and in doing so, it ‘gets rid of all kinds of subjectivistic approaches to monetary economics’ (ibidem). Rossi insightfully explains it in just a few words: ‘[b]eing the result of the monetization of total costs of production, money-income is the avatar of real output, its factual *alter ego*’ (ibidem).

Now money derives its provenance from the banking establishment, hence the contemporary reference to it as *bank* money. But more pointedly it is by observing the distinct manner by which banks emit it through double-entry book-keeping, that we can logically perceive that the banking system can’t but issue a mere *means* of payment that acquires its distinguishing dimension of *real* money – money-income – through the wage earning process. It is through this unique process of labour remuneration that income is created and takes the form of a bank deposit. This brings to the fore the *double intermediary role that is carried out by banks*, that of ‘issuing the vehicular (nominal) money required for the circulation of output, and of lending the income (real money) generated by production and entered by them as a bank

deposit' (Cencini 1995: 3). In fact, it is via this very channel<sup>12</sup> that we can conceptualize that 'money can simultaneously be a numerical entity and be endowed with positive purchasing power' (ibid.: 3).

Issued as a mere means of payment (accounting unit), bank money cannot be considered an asset or liability per se. Rather it is an asset and a liability *at the same time, the single neutral emission of which*, has the primary<sup>13</sup> effect to enumerate current output and render it 'homogeneous by providing it with a purely numerical expression' (ibid.: 21).

This twofold *asset and liability* aspect of bank money *implies* that it is naturally drawn back to its point of emission, *instantaneously*, upon being issued. 'Fundamentally, bank money is a pure unit of account with no axiologic dimension. Moreover, its dual nature of asset and liability prevents it from moving except in a circular way. The instantaneous flow of money to its point of origin, therefore, is not a condition of equilibrium but a logical imperative' (ibid.: 18). This is an important feature of bank money, the fact that it never truly ventures from the point it originates from, hence from the very banking establishment that issued it. Understood for all is worth, this boomerang effect should help home in on other issues key to the arguments that will be advanced throughout our work.

As indicated earlier, money-income comes into being in the form of a bank deposit – from that very instance banks intercept as *financial* intermediary between *initial*<sup>14</sup> income holders and enterprises (firms). From the moment *income appears as a bank deposit deposited* by initial income holders it is immediately lent to the associated production enterprise (the firm). Referring to income holders simply as IH and firms as F, Cencini asserts '[t]he fact that the bank owes IH what F owes the bank is proof that the credit granted by the bank to the firm is backed by income holders. The payment of wages does not presuppose the existence of a positive income, for the very reason that it gives rise to a new deposit that allows for the financial covering of the whole operation' (ibid.: 23). So through its **monetary** intermediation, banks mould money and output into income that they then transfer from the initial income holders to the enterprise in their role as **financial** intermediaries. The end product being 'that the final object of the firm's debt is a sum of real money (the income lent to it by IH) equivalent to that earned by the owners of the bank deposit' (ibid.: 24). This should drive home the fact that money – bank money – a mere vehicular unit of account, operates in a very circular manner never ever deviating or existing from its circular loop. In one instant, it is 'simultaneously created, associated with current output and destroyed, in a circular movement that leaves a book-keeping mark defining the value of currently produced goods and services' (ibid.: 21).

On top of their initial financial intermediation linked to the *production*<sup>15</sup> firm, banks expand on their role as **financial** intermediaries by facilitating the transfer of initial income holders' income to other economic agents who may be in need of a loan and have the ability to

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<sup>12</sup> That is, it is *through the co-existing occurrence of this dual role of monetary and financial intermediary*, as carried out by banks, that we can precisely understand how income is introduced to our practical world.

<sup>13</sup> Cencini states it very succinctly. 'The first intervention of banks, therefore, consists in issuing the numerical units required for the monetization of current output. It is only if they are monetarily defined that real goods acquire the common characteristic that places them in a unique 'space of measure'' (ibid.: 21).

<sup>14</sup> Wage earners.

<sup>15</sup> Our reference here is in relation to the credit of workers (initial income holders) lent to firms, via banks' financial intermediation, for the financing of initial production.

secure<sup>16</sup> their loan request. This enables enterprises to sell their current output and repay their initial debt with the bank, even before the *initial* income holders decide to expend their *earned*<sup>17</sup> deposits.

In sum, on the costs of production, we are reminded by Cencini that it is through the very payment of wages that a *new* income comes into existence. Moreover the remuneration of the workforce – thus being able to finance the integral costs of a new production – seals manpower as the sole factor of production. Finally, let us ponder the following observation, incisively encapsulated by Cencini.

The financing of production takes place through the intermediation of banks, but does not have its original source in the banking system. Banks act as intermediaries, transferring to the debtor what has been deposited by the creditor. The income generated by production is instantaneously deposited and lent to firms, whose costs are covered by the credit granted to them by workers and by all the other economic agents who take their place as income holders.  
(Ibid.: 24)

***On the cardinal raison d'être of Central Banks and the distinguishing difference between the monetary and the financial facets of payment transactions***

After all is said and done, that is, with respect to the genesis of bank money and money-income and how the latter's formation begins with production whilst the former has its root source in the banking establishment, and having analysed other fundamentals pertinent to secondary-level banking, we turn our attention to Central Banks and their key role<sup>18</sup> in establishing 'a common 'space of measure' for all the secondary currencies issued by the commercial banks of a given country' (Cencini 1995: 4). We observe how this role is what takes care – within nations – of what Keynes referred to as the *transfer* problem<sup>19</sup> at the international level (Cencini 1995). *At the national level, owing to the existence of a Central Banking system* that, through its multilateral clearing, conveys monetary homogeneity to the currencies of 'secondary issuing banks' (Cencini 1995: 4) – currencies thus 'pertain to the same monetary system' and as such payment transactions<sup>20</sup> 'only require the payer to find the necessary amount of real income to transfer to the payee' (ibid.: 5). That is, the only 'problem' that underlies payment transactions, at a national level, is of a *financial* aspect contrarily to a monetary one. This is because *national* money is of a *same central* monetary system and the monetary homogeneity that thus pervades it, provides for the proper vehicular

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<sup>16</sup> Meaning that the agents have the necessary solvent profile to back and thus eventually repay the credit granted by the bank.

<sup>17</sup> Earned as per the remuneration of their labour through the production process.

<sup>18</sup> As per his explanation, we are reminded that 'by acting as a multilateral clearing house between secondary banks', a Central Bank, 'allows for the homogeneity of the currencies issued at secondary level' – that is, it allows for the currencies 'of secondary issuing banks' to be drawn into 'a unique mass called national money' (ibid.: 4).

<sup>19</sup> This *transfer* problem is one that comes up at the international level whereby payments between nations prove more complex than simply securing the necessary financing which is owed to international counterparts given the countries have the added problem (still today) to find the proper medium with which to convey it to them. (See Cencini 1995:5)

<sup>20</sup> Or said another way, payment finality.

medium needed to transfer income from the payer to the payee – hence the transfer problem is automatically or put another way, naturally circumvented.

Cencini explains *just how* ‘our national banking systems’ (ibid.: 5) effectively solve – at the national level – the monetary aspect or ‘monetary problem’ of payment transactions.

The kernel of the analysis is again the distinction between the monetary and the financial aspects of every transaction. Being a purely numerical means of exchange, money should be made available free of cost to the economic agents who need it to convey their payments. And, surprisingly as at first sight it may appear to be, this is precisely what happens at the national level. What the debtor needs in order to pay for its net real purchases is a positive amount of income, the money necessary for its transfer to the creditor being circularly issued by the banking system. If we examine the accounting relationships involved in the transaction, we can easily verify that the payment amounts to the transfer of a bank deposit (income) carried out on behalf of the debtor. The vehicular money required for the transfer is instantaneously created by the bank of the payer and destroyed by this same bank as it flows back to its point of origin.

(Ibid.: 5)

This ‘monetary problem’ – the *transfer problem* of payment transactions – takes on a particular meaning and importance at the international level. Contrarily to how things transpire at a national level to take care of the transfer aspect of payment transactions, at the international level, there is no *international banking system* currently in place to provide the international vehicular money or, medium, necessary to properly carry out payment transactions<sup>21</sup>. This fact leads to serious payment anomalies as in the particular case of a nation’s payment of net interest on its external debt. We will later explore this in greater

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<sup>21</sup> That is, through a system of *absolute* versus that of relative exchange. Specifically, an *international clearing institution* is necessarily needed to enable the *homogenization* of the different country currencies *by monetizing* – through the intermediate vehicular medium of a chosen international currency – *the international payment transactions*. Moreover, this monetization should occur through an operation of *absolute* exchange. In this regard, Cencini recalls Schmitt’s reference in what the latter considered an absolute exchange. ‘Having no value as such, money leaves its place to real goods, and in its circular flow defines what Bernard Schmitt has called an *absolute exchange*, that is, an exchange whose two terms are money itself’ (Cencini 1995: 207). Cencini elaborates on this definition by explaining that ‘[u]nlike relative exchange, which requires the presence of two distinct objects, absolute exchange refers to a unique object’. He adds that ‘money takes the place of the physical product and becomes its numerical form, so that the exchange between money and output defines their integration: money and output become the two complementary faces of a unique object’ (Cencini 1995: 16). Analogously, at the international level, the key purpose of having an international currency would be so that it could provide the necessary homogeneous transfer zone (‘the common denominator of domestic currencies’ as referred to by Cencini 1995, p. 263) through which the national output of relevant trading countries could ultimately exchange the *shell* of their respective vehicular money. Said another way, countries would literally exchange the original country-currency representation of their *national* output with that of *another* country-currency (e.g., a trading partner), through an *absolute* exchange that according to Schmitt implies an ‘exchange whose two terms are money itself’ (Cencini 1995: 207).

detail. For now, let us primarily remember that at the international level, nations become involved on behalf of their residents ‘directly from the fact that international payments require the conversion of domestic currencies into foreign currencies. A national money is a country’s acknowledgement of debt. It is therefore immediately clear that a resident’s foreign payment entails, if carried out in domestic money, the external indebtedness of his country. In almost every case, however, countries are reciprocally involved in the payments of their residents, so that no payment by the countries themselves is actually required on top of that carried out by their residents (Cencini and Schmitt, 1991)’ (Cencini and Citraro 2012: 280–281). That is, between nations, ‘no net macroeconomic payment occurs’, rather ‘macroeconomic payments’ are ‘reciprocally balanced’ (ibid.: 281): the debtor country pays for *its residents’* net commercial imports (on their behalf) *providing* that the creditor country pays for the net importing country’s financial exports, as sold by the debtor country’s residents. It is important to understand that payment transactions are actually carried out by the trading nations’ residents themselves ‘as it is they who import (goods and services) and who export (financial assets); their country provides only the institutional framework for their transactions’ (ibid.: 281). Specifically, it ‘merely plays the role of a simple intermediary’ (ibid.: 281) *on behalf of its residents*.

There is however, as indicated above, one very transaction that *does* evidence a *net* macroeconomic payment: a nation’s payment of net interest on its external debt features an *unilateral* transfer which inherently lacks payment reciprocity and this combined with our faulty payment regime of *relative* exchange, causes it (nation) to ultimately suffer an unnecessary doubling cost of its external debt servicing. That is, *the country’s macroeconomic payment on behalf of its residents*, actually *adds* to the latter’s microeconomic payment. Cencini and Citraro 2012 explain below. In their stylized case, country A represents the developing net commercial importer nation (debtor country) whilst R represents the Rest of the World (creditor country).

In fact, as shown by Schmitt (2000, 2004, 2005, and Chapter 9 in this volume), there exists a unique case in which the macroeconomic payment of a country adds up to the microeconomic payment of its residents: the payment of net interest on the country’s external debt. Given that the payment of net interest entails a unilateral transfer from the debtor country to the creditor country, the lack of reciprocity precludes the balancing of the macroeconomic payment of A by an equivalent macroeconomic payment of R. The fact that country A’s net interest is paid both by its residents and by the country itself would have no consequence in the joint balance of payments of A and R if the macroeconomic payment of A were entered both in A’s and in R’s current or capital and financial accounts. Yet this is not what happens, as the payment of A benefits the whole of R and not any particular resident of R. A’s interest payment amounts to a decrease in A’s official reserves caused by the call to restore the level of A’s internal resources, now decreased by the payment of net interest entered in A’s current account. The macroeconomic payment of A’s net interest is entered in A’s balance of payments but goes unreported in R’s balance of payments. It is the macroeconomy of country R that benefits from A’s second interest payment, but this gain is recorded neither in R’s current account nor in R’s capital and financial account.  
(Cencini and Citraro 2012: 281–282)

Cencini also provides a good observation of the *effect* of this net macroeconomic payment with respect to the *double burden* on external debt.

We thus get the impression that external debt servicing takes place through a mechanism which reduces it to a self-defeating process. The analysis confirms this astonishing result: the servicing of external debt (interest and principal) within the key-currencies standard system can only take place through a double payment. This double payment is all the more surprising in that it never occurs at the national level. The servicing of a debt between residents of different regions of the same country requires only a single payment: the transfer of positive income from the debtor to the creditor. However, it has to be kept in mind that inter-regional payments take place within a single monetary system. Monetary homogeneity is what allows for a unique payment of debts; monetary heterogeneity, on the contrary, entails their double payment, since they require a transfer of income and the purchase of the vehicle necessary for the transfer in order to be effective. The point is that international debts have to be serviced, cumulatively, by the residents who have incurred them and by their own countries. The institution of a supranational Bank acting as a monetary intermediary between countries would avoid the double payment, since the Bank would prevent the purchase of the vehicular money by the indebted countries. Until then, external debts are bound to be serviced twice, the payment of the residents having to be backed by an equivalent payment of their nation.

(Cencini 1995: 7)

## **Between the devil and the deep blue sea**

By going as far as providing for a ‘single’ currency for some of its Member States, the Treaty on European Union (1992 Maastricht Treaty) has put the cart before the horse, causing a chicken to be hatched without the egg.

The reality of facts, twisted as they may be, has it that the Euro zone’s ‘unique’ currency is unable to convey ‘internal homogeneity’ (Cencini 1995: 124) to ‘the sets of national goods and services’ (ibid.: 124) of its Member States, the Euro lacking the necessary authenticity of a currency originating from one specific national economy. Specifically, given the current state of the *non-national* system of payments<sup>22</sup> that characterizes its banking infrastructure, the *zone* is neither with a unique *national* currency nor ‘with a common unit of measure capable of collecting national currencies within a unique monetary ‘space’, which would simultaneously allow for their sovereignty and their homogeneity’ (ibid.: 124).

To some who are already grasping the import of our meaning and thence accepting, even in the slightest, that the Euro zone is without a unique currency, the situation might feel like being faced with two equally undesirable choices: from one standpoint, the lure of the devil<sup>23</sup>

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<sup>22</sup> Or, if observed as well from yet another perspective, given the current state of the *non-system of international payments*...

<sup>23</sup> “Keep the Euro and become a United States of Europe...” a rustling and enticing whisper ostensibly reverberates.

seemingly selling the easier<sup>24</sup> of the two alternatives or, from another standpoint, the choice of having to brave the unknown adventures of a deep blue sea.<sup>25</sup> Umm... Affaire à suivre.

## Monetary homogeneity versus heterogeneity

*Extra-national* payment transactions need a payment system infrastructure<sup>26</sup> that operates through the mediation of a truly international clearing institution responsible for issuing its very own international monetary unit that, via an absolute exchange, would be up to ‘the task of making the sets of national goods and services reciprocally homogeneous, their internal homogeneity being already provided for by each national currency’ (ibid.: 124). Currencies of different countries are intrinsically heterogeneous by the mere fact that they are emitted by different central banking systems. ‘The solution to monetary heterogeneity requires the intervention of a supranational Bank that is given the task of issuing a currency which, through absolute exchange, acts as a catalyst with regard to national currencies’ (ibid.: 185).

Inserted into an exchange economy, international transactions require the intervention of money as simple vehicular intermediary between national outputs which have already been fully monetised in their countries of origin.  
(Ibid.: 124)

When concerned with monetary systems at the *national* level we speak of production economies but when referring to an *international* monetary system our meaning relates to an economy of exchange. This is so because there does not exist an international production that we can say is produced in an international zone, rather production associates – always – with the currency that monetises it. ‘Commodities produced in the USA, for example, are monetised in dollars, and it is precisely this monetary identity which defines their origin. If the same goods and services were monetised in marks<sup>27</sup>, they would be part of German national output despite being materially produced in America’ (ibid.: 123).

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<sup>24</sup> As may appear to some, at least in the short run.

<sup>25</sup> Venture a daring return to their respective sovereignties, whilst simultaneously embracing a massive reform of their current ‘non-system’ of international payments.

<sup>26</sup> Based on a regime of *absolute* exchange rates rather than on a system of *relative* exchange rates as per the current state of affairs.

<sup>27</sup> At the time of author’s writing (Cencini 1995), Germany had not yet abandoned its traditional currency for the Euro – the official monetary unit of the European Monetary Union. It adopted the Euro as its basic unit of money in 2002. Although this may seem a par for the course fact, it does bring a more important point to the fore: the *logical* impossibility for the Euro to monetize the *national* production of any one specific country of the Euro zone given the underlying foundation that formed and continues to characterize the *alliance* of Member States versus their amalgamation into a one-Nation country. A clear paradox comes to light: Member States are *in limbo and actually sitting on the fence* – not officially united into an integral Nation that they can call their own, yet having forfeited their respective monetary sovereignties, *technically* there should not be any national production to speak of that the Euro, their ‘unique’ monetary currency, can monetize, *according to what it exactly means to monetize*. Such is the absurdity that characterizes their alliance. It highlights the very paradox of the situation – the Euro can’t *logically* be a unique currency responsible for monetizing the *national* production of a single, *non-existent for that matter*, Nation of which

Production is very much an *affaire of Nations*, that is, in the strict sense of the *national* money which monetises it. Now, the other side of the coin is that a Nation's currency (*national* money) derives its purchasing power from the production of goods and services it is linked to, its very object. Without it, it is a mere unit of account of no value per se. As Cencini reminds us '[s]ince the science of economics began, money has been defined as a unit of account and its main task identified as the measurement of produced goods and services' (ibid.: 1). The picture which can't but emerge from obscurity here is that of the Euro – *what then is it truly*, this monetary unit of the European Monetary Union (EMU)? It is difficult not to answer: "In its current state? It is nothing but a mere currency appellation with no proper object to call its own, given the EMU is not a proper nation, per se". It simply does not fit the bill of a *unique* currency of a *unique* monetary economy (e.g. as is issued by the Central Bank of a nation)<sup>28</sup> neither does it have the distinguishing quality of a supranational money as would be issued by an international clearing institution capable of *final*<sup>29</sup> inter-bank clearing through a system of *absolute* exchange rates, given the manner in which international transactions are currently being carried out amongst its Member States.

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none of the Member States actually form an integral whole with. In other words, what is currently called *the Euro* is nothing more than a soubriquet to designate *the currency*. Take heed, it has not a proper output associated with it. That is, as it is currently utilized within the Member States themselves, *as though it was a genuine national money* rendered homogeneous via a single Nation's central banking system 'capable of gathering the various secondary banks in a common area' (ibid.: 184). Purchasing power originates from a national money's association with current output as is produced within a national system of a specific monetary sovereignty – the Euro, in its current state, has no purchasing power or even potential for it, it is simply an empty denomination. However, the fact remains that production *is* 'monetized' in each country of the Euro zone. But ultimately, first principles will remind us that there are only two possibilities for the said Euro: either it exists as the EU *unique* currency, in which case the EU would be a unique and homogeneous monetary area and the Euro *would* monetize the production of this area or, it does not exist, in which case only national currencies, national euros, *veritably* monetize national productions.

<sup>28</sup> Currently the ECB processes only official payments (between Member States, though alas, remiss of payment finality), it does not act as clearing-house with respect to the private payments between residents of different Member States. As a result, the Euro does not meet the necessary condition of a *unique and fundamentally homogeneous* money characteristic of *national* monies and which characteristic is the end product of inter-bank clearing as – comparatively – is enabled in individual nations via their respective Central Banks. This means that in each of the Member States what we *still* have, realistically, is a *specific* money. If you will for simplicity's sake, here onwards and when fitting, the thesis will refer to them as different country euros, e.g. French euro, Italian euro, German euro and so forth. (This reference will be further elaborated as the work progresses.)

<sup>29</sup> 'In fact, Euroland countries still have heterogeneous currencies, although the latter all have the same denomination since they were encapsulated in the European Monetary Union (EMU). Certainly, EMU is a misnomer, since to date there is no currency union across the area, which notably lacks a final-payment mechanism for the European System of Central Banks (ESCB). It is indeed the lack of payment finality between any two EMU member countries that has originated (observed and non-observed) soaring imbalances within the EMU, particularly since the bursting in 2009 of the systemic crisis that is devastating the euro area at the time of writing' (Rossi 2012: 221).

Every national economy has at its disposal a vehicular money, issued by banks, and a product associated with it. Purchasing power is thus accounted for as the result of this association between numerical form (money) and real content (output). Since no specifically international production exists, it is obviously impossible to define a purchasing power of extra-national origin. Even if a true international money existed (and, thus, also a supranational bank capable of issuing it), we would have no product to autonomously fill it with. If we want to go on speaking of international income or purchasing power we have to remember, therefore, that its existence is related to exchange only, which means that it has to be derived from national productions (which are the unique source of income at the planetary level).  
(Cencini 1995: 123–24)

If there is one fundamental element that underlines monetary sovereignty it is the economic *raison d'être* that it affords nations. As Cencini explains 'it is through the workings of Central Banks that nations come into economic existence defined by their own monetary systems. A country can enjoy its monetary sovereignty only if it benefits from the services of a Central Bank which, by acting as a multilateral clearing-house between secondary banks, allows for the homogeneity of the currencies issued at secondary level. The banking system adopted by our countries develops at two interrelated levels, the first being made up of secondary issuing banks, and the second of a Central Bank which takes them under its aegis, allowing for their currencies to become part of a unique mass called national money' (ibid.: 4). This *homogeneity* is precisely the vital element that the ECB, in its current role and workings, is unable to secure. Unlike a *national* Central Bank it does not act as a multilateral clearing institution for the entirety of the *inter-nations* payments transacted amongst Member States. Matter-of-factly, much of the 'clearing' function is decentralized to the respective Members themselves who carry them out through different bilateral payment arrangements. In not fulfilling the role of an authentic multilateral clearing-house, the ECB misses out on the opportunity to transmit in-house monetary homogeneity to the currencies issued at the national level of each of the individual Member States. The Euro is thus not the homogeneous end product of the *heterogeneous* currencies issued by the respective nations, Members of the Union. Oddly enough, it is these *heterogeneous* antiquated currencies that are still at play, only, under a *nom de plume* 'Euro' or perhaps more punningly fitting, a *nom de guerre*, given the *dolour* it has increasingly come to be associated with throughout the escalating financial crisis. The Euro is not a unique currency in the true sense of what it means to be unique. The ECB fails in the task of metamorphosing it into a *homogeneous* money, unique to Member States. The lack of payment finality, that is witnessed in the 'Eurosystème' or as also referred to by Rossi 'European System of Central Banks (ESCB)' (Rossi 2012: 221), confirms this. The evidencing of this missing 'final-payment mechanism' (ibid.: 221) – that according to Rossi (2012) became more apparent at the onset of the 2009 euro-area financial crisis – points, by its very self, to the fact that the Euro is not being processed, *as though it was a unique currency of a unique monetary system* as would be characteristic of a national money<sup>30</sup>. Otherwise, monetary homogeneity would prevail and payment finality would naturally ensue. But this is evidently not the case. This then, would thus appear as yet another strong piece of evidence supporting our claim that the Euro is **not a unique currency**. Neither is the Euro capable, in its current disposition, of acquiring purchasing power for the reasons relating to national output – as outlined earlier, income (purchasing power) can only derive from a production originating at the national level and monetized by a unique

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<sup>30</sup> Or, of a true currency union, for that matter.

*homogeneous* national money. As Rossi 2012 reminds in recalling the expression of Padoa-Schioppa 2004, under its present circumstances the Euro is ‘‘a currency without a state’ (Padoa-Schioppa, 2004, p.35)’ (ibid.: 236). It is but a new name replacing now obsolete ones such as the once almighty mark. The Euro has not replaced the former currencies of each of the Member States: the individual countries, Members of the Union, are still with each of their respective ‘ancient’ currencies and this fact will hold true until such time as the Member States unite into a United States of Europe, a genuine nation. Then again, Member States could choose instead to ‘return’ to or more factually put, to *keep* their respective original currencies<sup>31</sup> and simply unite under the aegis of a truly unique monetary *zone*. Doing so, conjunctionally with adopting a newly structured system of international payments<sup>32</sup>, *based on a regime of absolute exchange rates*, and complemented with a true international clearing-house and common international money, would not only assure payment finality for member participant Nations<sup>33</sup> in all of their international transactions, but as well, obviate the manifestation of the double burden effect with regard to their respective external debts. So if the European unit of account, the Euro – despite the many graceful folds of its current draping – is nothing but a soubriquet replacing the name of antiquated currencies<sup>34</sup> and not actually an authentic currency unique to the EMU, what does this mean in true existence? That is, in the final analysis, how does this predicament actually affect Member States of the Euro zone? It means that they are no more protected from the *double burden effect on external debt*<sup>35</sup> than any other country outside the EMU or any other net borrowing<sup>36</sup> country in the world for that matter, given the current absence of a truly functional<sup>37</sup> system of

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<sup>31</sup> Even if under the new names of different country euros, e.g. French euro, Italian euro, German euro et cetera such as to differentiate with the unique Euro of the ‘would be’ true Euro zone currency union and which Euro would be issued by a third counter party clearing-house such as the ECB.

<sup>32</sup> Albeit, on a smaller European level scale.

<sup>33</sup> Nation, in the proper sense of its economic existence – *the nation as a whole operating as a unit on behalf of the set of its residents*, rather than simply as the sum of its residents.

<sup>34</sup> Though alas, itself (Euro), devoid of their respective subsistence.

<sup>35</sup> External debts are pathological to the extent that, in our present *non-system* of international payments, they include *sovereign debts*, the result being that of an unwarranted double burden effect. We will expound the origin of this effect in subsequent chapters. In the interim, let us be clear on the following: a country’s external debt should merely define the foreign debt incurred by the country’s residents whilst the expression *sovereign debt* refers to the debt of the country as a whole, a debt which *anomalously adds* to that of the external debt of the said country’s residents.

<sup>36</sup> It is perhaps important to point out a differentiation here between non-key currency and key-currency countries, the latter whom finance their net imports using their own currency. In so doing, their indebtedness is thus not related to the sale abroad of domestic financial claims. But still, key-currency countries get indebted and have to pay interests on their debt. Moreover, it remains that the analysis concerning the problems affecting both the net payment of interests and the very formation of external debts applies also to key-currency countries: in our current *non-system* of international payments the *real* payment entails another *monetary* payment which is added to it, *unjustifiably*.

<sup>37</sup> Our meaning: an international *multilateral* payment framework that would intrinsically (via a ‘final-payment mechanism’ as coined by Rossi 2012) facilitate payment finality between Member participants and furthermore without inducing a double payment (*double burden effect* on external debt). That is, a payment system that would ensure that international debts are paid only *once* by the net debtor country *on behalf of the set of its residents and not*

international payments and the complementary infrastructure necessary to effectively support its networking.

What we need to ultimately develop at the international level (or, initially on a smaller scale, e.g. at the European level) is a shared monetary system between nations that would enable them to benefit from keeping their respective monetary sovereignties whilst avoiding having ‘to settle their commercial deficits both financially and monetarily’ (Cencini 1995: 5). An *international* Central Bank of *national* Central Banks operating within the framework of an absolute system of exchange rates is the indispensable bricks-and-mortar required to facilitate the coming into being of a truly *homogeneous monetary transfer zone* between sovereign nations that would solve both the heterogeneous problem of national currencies *and* their respective countries’ consequent transfer problem.

### ***Relative exchange rates regime versus that of absolute exchange rates: Delicate distinctions***

We should remember that it is at the *international* level of payment transactions, that a system of *relative* exchange rates strikes its full impetus by transforming currencies into net assets<sup>38</sup> despite their inherent vehicular nature to act as mere conveyors of payment – an operation which leads also to a *process of duplication* very part and parcel of a system of *relative* exchange rates. Combined with the effect of the principle of the *double* double-entry book-keeping mechanism<sup>39</sup> this regime of *relative* exchange rates not only facilitates the erratic fluctuation of exchange rates<sup>40</sup> but is indeed the cause of another calamitous effect: the double burden of external debt – a phenomenon which can be understood either by analysing the servicing of a country’s external debt (principal and its associated interest) or the payment process involved whenever a country is a net foreign borrower. Either analysis will show that this is again where a regime of *relative* exchange rates definitely hails a negative influence. As we develop the dissertation our arguments will endeavour to progressively evidence this claim.

In highlighting the differences and consequent implications between the two regimes of exchange rates, Cencini reminds that it is only when money is allowed to operate in a circular manner that exchange rate stability is enabled. ‘The transition from relative to absolute exchange rates is therefore that from a system in which money is an *object* of payment to one in which money is a *means* of payment; from a system in which money is itself an asset to

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***additionally to them.*** Currently ‘international debts have to be serviced, cumulatively, by the residents who have incurred them and by their own countries’ (Cencini 1995: 7). Specifically then, in order to circumvent this double payment, we require a payment network based on a regime of absolute exchange rates operating under the auspices of a third party authentic international clearing-house responsible for issuing an international unit of account with the ability to transmit monetary homogeneity to Member participants’ respective currencies through a *catalytic absolute exchange* process. The latter would ultimately take care of Keynes’s well-known *transfer* problem having the unparalleled ability to encapsulate the individual country currencies under the protective umbrella of a truly *homogeneous monetary transfer zone*.

<sup>38</sup> As positive assets these duplicates – mere acknowledgments of debt or said another way simple I.O.U.s – are thus empowered to ‘settle’ payment imbalances.

<sup>39</sup> To be expounded in a later chapter.

<sup>40</sup> The ‘net asset’ duplication is what eventually forms the official reserves of foreign assets that potentially find their way to the foreign exchange market, resulting in massive fluctuations of exchange rates.

one in which real and financial assets are ‘circulated’ by money. It is the circular use of money that, as in Keynes’s plan of reform, allows for the stability of exchange rates’ (Cencini 2000.: 18). He adds the following important particulars.

To reach exchange rate stability and find an effective solution to the external debt problem we will have to change radically the way we look at money and use it in international trade. It is highly important to understand fully Keynes’s message as to the nature of bank money and the logical rules a monetary system has to comply with. In particular, the time has come to abandon the ‘materialist’ conception of money and to work out a system of payments in which money is used only ‘vehicularly’. When this is done, the present regime of relative exchange rates will be replaced by a regime of absolute exchange rates in which each currency is exchanged against itself.  
(Ibid.: 18)

When it is said that in a system of absolute exchange rates, currencies will be exchanged against themselves, and this instantaneously, we mean *through the intermediary* of a chosen international currency and as issued by an international clearing-house. Now if we remember that in order for international payment finality (international clearing) to be effective, the exporting country must be rid of any remaining future claims on the importing country, we will thus also recall the importance that the latter counterbalances its net commercial imports with a net sale of financial securities. ‘Hence, instead of entering a sum of foreign currencies on the assets side of its banks’ balance sheet – the first step towards duplication – , the surplus country spends it immediately to purchase an equivalent amount of foreign securities. Whatever currency is chosen as the international means of payment (money A, money R or a new international unit like Keynes’s *bancor*), the circular flow of money is thus guaranteed by the necessary equality between the balance of trade and that of financial transactions’ (ibid.: 19). To better understand just *how* the international money would operate, we should primarily note an important and distinguishing aspect between our current system of relative exchange rates and that of an absolute exchange rates regime. The latter is one ‘in which the international monetary flow is kept separate from the flow of national currencies that takes place within each country’ (ibid.: 19). While on a national level a country’s currency provides its ‘body’ to the mass of goods and services that it then circulates amongst its internal economic agents, *on an international level* we recall that ‘money is also required to transfer goods, services and financial claims, although this time the objects to be circulated have already been monetised in their countries of production’ (ibid.: 19). So what actually happens in a regime of absolute exchange rates is that the ***chosen international currency*** ‘lends its form to the goods, services and financial claims exchanged between countries’ (ibid.: 19). For example, ***through its intermediary***, the exporting country’s *real* output (the goods and services it has exported) is *transferred* from its own national currency ‘body’ to that of the importing country’s currency ‘body’ in exchange for the financial securities it replaces it with (as sold to the exporting country by the importing country). Specifically, if we conjecture country A to be the net exporter and country R to be the net importer and ICU to mean International Clearing Union, the following is what occurs given international payment finality intends a reciprocal transfer of some *equal value* in exchange for its receipt of net commercial imports: ‘[t]hrough its absolute exchange, money A gives up its real content to the international money (the goods and services exported by country A) and replaces it with the financial bonds exported by country R and transferred from money R to the international money through the absolute exchange of money R. Thus, because of the exchange between the two countries, goods and services exported by A take the form of money R, while the

financial bonds sold by *R* take the form of money *A*. This substitution takes place through the intermediary of the international money with which both currencies are exchanged, and that disappears as soon as the reciprocal payment between the two countries has been carried out by the ICU' (ibid.: 20).

The problem with our current non-system of international payments being based on a regime of *relative* exchange rates is that the latter regime, most importantly, is not conducive to recognizing a nation in its proper sense<sup>41</sup>. Distinguishing between a country's residents and the country itself *as the set of its residents* is of prime importance particularly when considering a nation's external debt servicing. '[T]his is so because the debt problem is essentially macroeconomic. In particular, the payment of net interest by a country's indebted residents necessarily involves the country itself, whose payment – in the present system of international payments – adds up to that of residents' (Cencini 2012: 65). Specifically, if we consider country *A* as the debtor country and country *R* as the creditor country, we can better understand why that is, upon recalling the following authors' elaboration. '[T]here exists a unique case in which the macroeconomic payment of a country adds up to the microeconomic payment of its residents: the payment of net interest on the country's external debt. Given that the payment of net interest entails a unilateral transfer from the debtor country to the creditor country, the lack of reciprocity precludes the balancing of the macroeconomic payment of *A* by an equivalent macroeconomic payment of *R*' (Cencini and Citraro 2012: 281).

In fact, we could obviate the double burden of external debts with respect to the payment of interests if we correctly viewed nations from a macroeconomic perspective and considered them as true macroeconomic entities. But this not being the case and given that in reality, international transactions are not processed in such a way as to properly account for the *natural circular-flow* of bank money<sup>42</sup>, the end result is the emergence of severe international payment disorders – pathologies that the current *relative exchange rates based* payment infrastructure, in its *present inadequately fit status*, is unable to properly counter.

In general the overall international payment system, grounded as it is on a regime of *relative* exchange rates, is prone to diverse systemic monetary disorders that erupt in different areas or stages e.g. the *final settling* of international payment transactions *between nations*<sup>43</sup>. As referenced earlier (see Rossi 2012) if we consider, for example, the case within the euro area whereby lack of payment finality has led to substantial and continually accruing payment imbalances between the Member States. Moreover, as Rossi points out, '[t]his echoes the well-known 'exorbitant privilege' that so-called 'key-currency' countries have been enjoying for about 40 years within the 'non-system' for international payments' (Rossi 2012: 221) and which system is based on a regime of *relative* exchange rates that is very partial to key-currency countries.

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<sup>41</sup> A nation, properly understood from a macroeconomic perspective, is defined by the *set of its residents*, **not** the sum of its residents.

<sup>42</sup> As a system of international payments *based on a regime of absolute exchange rates* would properly do.

<sup>43</sup> Clearly, the payment infrastructure has a vital attribute missing – that of a *triggering* procedure that could automatically enable payment finality and this via a monetary homogeneity that would be conveyed to the system, as afforded through the intermediary of a chosen international money. A 'final-payment mechanism' to refer to Rossi's expression (Rossi 2012: 221) upon unveiling the serious implication of this missing attribute, as observed at the inter-nations payment level just within the euro region itself. Specifically, he notes that it is these consequential payment deficits of Euro nations that have 'originated (observed and non-observed) soaring imbalances within the EMU, particularly since the bursting in 2009 of the systemic crisis that is devastating the euro area at the time of writing' (ibid.: 221).

Without considering the *naturally* circuitous flow of bank money granted by double-entry book-keeping proper international clearing (payment finality) is compromised and it is not difficult to understand the resulting genesis of *monetary duplicates* that appear in foreign banking systems and their associated disastrous effects (e.g. erratic fluctuations of exchange rates).

Finally, on comparing the two regimes – relative versus absolute – it eventually becomes clear that it is only via a comprehensive regime of *absolute* exchange rates that the true macroeconomic existence of nations could properly be accounted for, at the international level. Such an *absolute* regime would enable a nation to properly operate *on behalf of the set of its residents* as opposed to *in addition to them*. Combined with an infrastructure that would include an international multi-lateral clearing-house, itself complemented with its very own international money, this would allow for the necessary monetary homogeneity<sup>44</sup> that is currently lacking at the international payment level and *which lacking* currently plagues our non-system of international payments with a serious *income-conveyance* problem – as Cencini notes ‘what Keynes called ‘the transfer problem’’ (Cencini 1995: 5).

On this note, let us conclude this section with a fundamental observation with respect to monetary homogeneity in relation to a regime of relative exchange rates. By logical analysis, it soon becomes obvious that the latter regime cannot logically convey monetary homogeneity to the national currencies of an international payment system given *relative* ‘exchange rates vary when (demand for and supply of) currencies vary’ (Cencini 1995: 125). Cencini elaborates this argument by eliciting a very important and critical condition that must be met by a ‘common standard’<sup>45</sup> if monetary homogeneity is to be guaranteed: ‘[a] good unit of measurement must be invariable. If the meter varied when the distance it has to measure changes, it could not be considered a good standard of length. Analogously, how is it possible to claim that national currencies are made homogeneous through exchange rates, given that exchange rates vary when (demand for and supply of) currencies vary’ (ibid.: 125)? He sums up the analysis of his observations with the following crucial points.

The relative exchange between national currencies does not determine a unique standard, and can therefore not solve the problem of their heterogeneity. Moreover, the very idea of relative exchange is inconsistent with the vehicular nature of bank money. Demand and supply have real goods and services as their object, and not a simple numerical vehicle. To subject money to the law of supply and demand amounts to considering it as a real good, a net asset purchased and sold on the basis of its presumed intrinsic value. Within every single country money is used as an *instrument* or *means* of payment. That is to say that the final object of monetary transactions is not money itself. What the

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<sup>44</sup> Let us recall and take heed of Cencini’s observations. ‘Monetary homogeneity is what allows for a unique payment of debts; monetary heterogeneity, on the contrary, entails their double payment, since they require a transfer of income and the purchase of the vehicle necessary for the transfer in order to be effective’ (Cencini 1995: 7).

Additionally, if monetary homogeneity prevailed, then payment finality would naturally ensue for every international payment transaction without entailing an extra anomalous cost to nations *in addition to the payment of their residents* (as is case e.g. in external debt servicing).

<sup>45</sup> He is referring here to the chosen international currency that would necessarily accompany a new international payment system based on a system of *absolute* exchange rates. ‘The solution to the problem of national currencies’ heterogeneity calls for the determination of a common standard through which they can be collected in a single numerical ‘space’ (Cencini 1995: 125).

payee gets from the payer is the content of vehicular money and not the vehicle itself, which, as such, has no real value.  
(Cencini 1995: 125-26)

## **Cross-border payments across Euro Land – the current state of affairs**

Though it is not our intent to reiterate the precise and thorough work already compiled with respect to the mechanics of TARGET2<sup>46</sup> – Trans-European Automated Real-Time Gross-settlement Express Transfer System (see the skilful analysis of Rossi, 2012) we will attempt to highlight (en grandes lignes) some elements of its infrastructure relevant to the issues we have been raising.

In a nut shell the following can be emphasized: its most outstanding systemic flaw is that its payment infrastructure consists of a *two-tier* network with the ECB operating ‘at the same hierarchical level as participating NCBs<sup>47</sup>, (Rossi 2012: 226). What this means is that under such conditions, the ECB is unable to convey monetary homogeneity to the system. In order to do so it would need to operate as a *third counter party*<sup>48</sup> Central Bank of Member States’ Central Banks. This would enable it to gather the whole of the heterogeneous country currencies of Member States under a unique monetary umbrella much like national Central Banks convey monetary homogeneity to different *intra-nations secondary* monies by *transforming* them into ‘central money’<sup>49</sup>, (Cencini 1995). ‘Currencies issued within a single monetary area are perfect substitutes, so that it is always possible to pass from one to the other through an operation of ‘absolute’ exchange. As we already know, absolute exchange differs from relative exchange in that, unlike the latter, it does not take place between separate objects, but between a single object and its monetary form’ (ibid.: 237–238). In fact, if the ECB acted as a true Central Bank of Central Banks<sup>50</sup> operating within a regime of absolute exchange, the first *monetary* (versus the *financial* aspect) step towards payment finality<sup>51</sup> would naturally ensue<sup>52</sup> within the inter-nations’ payment protocol if we consider,

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<sup>46</sup> The current version of the original Target which ‘provides the payment infrastructure within which all payment orders denominated in euros are carried out across the borders of the various, pre-existing national payment systems, all of which operate now with the Real-Time Gross Settlement (RTGS) protocol (see Rossi, 2007a, pp. 69-78 for analytical elaboration on this protocol)’ (Rossi 2012: 223).

<sup>47</sup> NCBs defining ‘[t]he national central banks (NCBs) of euro-area member countries’ (Rossi 2012: 221).

<sup>48</sup> Our meaning: within a three-tier payment system as Central Bank of Member States’ Central Banks and thus operating at a higher hierarchical level than the latter.

<sup>49</sup> His reference here is in relation to the national money of the individual Nations.

<sup>50</sup> Given its current mandate with respect to inter-nations’ payment protocol amongst the Member States, the ECB does not operate in the true sense of a Central Bank of Central Banks.

<sup>51</sup> Rossi clarifies payment finality by referencing Goodhart. ‘As Goodhart (1989, p.26) explains, the finality of a payment requires that the ‘seller of a good or service, or another asset, receives something of equal value from the purchaser, which leaves the seller with no further claim on the buyer’’ (Rossi 2012: 221). In other words, whether within the national or international level context, payment transactions *ultimately* require to be *financed*.

<sup>52</sup> Via the intermediary of the chosen international currency as issued by an international *multilateral* clearing-house, for example, the ECB. Moreover, the *financing* of a debtor

analogously, that at the national level ‘[i]n practice, an absolute exchange takes place every time the Central Bank intervenes to guarantee the equilibrated carrying out of interbank clearing’ (Cencini 1995: 238). Cencini also reminds that without a proper Central Bank of Central Banks a regime of *absolute* exchange rates could not be put into practical effect and so ‘European currencies would remain substantially heterogeneous and their exchange pertain to the category of relative transactions’ (ibid.: 238). Contrarily, at a national level, the system of payment is set up in such a way that monetary homogeneity is guaranteed quite simply *through the existence of a Central Bank given its prime function – in its role as inter-bank clearing-house – in establishing a common monetary system within a country.*

Let us consider the transactions taking place within a unique monetary zone. No one doubts that their results can be aggregated without it being necessary to raise the problem of their common unit of account. The very fact that they are carried out in national money is sufficient proof of their fundamental homogeneity. A payment in dollars carried out in New York can immediately be compared with any other payment in dollars carried out in the United States for the simple reason that the dollars issued by the American banking system are perfectly inter-exchangeable. Yet, it must be kept in mind that this characteristic, common to national currencies, is not guaranteed a priori. On the contrary, it is the result of interbank clearing carried out by each single country’s Central Bank. Monetary homogeneity is made possible by the existence of a national banking system, which requires the presence of a Central Bank capable of gathering the various secondary banks in a common area. Without any such institution, every private bank would issue a currency totally heterogeneous with regard to the others, and it would no longer be possible to speak either of a national monetary system, or monetary sovereignty.  
(Cencini 1995: 184)

In an analogous manner ‘at the international level’ monetary homogeneity can only be attained if provided the proper medium as next elaborated by Cencini. ‘Likewise, at the international level currencies can only be considered homogeneous if they are inserted into a structure making them mutually exchangeable. This task should be assigned to a true international Bank’ (ibid.: 184).

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country’s payment deficit would be facilitated through this multilateral clearing (see our Table 1 and associated explanation) in the event that ‘residents in creditor countries (like Germany) are unwilling to continue buying those financial assets, like corporate or government bonds, that residents within debtor countries (such as Greece) need to sell in order to finance their payment deficits’ (Rossi 2012: 230). This would resolve the current ‘end-of-period’ (ibid.: 230) imbalances whereby ‘trade-surplus countries still have a claim on trade-deficit countries’ (ibid.: 230). Now on considering what needs to really happen in order for *final* international clearing to effectively take place, Rossi captures it very pointedly ‘international transactions (in this case, between Greece and Germany) are cleared once the deficit country sells to the surplus country an amount of financial assets that corresponds to the debt the former country has encountered in commercial trading with the latter country’ (ibid.: 229). We should recall that, in this context, the international *multilateral* clearing-house could play, not only an additional, but a key role as *financial* intermediary by taking on an intervening relation between debtor and creditor countries (member participants). That is, in the event that a debtor country remains unable to secure the necessary funds with which to finance its payment transactions, *initially* via the system of multilateral clearing itself.

In sum, through his examination of ‘cross-border payment orders that are carried out through TARGET2’ (Rossi 2012: 227), Rossi highlights how the absence of an underlining logic relative to ‘money and payments’ (ibid.: 226–27) has marred this payment infrastructure with a two-tier ‘monetary-structural flaw’ (ibid.: 226) of grave consequences. ‘The logic of money and payments is indeed one and the same for participants in any payment system: the payer and the payee need a settlement institution that intervenes as a monetary intermediary in order for the payment to be final for all parties involved, that is, the buyer and the seller of the relevant items’ (ibid.: 226–27). Unfortunately, as can be observed, this is not how things transpire within the payment infrastructure of TARGET2.

On further thinking about it, it can be noted that operating within TARGET2’s current make-up, it is not just that the ECB is not even properly set up to function as a *monetary* intermediary<sup>53</sup> but thence, not even as a *financial* one.<sup>54</sup> (See our earlier reference in footnote 52).

Were the ECB to accept<sup>55</sup> to take on the role of ‘settlement institution for NCBs within the Eurosystem’ (ibid.: 231), or whether this function is ultimately assumed by some other European establishment, in either case, Member States of the current ‘EMU’ could re-claim their respective monetary sovereignties<sup>56</sup>. What is of essence, to ensure payment finality<sup>57</sup>

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<sup>53</sup> With a capacity to deliver monetary homogeneity through inter-Nations clearing of payment transactions as could be carried out by a *true* inter-Nations clearing-house within a three-tier system.

<sup>54</sup> See our footnote number 58 on the postulation of three case scenarios by which monetary payment transactions could be *financed* between countries.

<sup>55</sup> A situation, according to Rossi ‘rather unlikely to occur in the near future, owing to the ECB’s strong reluctance to act as the bank for NCBs within the EMU’ (Rossi 2012: 231). Instead, one European settlement institution that could intervene in the place of the ECB, as per Rossi’s suggestion, is the European Stability Mechanism (ESM) – whether in a capacity of monetary (e.g. bilateral/multilateral case-scenarios) or financial intermediary. In the latter scenario, it could be particularly fitted to act ‘as credit provider to those countries that are unable to obtain capital otherwise. In this regard, the European Stability Mechanism (ESM) could indeed act as an international financial intermediary, carrying out the monetary function of a European settlement institution that provides payment finality between any two member countries’ (Rossi 2012: 234).

<sup>56</sup> In interpreting Keynes with respect to the importance of limiting the role as assumed by an international currency or its international clearing house, Rossi points out how certain policies (e.g. interest rate setting) ‘should not be abandoned to some supranational institution like the ECB – whose monetary policy cannot do justice to the different needs of different EMU member countries’ (Rossi 2012: 235). More comprehensively, here is how he captures the meaning of Keynes as elaborated throughout some of the latter’s writings: ‘Indeed, as noted by Keynes (1942b/1980, p. 168), the euro is needed as ‘an instrument of international currency having general acceptability between nations... that is to say, an instrument of currency used by each nation in its transactions with other nations, operating through whatever national organ, such as a Treasury or a central bank’. In other words, the euro ‘should not trespass unnecessarily beyond this field’ (Keynes, 1942a/1980, p. 125). Keynes was indeed aware of the fact that ‘private individuals, businesses and banks other than central banks’ should be allowed ‘to use their own national currency as heretofore’ (1942b/1980, p. 168). This amounts to saying that monetary sovereignty, to wit, the possibility of steering the interest rates according to the country’s domestic needs (also with regard to foreign exchange rates) by a sovereign central bank, should not be abandoned to some supranational institution like the ECB – whose monetary policy cannot do justice to the different needs of different

between Member States in their inter-Nations' payment transactions, is that the latter 'be monetized by a European settlement institution in order for the payer country and payee country respectively to pay and to be paid finally' (Rossi 2012: 232). The establishment of a *genuine* international settlement house to primarily issue 'the means of final payment between the two trading countries' (ibid.: 231) is a first necessary step towards payment finality. Then what needs to take effect is the *financing* of these monetary payment transactions through the sale and purchase of government or corporate issued bonds by the relevant interacting trading countries via multilateral clearing. If this occurred then the debtor nations would be 'in a position to finance their trade deficits through a sale of financial assets' (ibid.: 228). If not the case, then a truly inter-Nations settlement institution (possibly the same European settlement institution responsible for primarily monetizing the payment transactions of the trading countries) is necessarily required to intercede, ultimately, as *financial* intermediary between the trading nations in order to secure payment finality. Otherwise, the debtor-country in question would simply have to limit its imports accordingly, in keeping with the conditional confines of the reform advocated for the future system of payments.

Now remembering that the avenue that we have been elaborating with respect to Rossi's recommended solution 'to transforming promises of international payment into final payments for the countries involved' implies an *Euro* 'to be issued by some European institution for the settlement of trade imbalances' *whilst* 'all EMU member countries recover their monetary sovereignty through the issuance of their own national currencies' (ibid.: 231), the primary justification for the existence of an intervening European settlement institution becomes clear. It is needed to collect all of the heterogeneous country currencies within a common homogeneous monetary area, primarily enabling the monetary aspect of payment finality in international payment transactions through the issuance of its own *central* money, the *Euro* that we refer to above. As Rossi puts it '[a] European settlement institution must intervene as monetary intermediary issuing the means of final payment' – the amount of *central* money units – 'necessary in order for the international payment to be final' (ibid.: 231, 232 respectively). But these monetary payment transactions ultimately require to be financed; that is to say – taking Greece and Germany as exemplary trading partners (*bilateral-case*<sup>58</sup> scenario) as per Rossi 2012 – they need to be complemented with a 'financial transaction through which residents in the payer country (Greece) issue and sell either corporate or government bonds, and residents within the payee country (Germany) purchase foreign bonds' (ibid.: 232). Let us next examine Rossi's description of the *bilateral-case*.

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EMU member countries (see Rochon and Rossi, 2006 for analytical elaboration on this point). In this respect, as Keynes (1943/1980, p. 234) wrote in the Preface to the April 1943 Clearing Union White Paper issued by the British government, the international monetary system is to be reformed in order to make sure that '[t]here should be the least possible interference with internal national policies'' (Rossi 2012: 235).

<sup>57</sup> As pointed out earlier, the current two-tier design of TARGET2's infrastructure – the Achilles heel from which payment finality is impeded – is without doubt the source of 'intra-euro-area imbalances' and '[t]he solution to this problem implies transforming promises of international payment into final payments for the countries involved' (Rossi 2012: 231).

<sup>58</sup> Three possible case scenarios can be postulated by which monetary payment transactions could be *financed* between countries. The first case consists of *bilateral* clearing (as described above by Rossi 2012). The second and third case involve, respectively, *multilateral* clearing or ultimately, the *financial intervention* of a chosen international institution that would intervene as a financial intermediary.

The bilateral case occurs when residents in the trade-surplus country (Germany in our stylized example) buy those bonds that are being sold by residents in the trade-deficit country (Greece in this case). If so, then the relevant financial-market transaction involves the European settlement institution as mere monetary intermediary, because it issues the number of money units that are necessary in order for the international payment to be final as regards the two countries involved thereby.  
(Ibid.: 232)

A significant observation worthy of notice with respect to the above account as Rossi points out, is that ‘all international transactions are finally paid, because they have been internalized and therefore no further foreign claim exists’ (ibid.: 232)<sup>59</sup>. He adds that this differs significantly with balance of payments entries as depicted in Table 8.1 (see Rossi 2012, p. 228) ‘which show that, to date, payments through TARGET2 are not final for the countries concerned by them’ (ibid.: 232).

Let us distinguish the *bilateral*-case<sup>60</sup> from that of the *multilateral*-case. *Multilateral* clearing is a payment procedure occurring on an ongoing basis<sup>61</sup> and involving more than two participant countries interacting all at once through the intermediary of a *third counter-party* international<sup>62</sup> institution (above in hierarchy) and this via a system of *absolute* exchange. In order to illustrate its distinguishing features, we provide a basic layout as an exemplary scenario (our own simple re-formatting of an original of Cencini whereby he details a numerical example<sup>63</sup> of the *multilateral*-case). In following with Cencini’s example, we depict (see Table 1.1) the three countries (Italy, Germany, France) interacting in a multilateral clearing through the intermediary of a *third counter-party* institution, e.g. the ECB.

In examining the payment interactions of Table 1.1 we can observe the advantages of multilateral clearing: it facilitates the *financing* of monetary payment transactions taking place amongst the interacting countries such that a trade-deficit country has a wider-range chance to raise the necessary funds it requires to back its purchases. In the example of Table 1.1, Germany (trade-surplus country) purchases an extra 5 F.C. from France who spends it to purchase 5 F.C. from Italy. So looking at it from the end-all perspective Italy was able to raise funds in the range of 5 F.C. that it sold to France instead of Germany (the latter having bought 5 F.C. from France instead of Italy) and this, on account of the facilitating mechanism

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<sup>59</sup> See balance of payments as depicted in Rossi 2012, Table 8.6 (The result of a delivery-versus-payment through a European settlement institution), p. 233.

<sup>60</sup> A simplified case-scenario *merely intended to enlighten-instruct* on the monetary intermediary role that could be assumed by a *third counter-party* clearing-house (operating at a higher hierarchical level within a *three-tier* system) as well as to demonstrate the simpler/direct type (in the bilateral case: occurring strictly between the respective trade-surplus and trade-deficit countries) of financial-claims exchange that could take place under its operation. The system that is clearly needed given its inherent advantage of offering a wider-spectrum source from which trade-deficit countries can pool their required sales of financial claims is that of *multilateral* clearing and is thus the very type of clearing that our suggested payment reform propounds.

<sup>61</sup> In the manner of Real Time Gross Settlement (RTGS) funds (money/securities) transfer systems.

<sup>62</sup> Our meaning extends to that of a European settlement institution.

<sup>63</sup> See Cencini 2008 *Elementi di macroeconomia monetaria* for his original numerical example of a truly *multilateral*-case.

inherent to multilateral<sup>64</sup> clearing. But in spite of that, the multilateral system may not always generate the funds needed by a particular trade-deficit country and the latter may ultimately have to appeal for assistance through the financial intervening of an international institution, the likes of the European Stability Mechanism (ESM)<sup>65</sup> or the ECB itself.

We should note that the institution chosen to fill the role of ultimate credit provider (financial intermediate) need not necessarily be one apart from the *third counter-party* institution essential for delivering the reform we are advocating relevant to the international system of payments. The importance rather is to distinguish between the roles played by this *third counter-party* institution or, respective institutions<sup>66</sup>. That is, as monetary intermediate as in the bilateral and multilateral case scenarios or, as financial intermediate as in the financial intervention case scenario.

Rossi does warn however that should the ESM accept to venture the challenges of the ‘hat’ as financial intermediary, its decrees would need to take certain economic factors into consideration in order to deliver optimally on its mission as credit facilitator<sup>67</sup>. He suggests, for example, some guidance principles (percentage of a country’s GDP) beyond which a nation should be allowed to sell financial securities in order to finance its commercial deficit. Likewise he strongly advises, in the spirit of Keynes, that these same limits (percentage of GDP) should apply to trade-surplus nations as well, rather than placing the entire burden onto the trade-deficit countries.

Indeed, as pointed out by Keynes (1942a/1980), the international rebalancing should be symmetrical rather than relying on deficit countries only: a substantial decrease of imports in the latter countries could potentially lead them as well as surplus countries into a (prolonged) recession or depression. Rather, the rebalancing mechanism should be so designed as to induce surplus countries (like Germany) to increase their commercial imports from deficit countries (such as Greece), which need to boost their exports – not least to pay for debt service, that is, interest on securities sold either to surplus countries or to the ESM to finance the country’s trade deficit.

(Rossi 2012: 235)

He sums up his argument in a clear-sighted assessment of the current state of affairs – in this regard, *consequential to this idée fixe of austerity* that continues to pervade policy-making.

Indeed, reducing imports in deficit countries – through austerity measures – cannot but aggravate the euro-area crisis, because it will also negatively affect sales figures in surplus countries like Germany (whose growth strategy is

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<sup>64</sup> The financial market transactions implicit in *multilateral* clearing involve the chosen *third counter-party* international institution as well (as in the case of *bilateral* clearing) as simple monetary intermediary in that it only serves to emit the sum of money units required for the finalization of international payments.

<sup>65</sup> See Rossi 2012, p.234.

<sup>66</sup> Our meaning for example: the ECB could assume the monetary intermediary role merely issuing the required number of money units necessary for the finalization of international payments; whilst the ESM could assume the extra function of ultimate credit provider as financial intermediary.

<sup>67</sup> It goes without saying that this same stipulation would apply to *any* international/European institution (e.g. the ECB) taking on the role of financial intervener.

structurally designed to maximize exports, some 60 per cent of which are oriented to other euro-area countries at the time of writing).  
(Ibid.: 236)

# ECB

## *ITALY*

Sells Goods:

70 > Germany  
60 > France

Purchases Goods:

100 < Germany  
50 < France

## *GERMANY*

Sells Goods:

100 > Italy  
110 > France

Purchases Goods:

70 < Italy  
90 < France

## *FRANCE*

Sells Goods:

90 > Germany  
50 > Italy

Purchases Goods:

110 < Germany  
60 < Italy

## *SIMULTANEOUSLY*

Sells Financial Claims (F.C.)

30 > Germany  
5 > France

Purchases F.C.:

10 < France

Sells F.C.:

10 > France

Purchases F.C.:

35 < France  
30 < Italy

Sells F.C.:

35 > Germany  
10 > Italy

Purchases F.C.:

10 < Germany  
5 < Italy

*Table 1.1:* Our reconstructed illustrative example of *Multilateral clearing* based on Cencini's original numerical example (2008).

## On re-visiting Euro Land's options amidst a rising tide of discontent

In recapitulation, we have analyzed the essence of monetary homogeneity versus heterogeneity in a system of payment and have assessed the advantage of the former in its ability to circumvent the transfer problem, whether at the national or international level. We have observed how the absence of homogeneity within an inter-Nations payment system can severely impair it with a lack of payment finality, in turn leading to substantial and soaring payment imbalances amongst the affected Nations. Finally, following an examination of how monetary homogeneity pervades a national system of payment with the effect of ridding its payment transactions from any monetary transfer problem encumbrance we have noted that such is not the case within our current non-system of international payments, whether considered at the European or more global level. Being based on a regime of relative exchange rates and lacking a *third counter-party* clearing-house<sup>68</sup> as is played out by Central Banks at the national level, the 'system' is consequently afflicted with serious payment anomalies of notable calamitous effect as is evidenced by the manifestation of the double burden of external debt.

In this regard, it is true that were the Europeans to contemplate the formation of a more stringently binding union beyond that of the EMU, the likes of a single sovereign state, they would avoid the double burden of external debt among themselves. But the current political climate – at the time of writing – seems to put in doubt that this might be the type of Union that the European nations, Member States of the Euro zone or of the EU, ultimately want to form. In fact it rather appears as though the current level of unionisation as already created via the EMU is already straining political and cultural relationships amongst the Member States. A European divide seems more on the brink of the agenda than any serious commitment towards a more closely knitted European alliance. There is even talk about the United Kingdom exiting the European Union. A growing disenchantment with what the latter has grown to be<sup>69</sup> seems to pervade the air which, we might even say, has become increasingly stifling for some. A bureaucratic network with far-ranging tentacles incessantly working at full stretch to quench an insatiable thirst for power – would it have grown too big for its own britches, with the risk yet of developing into a mammoth white elephant? The economic and political union of the 27 member states is already being referred to as a 'bureaucratic monstrosity'<sup>70</sup>. Baron Lawson of Blaby has forthrightly called for the United Kingdom (UK)

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<sup>68</sup> We have seen how the ECB is not even currently fitting to the role.

<sup>69</sup> Writing in *The Times* and as captured by Nigel Morris of *The Independent* in a May 2013 news article, former Chancellor Lord Lawson explicitly states '... [“b]ut all this is largely beside the point,” he wrote. “The heart of the matter is that the very nature of the European Union, and of this country’s relationship with it, has fundamentally changed after the coming into being of the European monetary union and the creation of the eurozone, of which – quite rightly – we are not a part”. And as Morris continues with his report on Lawson’s writings, “[j]ust as entry into the Common Market half a century ago provided a much needed change of focus, so might leaving the EU, an institution that has achieved its historic purpose and is now past its sell-by date, provide a much-needed change of focus today” (Morris, Deputy Political Editor at *The Independent*, 7<sup>th</sup> May 2013 *The Independent* news article).

<sup>70</sup> As per the vivid account of Nigel Lawson – Lord Lawson of Blaby – former Conservative Chancellor of the Exchequer, in a communication with *The Times* newspaper in May of 2013: ‘In his piece, the former chancellor said there would be some economic costs to leaving the single market but it would be outweighed by not having to pay for the “bureaucratic monstrosity” of the 27-nation bloc’ (Hannah Kuchler, UK News Reporter at *Financial Times*, 7<sup>th</sup> May 2013 *FT* news article).

to exit the European Union (EU)<sup>71</sup>. Strongly of the opinion that the UK would do better economically if it left the EU, he also criticized the latter for its ‘frenzy of regulatory activism’<sup>72</sup> that he felt could potentially stifle the country’s economic progress. He also warned that too many of the country’s commercial traders are ‘secure in the warm embrace of the European single market’<sup>73</sup> and as such are greatly missing out in failing to look beyond it to consider other business opportunities. And, on further dwelling on this, it brings to mind yet other avenues<sup>74</sup> which could be explored even with Asia in the spirit of Piffaretti and Rossi’s contribution on an institutional approach with respect to ‘the structural rebalancing of global imbalances’ (see Piffaretti and Rossi 2010)<sup>75</sup>.

Meanwhile others are even adamant that the European project<sup>76</sup> itself is unravelling at the seams. In a candid reaction to political leaders’ ‘management’ of the Cyprus crisis that erupted in the spring of 2013, Athanasios Orphanides<sup>77</sup> exposed some of the unpalatable and

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<sup>71</sup> ‘Writing in The Times newspaper on Tuesday, Mr. Lawson said he would vote in favour of a British exit in the referendum that David Cameron has promised if he wins the next election’ (Kuchler, UK News Reporter at Financial Times, 7<sup>th</sup> May 2013 FT news article).

<sup>72</sup> ‘Mr. Lawson, who sits on the Parliamentary Commission on Banking Standards, also said the EU’s current “frenzy of regulatory activism” including the “foolish and damaging” financial transactions tax, could damage the UK economy’ (Kuchler, UK News Reporter at Financial Times, 7<sup>th</sup> May 2013 FT news article).

<sup>73</sup> Nigel Morris from The Independent, reporting on Lord Lawson’s writing to The Times ‘Too much UK business and industry felt “secure in the warm embrace of the European single market and is failing to recognize that today’s great export opportunities lie in the developing world”, the peer wrote’ (Morris, Deputy Political Editor at The Independent, 7<sup>th</sup> May 2013 The Independent news article).

<sup>74</sup> Perhaps more of a structural nature but none the less bearing great economic and financial potential should the monetary payment reform we are suggesting be explored.

<sup>75</sup> Analogous to their case-study for a bilateral US-China Settlement Facility, the UK could explore this same avenue as a first step following their exit from the EU (whether with China as well or with both China and the US, with the idea and hope that other European countries would eventually follow their trail) – and as a milestone undertaking towards reining in the double burden of their external debt of which they are also a victim and will continue to be until an international clearing-house is set up to oversee massive monetary reforms at the international payment level. The analogical endeavor may seem overly optimistic and even far-fetched at first sight, but perhaps not on considering Lawson’s mood as he expresses ‘[t]he Bank of England is becoming increasingly frustrated by the mandatory nonsense emanating from Brussels’. He further elaborates on his thought as he explains in a next sentence in writing to The Times and as reported by Nigel Morris. ‘Escaping from this and reinforcing the escape by co-operation with the only other genuine world financial centre, the United States, would be a major economic plus’ (Morris, Deputy Political Editor at The Independent, 7<sup>th</sup> May 2013 The Independent news article).

<sup>76</sup> As reported by Ralph Atkins in London, ‘[h]is outspoken comments highlighted widespread alarm at eurozone leaders’ handling of the Cyprus crisis – including by the European Central Bank and European Commission’. He quotes Orphanides’s succinct assessment: “[t]he European project is crashing to earth,” Athanasios Orphanides told the Financial Times in an interview. “This is a fundamental change in the dynamics of Europe towards disintegration and I don’t see how this can be reversed.” (Atkins, FT Capital Markets Editor, 22 March 2013 FT news article).

<sup>77</sup> The Economist captured some of his professional profile in a prelude to interviewing with him in March 2013. ‘Athanasios Orphanides was governor of the Central Bank of Cyprus

ironic truths that have come to undermine the harvest of complete European integration as was initially intended by the ‘masterminds’ of the Euro seedling. As his interviewing account sagaciously points out, *at day’s end it is national interests that take priority*. It is indeed ironic, isn’t it? That is, that national ‘protectionism’<sup>78</sup> somehow always re-surfaces to validate its dominion – in trying times – over an initial game plan<sup>79</sup> that was intent on putting such national ambitions on the back burner. It would seem to reinforce the argument that, above all, nations want to be nations. The time certainly appears ripe for a fundamental re-thinking of the original mission of the project. A change of course is undoubtedly warranted though more along the lines of *structural* change as could be brought about by a massive payment system reform, conducive to nations re-claiming their respective monetary sovereignties.

Orphanides afforded The Economist a most forthright and straight to the point critic in interviewing with them, the details of which, we refer the readers to the actual transcript of the interview. The following are some telling excerpts from The Economist’s interview<sup>80</sup> with him. “The politics, in my mind, is what makes this episode so ugly, that some governments, to serve their own national or narrow political interests, arrived at a decision that inflicts irreparable damage to Cyprus”<sup>81</sup>. As well, it is worth taking heed of his closing comments as he reminds of the already existing disparities among the Member States “[t]hat will add to the divergences we already have and make the recession in the periphery of Europe deeper than it already is. This is really a disaster for European economic management as a whole” (ibid.: March 2013).

In yet another episode, this time involving Pascal Lamy, Head of the World Trade Organization (WTO), general discontent with the current political objectives of the EU was again not spared. He was speaking at a Brussels conference on the *future of the EU as external player*. Martin Banks, Senior Journalist at The Parliament Magazine captured some of his enthralling remarks in a May 2013 article<sup>82</sup>. As Banks reported ‘World Trade Organisation (WTO) chief Pascal Lamy has delivered a withering verdict on the “European project”, accusing it of having “lost credibility”’. He quotes the WTO chief’s cutting remarks. “There can be no doubt that, on the world stage, it has lost a lot of credibility in the eyes of many people. This is not because of any diplomatic failure but, more dramatically, is the result of people seriously questioning that Europe and EU is united”’.

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from 2007 to 2012, giving him a seat on the European Central Bank’s governing council and oversight of Cyprus’ banks’. On a personal and academic note it documented the following. ‘Mr Orphanides was raised in Cyprus, received his PhD in economics from the Massachusetts Institute of Technology and was an adviser at the Federal Reserve Board. He is now a lecturer at MIT and a fellow at the Center for Financial Studies at the Goethe University of Frankfurt’ (G.I. at The Economist, Washington, D.C., 28<sup>th</sup> March 2013 edited transcript of the interview).

<sup>78</sup> Our meaning: in the loose sense of overall national interests.

<sup>79</sup> Our reference is with respect to the European project on the whole.

<sup>80</sup> (G.I. at The Economist, Washington, D.C., 28<sup>th</sup> March 2013 edited transcript of the interview obtained via a combination of telephone and writing communications).

<sup>81</sup> His straight-shooting comments were in reference to how he believes Cyprus’s ultimate fate got tangled up in the grip of ambitious political interests prevailing the upcoming September 2013 German election.

<sup>82</sup> (Banks, Senior Journalist at The Parliament Magazine, 16<sup>th</sup> May 2013 article, The Parliament Magazine).

Yves Mersch, member of the ECB executive board, wrote an FT article<sup>83</sup> in which he mentions that ‘calls are becoming louder for the ECB to introduce new tools, swallow ever more risk and start economic fine-tuning. But this would be a diversion. The successful measures taken by the ECB are there to buy time for the political authorities to fix the governance framework and implement reforms. They cannot be a substitute for the repair work’<sup>84</sup>. On pondering his assessment of the situation, it is true that measures undertaken by the ECB cannot single-handedly be substitutes for the repair work needed on a home-national level. But the ECB could take on a vital role as reform leader itself if it became the instrumental tool with which to revamp the international payment system, at the European level, as a decisive and innovative first step towards curing the continent’s monetary and financial ills. The executive council member’s observations are right on target when he writes ‘[t]he eurozone faces a triple problem: stretched states, fragile banks and shrinking economies. If addressed properly, we can make a virtuous cycle that will help with all three. If managed poorly, however, they could descend into a vicious cycle’<sup>85</sup>. In considering his critical appraisal, it would seem timely indeed to venture a new approach by envisioning a way to circumvent the continent’s economic and financial distress from an entirely different perspective. In this regard, perhaps it is time to incline our ear to the wisdom of Rossi’s analytical findings whereby he concludes the following.

The euro-area crisis that broke out near the end of 2009 is not the result of excessive fiscal deficits in the sense of the Maastricht Treaty. Indeed, it is not the behavior of public sector officials with the complacency of domestic or foreign banks’ managers that can explain the structural disorder pervading the EMU. This disorder has a systemic origin, which pertains to a structural discrepancy between the essential laws governing money and banking, on the one hand, and the practical working of the euro-area-wide payment system (TARGET2), on the other hand. European institutions need therefore to design a monetary-structural reform in order for the TARGET2 system to comply with the nature of bank money at the international level, analogously to what actually occurs within domestic payment and settlement systems around the world.

(Rossi 2012: 236)

If the reality of the facts strongly suggests that our economic and financial woes are not *subjectively* consequential but rather the effect of a serious structural flaw in our current non-system of international payments<sup>86</sup>, why not step back and consider a more radical solution as a viable alternative to resolving our plight? Conventional approaches, thus far, have left much to be desired and have proven to be more self-defeating than progressive. Delaying a fresh plan of attack any longer, runs the risk that the situation may start to ‘descend into a vicious cycle’<sup>87</sup>, with no point of return. Instead of chasing after an even nigher alliance whose

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<sup>83</sup> The Financial Times article is titled: Europe’s ills cannot be healed by monetary innovation alone. It appeared in the FT on the 24<sup>th</sup> of April 2013.

<sup>84</sup> (Mersch, member of the ECB executive board – writing in to the Financial Times in an article that appeared in the FT on the 24<sup>th</sup> of April 2013).

<sup>85</sup> (Mersch, member of the ECB executive board – writing in to the Financial Times in an article that appeared in the FT on the 24<sup>th</sup> of April 2013).

<sup>86</sup> Whether considered at the European level or on a grander scale worldwide.

<sup>87</sup> In reference to the pictorial expression as coined by Mersch, ECB executive board member, in an article that he wrote and which appeared in the FT on April 24<sup>th</sup>, 2013.

‘sustainable development’ appears unattainable – realistically, perhaps the times are better suited to embracing a ‘sustainable retreat’ (Lovelock 2006: 7). This brings us back to the consideration of our third option as introduced earlier<sup>88</sup> – as a way to tackle an escalating economic and financial crisis. The approach that we advocate implies the upholding of monetary sovereignties whilst embarking on a massive structural reform of our current non-system of international payments. Though our main presentation model will target a smaller scale application at the European level, it will eventually dwell into larger global scale adaptabilities.

But let us first close on a lighter note (withal, of serious substance) than the dry humdrum that will follow in the ensuing chapters – nonetheless important – as we explore the construct of external debt, and explain through the presentation of other pertinent concepts and principles, the disastrous effect of its double burden given our current non-system of international payments. Moreover, we will show how a reform of the latter would be instrumental in circumventing the very payment anomaly that causes it. We thus leave the readers to ponder an analogous account of ‘sustainable retreat’ versus ‘sustainable development’ from an environmental perspective that, not so surprisingly, echoes our current state of affairs on an economic and financial level. In the end, we suffer the very making of our own kind. Next is Lovelock’s<sup>89</sup> enlightened reflection<sup>90</sup>.

The few things we do know about the response of the Earth to our presence are deeply disturbing. Even if we stopped immediately all further seizing of Gaia’s land and water for food and fuel production and stopped poisoning the air, it would take the Earth more than a thousand years to recover from the damage we have already done, and it may be too late even for this drastic step to save us. To recover, even to lessen the consequences of our past errors, will take an extra-ordinary degree of international effort and a carefully planned sequence for replacing fossil carbon with safer energy sources. We as a civilization are all too much like someone addicted to a drug that will kill if continued and kill if suddenly withdrawn. We are in our present mess through our intelligence and inventiveness. It could have started as long as 100,000 years ago, when we first set fire to forests as a lazy way of hunting. We had ceased to be just another animal and begun the demolition of the Earth. We are the species equivalent of that schizoid pair, Mr Hyde and Dr Jekyll; we have the capacity for disastrous destruction but also the potential to found a magnificent civilization. Hyde led us to use technology badly; we misused energy and overpopulated the Earth, but we will not sustain civilization by abandoning technology. We have instead to use it wisely, as Dr Jekyll would do, with the health of the Earth, not the

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<sup>88</sup> Refer to INTRODUCTION, The Euro zone – *On the horns of a trilemma*.

<sup>89</sup> James Lovelock is a British independent scientist and environmentalist in the Chemistry and Earth science fields. He is the originator of the Gaia Theory that ‘proposes that organisms interact with their inorganic surroundings on Earth to form a self-regulating, complex system that contributes to maintaining the conditions for life on the planet’ (Wikipedia encyclopedia). In Lovelock’s own words: ‘There is nothing unusual in the idea of life on Earth interacting with the air, sea and rocks, but it took a view from outside to glimpse the possibility that this combination might consist of a single giant living system and one with the capacity to keep the Earth always at a state most favorable for the life upon it’ (from What is Gaia? by James Lovelock, James LOVELOCK’s website: <http://www.ecolo.org/lovelock/index.htm>).

<sup>90</sup> In this parallel argument is couched great insight and wisdom from which we could draw from.

health of people, in mind. This is why it is much too late for sustainable development; what we need is a sustainable retreat.  
(Lovelock 2006: 6-7)

**Part II     A new analytic reasoning: forming a  
macroeconomic perception from macroeconomic roots**

## **2 On money; double-entry bookkeeping, nations as macroeconomic entities, the macroeconomic law of the identity between each single agent's sales and purchases, double double-entry bookkeeping; balance-of-payments in relation to double-entry recording**

### **Introduction**

We now move towards unveiling the anomalies of our current *non*-system of international payments through a *macroeconomic* perspective emanating from *macroeconomic foundations*.

It is not for any other particular reason other than a very *macroeconomic* one that Cencini and Citraro emphasize that '[t]he fact that country A's net interest is paid both by its residents and by the country itself would have no consequence in the joint balance of payments of A and R if the macroeconomic payment of A were entered both in A's and in R's current or capital and financial accounts' (Cencini and Citraro 2012: 281). When concerned with monetary systems at the *international* level, the macroeconomic aspect is taken to a whole new level of stringent importance. After all, it is at this very level – *macroeconomic level* – that the pathologies affecting our respective economic systems manifest themselves and so it is crucial that we angle our observations of their symptoms and subsequent analysis of their root causes from this starting point, that is, from a *macroeconomic viewpoint based on true macroeconomic groundwork*.

Moreover, it is through its monetary sovereignty that a nation delineates the core of its specificity and establishes its very economic identity. It is thus just as imperatively important that we conceptualize it from a holistic perspective, that is, as the *set of its residents* – operating *on behalf* of its residents and not additionally to them, thus from a purely macroeconomic standpoint. It is through this *nation as a whole* that the macroeconomic law of the identity between each single agent's sales and purchase – deriving from the *flow* aspect of bank money, particularly from banks' *bookkeeping manner* in issuing it – takes on a very specific significance with respect to international payment transactions among countries. Ultimately, it is the countries themselves – defined by their respective monetary sovereignties and central banking systems – that become these economic agents on the international scene. Thus this identity between each single agent's sales and purchase plays itself out last but not least at the international level and its unique significance at the latter level should not be unheeded. To understand it for all is worth, will help home in the analysis and understanding of the origins of the anomalies that plague our current international monetary system.

Finally, the decision to embrace a *macroeconomic versus a microeconomic* approach in our analysis of the monetary disorders that pervade the capitalist system worldwide, stems from the influence of compelling apologists<sup>91</sup> regard the argument that these deeply rooted economic anomalies emanate from the *structural* malfunction of monetary infrastructures that form the basis of payment systems, respectively at both the national and international level.

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<sup>91</sup> Schmitt, Cencini et al.

Consequently, the pathologies need to be evaluated and addressed from a purely macroeconomic as well as *structure-oriented* viewpoint ‘allowing the separation of the structural causes of economic crises from accidental disturbances due to economic agents’ behaviour’ (Cencini 2012: 194).

As we set sail, we should bear in mind that a macroeconomic approach invokes economic laws that relate to a country’s economic system *considered as a unit and, per se*, the analysis necessitates in-depth abstract reasoning<sup>92</sup>.

Let us return to the very basics, money – *bank-money* that is – since without banks the production of a country’s output would lose its economic *raison d’être*, much less money-income would be nonexistent.

### As regards money, bank-money

What can we say about money, that is, *bank-money*? What is *bank-money* and in which manner do banks issue it?

*Money* is essentially bank-money as it ***cannot be other than what it exists as***: the result of the implementation of double-entry bookkeeping by banks – essentially, a flow. Money, ***bank-money*** is a flow. It does *not* flow unless we are meaning instantaneous velocity, as bank-money *is the flow itself*. Hence, it should not be conceived of as matter or stock<sup>93</sup>, neither as an asset *per se*. It is none other than a ‘dematerialized vehicle’<sup>94</sup> through which payment transactions are conveyed and this, via its instantaneous flow.

Bank-money’s instantaneous flow is the very flow-vehicle that exists *only in payment transactions*. Matter-of-factness, its flow is present only the very instant a payment takes place. Banks issue the said bank-money as a simple accounting unit<sup>95</sup> – a mere book-entry

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<sup>92</sup> See Cencini 2012: 50, 54.

<sup>93</sup> The importance in understanding ‘that money is not a stock, that it does not circulate within a country or across countries, and that its ‘velocity’ is infinite, since in each payment it is instantaneously recovered by the bank issuing it’ (Gnos and Rossi 2012: 12) becomes crystal clear when the analysis graduates to the international level. It is at this stage that when bank-money is considered for what it is and what it is not, that it becomes definitely perceptible that countries, considered as a whole, that is, – each as the set of their respective residents – should never become indebted to ‘a stateless financial bubble’ (ibid.: 12).

<sup>94</sup> Cencini informs us that this conceptual way of viewing money is originally linked to Adam Smith. ‘It was this great Scottish economist who provided the first arguments against the concept of commodity-money. And it was his definition of money as the ‘great wheel of circulation’ that introduced the idea of a totally dematerialized vehicle which identifies itself with its charge (current output)’ (Cencini, 1988: 2).

<sup>95</sup> What should be kept in perspective is that though banks emit *nominal* money, *real* money arises through production, both events happening simultaneously. In other words, it is by means of labour – through the payment of wages – that nominal money associates with *current* output and once united, together they form *real* money: income. ‘Banks issue nominal money, and production creates real money in the same movement: the payment of wages’ (Cencini 1988: 2). Thus with regard to banks issuing *a simple accounting unit* (as stated within our text) it is important to take note of Cencini’s further clarification ‘it is correct to say that nominal money can count the product because it carries it, but, carrying it, nominal

marking – a double-entry bookkeeping<sup>96</sup> that *simultaneously delineates, both an asset and a liability*, the vehicular flow.

Bank-money can also be thought of as liquidity, that is, if we think of liquidity as ‘a quantum of money with no purchasing power of its own. Such money is also called nominal or vehicular. The vehicle currency has no economic value, for its function is not to finance any net purchases but to “monetize” the economy’ (Schmitt, 1973: 9).

It is important to retain that bank-money can never be the end term<sup>97</sup> of a payment transaction because it is purely an intermediate instrument, a simple means. ‘La monnaie n’est jamais un terme, ou un bien final, dans les échanges; elle est pur instrument d’intermédiation’ (Schmitt, 1984: 49). It is thus that in emitting bank-money, banks engage primarily in a monetary intermediation rather than in a financial one. ‘Dans l’émission, la banque est donc un intermédiaire *monétaire* et non à proprement parler *financier*’ (ibid.: 44). This is not to say that financial intermediation is not part of their day-to-day operations, it is just that this ‘financier’ role is very distinct from that of their monetary intermediation. The latter involves the creation of bank deposits whereas in assuming the role of financial intermediate they facilitate the transfer of an income between economic agents. We next highlight this fundamental distinction in the banks’ dual intermediary role using Schmitt’s very words.

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money is real money so that, finally, it is the latter and not the former that plays the role of unit of account’ (ibid.: 26).

<sup>96</sup> Meghnad Desai highlights Schmitt-Cencini’s strict adherence to ‘the discipline of double entry book keeping’ in a scintillating foreword to Cencini’s 1988 *Money, Income and Time, A Quantum-Theoretical Approach*. His reflection merits the following interludial pause to capture his words. ‘The revolutionary message from the Schmitt-Cencini école de Dijon is that money and income are not two separate entities. Money is not a commodity and its value should not be related to its commodity-like properties. Money is just another way of expressing the economic (not the physical) nature of output. In exchanging money for output, one is exchanging two forms of an identical ‘object’. Tautologies and identities impose a logic more ruthless than equations do, and the Schmitt-Cencini strategy is to adhere rigorously to the discipline of double entry book keeping. Thus the notion of banks creating money or of money circulating with a finite velocity are demolished carefully and thoroughly by Alvaro Cencini in this book. Money loaned by a bank is activated only when drawn upon by the borrower to pay someone but both before and after this *instant* of payment, banks’ books balance. Each debt is matched by a credit, each liability by an equivalent asset’ (Meghnad Desai in his Foreword to Cencini’s 1988: xii).

<sup>97</sup> As a matter of fact this *does* happen in international payment transactions (given our currently defective international payment system) and consequently leads to serious world monetary disorders. Schmitt (1984) distinguished between bank-money, an instrument of intermediation utilized *within national economies* purely as a means of payment and bank-money that *somehow* transforms into a final object of payment *in international payment transactions*. He called on an international payment reform that would defer to the vehicular nature of bank-money in order to circumvent this unbridled payment disorder that, *apropos, still today* continues to fuel world economic and financial malaise. ‘Dans les économies nationales, les monnaies bancaires sont des instruments d’intermédiation, la théorie le reconnaît depuis toujours; lancées dans les paiements internationaux, les monnaies bancaires sont au contraire des biens finals; elles sont dénaturées; la réforme doit donc assurer le maintien dans les paiements internationaux de la nature purement “circulatoire” de la monnaie bancaire’ (Schmitt, 1984: 76).

L'intermédiation *financière* est néanmoins une opération couramment pratiquée par les banques. Elle existe et peut être constatée quotidiennement mais elle est toujours distincte de l'intermédiation *monétaire*. La distinction est respectée par la terminologie puisque l'intermédiation monétaire est la création de dépôts, l'intermédiation financière étant la transmission d'une épargne.  
(Ibid.: 44)

To re-assert, it is through the theoretical construct of emission<sup>98</sup> that **both the distinction and, definite interrelation of nominal and real money** find their outlet. Though banks issue nominal money, *banks in themselves* cannot afford it its purchasing power – the latter comes from nominal money's integration with *current* output. And this happens at the very moment wages are paid to workers. '[m]oney acquires its purchasing power at the very instant it is paid out to workers' (Cencini 1988: 31). Real money thus emerges as 'the 'load' carried by nominal money, the 'empty vehicle'' (ibid.: 31). Defined in other terms, a monetary entity is thus moulded by the simultaneous union of shell and product, nominal and real money, respectively. Moreover, a conception of nominal money arises as that of the form enclosing the very kinship that connects output with labour. Cencini succinctly captures money's dual aspect – so quintessentially evidenced by the interrelating yet very distinctive characteristics of its *nominal and real* make-up – in his following observation.

Of course, real money is not material in the obvious sense of the term. The materiality of money is defined by the identity, established through the payment of wages, between money itself and current output, and not by its physical properties. Likewise, nominal money is not money with no real existence. This term is only meant to define the concept of the form of value and not the virtual or hypothetical existence of money. But – and this is a crucial proposition to which we shall come back again and again – it would also be wrong to believe that nominal money can exist autonomously from real money. Nominal money and real money are so tightly linked together that it is impossible to determine one of them without simultaneously determining the other. Yet the distinction of the two concepts is of the uppermost significance since it allows the classical economists to prove that, although it is not a commodity, money defines the whole of produced goods.  
(Ibid.: 30)

Now it is because banks are *not* endowed with the divine ability to create a net asset from nothing that '[t]he emission of money, therefore, has to give rise to a book-keeping entry defining, at the same time, a debt and an equivalent credit to the same person' (Cencini 1995: 12). What is more, 'in the same way as the discovery of the number zero marked an important advance in the field of mathematics', as Cencini reminds us, it was the conceptualization of bank-money as an asset-liability that turned the key 'towards understanding the laws ruling

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<sup>98</sup> 'Keynes's monetary analysis is indeed the first to provide the elements for the definitive solution of the neoclassical dichotomy between real and monetary variables. And the integration between (a-dimensional) money and output is precisely the cornerstone of quantum theory'. (The latter is in reference to the Schmitt-Cencini theory of money emissions from which evolved their modern theoretical approach – quantum monetary macroeconomics.) And moreover, as Cencini continues and sums up 'since the emission of money pertains to the banking system, the association of money and output shall result from this emission' (Cencini 1988: 7).

our economic systems' (ibid.:13). Actually, it is the milestone that helps explain the appearance of income (money-income) in what our contemporary economic systems have come to evolve as, that is, capitalistic systems. Money-income is after all, what is required to *finance* payments in a monetary system<sup>99</sup>. The crux of the matter is that the asset-liability emitted by banks must *somehow* connect with the goods and services of the *real* economy outside the confinements of the banking establishment, *if it is to be transformed to income, money-income*. In Cencini's words it 'has to be linked to a payment allowing for the transformation of nominal into real money' (Cencini 1995: 14). He further points out that *only one type of payment does not necessitate the pre-existence of income, that which concerns the payment of wages*. 'In fact, while the payment of all the 'other factors of production' implies the pre-existence of money both as a unit of account and as an income, the remuneration of labour is completely original: it is this operation that allows for the transformation of (nominal) money into income (real money)' (ibid.: 14).

Keynes's monetary ideology of production is where he developed logical identities that lead to the *terminus a quo of the macroeconomic bedrock of macroeconomics*. In fact, his identity between global supply and global demand concerns 'the economic system taken as a whole, to wit, the *global* economic system' (Cencini 2012: 47). The idea of a period of tâtonnement (ibid.: 44) preceding a point of equilibrium as claimed by Walras's GEA (general equilibrium analysis) is rejected as Keynes evidences that there is no basis to justify that supply and demand ever do calibrate, this by the very fact that they are the alter ego effect of a single and unique manifestation. And as such, both are invariably and necessarily equal to each other. Through the process of production a double-faced *macroeconomic* entity<sup>100</sup> is born, producing at once *supply* – the 'physical output measured in wage units' (ibid.: 46) – and, *demand* – the money-income 'necessary to finance the final demand for this very output' (ibid.: 47). It is thus that 'national product and national income are the two aspects of one and the same object, so that, literally, one is the definition of the other', a notion upheld and 'already clearly shown by Smith in *The Wealth of Nations*' (ibid.: 46–47). Keynes's logical identity between supply and demand crystallizes the lien as brought about by production between supply (physical output) and demand (income, the 'product-in-the-money' as coined by Schmitt 1998)<sup>101</sup>. Production is hence envisioned as a *macroeconomic event* by which physical output is monetized and as such 'a positive income is formed, which defines a net increase of wealth for the whole economy' (ibid.: 46). It is irrelevant that production might be generated by one

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<sup>99</sup> It might serve well to remember after all that 'Keynes's attempt to construe a monetary theory of production is based in fact on the idea that money and output are associated through production. As clearly suggested by Keynes's concept of wage units, the payment of wages is the transaction allowing for the association of money and output – and, therefore, also for the transformation of money proper into money income' (Cencini 2012: 46).

<sup>100</sup> And as Cencini reminds 'following Schmitt (1998), we could call 'the product-in-the-money'' (ibid.: 46).

<sup>101</sup> Cencini explains, more importantly, that the identity is a 'macroeconomic law' that 'derives directly from the numerical nature of money as emphasized by its asset-liability definition (see Schmitt, 1975), and from the very essence of monetary production' (ibid.: 47). He reminds as well that one of the first objective of the science of macroeconomics is to delineate 'the logical laws' (ibid.: 47) that drive our monetary economies such that we can thereafter better define the anomalous deficiencies that obstruct the optimum operation of their respective systems. He cautions on the observation that, moreover, 'logical laws apply equally in an 'orderly' or in a 'disorderly' system, and that it is precisely when they are not heeded that they still demand their due, thus revealing the pathological state in which the economic system has put itself' (ibid.: 48).

agent or, by the entire set of a nation's firms, the end effect will be that of a net augmentation in domestic income<sup>102</sup>.

As the readers are probably beginning to formalize, it is at the international economic level that macroeconomics' inherent logical laws will be better understood and appreciated. In turn, it will be that much easier to apprehend the monetary anomalies that manifest themselves at the macroeconomic level of our world economies. Withal, it will become that much clearer as to why and how these global financial disorders actually originate and therewith unfold their detrimental wrath from within the current infrastructure of our international payment 'system'. And whence we reach this stage, we should not forget the fact that the logical workings of macroeconomic identities never waiver and thus loyally apply within an operational system whether the latter is dysfunctional or not. Instead, the system itself will malfunction and consequently yield deficient results *if it is* that its infrastructure is not conducive to the natural workings of the laws that govern the applicable macroeconomic identities.

Having clarified the nature of bank-money from a distinctive *national* perspective, thenceforth, we can more easily embrace the domain of macroeconomics by drawing on the importance of *understanding nations as macroeconomic entities*. It all centers on production. Through its process, a country's bank-money is able to monetize the goods and services of its nation *as a set*<sup>103</sup>, forming a net income<sup>104</sup> for its *economy as a whole, its macroeconomy*.

Now, in as much as the nature of bank-money is invariant whether considered from a national or international perspective<sup>105</sup>, a country's very currency is what identifies the nation with its own 'macroeconomic set' and this, on account of the fact that production is necessarily a macroeconomic occurrence<sup>106</sup> of the said macroeconomy. This is even more evident if

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<sup>102</sup> 'According to this interpretation, Keynes's concepts of global supply and global demand stand for macroeconomic supply and macroeconomic demand, and concern every new production taking place in a given domestic economy' (ibid.: 47).

<sup>103</sup> Cantor's development of the notion of *set* is just as instrumental for the field of monetary economics as was the conceptualization of zero (first amongst a series of negative and positive integers) to double-entry bookkeeping, in that, as noted by Cencini, it 'helps define the whole of a country's economy' (ibid.: 54). Consequently, when we describe a nation's *macroeconomy* we intend the *set* of its inhabitants and this explains why any economic transactions executed by the latter must always 'be evaluated with respect to the set itself in order to determine whether they are of a macroeconomic nature' (ibid.: 54). As Cencini pointedly distinguishes 'an event is of a macroeconomic nature if it modifies the situation for the set of a country's residents, whereas it is of a microeconomic nature if it does not alter the initial situation of the set' (ibid.: 55).

<sup>104</sup> It should also be kept in mind that '[l]abour is at the origin of income, and this is essentially the reason why production is a macroeconomic event. The formation of a new income requires a new production, which itself requires – as a prerequisite – a positive 'expenditure' of labour' (ibid.: 57).

<sup>105</sup> '[T]he vehicular nature of money does not change when we move from an economy of production to an economy of exchange' (ibid.: 60). That is, from an economy of production within nations to an economy of exchange at the international level, 'international economics being identified with international exchanges' (ibid.: 58).

<sup>106</sup> '[D]etermining the amount of income available in the country as a whole (the macroeconomic set), production is a macroeconomic event even if it is carried out by a single producer' (ibid.: 54).

considered abstractly as in the case of multinational production<sup>107</sup>. The reason being is that a nation's unique currency is that which is ultimately responsible for monetizing the goods and services being produced as part of its national output, whether the latter are produced within its own nation or, abroad. 'Commodities produced in the USA, for example, are monetized in dollars, and it is precisely this monetary identity which defines their origin' (Cencini 1995: 123).

Before we forge ahead to elaborate on the subtle yet substantive significance with reference to the principle of double-entry bookkeeping, let us recapitulate. Thus far, we have seen why banks can't issue money *as assets per se*. The asset-liability, a mere accounting book-entry which but defines the issuing bank's acknowledgement of debt, *needs* the process of production in order to mould with current output and acquire purchasing power. Through labour it thus transforms into money-income that is *net* for the country as a whole. We should also by now have a clearer understanding as to why the identity of macroeconomic supply and macroeconomic demand logically derives from this asset-liability characteristic of bank-money, as does the identity *between each economic agent's sales and purchases* (see Schmitt 1975). We will eventually examine, more thoroughly, why the latter identity also very naturally applies to nations, that is, to countries as macroeconomic entities.

Next, moving onwards to double-entry bookkeeping.

### **As regards double-entry bookkeeping and double double-entry bookkeeping**

The fundamental significance, we could even speak of practical essence with respect to the *double record-entry* aspect of bank-money is that this distinctive element accounts for the fact that 'income is always necessarily deposited with banks' (Cencini 2012: 60). And a good proof of this is that this vehicular manner – double-entry bookkeeping – by which banks *can and only can* issue money<sup>108</sup> is what lays the foundation from which originates the macroeconomic law of the identity between each economic agent's sales and purchases. On a national level this implies that the labour force (wage earner) is a seller on the labour market (the instant wages are paid to the worker) and a simultaneous purchaser on the financial market. On paying wages to workers, banks credit the latter with a bank deposit. This marks the income earners' net purchase of bank deposit claims with the very banks where their income is held (in the form of bank deposits and defining the said income holders' financial market purchase). What is important to retain here, is that what these income earners (or, any other future economic agent eventually replacing initial income holders or workers) own is

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<sup>107</sup> 'Multinational production, as the name clearly suggests, takes place in various countries, and not in a true international 'space'. This is confirmed by the fact that a production 'nationality' is not determined by the place where it is carried out, but by the money it is associated with. Petrol extraction in extra-territorial waters is defined on the basis of the money used to cover its costs, and it is therefore part of the national production of the country (or countries) whose money is paid out to the factors of production' (Cencini 1995: 123).

<sup>108</sup> Without doubt, money – bank-money – is needed to measure the whole of a macroeconomy's goods and services, its national output. But as we have also shown, bank-money is not only vital in its role as an accounting unit but ultimately, through wage payment and the formation of bank deposits a new and net income appears – for the whole of the country's economic system – which essentially *monetarily* defines the said country's output.

not *income per se* but rather *bank deposit claims* with the banks whereby it is deposited (see previously cited above). And so when owners of bank deposit claims want to *purchase on the commodity market*, they must *sell on the financial market* (the banks whereby their income is held) their claims on these bank deposits in order to obtain the necessary finance to do so<sup>109</sup>.

Hence it does become very evident that, '[o]wing to the bank-entry nature of money' and the macroeconomic identity between each economic agent's sales and purchases which derives from bank-money's double-entry recording of payment transactions, inevitably then 'income is always necessarily deposited with banks' (ibid.: 60).

But how does this all play out at the international level? Well firstly, we have seen that nations are considered as macroeconomic entities by the simple fact that their respective unique monies 'outside their issuing banking systems, define the acknowledgement of debt of their entire countries' (ibid.:58). Nations are inevitably and necessarily implied in the payment transactions of their residents and as such reciprocally interchange between being net debtors of the rest of the world or, net creditors and this, on behalf of the set of their residents. We have also explained that bank-money's vehicular and nominal aspects do not vary, whether considered from within a national or international context. Within its country borders, bank-money represents the acknowledgement of debt of the very bank issuing it, whereas across its borders it represents the acknowledgement of debt of the said country, considered as a whole – as the set of its residents. And since this *asset-liability* is a flow that is instantaneously issued and returned *from and to* the same bank, it can thus never be transported (within or abroad). This fact clearly defining it as a mere means of payment, crystallizes the reason *why* it could never, of its own, *finance* a payment – its instantaneously occurring flow, very simply, is never intercepted. Matter-of-factly, this asset-liability is itself the flow whose instantaneousness and circular direction is *to and from the very issuing bank*, existing only during payments, to *record* the payment transactions. 'Because of its necessary circular flow, money cannot finance any net purchase, either within a single banking system or between countries. This clearly means that purchases have to be matched by simultaneous sales carried out through the circular flow of money' (ibid.: 60). From an international perspective, this establishes the premise by which the difference between a country's payments and receipts to and from foreign nations should equilibrate, always. This means that a nation's purchases 'of foreign real goods, services, and financial assets is necessarily balanced by its sales of domestic real goods, services, and financial assets' (ibid.: 60). Hence is the proof that the macroeconomic identity between each nation's (here considered as the economic agent) sales and purchases is also very real for countries, as macroeconomic entities. And the functional applicability of this macroeconomic principle will never waiver despite the state of affairs, that is, despite the fact that the infrastructure of the system (to wit, international payment systems as currently set up within the Euro area or worldwide) might not be conducive to its theoretical requirements. In fact it applies in defiance of any microeconomic endeavours whether with respect to the individual economic players' misunderstanding of applicable macroeconomic laws – a lack that could well explain why they would implement payment systems with dysfunctional infrastructure – or, in spite of any economic or financial decisions that they might then execute within these deficient systems.

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<sup>109</sup> As interestingly observed by Cencini 'banknotes themselves are nothing more than claims on the central bank's deposits' and as such 'the law is always verified: the purchase of real goods and services is necessarily balanced by a sale of financial claims' (Cencini 2012: 60).

Let us exemplify to what extremum and just how independently of economic agents'<sup>110</sup> decisions this infallible rule will apply, at the international level.

We begin our demonstration by referring to an illustration of Cencini whereby he describes the applicability 'of the identity between each country's sales and purchases' (ibid.: 60). He considers the example of a trade deficit country and explains how transactions would evolve depending on whether the country was or was not that of a key-currency. He differentiates between the two case scenarios by clearly stipulating that if the said country is a non reserve currency nation, it pays for its net commercial purchases either through an augmentation of its external debt (net foreign borrowing) 'or by reducing its official reserves of foreign currencies' (ibid.: 60). This implies that, ultimately, the non key-currency country *finances* its net commercial purchases with 'a net sale of financial claims – either domestic financial claims if it gets indebted, or claims on foreign bank deposits if it reduces its official reserves' (ibid.: 61). But next is the crux of the problem that can arise – given the yielding construct of the *relative* system of exchange that forms the basis of our current system of international payments – in the case in accordance with which the exemplary country *is* of key-currency grade. Somehow, still today, it is erroneously considered that such a country 'can settle its trade deficit' (ibid.: 61) by exporting an amount of its own currency to the *asset* side of its trading partner's banking system. However, as Cencini reminds us, given the very principle of double entry accounting, what is actually transferred to the creditor-country is *not* a quantity of the debtor-country's money but rather, a *claim on the bank deposits* of the latter. Moreover this shows that yet again in this key-currency case scenario, the debtor country's 'net commercial purchases are financed by' its 'net financial sales' (ibid.: 61). ***Infallibly, the macroeconomic identity between each trading nation's sales and purchases holds.*** What then is so anomalous with this end result? The problem is that the *relative* system of exchange underlining the infrastructure that governs our current international payment system is deficient in its ability to work in a complementary manner with the very principle of the identity. Quite seriously, the system is at odds with the identity's fundamental significance and consequently leads to grave monetary disorders one of which, being that, it enables 'monetary duplication' (see Cencini 1995: 13 and 2012: 65). Let's step back in order to properly consider this. As understanding the reason for the occurrence of this anomaly should in turn help us understand other detrimental effects that originate within our current international system of payments given its lack of respect for bank-money's vehicular nature and principle by which it is issued by banks via an asset-liability double-entry bookkeeping. In today's 'system' of international payments (*based on a regime of relative exchange*), a *reserve currency* nation has the special advantage (otherwise known as 'the exorbitant privilege' see Rossi 2009 and 2012) of being able to pay for its net commercial imports using its own currency. Very simply, it transfers its bank deposit claims over to the net exporting country. Hence the latter is paid with a mere acknowledgment of debt, an I.O.U. if you will<sup>111</sup>. But despite the fact that today's bank accounting device of 'double-entry book-keeping grants the 'vehicular' use of currencies both at the national and international levels' (Cencini 2000: 12) the 'key-currencies standard regime under which we live in' (Cencini 1995: 7) 'allows for a phenomenon of monetary *duplication*' (ibid.: 13). On examining the international accounting book-keeping entries, it can be observed (as was first noticed by Rueff 1963) that

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<sup>110</sup> Implying independently of any *behavioural* influence to include 'decisions taken at the microeconomic level' (ibid.: 61) of the respective trading countries interacting as macroeconomic entities in an international setting.

<sup>111</sup> Outside its issuing national banking system, a country's currency is nothing but an acknowledgement of debt of the institutional banking system of the said macroeconomic entity, the country considered as a whole.

when a key-currency nation pays for its net commercial imports, an amount of this debtor's currency is recorded on the asset side of the exporting-creditor country's banking ledger. 'To this end, no bank of issue should be able to lend a foreign creditor the currencies against which it had already created a buying power in its own monetary field' (Rueff 1963: 326). Now in keeping with the vehicular nature of bank money, the importing-debtor country's currency inevitably undergoes an instantaneous flow-back to its original point of issue, that is, to its country's very bank system. What should and does follow next is that the sum of its currency recorded on the asset side of the exporting country's bank accounting system 'should be immediately replaced by an equivalent amount of financial claims' (Cencini 2000: 13). 'This is indeed what happens' (ibid.: 13), given the exporting-creditor country's 'banking system becomes the owner of a bank deposit' (ibid.: 13) which came into being and still remains in the importing-debtor country. This means that the same claims over the debtor/net importing country's bank deposits are at the *simultaneous disposal of both the debtor and the creditor country*. However, the ones at the disposal of the latter are mere duplicates of the original counterparts still attached to the country of issue (key-currency importing country). More importantly, contrariwise to the duplicates, only the claims flowing within the debtor country carry *real* substance, '[s]ince the national output defining the object of these claims is not itself doubled' (ibid.: 13). And we should remember that whilst the issuing country's banking system (debtor) will loan within the debtor country 'the totality of its deposits' (ibid.: 13) 'the banking system' (ibid.: 13) of the exporting-creditor country 'is free to lend its duplicates on the foreign exchange market' (ibid.: 13). It soon becomes clear that the system of *relative* exchange rates that forms the basis of our current non-system of international payments is the very culprit of the latter's many economic, financial and political woes. For one, it permits key-currency countries to become indebted by paying with a mere acknowledgment of debt (in which case it deprives the payment system of payment finality, see also Rossi 2012). Moreover, their I.O.U.s thus transformed into *positive-asset duplicates*, they eventually find their way to the foreign exchange market to fuel a speculative market – of what is best referred to as *xeno-currencies* 'as suggested by Triffin' (ibid.: 13) (see also Triffin 1968) – which in turns fuels an erratic fluctuation in exchange rates<sup>112</sup>.

If instead, 'the system of international payments were founded on the circular use of an international currency' (Cencini 2000: 14) like it would be were it based on a system of *absolute* exchange rates, an inherent procedural mechanism would evoke a reciprocal transfer of financial securities to the exporters of goods and services as *final* compensation (*real* payment finality) for their exports. This optimal system currently not in place, consequently, the export-sellers potentially remain with a claim on the import-buyers (with particular reference to key-currency net importing countries). If we were to reform the structure of international payments 'on the circular use of' (ibid.: 14) an international monetary unit of account, duplicates would not *themselves* be transformed into positive assets and in the case especially of a key-currency country, the latter would thus have to exchange financial securities in order to *finance* its net imports *in such a way as to assure payment finality*. This exchange would trigger a refluxing such 'that the instantaneous reflux of its currency would be explicitly recorded, thus avoiding the book-keeping duplication of financial claims taking place today' (ibid.: 14).

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<sup>112</sup> 'The passage from the present system of *relative exchange rates*, implied by the use of national currencies as international objects of exchange, to a system of *absolute exchange rates*, in which currencies are no longer traded, will guarantee costless the stability of exchange rates without forcing countries to abandon their monetary sovereignty' (Cencini 2012: 66).

Now as indicated earlier, within the Euro zone, a similar occurrence of international payment finality absence is also evidenced given the confines of the regime of relative exchange rates that forms the basis of the existent non-system of international payments. Only, this problem was not so evident till the onset of the 2009 financial crisis, particularly the ‘euro-area crisis’ as referred to by Rossi. ‘In fact, before the euro-area crisis broke out near the end of 2009, that is to say, during the first ten years of Euroland, this problem was not perceived, as the large majority of those claims that resulted from a lack of payment finality between EMU member countries were cleared through the purchase by creditor countries’ financial institutions (including pension funds and insurance companies) of either corporate or government bonds issued by residents in debtor countries’ (Rossi 2012: 228). This meant that the debtor countries ‘were thereby in a position to finance their trade deficits through a sale of financial assets’ (ibid.: 228). Moreover, the reciprocal exchange would have likely enabled the instantaneous refluxing of their respective currencies versus remaining on the asset side of the exporter country’s balance sheet as a *problematic* duplicate.

This absence of payment finality witnessed within the Euro zone, highlights the serious deficiencies inherent within ‘the infrastructure and mechanics of the TARGET2 ... system’ (ibid.: 222). In his 2012 paper regarding TARGET2 imbalances, Rossi warns that ‘exporting countries still have a claim on the ESCB – also called the Eurosystem, which includes the European Central Bank (ECB) and the national central banks (NCBs) of euro-area member countries – once these countries are ‘paid’ for those goods, services, and/or assets that their residents export in excess of what they import during the relevant period of time. It is therefore a payment deficit that originates intra-euro-area imbalances eventually’ (ibid.: 221). Clearly, ‘all those unsettled positions within the euro-area-wide payment system’ (ibid.: 222) point to the alarming fact that ‘trade-surplus countries still have a claim on trade-deficit countries. Their debt-credit relation is not settled thereby. Quite to the contrary, it grows further, period after period, owing to repeated trade imbalances of the same algebraic sign’ (ibid.: 230).

In sum, the problem in having an international ‘system’ of payment based on a regime of *relative* exchange rates<sup>113</sup> is that currencies are exchanged against one another as though they were themselves commodities<sup>114</sup> that have to be paid for. Hence Keynes’s ‘transfer problem’ in reference to the difficulty of getting the financing of a debtor-country’s payment over to the creditor-country, particularly if the former does not have the distinguishing characteristic of being a reserve-currency country. Without this privilege, even the payment of net imports proves to be self-defeating as the country ends up having to finance the transport vehicle as well, in addition to financing the payment of the purchase itself. Simply, the accounting infrastructure via which international payments are processed is set up incompatibly with the vehicular nature of bank-money as dictated by its double-entry bookkeeping. Specifically, its current deficient construct is such as to render it incapable of *properly* respecting the infallible workings of essential macroeconomic laws such as the identity of each economic agent’s (nation as macroeconomic entity) sales and purchases which identity, let us remember, derives from the very vehicular nature of bank-money and banks’ double-entry bookkeeping

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<sup>113</sup> Such a regime operates in defiance of bank-money’s vehicular nature; in fact, it is within this regime’s non-conductive setting that bank-money rather ends up being considered as an asset per se.

<sup>114</sup> And, this runs against the fundamental essence of the macroeconomic law of the identity of each country’s sales and purchases as derived from the principle of bank’s double-entry bookkeeping of bank-money – a mere unit of account.

of it. In the absence of a *proper*<sup>115</sup> system of international payments, a country's purchases are not necessarily matched by *equivalent*<sup>116</sup> sales. Moreover, in addition to robbing the payment system process of payment finality<sup>117</sup> and, let alone the detrimental consequences<sup>118</sup> of the monetary *duplicates* themselves, both effects which result because of a lack of true understanding<sup>119</sup> of bank-money's inherent circular nature, this shortcoming is but one part of the problem. The added fact that the current 'system' of international payments does not respect nations as 'macroeconomic entities' (Cencini 2012: 58) existing independently of their residents, leads to yet another very serious monetary disorder at the macroeconomic level that particularly affects countries' external debt<sup>120</sup>. The problem is general and concerns both the net interest payment and the very formation of external debt. The analysis applies as well to reserve as to non reserve-currency countries: given the construct of today's 'system' of international payments, a *real* and *monetary* payment add up to one another and this happens whether the country is of key-currency or not. Though in the latter case (non key-currency), the country's *second monetary payment* (with respect to its net interest) negatively affects its official reserves, the implications differ for a reserve-currency country<sup>121</sup>. We thus come to realize that not only is it important that a true international payment system's infrastructure respect the inherent vehicular nature of bank-money and the principles and

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<sup>115</sup> Such as one of absolute exchange rates, whereby country currencies would be exchanged against themselves via the intermediary of 'an international currency playing the role of a common standard and of an international *means* of payment' (Cencini 2012: 65), analogously to how the payment process evolves in a national setting between secondary and central bank-money.

<sup>116</sup> Despite the infallible application of the identity, we have to keep abreast of the problem: a country's transfer of its claims on its domestic bank deposits over to foreign creditors as a form of payment, will lack payment finality in that it is but a transfer of a mere acknowledgement of debt of its very own institutional banking system. This lack of payment finality is currently evidenced in the Euro zone given the zone's monetary system is without a true unique currency (see Rossi 2012; also Cencini 2012a). The current situation, with respect to Member States' international payment transactions which result in 'soaring imbalances' (Rossi 2012), very much reminds of the 'exorbitant privilege' (see Rossi 2009 and 2012) that is afforded to key-currency countries and particularly enabled through an international 'system' of payment that, still today, is based on a regime of *relative* exchange rates. A regime that, incidentally, is partial to reserve-currency countries, if permitted a further parenthetical remark.

<sup>117</sup> Our meaning: our current regime of *relative* exchange rates enables key-currencies to act as though they were net assets (see also Rossi 2012 for an explanation of same phenomenon currently occurring within the Euro zone).

<sup>118</sup> If we remember what happens whence they find their way to the foreign exchange market and are traded as though they were commodities, the end result causing erratic fluctuations of exchange rates.

<sup>119</sup> As is evidenced by the manner in which international payments are currently carried out.

<sup>120</sup> This is not to say that today's economists deny the existence of nations independently of their residents. Rather, by accepting the existence of a country's external debt, they do, implicitly, recognize that a nation exists as well as a macroeconomic entity. However, it is the infrastructure of our current 'system' of international payments that is not compatible with this very reality. Consequently, countries get indebted (additionally to their residents) even though their residents have paid the totality of their purchases.

<sup>121</sup> Given its indebtedness, in relation to its net interest payment (as well in general), does not involve the sale abroad of domestic financial assets – an outcome of its key-currency status.

identities which derive from it, but so too is it just as important that the operational system is programmed in such a way as to recognize and respect the macroeconomic existence of nations, independently from that of its residents.

Now, before we progress towards ultimately defining a country's external debt and pinpointing the source of the crucial monetary disorders that currently affect it, it might be worthwhile to discuss the distinction of double-entry bookkeeping from that of double double-entry bookkeeping.

The differentiation arises on resorting to a more comprehensive meaning of *double-entry bookkeeping*. Though the *principle* implies the double recording of payment transactions in the accounting ledgers of the banks that carry them out, it does not imply that *only* the payee is credited and the payer is debited. 'As a matter of fact, each payment is double-entered twice, once with respect to the payer and once with respect to the payee' (Cencini and Citraro 2012: 261). This is in accordance with the true recognition that banks play only an *intermediary* role and that 'money is a simple catalyst, a means of payment, and not the object of the payment' (ibid.: 261). The authors consider the simple example of when output is purchased by the holders of income. '[T]he bank issues money to the benefit of the payer – it credits the payer with a positive amount of money – and carries out the payment on his behalf: it debits him with an equivalent amount. Simultaneously, the bank credits the payee with the same sum of money, and debits him by making him a bank deposit holder' (ibid.: 261). Hence the essence of **double** *double-entry bookkeeping* by which banks can indeed remain pure intermediaries whilst carrying out *double* credits and debits in a twofold manner with respect to payers and payees, a manner which respects the vehicular aspect of bank-money.

Now Cencini and Citraro explain how this intrinsic property which characterizes the principle of double-entry bookkeeping, that is, the recording of payment transactions via a twofold credit and debit – true double-entry bookkeeping: **double** *double-entry bookkeeping* – very naturally translates to the accounting of international transactions.

[T]he very principle identifying a national payment system can also be taken as the necessary reference for the economic recording of international payments. *Mutatis mutandis* then, each payment between residents and non-residents as well as each payment between countries (sets of residents) should be recorded as a double credit and a double debit, leading inevitably to a perfect balance between the payments recorded by each country, and those recorded by all the world countries taken together. In other words, based on the rules of double-entry book-keeping, the balance of payments of each individual country should necessarily add up to zero. Likewise, surplus and deficit countries being inter-related, the current account of all world countries should thus be perfectly balanced, as should be the world capital and financial account.  
(Ibid.: 262)

Nevertheless, they advert to the reality of a very different state of affairs that has become mysteriously alarming, whereby the world current and, capital and financial accounts are widely at variance – absolutely otherwise – with their expected harmonic balance. 'Known as the world current account discrepancy and the world capital and financial account discrepancy, these imbalances are a clear symptom of the disorder characterizing the current international monetary system' (ibid.: 262). The authors refer us to Citraro's 2004 in-depth study that moreover evidences that '[s]o far, however, analyses of world accounting discrepancies have identified their cause with statistical misreporting, thus failing to provide a satisfactory explanation of a phenomenon that has shown no abatement despite significant

improvements in data collection (Citraro, 2004)' (Cencini and Citraro 2012: 288-89). They draw our attention to the fact that, still at the very time of their recent writing 'conventional solutions fail, because they rest on a flawed understanding of the principles of international macroeconomics. To be clear, the macroeconomic aspect of international transactions goes totally unnoticed in traditional analysis. The lack of clear distinction between the aggregate of a country's residents and the country as a totality – the set of its residents – points to why the world accounting discrepancies are still a mystery' (ibid.: 262).

Next, let us regress a little so as to briefly revisit the true meaning of the balance of payments, particularly as can be evidenced from its relation to the principle of double-entry bookkeeping.

### **On re-visiting the balance-of-payments and its interrelatedness with double-entry bookkeeping**

Setting the stage then, let us take account of two important and factual points. The first is that '[c]onventionally, transactions are entered in two major accounts: the current account (CA) and the capital and financial account (KFA) according to the principles of double-entry book-keeping' (Cencini and Citraro 2012: 264). Yet despite this accounting convention, the equality of effect with respect to balance of payments – as should be expected from the strict adherence to double-entry recording – very much lacks. 'One of the most puzzling problems balance-of-payments experts have been confronted with is that of reconciling the statistical discrepancies resulting from data collection and compilation with the necessary equilibrium of the balance of payments entailed by the use of double-entry book-keeping' (ibid.: 264). The authors provide a compelling approach to interpreting the true meaning that should logically ensue from the balance of payments identity (see 10.1 ibidem 264<sup>122</sup>), that is, if insightfully understood from a macroeconomic perspective whilst, keeping abreast of the very principle which underlines double-entry bookkeeping. Their analysis draws a comparison between Meade's (see Cencini and Citraro 2012, as well Meade 1951) 'one-sided vision of the balance-of-payments equilibrium'<sup>123</sup> with that of a less orthodox and innovative interpretation of the identity as is afforded by 'applying to countries the macroeconomic law formulated by Schmitt (1975) in his *Théorie unitaire de la monnaie, nationale et internationale*. According to Schmitt's law, each agent's purchases are immediately balanced by equivalent sales and, reciprocally, each agent's sales are necessarily matched by equivalent purchases made by the same agent' (Cencini and Citraro 2012: 266).

Now we have shown that Schmitt's macroeconomic law of the identity between each economic agent's sales and purchases derives directly from the fact that bank-money is but an acknowledgment of debt of the very issuing bank, a mere unit of account – a flow whose circular direction is never intercepted from instantaneously returning to its very point of issue. Matter-of-factly, '[c]ompliance with double-entry book-keeping guarantees the vehicular use of bank money' (ibid.: 266). As such, money per se, can never *finance* a purchase which implies that 'each economic agent can finance its purchases only through simultaneous sales

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<sup>122</sup> Specifically, equation 10.1 as referred to by Cencini and Citraro 2012, p. 264.

<sup>123</sup> See Cencini and Citraro 2012, p.267

of the same amount' (ibid.: 266)<sup>124</sup>. In thinking about it, it is indeed the *manner* by which bank-money is issued, that is, via *double double-entry bookkeeping*, that accounts for the double-sidedness of payment transactions. As a result, each one of the latter should be 'recorded as a debit and as a credit of both the seller and the purchaser' (ibid.: 266). Contrarily to 'Meade's one-sided vision of the balance-of-payments equilibrium' (ibid.: 267) whereby 'the matching of debits and credits simply follows from the trivial observation that a country's sales are another country's purchases' (ibid.: 267), Schmitt's interpretation of the said equilibrium of the balance of payments, considered internationally, implies 'that each country is at the same time a seller and a purchaser' (ibid.: 266). His analysis derives from his very own macroeconomic law (see Schmitt 1975) of the identity between each economic agent's sales and purchases that itself is a natural consequence ensuing from the rule<sup>125</sup> that underlines *double, double-entry bookkeeping*. And, when Schmitt's macroeconomic law is 'applied at the international level it concerns the *flow of payments* carried out by countries' (ibid.: 266) and the law is validated whether with regard to the CA or, the KFA<sup>126</sup>. Hence it is through the international application of Schmitt's macroeconomic law of the identity between each economic agent's purchases and sales *which itself derives* from the very principle of double-entry bookkeeping – *double, double-entry bookkeeping* – that the latter's interrelatedness with the balance of payments becomes clear. In retrospect, it all boils down to the simple fact that bank-money is emitted by banks as a record-flow 'that has to comply with the rule of double-entry book-keeping' (ibid.: 266), the very manner by which it is issued by the said banks, and at that as a mere acknowledgment of debt. This essential fact lays the basis from which we can then readily understand why it is that money per se can never be the object of a payment transaction. And as well understand, the natural relevance of Schmitt's macroeconomic law regard the identity between each agent's sales and purchases that ensues from this double double-entry bookkeeping. Moreover, considered from an international perspective, it ultimately becomes evident how the latter identity, in turn, translates over to 'the balance of payments being a fundamentally logical identity' (ibid.: 262). Through an illustrative account, Cencini and Citraro 2012 show that the 'overall identity is thus the consequence of the logical requirement to enter each single transaction in compliance with the principles of double-entry book-keeping' (ibid.: 265). Their example demonstrates just how the identity 'implies the necessary equality between the net receipts (expenses) of a given country and its net foreign lending (borrowing)' (ibid.: 266). They take the example of a trading country and illustrate the ideological implications of the identity with respect to international payment transactions as recorded in both its current and capital and financial

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<sup>124</sup> Cencini and Citraro 2012 moreover remind us of what this means from an international perspective: 'when a country purchases on the commodity and financial markets, it has to finance its purchases by equivalent sales on one or both of these markets' (ibid.: 266).

<sup>125</sup> In an international setting, the rule establishes the premise by which each payment transaction between nations is doubly recorded, once with respect to each country – as both a credit and a debit for *each* of the countries. This reinforces the fact that from an accounting perspective, 'each country is at the same time a seller and a purchaser' (ibid.: 266).

<sup>126</sup> Specifically, as per the authors' (Cencini and Citraro 2012) elaboration 'every transaction in the current account being an income-related flow while every transaction in the capital and financial account is an asset-related flow' (ibid.: 266), the balance of payment equilibrium 'implies the necessary equality between the net receipts (expenses) of a given country and its net foreign lending (borrowing)' (ibid.: 266). However, we will later show that a thorough analysis of these payment flows proves crucial to understanding and finally pinpointing an anomaly that underlines substantial balance-of-payments *imbalances* that then lead to serious world monetary disorders.

accounts respectively, depending on whether the nation is considered a net commercial exporter or, net commercial importer<sup>127</sup>.

[I]f a country has a positive trade balance, this implies that it is a net purchaser of foreign claims. Indeed, the credit entered in the country's current account is balanced by a debit entered in its capital and financial account. Because of its net sales of real goods and services, the country benefits from a payment that is immediately invested toward the purchase of foreign financial claims, so that the credit of the country's current account is matched by a capital outflow. The opposite applies when the country runs a trade balance deficit. Its net commercial purchases are balanced by a net sale of financial claims, that is, by an increase in its foreign debt.  
(Ibid.: 266)

Now, the law of the identity between each nation's purchases and sales which is essentially the identity of the balance of payments 'applies equally well to payments relating to capital flows only' (ibid.: 266). Cencini and Citraro explain by considering the example of 'the payment matching a country's net export of financial bonds' (ibid.: 266). '[T]he capital inflow corresponding to the country's sale is immediately balanced by an equivalent purchase of claims on foreign bank deposits, which defines a capital outflow. By selling its financial bonds, the country is the recipient of a foreign investment and becomes the owner of foreign bank deposits' (ibid.: 267).

On summarizing then, when international payment transactions are carried out in such a manner as to respect the fundamentals of *double double-entry bookkeeping*, it should always validate the fundamental identity of a nation's balance-of-payments. Moreover, given the interrelatedness of debtor and creditor nations, 'the current account of all world countries should thus be perfectly balanced, as should be the world capital and financial account' (ibid.: 262). But in reality, this is not how things evolve. Despite the fact that payment transactions are entered in strict conformity with the principle of double entries (as per above) a balance-of-payments discrepancy is continually and increasingly evidenced with respect to both the world current and, capital and financial accounts. But what is equally as outstanding is that the source of the discrepancy has been a long-time mystery that continues to elude the understanding of many. 'Economists and IMF experts explain the existence of what they call a statistical discrepancy between the current account and the capital and financial account by referring to inaccuracies in data collection and compilation, the absence of simultaneity between corresponding entries, and differences in the sources of related data. 'Because data from different sources may differ in coverage, accuracy, and timing, the balance of payments accounts seldom balance in practice as they must in theory' (Krugman and Obstfeld, 2003, p.320)' (Cencini and Citraro 2012: 267).

If it is indeed a 'fact that balance-of-payments entries are recorded in accordance with the rules of double-entry-book-keeping' (ibid.: 267), where best then could we look to unravel the very source of the world balance-of-payments statistical imbalances? In a next chapter we will attempt to show why an examination of international payment flows might be a good starting point.

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<sup>127</sup> The true implications of the balance-of-payments identity *as outlined above*, could ideally be established through the implementation of a new and *generalized* system of international payments.

### **3 The black hole. An analysis of the monetary flows implicated in a country's net foreign borrowing and of the consequential monetary deficit that is pathologically generated**

#### **Introduction**

On examining international monetary flows, we are able to discern the manifestation of serious anomalies within our current international payment system. Each time a debtor country benefits from a net foreign borrowing to pay for its net foreign purchases/total imports or to increase its international reserves and refinance its domestic economy, in so doing, the country doubles its external debt. It might also bear a simultaneous increase in debt and decrease in official reserves<sup>128</sup>, the latter ultimately financing a *monetary* deficit. That is, the difference in its monetary inflows and outflows that arises upon borrowing from abroad.

We have a look at the monetary flows that are implicated for a country whenever it is involved in a net foreign borrowing due to the necessity to finance its deficit, difference between its total purchases (commercial and financial) and its total sales (commercial and financial). Specifically, we examine how these flows evolve, as dictated by the very fundament of double-entry bookkeeping. We soon detect that the faulty structure of our current system of international payments is unable to complement the *flow-aspect* of bank money and is essentially responsible for generating the *costly* monetary deficit that infallibly arises.

#### **On the *sovereign* and *external* debt of a country**

Broadly speaking, *external debt* intends the debt of a nation that is owed to foreign creditors. However, it is important to understand the expression within context of the specific meaning that is attributed to the said country. That is, whether we are referring to the domestic economy of the country or, to the country considered as its own macroeconomic entity (as the set of its residents). This is because when expressed with respect to a nation's domestic economy, it is not associated with any pathology<sup>129</sup>. But the situation is altogether different when the expression refers to the *nation as a whole*: it is here that the expression transcends to

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<sup>128</sup> The decrease in official reserves defines the second charge given a decrease in reserves is tantamount to an increase in debt. From here onwards, any time that we will speak of reduction in official reserves, we will implicitly consider it equivalent and interchangeable with the incurring of a new debt.

<sup>129</sup> External debts are anomalous only to the extent that, in today's non-system of international payments, they include sovereign debts. Sovereign debts are indeed anomalous and their very existence is what defines the pathology. 'Sovereign debts are always the charge of an external debt already carried at 100 per cent of its value by the domestic economies of countries whose imports are greater than their exports' (Schmitt 2014: 14).

that of a country's *sovereign debt* and this time the debt is considered anomalous and in fact, it should not even exist, that is, as a proper infrastructure would have it, *in a true system of international payments*. Our analysis of international monetary flows, in this chapter, aims to establish the double burden of external debt with respect to its very formation. We do this by evidencing the duplication that arises when a *sovereign debt pertaining to the country as a whole simultaneously and pathologically* adds to that of the *ordinary* (see Schmitt 2014) *debt of a nation's domestic economy*. 'Every economist makes the distinction between a country as a whole and its domestic economy. This distinction, not at all original since the beginning of our science, acquires an increased significance once referred to the separation between 'ordinary' debt and sovereign debt' (Schmitt 2014: 20).

Let us ponder the significant meaning that underlines Schmitt's following message on considering sovereign debt, sovereignty and the borrowing of foreign currencies.

Economists speak a lot of sovereign debt. What is totally unknown is the fact that the sovereign debt, incurred by deficit countries themselves, adds up to the ordinary debt incurred by their respective domestic economies. Moreover, the sovereign debt is conceived of as the unique charge arising out of net imports. Indeed, it has also to be admitted that the idea of sovereignty remains blurred. It can be correctly grasped only when foreign currencies lent to countries, set of their respective residents, are distinguished, as they must logically be, from the foreign currencies lent to their domestic economies:

- a. Foreign currencies lent to countries are real values; they are real values even though they are monetary.
- b. Foreign currencies lent to domestic economies respect the logical nature of money, because they are nothing other than pure numbers whose function is only to measure real goods.

The illogical nature, the ill nature we could say, of the foreign currencies borrowed by countries themselves is but the translation of the 'pathological' character of external debts' second charge.

(Schmitt 2014: 13–14)

The essential point here lies in the 'distinction between money units and sums of real goods' (ibid.: 37). That is, *foreign currencies lent to the nation as a whole* are considered as having *real value* because after all these '*foreign currencies borrowed to pay for net imports have as their object real goods to be exported in a future period*' (ibid.: 37). It is with this same logic that we observe that the *compensating loss* of the borrowing country's domestic resources, entailed in the payment of its net imports or domestic re-financing, implies a loss of a *net* asset that leads to the formation of an anomalous *sovereign debt which duplicates its ordinary external debt by adding to it*.

## The *net* monetary outflow

Schmitt's macroeconomic identity (1975) that stipulates that economic agents' sales and purchases are simultaneously and inversely balanced stems from the flow aspect of bank money that comes with adherence to *double* double-entry bookkeeping. We remember that this means that money, per se, can never be the end term of a payment and this holds as well at the international level. '[T]his means that, when a country purchases on the commodity and financial markets, it has to finance its purchases by equivalent sales on one or both of these

markets' (Cencini and Citraro 2012: 266). Moreover, we will see that in an international context, Schmitt's identity 'concerns the *flow of payments* carried out by countries' (ibid.: 266). But it is particularly because '*exchanges do not occur in the form of barter, but through monetary payments*' (Cencini 2012a: 37) that 'what matters the most is that these real exchanges are conveyed through monetary flows that are 'neutral', that is to say, that do not generate any pathological deficit' (ibid.: 27), that is, a difference between a nation's total monetary inflows and outflows.

Now a country, *considered as a whole*<sup>130</sup>, is necessarily involved in its residents' international payments because of the need to convert the national currency into a foreign one. It can access this foreign currency either through exports revenues or in incurring a debt by borrowing abroad. The thing to keep in mind is that though the identity of every country's sales and purchases holds in an international context, it does so on a *microeconomic* level, that is, between the countries' residents. On a macroeconomic level however, given the absence of an international monetary institution to act as a monetary mediator of a country's international payment transactions<sup>131</sup>, a country's sales and purchases get *disconnected in time*<sup>132</sup> with the consequence of transforming the identity into a *costly* 'condition of equilibrium' (see Cencini and Citraro 2012: 283). That is, a new external loan<sup>133</sup> is required in order to cover the very *monetary deficit* that results from the international monetary flows that are implicated, when a country benefits from a net foreign borrowing. Through an analysis of the country's monetary flows we will attempt to evidence how and why this happens. Particularly, we will explain how a pathological imbalance arises between the country's monetary inflows and outflows and attempt to unveil the origin of this malfunction.

The accounting structure of our current 'system' of international payments is the very malfunction responsible for originating a pathological difference between the monetary inflows and outflows that are implicated whenever a country pays its deficit through a net foreign borrowing. Adherent to double-entry book-keeping but paradoxically *systemically* unfit to supplement the inherent flow aspect of bank-money, the current payment infrastructure causes the implicated monetary flows to engender an anomalous asymmetry between its total outflows and inflows. The resulting monetary deficit or gap is compensated

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<sup>130</sup> 'A country is the set of its residents, and the public sector is only one of these residents. It is therefore mistaken to identify a country with its public sector, or with the State. A country gets indebted insofar as its residents borrow abroad' (Cencini 2012a: 2). Schmitt also elaborates on the importance of the conception of a country *considered as a whole* by emphasizing that foreign borrowings should *not ever pertain to it* (e.g. some country A). 'Country A does not carry on any international exchange on its own account. Every purchase and every sale of this country, to or from abroad, are transactions of A's domestic economy, commercial and financial, of its private or public sector. *External borrowings of country A as a whole should therefore not exist*' (Schmitt 2014: 28).

<sup>131</sup> That is, 'implementing the debit-credit relationship' (Cencini and Citraro 2012: 283) relating to payments between countries (set of their respective residents) – the 'macroeconomic transactions' as Cencini and Citraro 2012 put it, in reference to 'Schmitt's fundamental argument as to the existence of macroeconomic transactions' (ibid.: 283).

<sup>132</sup> 'Instead of being 'coupled' thanks to the mediation of money, a country's sales and purchases are separated. In these circumstances a country's overall exports and imports are no longer the terms of an identity. It is still claimed that they must be equal, but the autonomy of exports with respect to imports opens the way to a possible inequality, which leads to the world discrepancies affecting the global current account as well as the global financial and capital account' (Cencini and Citraro: 282).

<sup>133</sup> Specifically, by an amount equal to the monetary deficit that results within its economy.

by an equal reduction of its official reserves. The important fact to retain here is that if our current system of international payments were to operate akin to how it transpires *within* a nation, it would furnish ‘at zero cost the missing monetary inflow required to balance monetary outflows and inflows’ (Cencini 2012a: 31) thus avoiding it being covered through a new debt or through a reduction of official reserves, that is, through a substantial loss of asset that *pathologically doubles the country’s external debt*<sup>134</sup>. That is to say, in a fitting system of final payments, the borrowing nation’s augmentation in debt, in following with its domestic economy’s sale abroad of financial bonds, would *more simply and directly* be associated with its net goods and services purchase<sup>135</sup> from the rest of the world (see Cencini 2012a: 37). In the absence of a proper system of final payments at the international level<sup>136</sup>, the monetary flows happen such as to disconnect the associated real flows, resulting in a costly loss of asset for the borrowing country: a further increase in debt of the same amount of the net foreign borrowing<sup>137</sup>.

Now whether a country’s net foreign borrowing is expended to refinance itself in its own national currency or, to pay for its net imports, the negative end result is the same: monetary flows evolve in such a way<sup>138</sup> as to generate an additional anomalous cost for the borrowing

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<sup>134</sup> Hence the occurrence of *sovereign debt* is detected.

<sup>135</sup> In reference to the case scenario whereby a country’s net foreign borrowing is utilized for the purpose of paying for its total imports.

<sup>136</sup> In a later chapter, we will elaborate both a multi-country as well as a single-country reform that could properly furnish payment finality to international payment transactions without generating an anomalous duplication of countries’ or a country’s external debt.

<sup>137</sup> The borrowing debtor-country has to ‘borrow’ *twice* to pay for its total imports. It obtains a *first* loan (*ordinary* external debt) following the sale of its IOUs (the FBD: foreign bank deposit) and then a ‘second’ loan *when it expends the very FBD* to carry out the payment of its net foreign purchases. Yet this ‘second’ borrowing leaves it with no compensation whatsoever (after all, the associated ‘credit’ to the second monetary debit or outflow is no *new* credit, rather only the reproduction of the original one) after the FBD *consumption* which translates in a loss of net asset (*ordinary* external debt thus duplicates through the inclusion of a *sovereign* debt) for the borrowing debtor-country. See Schmitt’s elaboration, next. ‘[A] resident’s foreign borrowing can bring in foreign currencies that remain available ‘somewhere’ in its domestic economy... [to] this extent external borrowings are not *net*, because the currencies that are available are ‘liabilities-assets’ and not net liabilities... only matter the foreign currencies that are both received *and spent* by the country as a whole’ (Schmitt 2014: 42–43). Moreover, the second, pathological debt is the loss of a *net* asset because it has as its object the real goods that the debtor-country will produce at a future date. ‘[If] a dollar is obtained to finance a net import, it is despite all an ‘asset-liability’ and not a net asset. Why is it nevertheless correct and even necessary to conclude that it is a *net* asset’ (ibid.: 37)? As Schmitt explains, ‘[t]he fact is that *these borrowed currencies are real assets of the lending countries*’ (ibid.: 37). ‘*The sum borrowed is the value of future exports of real goods by the deficit country*’ (ibid.: 36) that the rest of the world pays for, in advance. ‘*[T]he currency lent to finance surplus imports is in fact spent by the country where it originates, R, to pay for the import of a future product of A’s economy*’ (ibid.: 38).

<sup>138</sup> Our current defective international payment system is incapable of neutralizing (see Cencini 2012a) the *costly* pathological imbalance that arises between the country’s monetary inflows and outflows.

country. Let us start by examining how they evolve when a country undertakes a sale abroad of domestic financial claims in order to pay for its net imports<sup>139</sup>.

We suppose a country C and we examine the totality of the monetary inflows and outflows for this country when its domestic economy (DC) borrows abroad from the rest of the world (RW), that is from the residents of some other country R, to pay for its (DC) net imports. The currency denomination of the loan is dollars and the amount is z billion \$. Let us have a look at the transactional *monetary*<sup>140</sup> flows implied<sup>141</sup>.

The **first flow** vehiculates money RW (\$) *instantaneously and circularly*<sup>142</sup> from RW's banks and back to RW's banks. In so doing, RW's banks **simultaneously credit and debit** DC with z billion \$ in exchange for its ceding of IOUs of a same amount value. The credit reflects the receipt of IOUs by RW's banks while the debit reflects DC's purchase of an RW bank deposit of same value<sup>143</sup>.

The **second flow** is another *instantaneous circuitous record-entry* to and from RW's banks. DC is **simultaneously credited and debited** for an amount of z billion \$ following its request that RW's banks carry out a payment on its behalf, that of its net imports (real goods and services exported by the residents of RW to DC). What happens is that, at execution of the order to pay, DC's bank deposit with RW's banks is cancelled given DC cedes it in exchange for the payment that RW's banks makes on its behalf. As such, DC is simultaneously both credited (revocation of its RW bank deposit) and debited (on account of the payment carried out by RW's banks, on its behalf) for a sum of z billion \$<sup>144</sup>. Let us keep in mind that in order

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<sup>139</sup> Our exemplary anecdote is analogous to a case elaborated by Cencini (see Cencini 2012a, Appendix 2) whereby he examines the monetary flows implicated when the domestic economy of a certain country A borrows abroad to pay for its net commercial imports.

<sup>140</sup> As stipulated in the Cencini (2012a) case of his appendix 2, the *real* flows involved consist of the financial bonds (IOUs for sake of simplicity and in keeping with Cencini's epithet) that the domestic economy of DC issues and which are of a value of z billion \$. These IOUs are exchanged for a portion of RW's domestic output, valued at z billion \$.

<sup>141</sup> Cencini emphasizes the important point at the onset of his case scenario of appendix 2 where he refers to countries A and R '*exchanges do not occur in the form of barter, but through monetary payments*. It is therefore necessary to consider the monetary flows implied in this transaction between A and R in order to verify if they are 'neutral' or if they are the source of an anomaly entailing a supplementary, pathological cost for A and/or R' (Cencini 2012a: 37).

<sup>142</sup> Bank money always returns to its point of issue and, at instantaneous velocity.

<sup>143</sup> Hence, the end result of this transactional flow is that DC has traded z billion \$ of IOUs in return for a deposit (bank account) of the same value with the banks of RW.

<sup>144</sup> It is via this final monetary flow of z billion \$ that DC *expends* (gives up) its bank deposit with the banks of RW in exchange for gaining possession of its imports of real goods and services, as exported by RW's residents. Essentially the end result, *in real terms*, of this second monetary flow, is that DC has exchanged a part of its *future* domestic output (IOUs) in exchanged for a part of RW's *current* domestic output (exported real goods and services), both valued at z billion \$. But what is important to retain from this fact, is that DC's expenditure of the *loan* that it *obtained from RW's banks* (in exchanged for DC's IOUs) essentially *consists of RW's payment for a part of DC's domestic output that the latter will produce in the future*. 'It is country R as a whole that becomes the owner of the real goods that will be exported' (Schmitt 2014: 38) by country C, in a future period. Thus, '*these borrowed currencies are real assets of the lending countries*' (ibid.: 37). Moreover, given RW's loan disbursement has not the capacity (purchasing power) of paying twice the amount of z billion \$, it is actually either a new debt of DC or a loss in official reserves that

to achieve one *real* flow (the exchange of DC's IOUs against part of RW's domestic output), country C incurred *two monetary outflows* versus *one monetary inflow*. Granted, one *debit* monetary outflow did yield it (as counterpart) a bank deposit with RW's banks but this very bank deposit was subsequently cancelled by RW's banks (DC *credited* by RW's banks) following DC's request that it carry out its payment of net imports on its behalf, which payment RW did carry out: hence the second *debit* monetary outflow. Yet, all in all, there is only *one* monetary inflow to be accounted for, given *the second credit*, part and parcel, *of the second monetary flow* is the *same credit* that is part and parcel, *of the first monetary flow*<sup>145</sup>. An asymmetry in monetary flows is detected: monetary outflows do not balance with monetary inflows and thus we would be best to heed to their suspected non-neutrality<sup>146</sup> and rather expect that 'they are the source of an anomaly entailing a supplementary, pathological cost' (Cencini 2012a: 37) for country C *as a whole*.

Now, if we examine these two *monetary* flows *one at a time*, seemingly it evidences no pathology. But, if considered *wholly*, it is then that we notice the anomaly: 'a discrepancy appears' (Cencini 2012a: 37) between country C's *total* outflows and inflows. This means that the 'match' in relation to DC's acquisition of its net imports, valued at z billion \$, is a double payment of this same amount by country C, which is fulfilled once through its increase in debt (financial bonds transfer to RW) and *once again* through a new debt or through a reduction of its official reserves by a same amount (notice that the end all transfer into its official reserves is nil after the cancellation of its RW bank deposit)<sup>147</sup>. This is so, because in our current system of international payments the law of the identity of each country's sales and purchases falters (on a macroeconomic plane): a country's sales and purchases are actually separated in time. '[T]he present 'non-system' fails to account for the macroeconomic aspect of international payments' (Cencini and Citraro 2012: 283). It 'does not provide a book-keeping structure allowing for this identity to be constantly satisfied. The lack of an international central bank implementing the debit-credit relationship to each

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compensate and inevitably incur the payment of DC's net imports, through an equivalent *anomalous* sum reduction: the foreign bank deposit is inescapably dissolved resulting in the loss of a net asset. It is an anomalous reduction given it amounts to an additional *monetary* payment by country C *on the whole*, on top of the *real* payment of DC's residents. Hence, the *macroeconomic* payment of C, *as a whole*, adds to the *microeconomic* payment of C's residents. Indeed, two payments, *each of z billion \$*, are required by country C in order to pay its net imports valued at z billion \$ only. And, the monetary flows involved in the transaction clearly evidence this: two monetary outflows from C versus one monetary inflow (foreign loan from RW). We next elaborate this in the text.

<sup>145</sup> If we elaborate this point in the spirit of Cencini's appendix 2 (see Cencini 2012a), we could say that the *initial* credit with which DC is credited with by RW's banks, 'obtained in exchange of its IOUs' (Cencini 2012a: 38) and which defines an 'inflow of foreign currency to the benefit' (ibid.: 38) of C, ends up being *re-directed* to the residents of RW from its initial beneficiary, that is, DC. As such, we can ascertain that the *second* credit that arises when DC relinquishes its bank deposit of z billion \$, (the 'second' inflow of foreign currency) is 'nothing else than the reproduction or replication of the first credit payment' (ibid.: 38). It is representative of the very *first and only* inflow of foreign currency to the benefit of DC rather than that of a 'second' inflow. It definitely 'does not define a *new* inflow of foreign currency' (ibid.: 38) to its profit.

<sup>146</sup> See Cencini 2012a.

<sup>147</sup> And, given that a loss in assets is considered an increase in debits, this double payment confirms that the analysis of the double burden of external debts will inevitably apply with respect to the formation of external debts.

payment carried out by a country has the annoying consequence of transforming the above fundamental identity into a condition of equilibrium' (ibid.: 283). Hence, the compensating factor brought about, by the borrowing country's official reserves that end up being reduced accordingly. The outcome: if we add up the two monetary outflows (representative of the two debits incurred by C, one on obtaining RW's bank deposit of  $z$  billion \$ and one on account of RW's payment of C's net imports of a same value, on C's behalf) and deduct from these the *one and only inflow* of foreign currency to C's benefit of  $z$  billion \$, we end up with a **net monetary outflow**. 'The difference between foreign currency outflows and inflows defines a monetary deficit, which is necessarily covered through a decrease' (Cencini 2012a: 38) in the international (official) reserves of C or through a new loan. Clearly then, in the absence of a proper transactional payment system at the international level, 'foreign borrowing is at the origin of a monetary deficit entailing the pathological duplication of the borrowing' (ibid.: 4) debtor-nations' external debt. 'As surprising or absurd as this might seem, respecting the principle of double-entry book-keeping leads inevitably to the discovery of a pathological difference between the monetary outflows and the monetary inflows related to the transactions implied by a country's foreign borrowing' (ibid.: 4).

Now as we have pointed out earlier, a same negative outcome for borrowing country C happens even in the case when the purpose for its net foreign borrowing is to enable a domestic currency refinancing for its national economy<sup>148</sup>. We next examine this case scenario<sup>149</sup> in order to evidence this but even more so to demonstrate *the reason for which this negative outcome manifests itself each time a country borrows from abroad* either to finance its net commercial imports or to refinance its domestic economy: the manifestation is none other than the effect of 'compliance with double-entry book-keeping, each credit-payment is also immediately a debit-payment' (Cencini 2012a: 15). Cencini elaborates on this and it is worth heeding his succinct observation on comparing the situation as it happens at an *international* level with what transpires at a *national* level. That is, with respect to how the missing monetary inflow – a consequential development related to the very adherence to double-entry bookkeeping – is furnished *free of cost* within national borders, whilst across nations' borders it ends up being compensated by the borrowing nation's official reserves.<sup>150</sup>

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<sup>148</sup> Our meaning here is that the 'foreign loan is used to refinance its domestic economy' (Cencini 2012a: 15). In other words, the country utilizes the net foreign borrowing to increase its international reserves and ultimately re-finance its national economy in its domestic currency.

<sup>149</sup> Here again we base our demonstration of this particular case by referring to Cencini's original account of this case scenario, this time as per appendix 1 (see Cencini 2012a: 34–36). Once again, we observe that 'a gap is formed between money outflows and inflows, which is covered through an equivalent loss in the country's official reserves' (ibid.: 4) or through a new foreign loan.

<sup>150</sup> '[W]hen a country benefits from a foreign loan, of say  $x$  billion dollars, its external debt increases by twice this amount, i.e. by  $2x$  billion dollars. The demonstration rests on the double-entry book-keeping nature of bank money, and applies to every conceivable case. In fact, the existence of a monetary gap between outflows and inflows is the unavoidable consequence of the implementation of double-entry book-keeping. In other words, a difference between monetary outflows and inflows arises every time an economic agent benefits from a loan, whether foreign or domestic. What makes all the difference between what happens when loans are obtained from abroad or from within a domestic or national economy is the presence or the lack of a system of final payments. In the case of domestic loans, the duplication is neutralised by the system of national payments, which provides at zero cost the missing monetary inflow required to balance monetary outflows and inflows. In

What we need then is an infrastructure of international payments that not only recognizes bank money's *vehicular aspect* inherent to double-entry book-keeping but moreover, a system that is able to *complement* this flow nature of money rather than work against it, in an anomalous way and, with crippling consequences whether with regard to the phenomenon of duplication (xeno-currencies) or, with respect to the double burden of external debt. A third counter-party institution is required at the international level to *monetize* payment transactions (convey financial component) 'allowing for the real payment of each of them, including external debt servicing'<sup>151</sup> (Cencini 1995: 360). Only such a *central* (third counter-party) institution, through the issuance of its own *central* money, would properly complement the infrastructure required to provide the system of payments with the necessary homogeneous zone that is *able* to take 'into account the fundamental heterogeneity of national currencies' (Cencini 1995: 156), a fundamental essence to payment finality.

But that all said, something else must also be considered along with banks' adherence to double-entry bookkeeping (whenever issuing bank money) and that is, the very *object* of bank money. It will help home in *the why it is* that the transactional bank payments involved, leave in the end, 'no counterpart at all for the borrowing country' (Cencini 2012a: 16) despite the rise in its external debt (ceding of IOUs)<sup>152</sup>. It has to do with the logical fact that *the bank deposit that DC* (domestic economy of country C) *obtains from RW's banks*, following the ceding of IOUs, outlines an exchange of domestic output (the *object*) between the two countries: RW provides DC with a part of its *current* domestic output (suppose a value of z billion \$) in exchange for a part of DC's *future* domestic output (same value) that it will produce at a future date. And, as we have already pointed out, given that the purchasing power of RW's domestic output is not double, it is only logical that it is thus unable to pay for anything else. This means that it is country C *as a whole* that ultimately bears the cost of the foreign borrowing and this, *in addition to* its residents' initial payment. ***The macroeconomic payment*** (monetary) *of country C considered as the set of its residents, thus adding to that of the microeconomic payment* (real) *of its residents*.

We soon observe that it is through double-entry bookkeeping, from which it derives its flow aspect, that bank money and its associated purchasing power have their full impetus. It is

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the case of foreign loans no such a system exists up to now, and the missing monetary inflow is compensated through a loss of the country's international or official reserves' (Cencini 2012a: 31) or through a new foreign loan.

<sup>151</sup> We will elaborate on external debt servicing in a later chapter.

<sup>152</sup> The key factor here is that the indebtedness which results from the sale abroad of domestic financial claims (IOUs) has no counterpart *in the sense that* it has no counterpart with which to pay neither a borrowing country's net imports nor the said country's refinancing of its domestic economy: this is because the counterpart (the bank deposit obtained with RW's banks of equivalent value) of these IOUs, logically pays – as the exchange dictates it – for a future domestic output of the borrowing country, the very IOUs (one could even say that the sobriquet alone of these ceded financial claims hints to their expected future fulfillment *in return for the current payment from RW*). As such the counterpart pays for nothing else, it simply cannot, given its object's (money-income originating from RW's domestic output) purchasing power is not double. The borrowing country *as a whole* is thus left to cover the cost of its net imports or, refinancing of its domestic economy and it does so through an equivalent new external borrowing. This is so on account of the very fact that '*the currency lent to finance surplus imports is in fact spent by the country where it originates, R, to pay for the import of a future product of A's economy*' (Schmitt 2014: 38). Schmitt's reference to some country A, as example, translates to country C in our case scenario; as well R translates to RW in our sample demonstration.

here, within this international context as it relates to transactional bank payments, that we can best appreciate the true meaning of this. In our case-reference, RW's current domestic output *is* what *finances* the purchase of IOUs (DC's) it is exchanged for, and this happens all in one double-entry bookkeeping stroke: the instant that DC experiences a credit-debit<sup>153</sup> that yields it a bank deposit with RW's banks, following the ceding of its IOUs. Essentially, dissimilar to 'the export of a product of  $p$ , the export of a product of  $p^\circ$ ' ( $p$  and  $p^\circ$  meaning *current* and *future* periods respectively, see Schmitt 2014: 38–39) 'is paid by a loan, more exactly by the real object of this loan' (ibid.: 38–39).

Let us now return to the re-enactment of this case scenario (see Cencini 2012a, appendix 1 for original demonstration).

Again, the country that we suppose is country C, only this time, we examine the totality of the monetary inflows and outflows that are implied for this country whenever it borrows from the rest of the world (RW) in order to allow for its domestic economy (DC) to re-finance itself in national currency<sup>154</sup>. DC<sup>155</sup> borrows from abroad a sum of  $z$  billion \$, the currency denomination of the loan being in dollars. We have a look at the transactional *monetary* flows involved.

The **first flow** consists of a monetary *inflow* of foreign money, that is, a credit-payment of  $z$  billion dollars for DC. This is as a result of DC's (its residents) sale of financial claims (IOUs) to RW's residents. Now, as we know, 'in compliance with double-entry book-keeping, each credit-payment is also immediately a debit-payment' (Cencini 2012a: 15) such that DC is 'necessarily credited *and* debited' (ibid.: 34) *simultaneously*, for a sum of  $z$  billion \$<sup>156</sup>. *At this stage*, we could say that the external debt that DC has newly incurred has a counterpart – the ownership of a *bank deposit* with RW's banks of  $z$  billion \$. But what is important to remember here<sup>157</sup> is that in spite of this, the amount of foreign monies (dollars) DC has acquired for its cession of financial claims is NIL: the double-entry bookkeeping's *simultaneous credit-debit* of  $z$  billion dollars leaves it with a zero entry-sum of dollars, the payment-transaction being '*a zero sum transaction in terms of money*' (ibid.: 34).

Thus far, there are two *monetary* flows to account for: one inflow worth of  $z$  billion \$ into DC as a result of its ceding of IOUs, which inflow entails a simultaneous outflow of same value such as to enable DC to acquire an RW bank deposit of  $z$  billion \$ worth.

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<sup>153</sup> The bookkeeping entry-structure that governs transactional payments is such that 'every credit-payment is an equal and simultaneous debit-payment, every debit-payment being an equal and simultaneous credit-payment' (Cencini 2012a: 16).

<sup>154</sup> Our meaning is in keeping with original description of appendix 1 of Cencini 2012a: DC will ask RW's banks to transfer the foreign borrowing ( $z$  billion \$) to country C's official reserves 'in exchange for a deposit denominated in national money' (Cencini 2012a: 34) that is, money C.

<sup>155</sup> Specifically, we mean the domestic economy of country C to include both its private and public sectors.

<sup>156</sup> To ensure that there is no misunderstanding as to the reason: *the credit* allocated to DC by RW's banks *is as a result of DC selling  $z$  billion \$ worth of IOUs to the residents of RW*. The *ensuing debit* which happens simultaneously to its credit *is representative of DC being debited by RW's same banks as purchase-payment for its RW bank deposit, of an equal worth of  $z$  billion \$*.

<sup>157</sup> Now and next when we will do a sum up comparison of total inflows and outflows for country C.

But next, if DC wants to convert these dollars into an equal amount of its domestic currency, it cannot simply transfer<sup>158</sup> this sum of foreign money to its central bank, because in actual fact, it has no foreign currency to speak of, ‘for it never gets hold of any foreign currency whatsoever’ (ibid.: 34). What it holds is ‘*not a sum of foreign currency, but a foreign bank deposit*’ (ibid.: 34) so that all that DC can do is to ask **RW’s banks** to ‘transfer’<sup>159</sup> the ownership of this bank deposit to the benefit of DC’s central bank (RC<sup>160</sup>). And when DC does ask RW’s banks to carry out this transfer of ownership to RC, on its behalf, it irrevocably relinquishes *its very own ownership over this foreign deposit*, which is consequently annulled.

What happens next is that RW’s banks will *all at once* both credit *and* debit RC for an amount of z billion \$. ‘As imposed by double-entry book-keeping, this inflow of dollars is immediately matched by an equivalent outflow’ (ibid.: 34). This is because RC is ‘not paid *in* money, but *through* money, notably through a circular flow’ (ibid.: 34–35) enabling RC to gain ownership of a bank deposit newly acquired and originating with RW’s banks. And, which deposit essentially yields it a right of ownership over a portion of RW’s national output. The main point here is that the *object* of the said bank deposit is ‘an undifferentiated quantity’ (ibid.: 35) of RW’s domestic output, ‘and not a sum of money’ (ibid.: 35). Consequently, the end result for RC is that not any amount of foreign monies are ‘deposited into its assets’ (ibid.: 35) *the z billion \$ flowing simultaneously in and out of it*. The reality is that the debit that RW’s banks submits it to, is such as to secure the payment for RC’s newly acquired ownership of a bank deposit with the banks of RW. The very fact that ‘every credit-payment is an equal and simultaneous debit-payment’ (ibid.: 16) makes it that RC does not inherit its newly acquired bank deposit for free, it has to pay for it. This explains the reason for which RC is debited, and as well evidences the second and last monetary outflow.

In sum, the transfer to RC that RW’s banks carry out on behalf of DC in following with the latter’s ‘decision to transform its bank deposit denominated in dollars into an equivalent bank deposit denominated in’ (ibid.: 35) its domestic currency, generates a sequence of significant accounting entries, that is, ‘significant’ in the sense of the effect that they bring about. Let us re-capture them in a next paragraph.

RW’s banks proceed with the transfer by simultaneously debiting and crediting DC. Let us consider this as the ***first monetary outflow***<sup>161</sup> for country C: the credit is simply the cession of DC’s bank deposit of z billion \$, whilst the debit is on account of the fact that RW’s banks carry out a payment, to the benefit of RC, on its behalf.

RW’s banks then simultaneously credits and debits RC. This results in a ***second monetary outflow*** for country C: the credit reflects the transfer of DC’s foreign bank deposit ownership to its benefit and the debit is simply to account for RC’s payment for acquiring an equivalent bank deposit of z billion \$ value.

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<sup>158</sup> If DC ‘could be credited with a positive sum of dollars or of any other foreign currency without being simultaneously debited, then a transfer would be conceivable’ (ibid.: 34), the foreign monies owned by DC would thus simply be transferred to RC (the official reserves of country C’s central bank). ‘Yet, money is a simple flow, and cannot be ‘stopped’ in its circulation’ (ibid.: 34).

<sup>159</sup> Let us be clear on our meaning from the onset: all that DC can actually do is to ask RW’s banks to cancel its (DC) bank deposit and to credit RC instead with an equivalent bank deposit. In fact, the bank deposit of DC is never actually *transferred* to RC: it is rather destroyed and another equivalent deposit is created to the benefit of RC.

<sup>160</sup> We designate RC to mean the official reserves of the central bank of country C.

<sup>161</sup> That is, if we were to omit the original inflow that grants DC a foreign deposit with RW’s banks, following its cession of IOUs.

The problem is that when we consider the totality of monetary flows for country C, we end up with two monetary outflows and only one monetary inflow. This is because whilst the two monetary outflows add up to each other<sup>162</sup>, it can be clearly observed that the totality of credit-payments involved reflect *one and the same monetary inflow* into country C. It benefits, from a first credit-payment, when RW pays for DC's sale of IOUs. This credit however is subsequently cancelled when DC gives up its acquisition of the foreign bank deposit (counterpart to its cession of IOUs) such that RW's banks can credit RC with an equivalent bank deposit (hence, the debit-credit that DC is submitted to by RW's banks). RC then benefits, itself, from a credit-payment (when RW's banks credit it with a bank deposit on behalf of DC) but **this 'second' monetary credit-inflow is none other than the original monetary inflow into country C's domestic economy**, following DC's cession of IOUs.

Now the essence here is that the **monetary deficit** that arises from the difference in monetary outflows and inflows, essentially the **net monetary outflow**, as sustained by country C ends up being compensated by RC, that is, by its country's official reserves. After all, the foreign bank deposit that RC acquires is 'immediately swallowed up by the monetary 'black hole' formed by the difference between' (Cencini 2012a: 36) the country's total inflows and outflows. The end all result is that there is no counterpart what so ever for country C's cession of IOUs (initial increase in its external debt) given that the very foreign bank deposit that RC ultimately benefits from, is instantly absorbed, or said another way, expended, in the conversion-payment implicated in refinancing its national economy. Country C has to pay *twice the amount of the foreign borrowing*, once via its internal resources (cession of IOUs) and once again via its external resources (reduction in official reserves).

Keeping in mind that a loss in asset translates to an increase in debits, we can conclude that country C incurs a doubling of its external debt, **once** through the microeconomic transaction of its residents' sale of IOUs and **once again** through the macroeconomic transaction that reduces its official reserves – the latter manifestation essentially defining the very formation of *sovereign debt*: the pathological component of country C's external debt.

## What do we derive from the facts?

What insight can we derive from the facts concerning the flow of international payment transactions? In a nutshell we could say that *at an international level*, the problem affecting transactional payments, as is evidenced when considering the totality of a borrowing debtor-country's monetary inflows against its outflows, is that the country has *first* to pay (IOUs) just to get access to its trading partner's currency (acquisition of FBD following sale of IOUs). It then has to pay once again (revocation of FBD resulting in reduction of official reserves) such as to actually carry out the payment, in foreign currency, for which initial purpose the loan was actually sought, e.g. payment of net foreign purchases. Hence the *transfer problem* as famously referenced by Keynes. The fact is that countries (non key-currency) do not pay their

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<sup>162</sup> They 'are distinct and separate (they are even separated in time)' (Cencini 2012a: 35). The two *credit-debit payments* amount to a total of two monetary outflows for country C. Granted, though two of the 'three' debits lead to the acquisition of a foreign bank deposit, we should not forget that the one initially acquired by DC is subsequently relinquished in a debit-credit when RW's banks is asked to transfer it to RC. Thus, the debt-payment of RC adds to that of the domestic debt-payment of DC, yet country C retains only one credit for two distinct debits that add up to each other: it pays twice z billion \$ for acquiring the ownership of only one foreign bank deposit of this same value.

imports, *neither their surplus imports* (in effect rendering the latter problematic), with their own currency (see Schmitt 2014). Rather, they pay them in the currency of the creditor country (dollars in our case scenario) because this latter's currency is after all 'the only currency fit to pay' (ibid.: 4) their (borrowing countries) imports, that is, in our current 'system' of international payments *based on a regime of relative exchange rates*. And with respect to *net* foreign purchases, this inevitably entails the sale of financial bonds by the borrowing debtor-country (*first* payment) **just to get access to the foreign currencies it requires** with which to ultimately carry out the payment (*second*) of their surplus purchases.<sup>163</sup> As Schmitt reminds us, the deficit nation has to pay *two times the required* 'amount of foreign currency in order to settle its net imports' (ibid.: 14).

One way to understand that these two payments (*first* and *second*) are *two distinct payments* incurred by the borrowing country and, *that moreover add to each other*, is to consider the two distinct loans that respectively enable them. '[T]hese two loans *do not pertain to the same reality*' (ibid.: 5). As Schmitt points out, whilst the object of the *first* foreign loan is a future good of the borrowing country, 'the object of the other is a product of the rest of the world' (ibid.: 5), that is, 'the *external* product is the object of the money incomes formed' (ibid.: 5) in RW: rest of the world. This, in itself, confirms 'that these two external loans' (ibid.: 5) *cannot be reduced to one single loan*. 'In reality, the total amount borrowed is of 2 dollars and not of one dollar only' (ibid.: 5). Hence, 'the external debts' charge falls not once but *twice* on the countries whose expenditures are greater than their gains in foreign currency' (ibid.: 4).

From an international *monetary-flow* perspective, we should remember that the *net* monetary outflow implies an anomalous 'net debit' (see Schmitt 2014) for the debtor country *as a whole*. This is so because this very 'net debit' has no *counterpart credit* given the deficit country benefits from *one and only one* first credit (FBD acquisition following its sale of IOUs). The 'second' is no **new credit** and hence its associated debit is *net*. Granted, this *net* debit still yields it (DC/RC) a foreign bank deposit (double-entry book-keeping compliance) but given that the purchasing power of the latter is not double and notwithstanding that it has already been spent<sup>164</sup> as payment for the debtor country's IOUs, its ultimate dissipation is nothing else but a mere use of **money** RW 'as a specious real good' (Schmitt 2014: 30).

*Debits-credits* formed in money R define this foreign currency as mere object of intermediation between real goods, whereas *net debits* of country A as a whole, scientific definition of its *sovereign debt*, lead to the use of *money* R as a specious real good.  
(Schmitt 2014: 30)

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<sup>163</sup> Schmitt reminds that contrarily to *surplus* imports, 'imports are paid, in foreign currencies, by exports' (Schmitt 2014: 7), that is 'imports-exports' (see ibid.: 7), and for this reason do not require *any other external loan*. But, '*additional* imports are the source of a true problem since, by all evidence, they are not paid for by any export of real goods. Uncompensated by a real export, net imports can be balanced in foreign currencies only through a foreign loan' (ibid.: 7). As such, unlike being paid by an income originating within the borrowing country's own domestic economy as are *compensated imports* ('imports-exports' see ibid.: 8), these '[s]urplus imports, on the contrary, are paid by an income formed within the domestic economies of the rest of the world' (ibid.: 8).

<sup>164</sup> It has been spent with income originating from RW's domestic production. As Schmitt captures it, '[t]he search for truth about the charge, simple or double, of external debts, requires the study of the relationship effectively holding between the two payments of net imports, in money R and *in money A*' (ibid.: 31). Schmitt's reference to R and A translates to RW and C in our case scenarios.

In closing, it would be negligent not to mention the parallel that can be drawn between Schmitt's 2014 observation (as captured by the above quote) and a same observation he'd made in a previous work of 1984. We once again draw the attention of the reader to our footnote (# 97) whereby we pointed out the distinction that Schmitt had emphasized, as early as 1984, with respect to bank-money as instruments of intermediation within nations and bank-money that transforms into final objects of payment across national borders.

In a next chapter, we resume our quest for unraveling the enigmatic source of the world balance-of-payments statistical imbalances by elaborating our analysis of the implication of these international monetary flows' evolution.

## 4 World balance-of-payments asymmetries: the global capital and financial account net inflow and current account monetary deficit. A single macroeconomic source?

### Introduction

In a previous chapter, our analysis of international monetary flows evidenced the double burden of external debt with respect to its very formation. In this chapter we attempt to demonstrate the double burden of external debt with regard to the net interest payment. We show how its payment from the debtor-country's current account entails yet another anomalous charge that is incurred by the country as a whole with the end all result exactly doubling the country's net interest payment. We do this by taking into account the highly significant macroeconomic nature of international payment transactions. Our analytic approach aims to explain, parallelly, the enigmatical imbalances that defiantly continue to manifest in the worldwide balance-of-payments despite the implementation of numerous statistical improvements in data compiling. In one fell swoop, we unravel the very pathology behind the *world accounting discrepancies*, contemporarily flagged as the 'mystery'<sup>165</sup> of the current account *missing surplus*<sup>166</sup> and capital and financial account *missing capital outflow*<sup>167</sup>, and trace its unique<sup>168</sup> macroeconomic origin to the double charge of the net interest payment.

Let us first briefly touch upon the importance of remembering that countries do exist as macroeconomic entities.

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<sup>165</sup> 'Experts know only too well that a numerical discrepancy exists between global current accounts as well as between global capital and financial accounts. Statistical data show it very clearly, and economists all over the world follow Krugman and Obstfeld in calling these discrepancies a 'mystery'' (Cencini and Citraro 2012: 277).

<sup>166</sup> '[T]he relevance and evolution of the world current account deficit are such that it would be naïve to impute it to statistical shortcomings in data collection and compilation. It thus appears entirely justified – following Krugman and Obstfeld (2003) – to speak of the 'mystery of the missing surplus'' (ibid.: 273–274).

<sup>167</sup> In their 2012 paper, Cencini and Citraro aim 'to show how the mystery of the 'missing surplus' and of the 'missing capital outflow' can be unravelled by a new macroeconomic approach, while evaluating the IMF experts' intuition about the role played by capital flight and by the so-called 'interest income position'' (ibid.: 262).

<sup>168</sup> Given the interconnectedness of the capital and financial account with that of the current account, '[t]he balances of these two accounts should be mirror images of each other, which clearly suggests that the two world balance-of-payments discrepancies must be the effects of one and the same cause' (ibid.: 275).

## On the essence of a nation as its own macroeconomic entity

Before re-examining the concept of a country *existing as a macroeconomic entity*, with a particular view to emphasize the inherent implication, we think it important to first deliberate some basic generalizations that specifically concern transactions *between* nations. We begin by revisiting a few, though nonetheless essential, differences between *national and international* macroeconomics.

### *Distinguishing factors between economies: domestic economy versus international economy*

As we have pointed out earlier on, the essential distinction that sets a domestic economy apart from that of an *international* one is that ‘the former is an economy of production and exchange while the latter is merely concerned with exchange’ (Cencini 2005: 179). And we remember that this implies then, that we can never speak of *international* production. The only thing that is logically conceivable is that of national production, ‘world output (multinational output included) being entirely the making of nations’ (ibid.: 179). Cencini elaborates on an important natural consequence of this. ‘It thus follows that a hypothetical international money could not derive its value from international production. At the international level the integration between money and output must first pass through the intermediation of national currencies’ (ibid.: 179). It is through its very integration with *produced output*, that a country’s currency is transformed into income. ‘As the distinction between money and income confirms, money is the ‘vehicle’ or ‘means’ by which payments are carried out, but it is not itself the ‘object’ of any payment. It is income that discharges debts and not money proper. Within countries, money acquires its purchasing power (that is, it becomes income) through its association with production. It is because produced output becomes the real ‘content’ of money that payments are effective’ (ibid.: 183).

Moreover, with respect to the formation and thus *origin* of income, let us remember that it is through production that ‘output is given a monetary form and a positive income is formed, which defines a net increase of wealth for the whole economy’ (Cencini 2012: 46). Surprisingly, this seemingly trivial factor will take on new relevance when we later consider the analysis of Schmitt 2014 regarding the double charge of external debt<sup>169</sup> that is implied in a net foreign borrowing (e.g. for payment of a country’s net imports).

Now, at the international level, whilst the *financial* aspect of payments is not in itself problematic, on the contrary, the *monetary* aspect of international payments becomes a true element of concern and evidences an especially significant disparity that exists between an international and domestic economy, which distinction should be heeded. The problem stems, as we have seen earlier, from the heterogeneity of country currencies. Within the nation, a *central* money<sup>170</sup> (the country’s single currency) renders homogeneous the various money units as issued by its secondary banks, through an inter-bank ‘system of clearing operated by the central bank’ (Cencini 2005: 179). On defining a country’s very currency, Cencini

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<sup>169</sup> Particularly, we will see Schmitt place strategic importance on the origin of the income that is specifically implicated in the payment (external loan disbursement) of a debtor-country’s sale of financial securities (net foreign borrowing for the purpose e.g., of paying for the totality of its net foreign purchases, see Schmitt 2014).

<sup>170</sup> ‘Through what Schmitt likens to a catalytic process, the different bank monies are given a common form (central money) and become part of a unique national currency’ (Cencini 2005: 179). With respect to the Schmitt reference, see Schmitt 1984.

elaborates the following. ‘The monetary units issued by banks pertaining to the same banking system are undifferentiated elements of the same set: national currency’ (ibid.: 179). Nevertheless, he warns that *homogeneity*, ‘is not an intrinsic characteristic of banks’ money but the result of a process’ (ibid.: 179) that is, ‘[i]t is through inter-bank clearing that the monetary units issued by each single bank are made homogeneous’ (ibid.: 179). Specifically, he discerns and emphasizes the following point: ‘[e]ach commercial or private bank is a different institution whose spontaneous acknowledgement of debt would remain heterogeneous with respect to that issued by any other private bank was it not for the system of clearing operated by the central bank’ (ibid.: 179). Contrarily, at the international level, we have a very different set of circumstances. It is not just that domestic currencies uniquely differ from one another but that moreover ‘their heterogeneity is not dealt with by any system of international clearing’ (ibid.: 180). Quite simply, our current *non-system* of international payments very much lacks in this regard. Being based on a system of *relative* exchange, we have to remember that what this means with respect to international payment transactions is that ‘the transaction taking place on the foreign exchange market specifies’ (ibid.: 180) not ‘the identity between’ (ibid.: 180) two currencies, rather it ‘is essentially a barter between’ (ibid.: 180) them and as such ‘it leaves them fundamentally as heterogeneous as they were before being exchanged’ (ibid.: 180).

It is not our intent here to revisit the specific differences between a regime of *relative versus absolute exchange*. Our aim is simply to point out, that for lack of a proper international banking system empowered with the ability to either establish the homogeneity (see *ibidem*) of currencies akin to how it happens within nations or, provide for a homogeneous monetary zone amidst sovereign nations<sup>171</sup>, the *monetary* aspect of international payment transactions becomes a genuine *transfer* problem that leads to serious monetary disorders at the international level. Not to re-examine the phenomenon of duplication<sup>172</sup> associated with key-currency nations, let us simply remind that with respect to *non* key-currency countries (the system of *relative* exchange being particularly partial to the former) the *transfer* problem or *monetary* aspect of international payments becomes very costly. ‘*A great disparity exists between reserve and non-reserve currency countries*. In particular, the asymmetry is such that while reserve currency countries can ‘pay’ for their net purchases simply by crediting the exporting countries with an amount of national money, *non-reserve currency countries are forced to purchase a foreign currency in order to pay for their trade deficit*’ (ibid.: 184). Specifically, it ‘is forced to increase its financial debt’ (ibid.: 185) *just* ‘to get hold of the reserve currency required’ (ibid.: 185). But ‘*non-reserve*’ and ‘*reserve*’ currency country aside, we remind that *any* country benefiting from a net *foreign* borrowing to pay its net *foreign* purchases, ‘‘imports-without-exports’’ (see Schmitt 2014), will suffer a doubling of its external debt given the second charge incurred by the *country as a whole* – the very formation of sovereign debt that pathologically adds to the external debt of the country’s residents. Given the infrastructure of our current ‘system’ of international payments, external debts include sovereign debts but, as earlier suggested, we should take heed of the fact that the latter are definitely anomalous and should not thereby even be enabled to form. Today’s international payment system clearly lacks an essential component as part of its overall mechanism. In its present form – without the benefit of a third counter-party institution to mediate the totality of payment transactions, akin to a process occurring within nations or, amid a proper *homogeneous monetary zone* of sovereign nations – the system conceptually and procedurally misses, entirely, the macroeconomic element so naturally inherent to a country’s international payment transactions. The international monetary disorders that

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<sup>171</sup> Our meaning here is simply of nations having each their own respective currency.

<sup>172</sup> That is xeno-currencies, as per our earlier description.

consequentially manifest<sup>173</sup> are admittedly very costly for countries, more so, *so illogically unnecessary*. The double charge entailed in a country's net interest payment is yet another very taxing *macroeconomic* disorder and we will attempt to evidence this in our exposition of the 'missing surplus' and of the 'missing capital outflow'.<sup>174</sup>

### ***The country as a macroeconomic entity – what about the macroeconomic existence of nations?***

Well, one good starting point is that if it were not for the recognition<sup>175</sup> of a country's macroeconomic entity, 'the implication for international transactions would merely reflect what already happens at a microeconomic level' (Cencini 2005: 248). Yet it is clear, just on considering the account of *official* reserves<sup>176</sup> that it 'is not the account of any particular resident but it reflects the reserve position of the country taken as a whole' (ibid.: 248). A net augmentation as deriving, for example, from net commercial sales 'defines an international gain for the country itself: neither its formation nor its ownership can be attributed to' (ibid.: 248) any individual denizen of the nation. Rather, it '*concerns the country as such* ... which, as the *set* of its residents, represents them all indistinctly' (ibid 235–36). Cencini elaborates the case-scenario such as to crystallize the evidence that indeed 'countries have a macroeconomic existence that cannot be identified with that of their residents ... If the residents of a country are paid in a foreign reserve currency for their net commercial exports, none of them is a creditor of the rest of the world, but their country is. This is so much so that the sum of foreign currency obtained from abroad is first changed into an equivalent sum of national currency – with which exporters are paid – and then transferred to the country's foreign reserve account at the domestic central bank, where it defines the net gain of the country as a whole' (Cencini 2012: 58–59).

Similarly, as he further points out, the same principle underlines the *global* perspective that is applied to a *country's international investment position* (IIP). 'The *IIP* reflects the country's

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<sup>173</sup> The Gnos and Rossi observation concerning the *logical laws that imbue the macroeconomic approach* of Schmitt et al., in analytic interpretation, is well worth the reminder. '[T]he present system of payments is inconsistent with the laws governing capitalist economies. Even more than physical laws, logical laws prevail under whatever conditions. If the payment system does not comply with them, they apply anyway, and the discrepancy between them and the way payments are actually carried out is sanctioned by the emergence of a pathology, which affects the whole economic system' (Gnos and Rossi 2012: 10–11).

<sup>174</sup> See Cencini and Citraro 2012.

<sup>175</sup> Albeit, still today, it remains a very blurry recognition: '[t]oday, economists and experts are caught in a self-contradictory situation, ... while acknowledging the principle of the mandatory equality between debits and credits, they recognize it only at the microeconomic level, while missing the international side of macroeconomic payments. Whereas, on the one hand, they overlook the fact that countries exist as macroeconomic entities, on the other hand ... they work out a properly macroeconomic concept like the international investment position' (Cencini and Citraro 2012: 291). It is not surprising then, that with such an obscure understanding of the macroeconomic existence of nations that, our current 'system' of international payments remains saddled with an indistinct and faulty infrastructure that, likewise, is unable to account for the element of *macroeconomic entity* that is naturally implicated and necessarily ensues from the international transactions of a country's residents.

<sup>176</sup> Or, if you will, just on considering 'the very conception of *official* reserves (country's reserves as opposed to private reserves)' (Cencini 2005: 249).

financial position, and is clearly concerned with the global situation of the nation' (Cencini 2005: 248).

But undeniably, the ultimate thrust that can seal a nation's existence as its very own macroeconomic entity is the existence itself, of its unique country currency. Cencini drives the point home when he reminds us that, after all, a currency is essentially the 'acknowledgement of debt' of a nation's very banking system. 'Being an acknowledgement of debt spontaneously issued by a country's banking system, national money is what gives nations their own economic identity and specificity' (ibid.: 250).

In sum, why is it so important that the *macroeconomic entity of a country*<sup>177</sup> be so explicitly recognized? It boils down to its *natural implication* when the *international* payments of its country residents are concerned. But more so, it is *on account of its very involvement* that we need to ascertain that this implication of the *country as a whole* occurs neutrally, that is, as a mere intermediation on behalf of the set of its residents, and that it does not create an anomalous situation that leads to the addition of two distinct costs.

Now, much of international trading is reciprocal such that the implication of a nation with respect to the *foreign* payments of its denizens is compensated 'so that the analysis can be limited to the payment carried out by the residents' (ibid.: 250). This is because *reciprocal* transactions occur neutrally, without entailing any anomalous results as it does, for example, when a country is a *net* importer and benefits from a *net* foreign borrowing.

Contrarily, the *one-sided* transaction such as is involved in a country's net interest payment is a clear scenario of monetary macroeconomic dysfunction. As pointedly observed by Cencini, 'when transactions are unilateral a problem arises' (ibid.: 250). Specifically, 'the payment of net interest by a country's indebted residents necessarily involves the country itself, whose payment – in the present system of international payments – adds up to that of its residents' (Cencini 2012: 65). Irrefutably, a better understanding and clearly defined recognition of a nation *existing as its own macroeconomic entity* would be a progressive step when re-considering the proper infrastructure that should be implemented such that the international system of payments can omit this double payment. 'The double charge of net interest payments could be avoided only if the macroeconomic existence of countries were explicitly accounted for, and payments carried out respecting the flow nature of money' (ibid.: 65). It is true indeed that the *vehicular* aspect of money, as well, needs to be reckoned with in a *proper* system of international payments: 'because of its circular flow – a national currency can never leave the banking system from which it originates' (ibid.: 64). More so, as earlier pointed out, this confirms the country currency's unique economic fingerprint, given after all, it is the 'acknowledgement of debt' (Cencini 2005: 250) of its very own banking system. But what also matters is that, again, '[b]ecause of its necessary circular flow, money cannot finance any net purchase, either within a single banking system or between countries' (Cencini 2012: 60). This implies that at the global level, country 'purchases have to be matched by simultaneous sales carried out through the circular flow of money' (ibid.: 60). We will see through our continued analysis of monetary macroeconomic disorders that both these factors<sup>178</sup> take on

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<sup>177</sup> It is at this level, that the international economy has its full impetus. Cencini sums it up, by emphasizing the following. '[T]he involvement of nations in the external payments of their residents is a direct implication of the macroeconomic aspect of international economics. It derives straightforwardly from the necessity to convey between countries the foreign payments of their residents, that is, from the need to convert domestic into international payments' (Cencini 2005: 250).

<sup>178</sup> Issued as an *acknowledgment of debt* by the very banking system of their respective nations, currencies are necessarily linked to their country origin; because of the flow aspect of bank money, it can never be the end term of a payment, whether within countries or beyond

particular significance at the international level of payments, specifically from the perspective of a country *considered as a whole*, that is, as its own macroeconomic entity.

We thus carry on with our journey by briefly reviewing the progress realized to date in understanding world accounting discrepancies.

### **The evolving tide with regard to the interpretation of *global balance-of-payments* statistical gaps**

To begin with, back in 2000, Schmitt documented the ‘curious phenomenon’ of the world current account net deficit as having been ‘shrouded in mystery’ and, since ‘some time’ (see Schmitt 2000). ‘Let us dwell briefly on a point that is incidental yet important: the growth of deficit within the trade balance, equivalent to the paid interest, explains a curious phenomenon, which economists have known and accepted for some time, but which has remained shrouded in mystery: namely that the sum total of the current-account transactions of all the countries in the world is not nil but largely negative. This cannot be helped, because debts  $D^{**}$  define the *net deficits of all countries taken together*’ (Schmitt 2000: 15–16)<sup>179</sup>. According to Schmitt, this was ‘enough to convince one that net interest relating to external debts is subjected to two distinct payments that should on no account be taken as one single payment. *The double weight of interest is thus a true theorem*’ (ibid.: 16)<sup>180</sup>.

So it would seem that the idea of a *missing surplus* was not novel, even back then, and clearly, Schmitt had already begun to unravel its mystery. But, from another standpoint, as Cencini and Citraro point out, still in 2012 mainstream thinking continued to be baffled by it: ‘[t]raditional attempts to explain world accounting discrepancies have sought to highlight the imperfections in statistical data collection, promoting a series of technical measures liable to improve balance-of-payments statistics’ (Cencini and Citraro 2012: 262). According to the latter authors, the fact that, despite numerous statistical improvements, ‘world accounting discrepancies’ still mystify traditional reasoning, can be explained. It lies with one important point. ‘[C]onventional solutions fail, because they rest on a flawed understanding of the principles of international macroeconomics. To be clear, the macroeconomic aspect of international transactions goes totally unnoticed in traditional analysis. The lack of a clear distinction between the aggregate of a country’s residents and the country as a totality – the set of its residents – points to why the world accounting discrepancies are still a mystery. If nation-states as such are not directly affected by the international transactions carried out by their residents, it becomes impossible to understand why, despite significant improvements in statistical reporting, world current, and capital and financial accounts remain severely out of balance’ (ibid.: 262).

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their national borders: the very principle of double double-entry bookkeeping from which stems its flow nature, guarantees this.

<sup>179</sup> Schmitt’s reference to  $D^{**}$  implies the ‘debt elicited by the payment of interest’ (Schmitt 2000: 5) whereas  $D^*$  intends the net ‘interest debt’ (ibid.: 5) itself. ‘We observe that debt  $D^*$  is met by LDCs’ *domestic economy*, whereas debt  $D^{**}$  diminishes their *international reserves*’ (ibid.: 15). LDCs intend ‘the group of developing countries’ (ibid.: 5) trading with the rest of the world.

<sup>180</sup> See Schmitt 2005 and 2007 for some of his further writings on his development of the Interest Theorem.

Yet according to Schmitt's 2000 account, it appears the World Bank was however aware of the fact that 'the payment of interest brings about an equivalent reduction in the net transfers accruing to the LDCs at the hand of the rest of the world ... We see that interest imposes a *first cost* on LDCs, registered in their current-account balance and that interest imposes a *second cost* on these countries, precisely because its payment cancels an equivalent fraction of transfers granted by the rest of the world' (Schmitt 2000: 20). This fact is indeed noteworthy and, if its implicit meaning is correctly understood, it certainly sets the stage for Schmitt's 2006 'fundamental argument as to the existence of macroeconomic transactions' (Cencini and Citraro 2012: 283). After all, as earlier explained by Schmitt, '[e]verybody can see that the payment of interest *scoops out an equivalent deficit*, since the amount of foreign currency received from exports is reduced by the sum of paid interest' (Schmitt 2000: 22–23). Nevertheless, as pointed out by Schmitt, though '[e]conomists are perfectly cognizant of debts  $D^*$ ' (ibid.: 23), 'with respect to net interest due by countries, the scientific community hardly ventures any further' (ibid.: 23). Rather, it remains 'oblivious to debts  $D^{**}$  which do emerge in the real world, the payment of debt  $D^*$  giving invariably rise to a second and equal debt,  $D^{**}$ ' (ibid.: 23). There is where the paradox appears to manifest, that is, 'economists and experts are caught in a self-contradictory situation, which explains why they are still unaware of the double payment of net interest, hopelessly searching for a statistical solution to the world balance-of-payments discrepancies' (Cencini and Citraro 2012: 291). Specifically, though 'the expression of 'unrequited transfer'' is correctly referred to by the World Bank and the IMF (see Schmitt 2000: 23), they seem to miss the crucial point that 'payment of debt  $D^*$ ' (ibid.: 23) *does give* 'invariably rise to a second and equal debt,  $D^{**}$ ' (ibid.: 23). And yet this, by itself, should easily confirm *the addition of the two distinct debts* ( $D^* + D^{**}$ ). Schmitt is very clear in explaining why that is. '[I]nterest debt ( $D^*$ ) is positively and definitively paid as soon as an export *tout court* – and not an amount of *excess* exports – is transferred abroad, by a transaction which both the World Bank and the IMF rightly refer to by the expression of 'unrequited transfer'. For interest to be actually settled within period  $p$ , rather than being carried over to a later period, one only needs to fund its payment by an export taking place right in  $p$ ' (ibid.: 23)<sup>181</sup>. Let us be very clear as regard the *blind spot* of the 'scientific community' (see ibidem and Cencini and Citraro 2012) and as it stands, still today: though well in the know of the 'unrequited transfer' (see Schmitt 2000) involved in the *microeconomic* payment of net interest that takes place in the debtor-country's current account, it somehow overlooks the *macroeconomic* element inherently implied by this very initial *real* payment, that is, that it inevitably entails a second *monetary* payment of equal value. Only this time, at a macroeconomic level: international reserves are inescapably burdened (see ibid.: 24).

Clearly then, it becomes all the more convincing that the problem with today's international 'system' of payments is that this very *non-system* (see Cencini and Citraro 2012) 'fails to account for the macroeconomic aspect of international payments, which leads to the formation of a monetary deficit each time an LDC pays its net interest on debt. The decrease in LDCs' official reserves necessary to restore equilibrium defines a dramatic loss of resources suffered by debtor countries, and accounts for the global discrepancies affecting the world current account and the world capital and financial account' (ibid.: 283). Moreover, as summed up by Schmitt (see ibid.: 283), the anomalous payment (the '*second cost*' as referred to by Schmitt 2000) 'of net interest amounts to the expenditure of a saving suffered by the debtor country' (Cencini and Citraro 2012: 283) 'and to a saving of an expenditure enjoyed by the creditor country' (ibid.: 283).

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<sup>181</sup> See Schmitt's 'preliminary notes': 'p, any year whatever when interest falls due' (Schmitt 2000: 5).

Now it is interesting and certainly worthy to note Schmitt's 2014 theoretical advances whereby he distinguishes (albeit, in an entirely independent argument) the payment of *compensated* imports from that of 'imports-without-exports' (see Schmitt 2014) *depending on the origin of the income behind the payment*, that is, whether it is financed by an income formed by the domestic production of the debtor or, creditor country. In following with Schmitt's 2014 analysis (with respect to the payment of net imports), one could infer<sup>182</sup> that the *unilateral* transfer involved in the net interest payment of the debtor-country's external debt 'obtains the reconstitution of' (Schmitt 2014: 8) the creditor-country's 'own domestic income' (ibid.: 8) and, *simultaneously* creates a hole in the debtor-country's economy. That is to say, it 'leads to the formation of a monetary deficit' (Cencini and Citraro 2012: 283) suffered by the debtor-country. And particularly a *double*<sup>183</sup> deficit as is evidenced in the case of LDCs, which for the most part are trade-balanced countries<sup>184</sup>. The double deficit<sup>185</sup> is ultimately covered by a simultaneous increase in debt (new foreign loan to *provide* it with the foreign currency required to pay for the totality of its foreign purchases) and, decrease in its official reserves (*expenditure* of the foreign bank deposit corresponding to said loan – the *monetary conversion cost*, the payment in foreign currency incurred to the country as a whole). Thus, the debtor-country is indebted twice, that is, it incurs two payments, each of a same value of its net interest payment. Hence, we observe a *doubling* of the net interest payment.<sup>186</sup>

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<sup>182</sup> The readers should nevertheless be *on the qui vive* that the two arguments (Schmitt's earlier analysis of the double payment of net interests and his 2014 analysis of the payment of net imports) are not exactly the same. When a country pays for its net imports, commercial and financial, it obtains part of the rest of the world's output, whilst the payment of its net interests consists of an *unrequited* transfer and, not to mention, the analysis of net interests payment has its own specificities. The difference between the two analyses should become clearer, later on, when we will more closely examine Schmitt's 2014 argument with regard to the payment of net imports.

<sup>183</sup> Later on in our paper, we will elaborate on how the *missing surplus* can be inferred from the occurrence of this *double* deficit arising in the debtor-country's current account (see Cencini and Citraro 2012). The authors evidence the manifestation of *two* deficits in the debtor-country's current account versus *one* surplus in the creditor-country.

<sup>184</sup> Just to draw a comparison, '[t]he trade balance of least developed countries (LDCs) being essentially even' (Cencini and Citraro 2012: 283) their external debt net interest payment would generate a double deficit that would be financed partly by a new foreign loan, partly by a reduction in its official reserves. Whereas, in the case of a country whereby its trade-surplus was, say the double of its due net interest payment, half of the surplus revenue would go towards the paying of the net interest payment and the remaining half towards restoring the said country's 'internal relationship between income and output' (Cencini 1995: 317). In supposing a country whose 'amount of net commercial exports' (ibid.: 315) 'is twice the size as the external debt servicing carried out by its residents' Cencini explains the following. 'Half of the foreign exchange earned through net commercial exports is paid out by the country as external debt servicing, while the other half is used to recover the domestic income transferred to the rest of the world by the indebted residents' (ibid.: 315).

<sup>185</sup> We will later on explain just how this double deficit comes about.

<sup>186</sup> It should be noted that though one of these, loan-payments or costs, is legitimate, the other is pathological in the sense that its cost is incurred by the country as a whole (official reserves reduction), *in addition*, to that of the initial cost incurred by its residents.

Curiously enough, despite the insightful advances and theoretical progress of some, Cencini and Citraro's 2012 findings, still delineate an economic community that continues, overall, to be trapped in a *statistical* resolve with respect to world accounting imbalances.

If we consider the world current account for example, international trade has it that '[a] country's net commercial exports are the rest of the world's net commercial imports' (Cencini and Citraro 2012: 272). One would expect from this that, naturally then, 'the world current account, that is, the current account of all the individual countries taken together, should be perfectly balanced. 'In principle, the combined surpluses and the combined deficits arising from the current account transactions of all countries (including international organizations) should offset each other, because one country's credits are the debits of another' (International Monetary Fund, 2000, p.2)' (ibid.: 272). But the situation is very much otherwise and substantially so with statistical realities reporting a significant *global current account deficit*. 'In reality, statistics show 'that the world as a whole is running a substantial current account *deficit* that increased sharply in the early 1980s and has remained high' (Krugman and Obstfeld, 2003, p.314). The first study on the world current account discrepancy was carried out by an IMF Working Party, whose official report was published in 1987. Now, although many statistical adjustments suggested by the IMF Working Party experts have since been implemented by specialists in data collection and compilation, the discrepancies in world current account balances have not substantially lessened' (Cencini and Citraro 2012: 272–273). The latter authors clearly demonstrate this in their statistical tables (see ibid.: 273) which capture the world current account balance for years ranging from 1978 to 2002 and, document the IMF as data source. Looking particularly at years from 1985 onwards (given 1987 was the year of the first IMF official report), it becomes clear that indeed 'statistical adjustments' have not done much in easing the global current account imbalance. Moreover, it certainly vindicates Cencini and Citraro's claim that 'the relevance and evolution of the world current account deficit are such that it would be naïve to impute it to statistical shortcomings in data collection and compilation' (ibid.: 273).

And, what is more, yet another discrepancy is reported 'at the world capital and financial account level. As a country's capital outflows are another country's capital inflows, world capital flows should balance: the sum of capital inflows should equal the sum of capital outflows. 'For *the world as a whole*, every inflow into one country is an outflow from another country; if all transactions are properly recorded, their total should add up to zero' (International Monetary Fund, 1992, p. xiii). This is however not what happens in practice, the world capital and financial account showing a substantial net capital inflow' (Cencini and Citraro 2012: 274). On thinking about it, it is wondrous after all, that despite the very fact that 'the world is a closed economy and since the balance of payments is construed according to the rules of double-entry book-keeping, the necessary balancing of' (ibid.: 272) each of these world accounts *is not empirically proven*. It thus become increasingly convincing that *something is not quite right*, as though some elements were indeed mysteriously missing from the equation and, with a cause, itself, mysteriously unbeknownst. But as the latter authors sagaciously point out, one thing is certainly clear. That is, given the tight interrelatedness between these global accounts<sup>187</sup>, '[t]he balances of these two accounts should be mirror images of each other, which clearly suggests that the two world balance-of-payments discrepancies must be the effects of one and the same cause' (ibid.: 275). Yet, as they explain, though IMF economic researchers had 'observed that the 'negative sign of the discrepancy...in investment income is consistent with the positive sign of the discrepancy in the global financial account data' (International Monetary Fund, 2003, p.4)' (ibid.: 275), still, the *missing* surplus and capital outflow were merely being connected to *statistical*

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<sup>187</sup> Specifically: the world current account and the world capital and financial account.

*inaccuracies related to misreporting of data*, though albeit, specifically to “‘the systematic misreporting of international interest income flows’ (Krugman and Obstfeld, 2003, p. 314)’ (Cencini and Citraro 2012: 275). Nevertheless, progress was on the brink with some economists venturing that much closer to a trailhead that could potentially lead them to the culprit-source of world accounting discrepancies. In their continued search of a sound explanation of the ‘missing surplus’, Krugman and Obstfeld had already connected the size of the discrepancy in the global current account with that of variations related to interest payments. ‘Analysing the problem of the ‘missing surplus’, Krugman and Obstfeld (2003) observe that a strong correlation exists between the size of the world current account discrepancy and the size of interest payments’ (ibid.: 288). And statistics did confirm this observation, since as per Cencini and Citraro: ‘when world interest rates fell (mid-1980s, early 1990s) so did the world current account deficit, whereas it grew bigger every time interest payments rose because of a rise in either interest rates or the volume of external debt. ‘World interest rates rose sharply after 1980, and the size of the world interest payment discrepancy increased with them. The interest payments hypothesis therefore offers a potential explanation for the increase in the global deficit’ (Krugman and Obstfeld, 2003, p.322)’ (Cencini and Citraro 2012: 288). According to the latter authors, it is thus that the ‘interest payments hypothesis’ was borne. An observed correlativity had re-ignited the hopes of a scientific community that was evidently determined to press forward in its endeavor to unveil the source-cause of world accounting imbalances. But as they documented, its<sup>188</sup> quest had certainly been that of a long journey and not without its blind alleys. For example, back in 1986, Dooley’s analysis had also raised hopes when he’d set out ‘to capture unreported capital flows’ (ibid.: 278). But though it was initially thought that his analysis had ‘the merit of emphasizing the pathological aspect of capital flight by identifying the need to account for asymmetrically reported capital flows’ (ibid.: 278), it was found that, overall, his method was not completely developed. Though his course of action to capture the *magnitude* of escaping capital flows certainly had validity, on the whole, it was felt that his methodological approach was not without its shortcomings and could easily lead to a circular claim (see *ibidem*), unless it was further advanced<sup>189</sup>. They elaborate, very clearly, on their reasoning. ‘As essential as it might be to quantify the problem, it cannot be considered more than a first step on the long way leading to its understanding and to its solution. A wide gap exists between reported statistical data; that is a fact. The various methods elaborated by the World Bank, Morgan Guaranty, Cline, and Dooley suggest comparable ways for measuring this gap. But how can it be adequately explained? As we have already pointed out, unless capital flight is defined and measured independently of the balance-of-payments misreporting, it will be viciously circular to claim that, as the gap measures capital flight, capital flight is its cause. The measurement of the gap due to unreported capital flows shows the evidence and the extent of the problem; it fails to explain it’ (ibid.: 278–279).

In considering the general state of things as it continues to exist today, there is indeed much merit in Cencini and Citraro’s 2012 claim that the reason conventional analysis is still unable to demystify the cause of global accounting imbalances<sup>190</sup>, is quite simply that it bypasses the

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<sup>188</sup> That is, the scientific community’s quest. See Cencini and Citraro 2012.

<sup>189</sup> According to Cencini and Citraro 2012, this was also the risk inherent in alternate methodological approaches such as propounded by other endeavoring economists, that is, as in the ‘various methods elaborated by the World Bank, Morgan Guaranty, Cline, and Dooley’ (see *ibidem*). See also the working paper of Claessens and Naudé (1993) that Cencini and Citraro 2012 recourse to when analyzing the different approaches attempted *in order to quantify capital flight*.

<sup>190</sup> And, along with it, the double charge of net interest payments.

international aspect of macroeconomic transactions, notwithstanding, quite unknowingly. ‘Today, economists and experts are caught in a self-contradictory situation, which explains why they are still unaware of the double payment of net interest, hopelessly searching for a statistical solution to the world balance-of-payments discrepancies. In fact, while acknowledging the principle of the mandatory equality between debits and credits, they recognize it only at the microeconomic level, while missing the international side of macroeconomic payments’ (ibid.: 291). One thing is certain and, quite evidently, too little emphasis has been placed by traditional analysts on *the true meaning behind the fact that a nation does subsist as its very own macroeconomic entity*. So much so, that still in 2014, Schmitt must address the reality that the concept of *sovereignty* exists but in obscurity. Very interestingly, he brilliantly challenges the state of affairs by introducing a most innovative approach to conceptualizing it. In so doing, he takes the notion of sovereignty to a whole new level capable of homing in on a truly scientific meaning of *countries existing as macroeconomic entities*. Though we will later elaborate on just how his innovative approach might help us better understand the global monetary anomalies currently afflicting international payment transactions, let us merely adumbrate for the time being, using Schmitt’s own writings. ‘Indeed, it has also to be admitted that the idea of sovereignty remains blurred. It can be correctly grasped only when foreign currencies lent to countries, set of their respective residents, are distinguished, as they must logically be, from the foreign currencies lent to their domestic economies’ (Schmitt 2014: 13).

In sum, traditional theories, thus far, remain conceptually deficient in providing a complete analysis of global balance-of-payments statistical gaps that could soundly explain the exact cause behind them. The situation undeniably calls for a fresh analysis of our present *non-system* of international payments, specifically of, the effects of the monetary flows that are implicated in international payment transactions. We next set our attention on showing *how the imbalance* that arises between the totality of inflows and outflows can as well explain both the ‘*missing surplus*’ and, ‘*missing capital outflow*’<sup>191</sup>.

In a following section, we thus return to our analysis of international monetary flows, this time with a dual aim. We will attempt to explain how the two global accounting discrepancies<sup>192</sup> derive from a unique source-cause and, concurrently confirm the pathological double charge inherent in a country’s net interest payment.

This brings us next to our review of the world current account and, world capital and financial account discrepancies. We show<sup>193</sup> that both imbalances are effects originating from a same source: countries’ external debt servicing. We begin our analysis with that of the global current account net deficit or, the ‘missing surplus’.

## **On the global current account net deficit, contemporarily referred to as the ‘missing surplus’**

It is not only that double-entry bookkeeping inherently enforces a faultless balancing of credits and debits<sup>194</sup> and that the identity<sup>195</sup> between each nation’s purchases and sales

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<sup>191</sup> See Cencini and Citraro 2012.

<sup>192</sup> The global current account *net deficit* and, global capital and financial account *net capital inflow*.

<sup>193</sup> Our conclusive explanation stems from the analysis as elaborated by Cencini 2005a, Cencini 2005, Cencini and Citraro 2012. See also Schmitt 2012.

<sup>194</sup> That is, *double credits* and *double debits*. See Cencini and Citraro 2012: 262.

naturally ensues from this, but also the fact that trading countries are reciprocally linked in their exchanges<sup>196</sup>, that one would expect the world current account to add up to *nil*. '[B]ased on the rules of double-entry book-keeping, the balance of payments of each individual country should necessarily add up to zero. Likewise, surplus and deficit countries being inter-related, the current account of all world countries should thus be perfectly balanced, as should be the world capital and financial account' (Cencini and Citraro 2012: 262). Yet as the latter authors have pointed out, the reality is that both world accounts continue to evidence substantial discrepancies. The global current account, for its part, amounts to a *net deficit*. And what is more, as we will attempt to show, it is very much linked to the global capital and financial account imbalance that is marked by a *net capital inflow*.

Now, as earlier explained, '[n]umerically far too important to be simply due to errors and omissions in statistical data collection and compilation, the world current account imbalance has usually been correlated to misreporting of international investment income transactions and to capital flight' (Cencini 2005a: 1. See also Cencini and Citraro 2012). On considering the statistical components that are methodically captured within the accounts of a country's balance-of-payments<sup>197</sup>, it becomes clearer as to how this correlation might of come about.

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<sup>195</sup> The very fact that the '*fundamental balance of payments identity*' (Cencini 2005a: 4) does fall apart at the international macroeconomic level, that is, that it reduces to 'a condition of equilibrium' (Cencini and Citraro 2012: 283) should be enough cause for alarm that *something else is fundamentally wrong, the culprit*. After all, 'an identity is an equality that holds under any circumstances' (Cencini 2005a: 15). And more so, given that a nation's sales are another's purchases and vice versa: 'the world as a whole is a closed economy' (see Cencini 2005a and, Krugman and Obstfeld 2003), it can't but baffle that the identity, indeed, does not hold at the global level. As well, the discrepant sums are way too substantial to accrue to mere compilation errors or fact that entry-data emerges from varied channels. It does seem odd then, that despite all, IMF statisticians (see International Monetary Fund 1993) resign themselves to 'claim that, 'because data for balance of payments entries often are derived independently from different sources, implementation of the double-entry recording system is not perfect' (ibid.: 160)' (Cencini 2005a: 15). Would it not be more logical, instead, to reason it out deductively? That is, to deduce that it could have more to do with the fact that the *infrastructure* of our current international payments system might, very simply, be at odds with the macroeconomic laws that should otherwise govern it, such as *the identity*? '[W]e are confronted with the choice between a logical identity that does not allow for individual behaviour to play any equilibrating role at the global level, and a conditional equality in which a prominent role is reserved for an adjustment mechanism based on individual and aggregate decisions. Inherently macroeconomic, the first alternative emphasizes the structural aspect of the system of international payments and aims at explaining today's economic disorders by referring to the lack of alignment between the laws the present system should comply with and its actual working. The second alternative, on the contrary, is essentially microeconomic and it is implicitly centred on the idea that economic order is the momentary result of a process of adjustment taking place between opposite forces in a constantly renewed attempt to equilibrate more or less diverging forms of behaviour' (Cencini 2005a: 8).

<sup>196</sup> '[A] country's net entries in its current account being necessarily matched by equivalent net entries of opposite sign in the current account of the rest of the world, the current account of the world considered as a whole should always be equal to zero' (Cencini 2005a: 1).

<sup>197</sup> It might be efficacious, from the onset, to take notice of the IMF's specific classification with respect to the two main accounts that make up countries' balance-of-payments and, their respective components. 'According to the fifth edition of the *IMF Manual*, the standard

Still, understood from this narrow perspective, the clues remained frail and misleading. It should not surprise that the discrepancies continued to lack a sound explication. But in 2005 Cencini, and again with Citraro in 2012, ventured a different *distinctly macroeconomic* approach in tackling the problem (See Cencini 2005a and Cencini and Citraro 2012, respectively). They advanced that the two world accounting discrepancies were the effect of a same source-cause and, particularly originating from countries' external debt servicing. They substantiated their findings with those emanating from Schmitt's long time investigation<sup>198</sup> of the *double charge* linked to the net interest payment of countries' external debt. Their analysis began with a new construe for what the meaning of capital flight should intend if it is to be heralded as a viable avenue capable of demystifying the global accounting imbalances. Using their own words: '[i]f capital flight is to explain world balance-of-payments discrepancies, it has to be shown that it is at the origin of unreported capital flows' (Cencini and Citraro 2012: 276). Essentially, their focus centers on properly re-defining the causality such that it could soundly explain the pathology behind the discrepancies. That is, in lieu of attempting to measure *unreported* capital flows and thereafter linking these to *capital flight*, they primarily characterize the latter 'analytically, and then measure it accordingly' (ibid.: 279). Their purpose is thus to demonstrate that the very accounting imbalances are the effects of an anomaly that *marks* 'a capital flight, whose amount corresponds very closely to that of the world discrepancies' (ibid.: 279). They particularly caution on the importance of defining and measuring 'capital flight independently of the discrepancies appearing in the world balance of payments and generically identified with unreported capital flows' (ibid.: 277) to avoid being drawn into circular argument by otherwise simply deducing 'that capital flight is the cause of these discrepancies from the assumption that capital flight is measured and defined by these same discrepancies' (ibid.: 277). In other words, it is only in this manner, observed *primarily* from a distinct entity perspective rather than simply in relation to,

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components of the balance of payments are classified in two major accounts: the current account, and the capital and financial account (itself made up of a capital account and a financial account). Transactions entered into the current account relate to goods and services, income, and current transfers. Exports and imports of real goods and services, compensation of employees, investment income (dividends, profits, reinvested earnings, and interests), workers' remittances, and gifts are among the transactions entered in the current account. The major components of the capital account are capital transfers (transfers of funds linked to, or conditional upon, acquisition or disposal of fixed assets), and acquisition/disposal of non-produced, non-financial assets (patented assets, leases or other transferable contracts, goodwill). Finally, transactions relating to direct, portfolio and other investments, and to reserve assets are entered into the financial account' (Cencini 2005a: 2). See also IMF 1993. It is also interesting to note, as observed by Cencini, that contrarily to what the name appears to suggest, the *balance-of-payments* intends transactions, in a broad sense, rather than being concerned specifically or, only, with payments. 'As stated in the *Balance of Payments Manual* edited by the International Monetary Fund (IMF), the balance of payments is essentially 'a statistical statement that systematically summarizes, for a specific time period, the economic transactions of an economy with the rest of the world' (International Monetary Fund 1993: 6). A wider instrument than the simple record of foreign payments, the balance of payments is concerned with all sorts of international transactions, included those that do not involve any payment. Thus, 'despite the connotation, the balance of payments is not concerned with *payments*, as that term is generally understood, but with *transactions*' (ibid.: 8)' (Cencini 2005a: 2).

<sup>198</sup> See Schmitt 2000, 2004, 2005, 2006, 2007, 2012.

that capital flight could ever be effectively evaluated as a potential source-cause of world accounting variances.

### ***So on to the development of a new meaning for capital flight***

It would seem that a fresh understanding of the concept was borne from an insight as provided, albeit primitively, by the World Bank when back in 1985 they began to associate it with that of ‘an unrecorded capital outflow, that is, of a capital lost by some countries without being recorded in the balance of payments to the rest of the world. This seems to be the first meaning given to capital flight by the World Bank, by which it refers to the increase in external debt and, at least implicitly, to the payment of interests’ (Cencini 2005a: 21). See also World Bank 1985. This led to the measure of capital flight as a difference originating between capital inflows and outflows and, defining an inexplicable sum lost from debtor-countries’ official reserves. ‘According to the *World Development Report*, in fact, capital flight is measured as the difference between capital inflows – as determined by the increase in external debt and net foreign investment – and capital outflows – as determined by current account deficits and variations in official reserves’ (Cencini 2005a: 21). Now, as pointed out by Cencini, this *new perception of capital flight* was not without implying that the global balance-of-payments variances could very well ‘derive from a loss of capital suffered by indebted countries and that this loss is closely related to the payment of their current account deficits. Furthermore, if we take into consideration the fact that current account deficits are mostly due to interest payments, we arrive at the conclusion that *the payment of interest on external debt is the most likely common cause of world accounting discrepancies*’ (ibid.: 23). So from having thus established a distinct individual cause from which the pathology of global accounting imbalances could potentially emanate, further study appeared ‘to corroborate the idea that both the ‘missing surplus’ and the ‘missing capital outflow’ exist because the payment of interest fails to be recorded in both the current account and in the capital and financial account of creditor countries’ (ibid.: 24). On first consideration, this seemed to suggest then that ‘[t]he world current account discrepancy would thus pose the problem of tracing down the payment of interest in order to enter it to the benefit of creditor countries’ (ibid.: 24). Yet further in-depth consideration offered another more innovative perspective: the prospect that a *second anomalous payment was at play*. As intuitively observed by Cencini, it could be ‘that the payment of interest elicits a second, pathological payment of net debtor countries’ current account’ (ibid.: 25) amounting to ‘an over-expenditure carried out by the indebted countries and unrecorded by creditor countries’ (ibid.: 25). This then led to substantial progress on the subject matter as he further advanced the challenge that ‘[i]nstead of looking for the ‘missing surplus’ in order to transform it into a recorded payment, the problem would then be avoiding the overpayment of interest in the first place’ (ibid.: 25). The key word here is that of ‘overpayment’ as the mere thought of the possibility of an anomalous ‘over-expenditure’ shed light on a new way of conceptualizing the problem and this meant not only knowing *what* happens but more so *how* the pathology actually manifests. It was no longer enough to suspect that the world accounting discrepancies might very well be the counter-part results of a same source-cause linked to external debt servicing. If, the latter does indeed involve a *second anomalous* payment that shouldn’t even happen, then shifting the focus to discovering more about the *how it happens*, was certainly pre-emptive to finding a way to correct the anomaly<sup>199</sup>.

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<sup>199</sup> Cencini hinted to a viable investigative starting point by reminding that given that the ‘discrepancies are concerned with the transactions entered into the balance of payments. They

To append to the above and before we begin on a more elaborate account of the malfunction of the flows implied in the payment of net interest, let us first mull over yet another brilliant observation, this time as pointed out by Schmitt as early as 2004 and which observation he revisits in 2014 in his analysis of external debt's double charge (see Schmitt 2004 and 2014). His explanatory description characterizes the very *foreign* currencies as implied in the net interest payment of a country's external debt, Brazil's, in this 2004 example of his, and hints to their pathological role in the formation of the world accounting discrepancies. 'The sum of foreign currencies flowing out of Brazil for the interest payments are thrown into a state of dysfunction owing to the fact that they *usurp the status of real assets*; if order, justice and logic prevailed, no monetary unit could ever intrude into the category of real assets, comprised of goods and services, bonds and securities. In the present sorry state of affairs, each and every unit of (foreign) currency thrown into the transnational interest payments assumes two fundamentally distinct and separate predicates all at once: it "functions" as a medium of exchange and, simultaneously, it equally "malfunctions", the exact pathology lying in the fact that when the interest payments are taken into account, the logical equality between the inflow and the outflow of foreign currency is adversely affected' (Schmitt 2004: 46). Next, we turn our attention to explaining the connotation with reference to the adjective *missing*, when describing the puzzling occurrence of a 'missing surplus'.

### ***The 'missing surplus'***

We begin our explanation by evidencing how the payment of net interest entails a *double* deficit for the debtor-country, e.g. LDC<sup>200</sup>.

If we keep abreast of the *macroeconomic* element inherently implied in cross-border payments, we will understand from the on start, how this naturally 'leads to the formation of a monetary deficit each time an LDC pays its net interest on debt' (Cencini and Citraro 2012:

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are thus the sign of a disorder deriving from the recording of flows'. (Cencini 2005a: 25). He further advanced the following worthy observation. 'The payments of interest made by the current account correspond to a transfer to the creditor countries of part of the debtor countries' domestic output: a stock. If two flows were necessary for the transfer of this unique stock, a discrepancy would appear that could not be considered merely the side effect of imperfect data collection' (ibid.: 26). Rather, as he suggested 'the disparity between stock and flows' (ibid.: 26) would more pointedly reflect an *infrastructure malfunction* of the international payment system. '[T]he present system of international payments is so structured as to impose on indebted countries a double payment of interests. Two equivalent flows are required to convey the real payment of net interests between countries' (ibid.: 27) giving 'thus rise to an unreported capital outflow defining a net loss for the indebted countries' official reserves. It is this unaccounted loss that explains the mystery of the 'missing surplus'. To understand it thoroughly it is necessary to unveil another little understood phenomenon: the macroeconomic servicing of external debt' (ibid.: 27).

<sup>200</sup> In following with Cencini and Citraro's demonstration, we exemplify the case-scenario of least developed countries keeping in mind that '[a]dmittedly, the world current account discrepancy does not refer solely to LDCs. Yet it is also certain that LDCs represent a substantial part of the world's indebted countries, so that their net interest payments account for most of the world's missing current account surplus' (Cencini and Citraro 2012: 286). For this very reason, the data easily corroborates theoretical expectations, that is, when an analyst attempts to depict a correlation between world accounting discrepancies and the net interest payment.

283). It is also important to remember that the interest payment<sup>201</sup>, is funded by the debtor-country's *commercial* exports given that it is processed by the current account<sup>202</sup>. What this all means, is 'that the payment of interest *scoops out an equivalent deficit*, since the amount of foreign currency received from exports is reduced by the sum of paid interest' (Schmitt 2000: 22–23). And, what this translates to, effectively<sup>203</sup>, is that some of the debtor-country's *imports* will be left *uncovered*, by an equal amount to the net interest payment (Cencini 2005). Now given that our country-case (LDC) under observation has a trade account that is balanced, it will have to finance the *monetary deficit*<sup>204</sup> (uncovered imports) in its current account with a foreign loan<sup>205</sup>. But we have to remember, as previously established (see Schmitt 2014), that the foreign income implied in this loan has not a purchasing power that is *double* such that it finances *only* the purchase of the debtor-country's financial bonds (IOUs) and nothing else. This means that the sale of IOUs by the debtor-country can only provide it with the *access* to the foreign currency it requires to cover its uncovered imports, *through the acquisition of the foreign bank deposit* following the sale of its IOUs. In this sense, the deficit entailed by the first<sup>206</sup> payment of net interest (the microeconomic payment) is thus made up for in that the debtor-country has restored its previous<sup>207</sup> level of internal resources. *But a monetary deficit*<sup>208</sup> *remains: the debtor-country has now to **expend** this foreign bank deposit*

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<sup>201</sup> That is, the *first* interest payment or, charge.

<sup>202</sup> Now, this is so, because it involves 'the transfer to *R* of part of *A*'s domestic output ... since interest is the income paid to *R* for an investment of capital in *A*. Part of the output generated by this investment is due to *R*, which precisely means that *A* pays its due by transferring part of its domestic resources to *R*' (Cencini 2005: 260). The author's reference to *R* and *A* in his case-example, intends respectively, the creditors of *A* '(countries *R*)', and 'indebted countries (*A*)' (see *ibidem*: 257). 'The first payment of interest is the transfer to *A*'s creditors of a sum of foreign exchange earned by *A* through its exports of real goods and services. This first flow of ten units out of *A*'s current account is matched by an equivalent flow into *R*'s current account and corresponds to a stock of equal amount: the real resources transferred from *A* to *R*' (*ibid.*: 269).

<sup>203</sup> If we consider the case whereby the country (e.g. LDC) has an even trade balance, in following with the LDC case-model of Cencini and Citraro 2012.

<sup>204</sup> The net interest payment essentially creates a hole ('monetary deficit' see Cencini and Citraro 2012 and, Schmitt 2000) in the debtor-country's economy that is never recovered on account of the very unilateral aspect of this transfer payment. Ultimately, it is a reduction in the debtor-country's official reserves that will compensate. On this note, Schmitt has an interesting observation as follows. 'The cost involved when the 'vacuum' (or the 'black hole') is filled is less clear in periods when LDCs land a surplus. Nevertheless, in no conceivable circumstances could it be inferred that the payment of interest does *not* produce an equivalent deficit' (Schmitt 2000: 23).

<sup>205</sup> 'In order to face the current account deficit entailed by the payment of in, *A* has to increase its exports or incur a new debt by selling financial claims to *R*. The trade balance of least developed countries (LDCs) being essentially even, let us consider the case (by far the most widespread) where *A* finances its current account deficit through a new loan' (Cencini and Citraro 2012: 283). The authors' reference to 'in', '*A*', and '*R*' in their exemplary case, intends the sum of net interest (in) payment to *R*, the LDC (*A*) and some other country (*R*), respectively.

<sup>206</sup> That is, as carried out by the debtor-country (LDC's) residents.

<sup>207</sup> Our meaning: previous to the first microeconomic payment of net interest.

<sup>208</sup> What distinguishes this monetary deficit from the first (uncovered imports) is that it 'is not matched by a current account surplus of the creditor countries' (Cencini and Citraro 2012:

*in order to complete the purchase of its uncovered imports.* As such, it is the country *as a whole* that, this time, comes to the rescue. Hence the second<sup>209</sup> payment of interest which brings about a loss in the country's official reserves. The relevant point here is that this second payment of interest is also processed by the debtor-country's current account, notwithstanding that the cost of it is incurred by its capital and financial account<sup>210</sup>. This implies *two* deficits in the debtor-country's current account versus *one only surplus* in the creditor country, thus the mystery of the 'missing surplus' is unveiled: a surplus is *missing* from the global balance-of-payments and this consequently leads to the world current account *net* deficit. 'The fact that two deficits are present in the current account of the indebted countries while foreign creditors are only paid once fully explains the discrepancy existing at the global current account level. A's current account deficit is twice the amount of R's current account surplus, which is why a surplus is missing in the world current account' (Cencini and Citraro 2012: 285). The authors' inference in their case-example, with respect to A and R, is that of LDC (A) and some other country R.

The fact that the unilateral transfer payment, as pointed out by Schmitt, 'amounts to the expenditure of a saving suffered by the debtor country' (ibid.: 283) *macro-economy* 'and to a saving of an expenditure enjoyed by the creditor country' (ibid.: 283) *macro-economy*, explains why it is that, though the *pathological macroeconomic* payment is recorded in the current account of debtor nations, *it is not entered into the current account of creditor nations*. And this in turn, demystifies the manifestation of a global current account *net*

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285). This is because it happens at the *macroeconomic level* and as such, involves the country *as a whole*, ultimately reducing its OR (official reserves) by a same amount as that of the net interest payment. Given the current deficient state of our international payment system, the *monetary* deficit (uncovered imports) that is *initially* generated by the microeconomic payment of net interest, will be 'paid both by a foreign income *and by a domestic income*' (Schmitt 2014: 58), that is, by the *expenditure of the foreign* bank deposit (foreign income) that was obtained following the cession of IOUs (domestic income). '[T]hrough its change in money R, the same imports are settled through the expenditure of a foreign income from the moment they are defined to the debit of country A, considered as a whole' (Schmitt 2014: 58). The author's inference with respect to 'money R' is that of some other foreign currency; whereas 'country A' implies some debtor-country. When all is finally settled and concluded, indeed, the **duplication** of net interest payments, lies in the very fact that, ultimately, net interests are paid both in real and in monetary terms, that is, in products and in money.

<sup>209</sup> This second macroeconomic payment is incurred to the country *as a whole*, through a reduction in its official reserves.

<sup>210</sup> '[T]he second payment of interest is carried out by A's current account even though its cost is taken over by A's capital and financial account. Both the payment of interest and of  $im_i$  are in fact entered in A's current account since they imply the transfer to R of part of A's domestic output. This is clearly true for the payment of  $i$ , since interest is the income paid to R for an investment of capital in A. Part of the output generated by this investment is due to R, which precisely means that A pays its due by transferring part of its domestic resources to R. As for  $im_i$ , it is likewise clear that its payment originates in A's current account, since it is this account that is debited for all of A's imports, including those which cannot be financed by A's exports' (Cencini 2005: 260–261). The author's reference to A, R,  $im_i$  and  $i$ , intends respectively, 'indebted countries (A)', the creditors of A ('countries R)', 'the payment of imports no longer covered by the exports because of the payment of interest,  $im_i$ ', and 'the payment of interest itself,  $i$ ' (see ibidem: 257, 258).

*deficit*<sup>211</sup> and explains the ‘missing surplus’. As well, the loss suffered by the debtor nations when their official reserves come to the rescue of the monetary deficit *remaining* in their respective current accounts, ‘explains the world capital and financial account discrepancy, and thus solves the mystery of the ‘missing capital outflow’’ (ibid.: 289). Let us next consider how the monetary flows implied, evolve in such a way as to lead to the manifestation of a net capital inflow *that explains the ‘missing capital outflow’*.

## **On the global capital and financial account net capital inflow, contemporarily referred to as the ‘missing capital outflow’**

### ***Back to capital flight***

So with a new understanding of capital flight at the helm, a door was opened that eventually led analysts onto the right path towards unveiling the global capital and financial account discrepancy. As emphasized by Cencini and Citraro 2012, what had to be found was a flight of capital that could ‘be identified as a pathological capital flow only partially recorded in the world balance of payments’ (ibid.: 279). The authors found that the optimum approach in realizing this was to factor in the *macroeconomic element* inherently implied in international transactions, when analyzing a country’s net interest payment as a possible source-cause for world accounting imbalances. After all, ‘if double-entry book-keeping is complied with, no payment between residents and non-residents can generate any world current account or capital and financial account discrepancy. If we specify as microeconomic the payment between residents and non-residents, we can therefore conclude that no microeconomic payment can ever be the cause of a world balance-of-payments discrepancy (statistical misreporting notwithstanding)’ (ibid.: 280). This led them to consider the possibility of a *second* pathological payment occurring at the *macroeconomic* level.

Their analysis highlighted a distinct observation from the on start. Despite the fact that a country’s macroeconomic net interest payment *adds* to that of its microeconomic payment, this ‘would have no consequence in the joint balance of payments of’ (ibid.: 281) the debtor and creditor countries involved, if the debtor-country’s macroeconomic payment was recorded in the ‘current or capital and financial accounts’ (ibid.: 281) of *both* countries. But such is not the case as the world accounting discrepancies well evidence. Let us see why that is and just how it also unveils the ‘missing capital outflow’.

### ***The ‘missing capital outflow’***

As we have earlier established, the *unilateral* transfer involved in the first payment of net interest inevitably entails a monetary deficit in the current account of the LDC, leaving it with uncovered imports that will have to be covered by a foreign loan and, ultimately by the

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<sup>211</sup> We refer the readers to Cencini and Citraro 2012 for their compilation of data that clearly supports a correlation between the global current account imbalance and the payment of net interest by LDCs, for an interval period of 26 years (1980–2005), (see ibidem: 286, IMF 2007 and World Bank 2007).

countries official reserves<sup>212</sup>. Analyzing this from a flow's perspective, whilst keeping abreast of the inherent macroeconomic aspect at play, the following can be observed. Altogether, the LDC's capital and financial account incurs two flows, one relating to the foreign loan sought on account of its current account deficit (result of uncovered imports) and one relating to the loss of OR that are ultimately expended in the payment of these uncovered imports. But the problem is that the 'two flows compensate' (Cencini 2005: 270) resulting in a *net capital inflow* that is recorded in the debtor-country's capital and financial account, but with *no* counter-part capital outflow in the creditor-country's balance-of-payments. This is on account of the fact that the second anomalous payment does not accrue to any particular resident of the creditor-country, neither does it 'identify with any official transfer from' (Cencini and Citraro 2012: 284) the debtor to the creditor-country but rather benefits the latter's macroeconomy, that is, the creditor-country, *as a whole*. The second anomalous payment of interest, thus goes totally unrecorded in the creditor-country's balance-of-payments and, decisively enlightens the phenomenon of the global capital and financial account imbalance: the world's capital and financial account *net capital inflow*, as well, the 'missing capital outflow'<sup>213</sup>.

### **On the interest payment *double charge***

Having demonstrated that external debt servicing is indeed the unique source-cause behind both global accounting discrepancies, we can further observe that the very evidence of these world imbalances corroborates the hypothesis of a '*net macroeconomic payment*' (ibid.:281). That is, notwithstanding that the macroeconomic payment of the country *as a whole* adds to that of its residents' microeconomic payment, but more so if considered globally, the discrepancy clearly reveals an extra net expenditure on the part of the debtor-country with respect to the creditor country. Because the *initial* net interest payment from the debtor to the creditor country involves a transfer that is *unilateral* 'the lack of reciprocity precludes the balancing of the macroeconomic payment of' (ibid.: 281) the debtor-country with an equal payment from the creditor-country, at the macroeconomic level. This leads to a loss of internal resources on the part of the debtor-country that is never re-covered: ultimately its official reserves are compromised. And given that the implied pathology also leads to a recording asymmetry<sup>214</sup> on considering the *whole* of both countries' balance-of-payments,

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<sup>212</sup> We refer the readers to Cencini and Citraro 2012 for their compilation of the relevant data covering an interval of 29 years (1976–2005), that evidences a reduction in LDCs' official reserves from an otherwise expected value. The discrepancy attests, very evidently, to an amount consumed by the second pathological net interest payment: a calamitous cost incurred by the country *as a whole* (see ibidem: 286–288, also World Bank 2007).

<sup>213</sup> Cencini and Citraro 2012 sum up the following important observation, regard the missing *global* capital outflow: 'To the extent that LDCs account for the greatest part of the net interest payments occurring worldwide, the missing world capital outflow is thus explained by the loss in official reserves suffered by LDCs because of the second (pathological) payment of interest, gone unrecorded in the creditor countries' balance of payments' (ibid.: 288).

<sup>214</sup> 'The first payment of interest benefits *LDCs*' creditors, residents of *R*, and is recorded both in *A*'s and in *R*'s current accounts. Yet, while the second, indirect, payment of interest is also recorded in *A*'s current account – because it implies the transfer of a positive amount of *A*'s domestic resources – its counterpart remains unrecorded in *R*'s balance of payments – since it amounts to a gain obtained by country *R* considered as a whole. If we look at the global

inevitably, it all comes out in the wash, as is well evidenced by the world accounting discrepancies. Schmitt's argument that 'the pathological payment of net interest amounts to the expenditure of a saving suffered by the debtor country ... and to a saving of an expenditure enjoyed by the creditor country' (ibid.: 283), is easily vindicated. See also Schmitt 2006.

In sum, the *double* charge of debtor-countries net interest payment lies in the fact that the second macroeconomic *monetary* payment is a pathological *spin-off* that is entailed by the first microeconomic *real* payment of the countries' residents and that, undeniably, the two payments add to one another. The added cost is incurred to the country *as a whole*, through a reduction of its official reserves by a same amount as the net interest payment.

In a next chapter, we re-examine the *double charge* of a country's external debt *with respect to its very formation*, this time by considering, singularly, the approach of Schmitt's 2014 analysis. We will review his latest and most revolutionary reasoning as he explains the very formation of *sovereign* debt that is ultimately responsible for duplicating countries' external debts.

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current accounts of *A* and *R*, we can thus easily verify that, only half of the payments entered by *A*'s current account are recorded in *R*'s current account, and a global deficit arises whose amount is determined by the indirect payment of *A*'s net interest on its external debt' (Cencini 2005: 267–268). Specifically, on the *sovereign* debt that is pathologically included in its external debt (see Schmitt 2014).

## 5 The double charge of external debt: the very formation of sovereign debt

### Introduction

In a precedent chapter we have evidenced the double charge of a country's net interest payment from which the duplication of the country's external debt could be deductively reasoned. In a next segment we attempt to show, this time through a single-handed approach, how this duplication arises whenever a country benefits from a net foreign borrowing to pay the totality of its imports. We do this by highlighting the *formation of a sovereign debt* that pathologically duplicates the charge of the country's external debt. The study that permeates our presentation is that of Schmitt's multi-level analysis regard the subject.<sup>215</sup> The arguments that he advances, to prove the formation of a sovereign debt that anomalously doubles the charge of countries' external debts, are enthrallingly convincing given their logical and scientific character.

Our aim is not to re-create the meticulous and profound details of Schmitt's very analysis but rather to present its *grandes lignes*, with a particular intent to encapsulate the vital and crucial points that form the basis of his varied arguments *in confirming the existence of an anomalous and unnecessary double charge*.

### Net imports – a distinctive payment

The payments of 'imports-exports' and that of 'imports-without-exports'<sup>216</sup> are distinctively dissimilar from one another. In simple terms, 'imports-exports' intend *compensated imports*<sup>217</sup> in that they *are paid, in foreign money units, by the country's exports* whilst

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<sup>215</sup> See Schmitt 2014.

<sup>216</sup> We will often return to these two expressions of Schmitt's that pervade his 2014 paper. His analysis revolves about some country A that he defines as the *deficit* nation given its imports are more than its exports. As per his own description, '[s]urplus imports over exports is the deficit, the country being itself 'in deficit', its purchases being greater than its sales, but also 'in excess' with regard to its imports. 'Imports-exports' are exchanges insofar as purchases and sales are equal. 'Imports-without-exports' are the excess of imports over exports; these imports are net' (Schmitt 2014: 16).

<sup>217</sup> See Schmitt 2014. Or, 'exchanges', as intentionally referred to by Schmitt (see *ibid*) given it implies the position of *equality* of receipts (export-sales) and expenditures (import-purchases), that is, with respect to his case-example (country A). Now as he explicitly specifies, the *equality* 'so obtained is that between the *payments* in dollars of A's imports and exports, and not that between the values of the real goods exchanged by A and R' (*ibid.*: 3). His meaning with regard to R is simply some country-example R (rest of the world) whose currency is that of dollars or MR (money R); this currency is foreign to country A whose

‘imports-without-exports’ imply surplus imports for the deficit country. It is the requital of these surplus imports that is particularly problematic as, given the current deficient state of our international payment ‘system’, it leads to a double<sup>218</sup> and unjustified charge for the deficit country. As a matter of fact, the totality<sup>219</sup> of a country’s imports is invariably paid in foreign money such that as far as its ‘imports-exports’ are concerned, the country acquires the foreign currency it requires to pay for them, through the payment of its exports. Very clearly, the need for a foreign loan, in the case of ‘imports-exports’, is not warranted: the nation earns *for free*, by way of its export-receipts, all of the foreign money it needs for its import-expenditures of a same value. Contrarily, with respect to the net disparity (‘imports-without-exports’) between its expenditures and receipts, the deficit country (e.g. say country A<sup>220</sup>), must take up a foreign loan<sup>221</sup> and this entails a very peculiar and nefarious consequence for country A. The peculiarity – *and one that matters* – of this foreign loan, is that it involves a **foreign income**<sup>222</sup>, that is, an income that originates within the production of the domestic economy of country R (rest of the world), for example. It is evidently the only way by which country A can obtain the foreign currency (money R) that it requires to pay for its net imports, given the latter have no actual exports-revenue that covers them and, money R is the only acceptable<sup>223</sup> currency that can enable the payment of country A’s total imports. Now, the implication of an income originating from the production of R’s domestic economy in the payment of country A’s surplus imports should be a clear harbinger of the inevitable double charge that this will entail. Country A will first have to borrow from R, just in order to obtain

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domestic money is referred to as MA (money A). The rate of exchange is to be understood as constant and, with 1 (billion) dollar = 1 MR = 1 MA.

<sup>218</sup> ‘The initial formation of external debts relate to net imports, also called surplus imports. External debts are initially equal, interest included, to the value or cost of net or surplus imports. Yet, external debts are ‘multiplied by 2’ if they add up to twice as much as the value of surplus imports’ (ibid.: 16). Schmitt also specifies the deficit country’s external debts as the debts of its residents (domestic economy) and additionally the debts of this deficit nation *considered as a whole*, maintaining that both debts add to one another and that this leads to an anomalous duplication of this nation’s external debts. He explicitly refers to the external debt as it pertains to the deficit nation’s domestic economy as the *ordinary* debt whilst he defines the debt of the nation itself (taken as the set of its residents) as the *sovereign* debt. This latter debt *which is included in the external debts* is in fact the pathological duplication of the ordinary debt and we will later again elaborate this point as we continue to study Schmitt’s argument in this regard.

<sup>219</sup> In Schmitt’s text (2014), the terms imports and exports refer to, respectively, the total purchases of commercial and financial assets or goods, and the total sales of commercial and financial assets or goods.

<sup>220</sup> We will as well and throughout, refer to a/the deficit country as some country A, in keeping with Schmitt 2014’s country-example with respect to the country in deficit.

<sup>221</sup> As Schmitt describes it, ‘*additional* imports are the source of a true problem since, by all evidence, they are not paid for by any export of real goods. Uncompensated by a real export, net imports can be balanced in foreign currencies only through a foreign loan’ (ibid.: 7).

<sup>222</sup> The fact that the deficit country’s net imports are paid by a foreign income is a recurring theme in Schmitt’s arguments and one which is central to the confirmation of the double charge.

<sup>223</sup> That is, acceptable to the rest of the world, as payment for country A’s imports. See Schmitt 2014.

in the current period (p0), the value of the goods<sup>224</sup> that its domestic economy will produce in a later period (p1) to the benefit of country R. It should be understood that though the *real* borrowing consists of an advance borrowing<sup>225</sup> from its (A's) domestic economy's future output, this borrowing is strictly enabled through a loan that A obtains from R, which loan actually *finances* this very production of A's future real goods. For all intents and purposes, country A will have to sell financial bonds (IOUs) to R. It is an income from the domestic economy of R, not of country A's, that ultimately enables the financing of this *advance* borrowing from A's future output and, this first foreign loan, by itself, will increase<sup>226</sup> A's external debt (formation of the *ordinary* debt of its domestic economy) in the initial period in which the borrowing occurs. This first foreign borrowing is required such as to enable A to pay for its net imports in real goods. But, as it has been explained earlier, the income from R's residents (investors) has not the purchasing power to pay both the acquisition of A's (future) real goods (object of R's ordinary loan) and, for A's net imports. The deficit country's sale of IOUs will provide it the purchase of a foreign bank deposit (FBD). This first loan finances the production of A's future real goods, *it is thus spent*<sup>227</sup> *by A to finance this very production of real goods that are immediately*<sup>228</sup> *appropriated by R*<sup>229</sup>. Consequently, yet

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<sup>224</sup> In his own words, 'the sum borrowed is logically of 2 dollars when, in order to pay for its surplus imports, country A and its domestic economy borrow abroad *foreign currencies* (1 dollar) and *real goods* that will be produced by A's domestic economy (of 1 dollar value): it is undoubtedly more obvious to consider the real borrowing as taking place inside A's economy. This is perfectly exact on condition that it is understood that this loan is granted to country A by the outside world; these two loans *do not pertain to the same reality*' (ibid.: 5). And this is all the more reason for which the two **would** add up to each other, after all, as Schmitt points out '[b]oth external loans are observable in practice' (ibid.: 4). Moreover, as he reminds, the object of each differs such that it would not be logical to conceptualize them as reducing to one unique foreign loan. 'In each period country A must borrow 1 dollar abroad in order to obtain 'now', in advance, goods of 1 dollar value that its domestic economy will produce and export in a subsequent period. The object of this loan is therefore a (future) good of country A itself. Through the *other* external loan, which it realizes in the same period, country A obtains 1 dollar in order to pay in money R (dollars), and not in domestic currency (MA), its net imports. The object of one of these foreign loans is a product of country A, whereas the object of the other is a product of the rest of the world' (ibid.: 5).

<sup>225</sup> 'In each period country A must borrow 1 dollar abroad in order to obtain 'now', in advance, goods of 1 dollar value that its domestic economy will produce and export in a subsequent period' (ibid.: 5).

<sup>226</sup> Schmitt's case scenario assumes it to be zero at the on start of the period under review. 'A's external debt is nil at the beginning of the first month of our investigation' (ibid.: 3).

<sup>227</sup> The idea that A exports future goods via the expenditure of the FBD obtained from R, means that R finances a future production of A, *yet A's expenditure for the financing of this production takes place in A*.

<sup>228</sup> That is, before they (real goods) are actually produced.

<sup>229</sup> It should be considered that what is actually achieved by the deficit country, through this first loan from R, is equilibrium of its balance of payments that also applies to deficit nations. 'In order to acknowledge the undeniable fact that balance of payments' equilibrium applies also to deficit countries, it is essential to include the real aspect of the foreign loan that finances their surplus imports' (ibid.: 30). As Schmitt points out and as outlined in the example he refers to, throughout his paper, the equilibrium of the deficit nation's balance of payments is always, nevertheless, strictly adhered to. 'In the example we are using throughout this paper, country A's surplus imports are equal to 1 MR. Even though A is a deficit country,

another loan will be required to finance the payment of A's net imports. It is this second loan that creates A's *sovereign* debt, this time incurred by the country as a whole and, with the anomalous result of doubling<sup>230</sup> the deficit country's external debts.

This brings us to the study of a first proof of Schmitt 2014, whose paper endeavors to show that the *existence of this sovereign debt is the effect of an anomaly that detrimentally alters the formation of deficit countries' external debts*, whenever these countries benefit from a net foreign borrowing to finance their net expenditures.

## Net imports are paid both in real and in money terms

As the title of this section suggests, the main idea of this proof is that, given our current 'system' of international payments, net imports have to be paid twice: once in real terms and once again in money terms. The argument assumes that the indebted nation borrows abroad *twice*<sup>231</sup>, in order to meet these two payments. One of the two foreign loans enables the indebted country A (its domestic economy) to give up, and this from the period its net imports take place, a part equal in value to e.g. 1 MR (money R), of its future output. In other words, the loan provides A with the means to pay its net imports *in real terms*. The other<sup>232</sup> loan provides A with the *money R* required to cover the difference between A's total expenditures and its total sales: its net imports<sup>233</sup>. One of the loans finances A's exports *of future goods* whilst the second finances the *monetary* payment of A's net imports<sup>234</sup>. The object of the first loan is a sum of real goods<sup>235</sup> whereas the object of the second loan is an amount of money R.

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its balance of payments equilibrium is perfectly respected: its purchases have a value of 11 MR, equal to the value of its total sales, because its exports\* equal to 1MR add to its exports+ equal to 10 MR' (ibid.: 29). In this sense, it should be naturally understood 'that this loan of 1 MR is, from the outset in the period considered, the payment by the rest of the world of a real export of the deficit country' (ibid.: 30). We will see, that this point is a salient feature that forms the basis of yet another of Schmitt's proof of the double charge, as we cover it in a separate section of this chapter.

<sup>230</sup> The *sovereign* debt of the country as a whole **adds** to the *ordinary* debt of A's domestic economy. We will later more closely examine this additive correlation between the two debts that indeed both manifest within a same period, thus resulting in a double charge for the deficit country.

<sup>231</sup> In another simpler demonstration *of the double charge* that we will later exhibit, Schmitt (2014) assumes that the deficit nation borrows abroad only once the currency that it needs for the payment of its net imports. Nevertheless, he shows that the result is the same: the charge is double.

<sup>232</sup> The order of the foreign loans required is not important, since both loans are necessary and, take place in the same period.

<sup>233</sup> This payment, in money R, of A's net imports, is the very source of the *sovereign* debt.

<sup>234</sup> It should be observed that though A spends 2 MR in favor of R, this does *not* correspond to a flow of 2 MR from A to R. In fact, despite that they are both in favor of R, *one of the two expenditures occurs in A* and defines the acquisition by R of a future real good of A.

<sup>235</sup> The fact that the object of the first loan is a sum of A's future real goods means that *the loan granted by R finances the production of these future real goods, which will be exported by A only in a subsequent period but are immediately appropriated by R*.

Now, we observe that the *inceptive*<sup>236</sup> *formation of external debts* is connected to surplus imports. The problem is that the payment of these ‘imports-without-exports’, by way of a foreign borrowing, inevitably leads to a double charge. It is here that the distinction of the nation considered as a whole (set of its residents) from that of its internal economy, becomes crucial and thus we should keep abreast of this as we continue our study.

The thrust of Schmitt’s argument<sup>237</sup> is that if the deficit<sup>238</sup> nation were to borrow abroad *only once*, it would be unable to pay the totality of its net expenditures. On account of our current non-system of international payments, the nation’s internal economy incurs the cost of the *real payment* of its deficit, whilst the nation *as a set* incurs its *monetary* cost: it will ultimately bear the financial responsibility to carry out the requital of its net imports in foreign currency units. It should be clearer by now as to why that is, if we remember that the deficit country has no export revenue with which to cover the value of its net imports, contrarily to how it pays for its ‘imports-exports’. This means that it will have an inadequate supply of the *foreign*<sup>239</sup> *money* (MR) that it requires to cover the value of its net imports. And, if one mulls this over, it is soon realized that this implies the need for a foreign loan, hence a foreign income<sup>240</sup>, indispensably.

In order to establish equality between the payments in foreign currency units of country A’s exports and imports, the country must undergo ‘two necessary equalisations’ (as coined by Schmitt 2014: 3). It must sell financial bonds, of a value of 1 MR, to the avail of R, real goods that A’s internal economy will furnish in a future period. Simultaneously, A has to borrow abroad, *a same amount in money R*. Each of the two equalizations is unique and consists of a separate and very distinct reality. One is attained via the delivery of part of A’s output that it will produce and export in another period (payment *in real terms*) whilst the other is arrived at, through the foreign borrowing of an amount of money R (payment *in money terms*). Still, each is of an equivalent value of 1 MR and both necessitate a foreign loan of this value. Considered integrally, it becomes obvious that the two loans generate a ***double charge*** for the deficit country. In sum, despite their trenchant distinctions, both foreign loans are indispensable to country A for the payment of its net imports: one enables it to balance its

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<sup>236</sup> ‘External debts are initially equal, interest included, to the value or cost of net or surplus imports. Yet, external debts are ‘multiplied by 2’ if they add up to twice as much as the value of surplus imports’ (Schmitt 2014: 16).

<sup>237</sup> That is, in this first proof of the double charge and in several other demonstrations that Schmitt resorts to, to confirm the reality of a double charge (see Schmitt 2014).

<sup>238</sup> ‘Surplus imports over exports is the deficit’ (Schmitt 2014: 16).

<sup>239</sup> Let us deviate, even if only slightly, from the issue at hand and consider the following important observation: in the case of the Euro zone, one might assume that net imports do not necessarily imply a net foreign borrowing for the deficit country given there is no need to carry out its (surplus imports) payment in a foreign money, this on account of the zone’s ‘unique’ currency (the Euro). But, if we heed the fact that, *in reality the zone is without a unique money*, it should then be understood that without a net foreign borrowing to cover a deficit nation’s net purchases, the situation leads to payment imbalances between the Euro zone trading partners, given the lack of payment finality that this inevitably entails (see Rossi 2012).

<sup>240</sup> Though the underlining theme of this proof of Schmitt’s is not *deliberately* centered on the idea that the deficit country’s net imports are paid by a foreign income (neither that it highlights the effects that ensues from this and, that we will cover in our review of a next proof of Schmitt 2014) it is nevertheless observed that it ultimately sets the basis for the *real* payment, that is, one of the foreign loans, *necessary though non-sufficient*, for the payment of its net imports.

exports and imports of real goods whilst the other enables it to balance its gains and expenditures of foreign money. Moreover, considered separately, each loan is necessary<sup>241</sup> but not sufficient on its own.

In his demonstration of this proof of the double charge, Schmitt differentiates<sup>242</sup> between ‘exports\*’ and ‘exports+’ with the former relating to the sale of future output whilst the latter refers to that of current sales. The basis of his argument is that the foreign borrowing obtained by A’s internal economy has only the income able to finance ‘exports\*’ (sales of its domestic economy’s future output) and not that of A’s net imports, as well<sup>243</sup>. Specifically, the latter remain unpaid, and this *even after a real payment has been carried out* by A’s domestic economy. The result is that A will thus have to obtain yet another foreign loan to cover its outstanding net imports: this second<sup>244</sup> cost is, this time around, incurred by country A *as a whole* and consists of the *monetary* payment of the net imports. The deficit (*net imports*) is thus acquitted following a settlement of twice its original value<sup>245</sup>, one part being settled via a *real* payment (ceding of A’s future output), whilst another equal part of it is settled through a *monetary* payment (foreign currency, MR). The point being, that *one payment only* should be sufficient for A to settle its debt of 1 MR (value of its net imports) such that after its cession of a same value of output (future real goods), A should be considered finally quits<sup>246</sup> of its external debt related to its net imports. It should not have to pay once again the same value in *money* terms. But as Schmitt *describes it in actual fact*, when exports\* of a same 1 MR value of A’s net imports, are added to exports+ (current products of 10 MR value), this results in the **real debt**, the cost of which is incurred by A’s internal economy. The **monetary debt** forms when ‘imports-exports’ are actually topped by the net imports, the cost this time being incurred by the nation as a whole. Consequently, the two debts add<sup>247</sup> to each other. The charge is thus evidently double.

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<sup>241</sup> Schmitt’s own words, on the current situation which mandates that the deficit country’s imports be financed via a foreign money: ‘[t]his time the foreign loan of 1 dollar is no longer enough; it is still necessary, but it is forcefully accompanied by a *second external loan of 1 dollar*’ (Schmitt 2014: 6).

<sup>242</sup> He applies ‘the same distinction to imports even though they all concern actual values. Imports+ correspond to exports+; imports\* to exports\*’ (ibid.: 19). His numerical (see ibidem) demonstration delineates *total* imports of 11 (value units); a ceding of exports+ amount to 10 of A’s current real goods whilst exports\* of 1 are the goods that A’s domestic economy will produce and export *in the future*; imports\* of 1 consists of A’s *net purchases* whilst imports+ of 10 relate to A’s current expenditures *compensated* by its exports+ sales (current real goods).

<sup>243</sup> ‘[T]he expenditure of the sum borrowed, equal to 1 dollar, has only one effect: it enables economy A to increase by 1 the value of exported real goods, exports\* of 1 adding up to exports+ of 10 dollars’ (ibid.: 20).

<sup>244</sup> ‘*The double charge of external debts is real for the one part and monetary for the other*’ (ibid.: 19).

<sup>245</sup> ‘On either hand it is only paid up to its value, nothing more. In our example, country A’s net imports of 1 MR value cost exactly this value both in a sum of real goods and in money units’ (ibid.: 19).

<sup>246</sup> Though albeit, it is understood that even if the payment takes place in the current period, the actual *re-imburement* takes place in a subsequent period.

<sup>247</sup> As Schmitt sagaciously reflects, ‘[i]t would be illogical to apprehend them as one unique debt, as if the *monetary* debt (payment of an import) simply represented the *real* debt (payment of export\*)’ (Schmitt 2014: 20). Moreover, the fact that the cost of one is incurred by the nation *as the set of its residents* whilst the other is incurred by A’s internal economy,

The crux of his argument is that there are two equalizations<sup>248</sup> to be met by the deficit country, one being that it must balance the amount of its export-values with that of its import-values (both, of real goods) and, the other is that it must offset the amount of its foreign currency-expenditures with that of its receipts of foreign currency. It thus requires two distinct foreign loans in order to carry out both equalizations. This is better understood when we remember that A's domestic economy clearly earns only 10 MR in export-revenues: the payment by R of exports\* of 1 MR has the sole effect of financing an equivalent sum of future real goods and as such it does not increase A's export-receipts<sup>249</sup> (earnings of foreign currency), in the current period. Consequently, another foreign loan will be required to cover the outstanding net imports. So, as Schmitt questions '[w]here is the money that the domestic economy is lacking to be found' (ibid.: 21)? His answer to this essential query, is by now, not surprising: '[t]he missing unit of money comes from country A as a whole, since it has been proven that it does not come from its domestic economy' (ibid.: 21). Hence the double charge is vindicated: indeed, two distinct foreign borrowings, each of 1 MR value, will be required by the deficit country in order to pay its surplus imports of a same value. The cost of one of the loans is paid in *real* terms by A's domestic economy, the other cost is ultimately settled in *money* terms by the nation as the set of its residents<sup>250</sup>.

Now Schmitt elaborates his argument by pointing out, nonetheless, that at the very moment that A's internal economy acquires the foreign loan from R's lenders in exchange for the real goods that it will produce in a future period, these goods are *immediately* (before they are actually produced) appropriated by R. This being the case, '[i]t forcefully follows that the sum of money borrowed abroad is the foreign payment of a future export of economy A' (ibid.: 22). How then, could this same sum of money (1 MR only) *simultaneously* pay its net imports of the current period<sup>251</sup>? The reason for the need of yet another foreign borrowing of equal value, for the payment of A's net imports, is again obvious given that the first foreign loan acquired by A's internal economy funds exports\*, and these only: *its net imports are still outstanding*.

In sum, the payment of A's external debt in (*future*) *real goods* that are immediately appropriated by R, defines the 'ordinary' debt of its domestic economy. The *monetary* payment<sup>252</sup> of its external debt affects the nation as a whole and, defines the sovereign debt. The two very distinct debts being defined both *in kind* and *in money* terms, the charge inevitably doubles, the sovereign debt undeniably adds to that of the 'ordinary' debt.

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leads Schmitt to distinguish between a sovereign debt (as carried by the nation as a whole) from that of an 'ordinary' debt (as carried by the domestic economy of A) See *ibid.* We will return, in a next section, to the import of these distinctions given they form the basis from which derives the additive aspect of the two payments, real and monetary.

<sup>248</sup> To use Schmitt's very expression (see *ibid.*: 20).

<sup>249</sup> Our meaning is that though the foreign loan that A's domestic economy obtains, finances an increase in exports (future), the very exports\*, the increase is *in kind* only and not in way of export-receipts.

<sup>250</sup> Again, we see the important distinction that Schmitt emphasizes between a nation as the set of its residents and, the said country's domestic economy. And, the essence of this distinction helps to crystallize the additive element of the two distinct debts, each carried independently, from one another: the sovereign debt clearly adding to the 'ordinary' debt.

<sup>251</sup> As he points out, 'it is obviously inconceivable that the same loan of 1 MR pays for, at the same time and for the same period, an export of 1 MR and an import of 1 MR of a same economy' (*ibid.*: 22).

<sup>252</sup> In Schmitt's own words, '[c]ountry A as a whole comes to the rescue of its domestic economy by paying its debt in *money* units' (*ibid.*: 24).

## Net imports are paid by an income originating from the domestic production of the rest of the world

Through an alternative demonstration of the duplication of countries' external debts, Schmitt once again evidences the double charge generated by the deficit country's need to borrow twice the amount of its net imports, in order to settle their payment. This new proof is only slightly different from the previous one and rests on the fact that the deficit country's net imports are paid by an income originating from the production of R's domestic economy<sup>253</sup>.

We will see that the consequence of this is detrimental for the deficit country (A). The payment of the difference between A's imports and exports by means of a loan granted by R (hence income of R), reduces the payment by R of its own imports (A's exports) and is at the origin of a new difference between A's expenditures and its sales, which can only be covered through *yet a new foreign loan*.

In essence, because the loan granted by R, is spent by A to finance its net imports, this payment of A, *in turn finances part of R's imports*. The result is therefore that, an equivalent part of A's exports will ultimately have to be paid by A, itself. What happens is that the very payment by A of its net imports, reconstitutes<sup>254</sup> by a same amount the domestic income of R with which the latter pays a same portion of its own imports from A, hence reducing its payment of A's exports by a same amount. This leaves country A, short of money R (MR)<sup>255</sup> *with which to pay its now uncovered imports* that are no longer paid through its export-revenues (from R)<sup>256</sup>. This is thus the reason for which country A requires yet a second loan to cover these newly uncovered imports. Specifically, A has to obtain *once again*<sup>257</sup> money R

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<sup>253</sup> Again and throughout this chapter, we intend (in following with Schmitt 2014) by R, some country or countries of R (rest of the world); by A, some deficit country, the deficit being the net imports or, as defined by Schmitt, '[s]urplus imports over exports' (see *ibidem*: 16, *Expressions*).

<sup>254</sup> Schmitt sums up the core of his argument which develops from the idea that R reconstitutes its own internal (domestic) income from A's payment (with an income from R) of its (A's) net imports. 'Country A obtains the value of 1MR (1 dollar in our example) of the income formed by the rest of the world's domestic production. The expenditure of this income by A is the external payment, of 1 MR, of part of its total imports, whose value is 11 MR. Countries or country R thus obtains the reconstitution of its own domestic income. *For R this payment of 1 dollar in value finances its imports from A*. Alternatively said, *country A finances itself R's imports, valued at 1-dollar, that is to say, A's own exports*. This means beyond any doubt that *economy A's exports, whose value is 10 dollars, are paid by the country itself to the extent of 1 dollar*' (*ibid.*: 8).

<sup>255</sup> And this will be the source of a true problem for country A, as Schmitt reminds, that is, 'from the moment one examines what really happens in our economies, where the sum of imports is always paid in foreign currencies' (*ibid.*: 7).

<sup>256</sup> We remember that 'imports-exports' are paid, *in a foreign currency*, by a country's (e.g. A's) exports. The need for a foreign borrowing is thus not necessary for these very imports. The country earns via its export-sales all the foreign currency that 'it spends for its imports of equal value' (*ibid.*: 7). But, the situation changes once *the deficit country pays for its net imports by means of a foreign loan granted by the rest of the world (income of R)*. The consequence being that this very payment of A (deficit country), in turn, reduces R's payment to A, for its (A's) exports, *by a same amount*. The result is that A's imports are no longer integrally covered by its export-revenues, the latter having been reduced by R.

<sup>257</sup> Now at this stage (though all same period), the residents of A (its government included) would no longer be implicated, having already paid their net imports, such that even if the

(1 MR), in order to cover the integral payment of its imports (that are no longer covered integrally by its export-revenues from R, the latter having reduced this payment to A).

Another way to understand this very proof is to consider the fundamental question as posited by Schmitt. 'In terms of real goods, country A imports more than it exports, to a value of 1 MR. As far as its imports are concerned, country A's wealth is increased by real goods valued at 1 MR. The essential question that arises here is the following: does country A pay for the increase of its wealth in *real goods*' (ibid.: 7)? The reason the question is crucial is that if the answer were in the negative<sup>258</sup>, the increase in A's external debt would be single and not twice the amount of its net imports. Now the essential point to remember when considering the payment of importations is that we *should be mindful* 'of distinguishing their payment in money R from that of money A' (ibid.: 7). This is because, though there is no difference between the payment of 'imports-exports' and 'imports-without-exports', this is only to the extent that the deficit country's purchases are executed in its own currency. However, we should stay abreast of the fact that R (its exporters) is paid also in its own currency, money R, for the totality of A's purchases. This means that A will have to borrow the amount it requires in money R (1 MR) in order to pay for its 'imports-without-exports'. But, as we have already observed, this foreign loan of 1 MR is not sufficient for country A given that after it spends it to finance its net imports, it finds itself with a renewed deficit of a same amount: uncovered imports that are no longer covered by its export-revenues. Let us revisit why, exactly, this happens. As Schmitt emphasizes, this is on account of the fact that even though 'imports-exports' and 'imports-without-exports' are both paid in money R, nevertheless, 'an essential distinction separates, all the same, the two payments' (ibid.: 8). The difference lies in *where the income that substantiates the payment originates from*, that is, whether it originates from within the deficit country's own internal economy or rather, from a production of R's domestic economy.

It has already been established that 'imports-exports' are paid by an income originating within the domestic economy of our example-country (A)<sup>259</sup>. We have also seen that the situation is, however, very different when it relates to the payment of net imports. And the essential difference is all about the vital fact that 'imports-without-exports' are very simply just that, *without exports*. That being the case, it is logically impossible to conceive that their payment is financed by an income originating from the domestic economy of the deficit country. As

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government (or some other institution) of country A, would *in practice* be the one to issue new financial bonds to sell to R, the cost of this second loan would ultimately be incurred by the country *as a whole*. That is, through the expenditure of the new FBD (foreign bank deposit) obtained (result of second sale of financial bonds, the IOUs), thus leaving the country *as a whole* with no compensation-counterpart (FBD) to yet a newly acquired external debt (of same value of its net imports): the very formation of the sovereign debt which doubles the deficit country's external debt, *by adding* to the 'ordinary' debt of its residents (first loan from R that enabled the payment of A's net imports).

<sup>258</sup> That is, specifically, in the period under investigation.

<sup>259</sup> Schmitt refers to these very imports as '*compensated imports*' and his following remark is worthy of being noted. 'Incomes spent for its imports compensated by its exports, 10 for 10, are interior to county A (are domestic incomes of country A). In each period A's national production is, for example, of a value total of 26 dollars (1 dollar = 1 MR). Its imports of 10 dollars value reduce its domestic income to the value of 16 dollars. This loss is exactly compensated by its exports. A domestic income of 10 dollars value is the final payment of equivalent imports of A's economy. Despite the fact that their external payment is carried out in foreign currencies, such as the dollar, country A's *compensated imports* are financed by an equal amount of its domestic product, object of its exports' (ibid.: 8).

Schmitt highlights, '[t]he reason being that the exports corresponding to the surplus imports are nil. It is therefore an income formed in R and not in A that finances the 'imports-without-exports' of country A' (ibid.: 8).

And now this brings us back to the initial stage of the fundamental question<sup>260</sup>, that is, *whether or not*, the deficit country pays, within the period under examination, for its imports in excess of its exports and, at that, in *real goods*. The answer lies with the fact that the payment by A of its net imports, *with an income borrowed from R*, entails the payment of its exports (itself, in lieu of R), by a same amount. This is because the very payment reconstitutes R's own internal income with which it (R) pays a same portion of its own imports, ***thus reducing by a same amount its payment of A's exports***. This savings for R, very obviously, comes at an extra payment for the deficit country (A). Hence, the answer to the fundamental question finds merit only if characterized by affirmation. The deficit country, indeed pays and, in the period in question, for its surplus imports, that is, 'for the increase of its wealth in *real goods*' (ibid.: 7). It does so by the mere fact that its very payment of its net imports has the effect of paying a same portion of R's own imports, thus reducing the latter's payment (same amount) of A's exports. This implies that A will actually have to pay a same sum of its exports (*real goods*), itself<sup>261</sup>.

Now the impact of this development is that it forcibly generates the assured need for yet another foreign loan on the part of the deficit country, that ultimately finds itself deficient of foreign currency (unrequited exports by R) with which to pay the totality of its imports, specifically its imports that are now no longer covered by its export-revenues from R. The duplication of its external debt is therefore, inevitably, ascertained<sup>262</sup>. The undisputed authenticity of the need for a second loan (source of the sovereign debt) rests with the fact that net imports are paid with a *foreign* income.

### ***Action-Reaction***

Schmitt takes a scientific approach to demonstrate a general application<sup>263</sup> of his proof by envisioning a reaction that naturally follows an action. That is, at the instant that the deficit country pays for its net imports with a loan (income) from R (the action), what naturally follows from this is that R pays A's exports less (the reaction), by an exact same amount of A's surplus imports. The action and reaction happen simultaneously<sup>264</sup> in that the payment of the net imports reconstitutes R's domestic income with which it pays its own imports from A (a savings for R): the reaction naturally translating into the fact that this means they reduce their payment of A's exports by a same amount. All develops in one fell swoop.

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<sup>260</sup> In Schmitt's own words, 'does country A pay for the increase of its wealth in *real goods*' (ibid.: 7)?

<sup>261</sup> '[C]ountry A pays its own *exports* to the exact extent that it pays its own *imports* by an income borrowed abroad. These two payments, which reduce to one, are carried out through *the expenditure of an income of 1 dollar, borrowed from country R by country A*' (ibid.: 8-9).

<sup>262</sup> As Schmitt succinctly sums it up: '[s]ince A's exports of 10 dollars value are only paid up to 9 dollars by R, the second external loan of 1 dollar is absolutely necessary to country A, which would otherwise have at its disposal only 9 dollars to pay for imports equal to 10 dollars' (ibid.: 9).

<sup>263</sup> See Schmitt 2014: 9

<sup>264</sup> 'In reality, imports and exports vary concordantly and simultaneously; under no circumstances do imports ever vary alone' (ibid.: 10).

Schmitt's demonstration causes us to ponder yet another fundamental question which he puts forward. 'At the beginning, the totality of purchases are imports-exports of 10 dollars value. Surplus purchases are 'imports-without-exports' of 1 dollar. What then is simultaneously the value of this same country's 'exports without imports''<sup>265</sup> (ibid.: 10)? The idea that he advances is that *the reaction to the action* can't but reduce the amount of foreign currencies that A will receive for its exports, specifically, to '9 dollars only' (ibid.: 11). Moreover, he points out that this very reality goes missing in traditional thinking, that is, a crucial fact is bypassed: 'the rest of the world reduces the payment that it devotes to A's exports by the exact value of the payment it devotes to A's surplus imports' (ibid.: 11). And, that this fact means none other than 'an equal part of A's exports is paid by A instead of being paid by R' (ibid.: 11). Now exports of the deficit country that are not paid by the rest of the world entails a high price for the said nation, as much as the value of the deficit itself, that is, the surplus imports: hence the double<sup>266</sup> charge. Ultimately, it will require two<sup>267</sup> foreign loans, each of a same amount of that of its net imports, such as to *settle the payment value of the totality of its imports*.

The claim of the double charge is all the more vindicated by the very fact that there is no doubt that deficit nations definitely pay in full and, in each period, their net imports, by the mere fact that 'it is they, instead of the rest of world, that pay for an equal amount of their own exports' (ibid.: 12). Moreover, it is on account of this very fact that it should not be expected that they should have to indebt themselves further, through yet a second foreign borrowing which inevitably and unnecessarily doubles the initial value of their deficit, the surplus imports. But the reality is that deficit countries are indeed, detrimentally affected<sup>268</sup> by the current status of our international payment system, when it comes to paying their surplus imports, *with an income which originates from the domestic economy of the rest of the world*.

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<sup>265</sup> The question does cause one to ponder that, indeed, a same portion of A's exports will, as a result, no longer be covered via the payment of an import (R's to A). In this sense, it does in fact leave part of A's exports *without imports*, that is, without the corresponding payment from R that would otherwise be part of A's export-revenues. But one point we should be clear on is that A's exports have not changed from their initial value of 10 MR or dollars, it is just that *as a reaction to the action* (A's payment of its net imports with an income from R), these exports of A's, can now 'only finance imports up to a value of 9 dollars' (ibid.: 12). Schmitt emphasizes this point by clarifying that the foreign loan obtained by the deficit country's internal economy does not increase 'in *money* its export receipts; its acquisitions of foreign currencies, on the contrary, remain at their initial level of 10 MR. It is effectively so, A's economy can rely only on 10 MR, a sum that is insufficient for the total payment of its imports, whose value is of 11 MR' (ibid.: 26). Following the expenditure of the first foreign loan, however, A's acquisition of foreign money units is reduced from its former level of 10 MR, to 9 MR.

<sup>266</sup> 'The sum of imports is of a value of 11 dollars. If exports worth 10 dollars were paid in their totality to country A by the rest of the world, 'imports-without-exports' would be of 1 dollar worth; in reality they are of 2 dollars, because, for the exact amount equal to 1 dollar, A's exports are not paid by R' (ibid.: 12).

<sup>267</sup> '[T]hrough the action exerted on its imports, henceforth incapable to force R to pay 10 dollars for its (R's) imports of this very value *and thus receiving for them* only 9 dollars, *country A has to recur to a second external loan of 1 dollar in order to finance its imports of 1 dollar value that are no longer financed by its exports*' (ibid.: 12).

<sup>268</sup> As Schmitt describes it, 'it is a true disease affecting all the payments of net imports in foreign currencies' (ibid.: 13).

Now in closing our discussion of this proof, it is worth mentioning the following. Schmitt brings up another interesting point in the elaboration of his argument of the double charge. That is, that it is more the *additive element of the anomalous sovereign debt to that of the ‘ordinary’ debt* that is actually missed rather than the existence of the sovereign debt itself. This is because the very sovereign debt is the *only charge*<sup>269</sup> that is observed as seemingly being generated from surplus imports. Regardless, the end all detrimental result is an authentic product of our current ‘system’ of international payments. And, the very pathology of the double charge rests with the fact that the sovereign debt is a debt that should not exist at all, since deficit countries’ net imports *have already been paid* by their respective internal economies. This brings us to a next demonstration of the double charge of external debts whereby Schmitt elaborates the additive lien between sovereign and ‘ordinary’ debts.

### **The duplication of external debts derives from the additive lien between sovereign and ‘ordinary’ debts**

Schmitt’s argument that we illustrate in this section centers about the fact of *whether or not* the two payments, that of the ‘ordinary’ debt and of the sovereign debt, actually add up to each other. His demonstration confirms that they indeed do add up and this result, in turn, proves the double charge of nations’ external debts. His approach starts by examining the monetary tie that, in effect, connects each of the *two* payments by the fact that *payment* is first carried out in country A’s domestic currency (MA) and, once again, in a foreign money (MR). We recall the fact that the ‘ordinary’ debt is carried by country A’s residents and is generated as a result of its foreign borrowing (the ‘ordinary’ loan from R) for the purpose of paying its net imports. Now despite the fact that the *totality* of A’s imports are first paid in its domestic currency (MA), they are also, ultimately, paid in money R (very source of the sovereign debt). And, we will see that it is the fact that the latter debt is carried by country A, as the set of its residents, that the two distinct debts (or charges) add up.

Schmitt lays out, from the outset, a proper understanding of a country’s external debt in that it merely equals the value of its internal economy’s surplus imports, the ‘imports-without-exports’. He elaborates his description, which essence we capture through his own words ‘[t]his is the value of the *legitimate*, ‘ordinary’ debt defined by the balance of payments’ (Schmitt 2014: 32). The author emphasizes that what *doubles* the external debt is the fact that this ‘ordinary’ debt entails yet another debt, *the sovereign debt that ultimately adds to it*<sup>270</sup>.

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<sup>269</sup> ‘[T]he Troika forces deficit countries to pay the rest of the world, R, as a consequence of their action (surplus imports) even though these countries have already entirely paid R through the reaction (non-payment of an export), of which nobody is aware’ (ibid.: 13). This brings us to an important observation *à propos de*, that is, that the reason for which *the reaction* is missed might very well be related to the fact that, unlike the case of the ‘ordinary’ debt, the sovereign debt is cumulative in time. The reason being that any time an old sovereign debt is reimbursed, a new gap is created between the deficit country’s total expenditures and its total receipts, the payment of which brings back its (deficit country’s) very sovereign debt to its previous level.

<sup>270</sup> ‘The addition of the *sovereign* debt ‘multiplies by 2’ the charge of A’s external debt, which finally amounts, erroneously, to 2 MR for a deficit of 1 MR’ (ibid.: 32). We recall that Schmitt defines the deficit as the net imports. ‘Country A’s external debts are the debts of this country taken as a whole and the debts of its domestic economy. Surplus imports over exports is the deficit’ (ibid.: 16).

But what is even more outstanding is that the *double charge* of external debts remains unknown, still today, by economists, politicians and other key players in general. ‘What is totally unknown is the fact that the sovereign debt, incurred by deficit countries themselves, adds up to the ordinary debt incurred by their respective domestic economies. Moreover, the sovereign debt is conceived of as the unique charge arising out of net imports’ (ibid.: 13). Yet, as Schmitt insists ‘[s]overeign debts are always the charge of an external debt already carried at 100 per cent of its value by the domestic economies of countries whose imports are greater than their exports’ (ibid.: 14). Let us see, exactly, why that is.

But before dwelling further, if we were to start by pondering the mere, though nevertheless essential, fact that international transactions, whether financial or commercial, are very much *une affaire*<sup>271</sup> of a country’s *internal* economy, we should then more readily understand that the idea of foreign loans *carried by the country as a whole* is nonsensical. Yet these loans, or charges, do materialize and are very much a reality of our current ‘system’ of international payments. So how is it that they even come to subsist if, logically, they are indeed inconceivable?

It begins with another fundamentally important reality that applies to nations, whether or not they are in deficit. That is, *compliance with the balance of payment’s equilibrium*. The deficit nation borrows abroad<sup>272</sup> ‘in order to finance its expenditures without receipts’ (ibid.: 29). This means that the deficit nation’s exports of future real goods (exports\*) *add*, in the period under examination, to its current exports (export+) such that, considered integrally then, the value of its total purchases is the same as that of the totality of its sales<sup>273</sup>. In acquiescence

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<sup>271</sup> We next extend on our meaning, using Schmitt’s own explanation. ‘Country A does not carry on any international exchange on its own account. Every purchase and every sale of this country, to or from abroad, are transactions of A’s domestic economy, commercial and financial, of its private or public sector. *External borrowings of country A as a whole should therefore not exist*. This is to say that its sovereign debt should be permanently nil, whatever the value, even if it is high, of its entire national economy’s surplus imports’ (ibid.: 28).

<sup>272</sup> Its domestic economy borrows from R such as to obtain ahead of time, that is, *now in the current period*, the value of the goods that it will produce *in a subsequent period*. The effect of this first foreign borrowing is that it enables the deficit country (its internal economy) to pay for its surplus imports *in real goods*, in accordance with *its balance of payment’s equilibrium*.

<sup>273</sup> This does not mean however, that the deficit nation has obtained equality in way of export-receipts. That is, if we remember that the payment by R of exports\* has the sole effect of financing the production of an equivalent sum of *future* real goods and as such it does not increase the deficit nation’s export-receipts, in the current period. Specifically, this first foreign loan that the deficit nation’s domestic economy obtains, finances an increase in exports (future), the very exports\*, but the end-all effect in the current period, is an increase *in kind* only and not in way of export-receipts. It therefore, still, has to obtain yet another foreign loan to pay for its outstanding net imports, in money R.

Just the same, the *real* element that forms the basis of the first charge, very object of this first foreign loan from R, *the ‘ordinary’ loan*, needs to be reckoned with. Unfortunately, as Schmitt points out, such recognition goes missing in our contemporary economic community. ‘Economists take heed only of exports of current or ‘actual’ products, forgetting completely about exports of future goods. This is the viewpoint of the alleged economic science today. It is incomprehensible, because exports\* are directly observable in all cases, which are indeed frequent, when a country’s imports exceed its exports. The deficit country is forced, in order to finance its expenditures without receipts, to borrow foreign currencies abroad’ (ibid.: 29). Moreover Schmitt stresses the fact that in order to better understand that ‘*sovereign debts are*

with the equilibrium of its balance of payments, the nation's domestic economy, as such, carries the first charge of its deficit. In essence, this first foreign loan<sup>274</sup> is required to allow it (deficit country's internal economy) to pay for its net imports in real goods. It thus becomes indispensable that 'the real aspect of the foreign loan that finances their surplus imports' (ibid.: 30) be taken into account. It is only then that it will be fully acknowledged that nations are obliged to incur the cost of its deficit, not once but twice. Once, in accordance 'with their balance of payments' equilibrium' (ibid.: 29) and once again, 'because of the *sovereign debts* that form spontaneously against them' (ibid.: 29)<sup>275</sup>.

So, it is, that even though the concept of foreign loans as carried by a country *as a whole*, is logically nonsensical, the reality is that they do manifest and, are the very source of sovereign debts. Moreover, these debts are always carried by the country *as a whole*, in addition to a same-value debt that is being carried, already, by its internal economy: the cost of the 'ordinary' loan. '*Sovereign debt* is thus finally acknowledged in its precise nature: it is carried *in addition to the debt that is naturally included in the balance of payments*' (ibid.: 29).

Now as Schmitt readily admits, it is entirely normal that the internal economy of country A, ends up carrying a debt as a result of the 'ordinary' loan it obtains from external lenders (R's investors), which loan allows it to pay its net imports in *real* terms. No one could logically contest the legitimacy of this first payment. What is questionable is that as a consequence of its 'imports-without-exports', the deficit nation should have to incur yet a second cost of same value, in order to pay these surplus imports, *a second time in money terms*<sup>276</sup>.

The author reminds us that, after all, *real* goods are the very objects of exchanges, whether the latter are domestic or external. And, for this very reason, it is important to keep abreast of the fact that the 'ordinary' loan *is and from the start of the initial period* a payment by R for a part of the deficit nation's *future* output: A's exports\*. According to Schmitt, if *balance of payments* could be correctly understood, a clear comprehension of sovereign debts would naturally follow in that the 'money that defines them is erroneously added to the real goods, which are the unique object of international exchanges' (ibid.: 30).

The fact that net imports consist of a distinctive payment, that very much differs from that whereby imports are covered by *current* exports, again comes to mind. As Schmitt points out, in these latter exchanges ('imports-exports'), the use of foreign money 'is a zero sum transaction, leaving only as extant the demand (imports) and the supply (exports) of real goods' (ibid.: 30). But, what needs to be heeded is that to the extent that money R (MR) is *spontaneously demanded and supplied*, the resulting credits-debits in MR ensures that money intercedes only 'as mere object of intermediation between real goods' (ibid.: 30). However, such is not the case when the very monies that explain sovereign debts, that is, the **net debits**

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'*free lunches*' for the rest of the world, not for indebted countries' we must first 'acknowledge the undeniable fact that balance of payments' equilibrium applies also to deficit countries' and as such we must 'include the real aspect of the foreign loan that finances their surplus imports' (ibid.: 30).

<sup>274</sup> The deficit country borrows from R in order to obtain in the current period the *value* of the goods that its domestic economy will produce in a next period.

<sup>275</sup> Schmitt's meaning is that in order to settle in full, its deficit (net imports), nations have **two** obligations: in addition to meeting the required compliance with regard the *balance of payments' equilibrium*, through a first foreign borrowing (the 'ordinary' loan), the deficit nations must also have their respective governments, on behalf of the *nation as a whole*, carry the cost of an additional foreign loan, this time to pay the net imports *in money terms*.

<sup>276</sup> 'R's claims are legitimate and morally acceptable only for the extent of the debt incurred by A's economy, which spends more than it earns. The *additional* debt, formed in excess, of country A itself is a *sovereign and totally unjustified*, charge' (ibid.: 29).

of the nation as the set of its residents, ‘scientific definition of its *sovereign debt*, lead to the use of money R as a specious real good’ (ibid.: 30). In this latter case scenario, the foreign money clearly plays more than an intermediary role: it forms the basis of the very excess monetary payment, source of the sovereign debt that delineates the double charge of external debts.

The problem with today’s non-system of international payments is that the two charges, as related to the ‘ordinary’ and the sovereign loan and, each of an equal value of the deficit country’s net imports, do add up. But more importantly, the problem arises more on account *that this fact is not recognized*<sup>277</sup>. The consequence of which, the deficit nation *as a whole* ends up carrying the cost of the net imports in money terms (in MR) *without heeding the fact*<sup>278</sup> that these ‘imports-without-exports’ have already been paid, a first time, in the nation’s own money (in MA). Such is the relation, in effect, that holds between *the two payments*, in regard to the deficit country’s surplus imports and which indeed verifies its additive element. The second payment undeniably **adds** to the previous one rather than cancels it: this is ascertained by the mere fact that the second takes place unknowingly<sup>279</sup>, or without acknowledging that the first justifiable payment has already been assured by the deficit nation’s domestic economy.

The fact of the matter is that the first foreign borrowing which generates the ‘ordinary’ debt merely consists in the domestic economy’s (A’s) compliance with its balance-of-payment’s equilibrium, the payment *in real terms*: the exports\*. The sovereign debt<sup>280</sup> that ensues and which cost is carried by the deficit nation as a whole, leads to an anomalous second charge that defines the payment *in money terms*.

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<sup>277</sup> And this, despite that statistical data supports the claim of the duplication of countries’ external debts. See Schmitt 2014: *Section 8 Statistical verification of the double charge of external debts*.

<sup>278</sup> Schmitt explains how this happens. ‘The sum total of country A’s imports is initially paid in its own domestic currency, in units of MA. Surplus imports are therefore paid in money R, *though initially they are paid in money A*. ‘Scholars’ ignore the deficit’s payment in money A simply because foreign countries convert this payment into money R. It is true that country A as a whole pays directly the deficit in money R without caring about the payment in money A, which is nevertheless certain’ (ibid.: 31).

<sup>279</sup> Or, as Schmitt precisely describes it, ‘without caring about the payment in money A’ (ibid.:31).

<sup>280</sup> Should there remain an iota of dubiousness regard the true existence of sovereign debt, Schmitt shares an essential observation in his case-scenario of a certain deficit country A whereby its total imports is that of 11 MR (net imports being of 1 MR value) whilst its total exports amount to 10 MR. ‘Whether the sovereign debt exists or not, country A’s domestic economy pays the totality of its imports, whose value is of 11 MR. And whether the sovereign debt exists or not, A’s domestic economy obtains only 10 MR as payment for its total exports of already produced goods’ (ibid.: 31). If one ponders this, it becomes clear that A’s exports\* which are added to its exports+, consists of a payment *in kind* only and, more so, of a *future* delivery of A’s output, such that, logically then, it does not bring it export-receipts in the initial period in question. ‘No one would conclude that the export of real goods produced in the same period has been raised to the value of 11 dollars. It remains, on the contrary, equal to 10 dollars’ (ibid.: 37). Country A must therefore resort to yet a second loan *in this same initial period* in order to finally settle the payment of its net imports, and it does so, this time in money terms. Precisely, this second loan amounts to yet another charge that this time around ends up being carried by the country as a whole, the very sovereign debt that undeniably adds to the ‘ordinary’ debt of the country’s internal economy.

Schmitt elaborates on his claim of the double charge by clearly defining the calculation of the formation of a country's *new* external debt in that it is strictly equal<sup>281</sup> to the positive variation between its exports (sales) and imports (purchases), in a given period. Despite this reality, what is actually observed in practice is that whilst '[t]he *'ordinary' debt* is simply the charge of paying 'imports-without-exports' (ibid.: 31), for its part, the *sovereign debt* 'is equal to the payment in money R of country A's surplus imports' (ibid.: 31). But the fact of the matter remains, that in theory, the exact total of a country's new external debt<sup>282</sup> is very simply the value of its internal economy's surplus imports: the justifiable 'ordinary' debt as delineated by its balance-of-payments. The fact that the external debt ends up to be *twice* this value is because, indeed, an anomalous sovereign debt *of a same value* ultimately adds to this first 'ordinary' debt. And in this sense, we could say that the pathological aspect of external debts is the fact that they *include* sovereign debts, which debts should not even exist. To this we could add, as Schmitt observes, that where traditional thinking errs on the side of properly 'quantifying external debts' (ibid.: 34) and as well the magnitude of their effect, is that it concentrates on the insignificance that the ratio of *debt-amount* to *output-value* truly brings in determining the country's accurate extent of external debt formation.

### ***Sovereign debt is cumulative in time***

In a further demonstration to show that the two debts, that is, the 'ordinary' and the sovereign debt, are definitely *distinct debts that thus add to each other*, Schmitt shows moreover that they also evolve differently 'in the flow of time' (ibid.: 32). He considers again the case-example, country A against R (rest of the world). Each month, A forms a *new* deficit of 1 dollar (MR). This time, a series, not just one, of months is the period (considered in its totality) within which international exchanges take place. He points out at the outset, that what is observed is that a sovereign debt of 1 dollar (MR) forms *each* month 'because this is the amount of the ordinary debt formed each month' (ibid.: 33). But he warns that one other very interesting observation is the fact that the evenness-rapport between the two debts is not retained, if one were to measure the entirety of both 'ordinary' and sovereign debts formed for a total period extending from 0 to *n*. For example, what *will* be noticed is 'that the *sum* of all the ordinary debts formed in each period, from 1 to *n* (30), is equal to 1 MR in the thirtieth period whereas the *sum* of all the sovereign debts formed in the same interval of time is of 30 MR in the thirtieth period' (ibid.: 33). Now, though this may cause one to think then that the sovereign debt is therefore not the illegitimate duplicate of the 'ordinary' debt, it remains indeed just that. Schmitt explains, precisely, the reason for which it might *seem* otherwise. 'The unique difference is the following: ordinary debts are effectively paid in each successive period while sovereign debts, remaining unpaid, 'inflate' over time' (ibid.: 33). The fact that the payment of the 'ordinary' debt does take place and this, in *each* successive period, leads one to correctly reason that what is actually happening 'is that the ordinary debt formed in the second period is nothing other than the repetition of the external debt already formed in the first period' (ibid.: 33). Understood in very simple terms: whilst A's internal economy

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<sup>281</sup> 'The only data that matters are those of the balance of payments. If  $x$  MR is the sum of all the expenditures,  $y$  MR being the lower sum of all the gains, country A's foreign debt increases by  $(x-y)$  MR' (ibid.: 31).

<sup>282</sup> Precisely, 'the exact extent of its external debt is simply the difference between the sum of foreign currency that the country spends and gains. If the sum of expenditures (imports) is of  $x$  dollars while the sum of gains (exports) is of  $y$  dollars, the correct amount of the external debt thus formed is of  $(x-y)$  dollars' (ibid.: 33-34).

reimburses, in a subsequent period, residents of R from who they have borrowed 1 dollar (MR) in the initial period, this reimbursement is nevertheless matched by a new foreign borrowing of a same value. The two (reimbursement and new borrowing) being reimbursed and newly obtained by A's domestic economy, all within a same period (e.g. second or subsequent), the external debt thus formed in that particular period is merely the 'repetition', to use Schmitt's connotation, of the debt previously formed. This is the reason that the total amount of external debts evident in this second or subsequent period adds up, always, to 1 dollar (MR) only. And, this same result could assuredly be expected, as well, for a total period whereby  $n$  is 30, for example. 'Ordinary' debts are not cumulative in time.

Sovereign debts, on the contrary, add up with time, that is, if A's net imports are renewed period after period, its sovereign debt increases, even though its 'ordinary' debt does not, as Schmitt has established. The very reason that the sovereign debt, for its part, is cumulative in time, is because whenever an old sovereign debt is reimbursed, a fresh gap is created between A's total expenditures and its total receipts, the payment of which brings back A's sovereign debt to its previous level.

All things considered, in particular the fact that the two debts each manifest very *uniquely* 'in the flow of time' (ibid.: 32), should be sufficient evidence in itself, that the two are definitely distinct debts that therefore logically and quite convincingly add<sup>283</sup> to one another, hence vindicating Schmitt's claim of a double charge.

We now turn our attention to one of Schmitt's more general demonstration of the double charge of countries' external debts.

### **The single loan proof – a general explanation of the double charge**

In the preceding sections we have concentrated on some of Schmitt's demonstrations of the double charge of countries' external debts, which illustrations supposed that deficit nations borrowed abroad, **twice**, the amount required for the payment of their net imports. We next evidence his illustration of the **single** loan proof which assumes, this time, that the indebted nations resort to foreign borrowing *one time only* in order to settle the international payment of these 'imports-without-exports'. Schmitt shows that, withal, the consequential result is the same: the charge of the country's external debt doubles.

The resonant timbre nonetheless evoked from this rather, more general, proof of the double charge, clearly resounds the malfunction that severely clouds the interrelationship between **money** and *real goods*, in today's international payment transactions.

Schmitt begins by highlighting the difference between two types of foreign currency loans that are obtained from external lenders<sup>284</sup>. He distinguishes between the loans whose foreign monies bring mere 'credits-debits', the very 'ordinary' loans as obtained by countries from

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<sup>283</sup> Though they evolve differently in the course of time, the sovereign debt being cumulative whilst the 'ordinary' debt is not, they very evidently, add to each other, in a given time period.

<sup>284</sup> Schmitt once again considers some country A which, in the period under examination, 'raises the value of its imports to 11 dollars while maintaining its exports to the value of 10 dollars. To finance the difference, A borrows 1 dollar (always in billions) from sleeping partners (foreign lenders)' (Schmitt 2014: 36). He specifies that the loan under study concerns 'the positive difference between imports and exports of country A considered in its transactions with the rest of the world (R)' (ibid.: 36).

external lenders and, those whose currencies (foreign) bring ‘credits-without-debits’<sup>285</sup> to the *borrowing* country. Moreover he differentiates between the *net* economic gain as obtained through the nation’s exports-receipts and, the positive gain as obtained when it borrows abroad<sup>286</sup>. Whilst the former defines ‘a net economic value, a monetary sum obtained and not due, a net credit and not a credit-debit’ (ibid.: 36), the sum of external currencies that it disposes<sup>287</sup> of as a result of the foreign borrowing, the ‘ordinary’ loan<sup>288</sup>, are positive monetary assets and liabilities, the one as well as the other. But Schmitt reminds us, nevertheless, of one essential fact: given that the external loan of foreign currencies has been sought for the *real* payment of its net imports, ‘[t]he sum borrowed is the value of future exports of real goods by the deficit country’ (ibid.: 36). This then, firmly confirms, that ‘foreign currencies borrowed to pay for net imports have as their object real goods to be exported in a future period’ (ibid.: 37). He considers, all the same, that external currencies as lent by R’s lenders to A for the purpose of the latter’s *real* financing of its surplus imports (essentially R’s purchase of A’s exports\*) are, first and foremost, *assets-liabilities*, that is, rather than *net* assets. Yet, though they are primarily, *assets-liabilities*, he nonetheless shows that *they are net assets, after all*<sup>289</sup>. It is in considering what differentiates a mere sum of units of money from that of a sum of *real goods* that we inevitably understand just why that is.

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<sup>285</sup> The two expressions ‘credits-debits’ and ‘credits-without-debits’ are that of Schmitt 2014 who utilizes them to differentiate the very foreign currencies of the two types of external loans.

<sup>286</sup> ‘The new foreign loan obtained by the deficit country (A) brings in a sum of foreign currency (1 dollar), which is positive, not nil, and it increases the country’s assets in foreign currencies’ (ibid.: 36). Moreover, Schmitt clarifies that foreign currency held in a nation’s reserves (private or official) is immediately considered as a *positive asset even in advance of* it being converted to a *financial asset* (toward R). ‘It is a positive value, whether or not it is changed into foreign financial assets, bonds or shares, private or public’ (ibid.: 35). He furthermore warns that, in fact, part of the problem of our current international system of payments is on account that ‘foreign money present anywhere in the national economy defines a positive value’ (ibid.: 35). He adds to this by recalling the particular case of foreign currency sums that are present in a country’s economy but that have not already been spent towards foreign financial assets. Now the reason that these should perhaps be heeded is that they actually define ‘rights on foreign banks that will have to pay, as is the case for any demand deposit, their clients’ purchases’ (ibid.: 36). Specifically, if these foreign currencies have been obtained through a foreign loan, then we should remember that *they have already been spent* by the external lenders (of R), in their payment for a future product (import) from A’s internal economy.

<sup>287</sup> Schmitt specifies his meaning in the following statement. ‘Any currency borrowed abroad is part of the borrowing country’s positive assets until the moment that it is spent in favour of a non-resident’ (ibid.: 36). We note as well the importance here of his differentiation between *real goods*, that he considers exclusively as part of a country’s balance of payments, and that of *bank deposits* which are not to be considered as either financial or commercial goods. That is, except for, foreign currency reserves. ‘The only bank assets that are true goods are foreign currencies in the reserves’ (ibid.: 36).

<sup>288</sup> It is important to observe, as Schmitt points out, that at this stage of the foreign borrowing, external lenders are mere ‘creditors of a sum of money, namely of the dollar that is the object of the transaction’ (ibid.: 36).

<sup>289</sup> He also stresses the essential point that ‘[o]nly the foreign currencies borrowed to finance net imports are concerned here. These currencies can be ‘returned’ or refunded, in equivalent units, only in a subsequent period’ (ibid.: 37).

Now considered on their own<sup>290</sup>, ‘ordinary’ loans are merely monetary liabilities and assets. But *the very aspect* of the loans of foreign currencies *transforms*, the instant they effectively bring positive assets to the deficit nation, that is, to match the level of the totality of its imports. As such, it becomes the purchase payment of an export of part of A’s future output<sup>291</sup>. Moreover, it is a future export of A that *country R as the set of its residents will become owner of*, rather than the external lenders themselves, and this in a subsequent period. It is in this sense that it can be affirmed that the foreign currency lent (R to A) is therefore a monetary-asset and real-liability for the borrowing country and, a real-asset and monetary-liability for the lending country. And in this sense as well, they are indeed net assets, of the borrowing countries. The end-all effect of the said foreign loan is that nation A, gains access to units of money R whilst it relinquishes a portion of its future output (real goods); country R, for its part, obtains real goods (future) whilst it parts with mere money units. Let us recapitulate the essential points. The foreign money units that A borrows from R to finance its surplus imports are thus **monetary assets-real liabilities**. That is as far as country A *as a whole* is concerned<sup>292</sup>. This means then that these foreign currency units are **real** assets of country R<sup>293</sup>. And indeed they are as after all, they can effectively be reimbursed only through a future output that A’s domestic economy will produce in a later period<sup>294</sup>. In this sense, it will be a ‘different’<sup>295</sup> dollar or MR, though of an equal amount, that will ultimately be returned to R, following a future export of A, in a next period.

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<sup>290</sup> Schmitt elaborates on the specificity of ‘ordinary’ loans in that they ‘all result in the equality, for both the lenders and borrowers, between purely monetary assets and liabilities. Considered in itself, before reimbursement and interest, the transaction provides a ‘liability-asset’ to the lending country and an ‘asset-liability’ to the borrowing country. The required definitions are clear: ‘ordinary’ is every loan whose function is not to finance net imports’ (ibid.: 38).

<sup>291</sup> ‘As soon as the international loan of a currency has the function and effect to increase the revenues of a deficit country, to bring them to the level of its total imports, *it changes its nature: it becomes the payment of a future export of real goods*’ (ibid.: 38).

<sup>292</sup> ‘At country A’s level, the liability is the transfer of the monetary payment of the future export of real goods while the asset is merely and simply a sum of foreign currency’ (ibid.: 40).

<sup>293</sup> ‘The fact is that *these borrowed currencies are real assets of the lending countries*’ (ibid.: 37). Schmitt explains exactly why that is. ‘As soon as one agrees, as facts require, that the positive asset obtained by the lending country (R) is real – since the final object of the currencies lent consists in a quantity of *real* goods equal to 1 dollar value produced in  $p^0$  by A’s economy – it is illogical to assume that country R acquires a positive *monetary* asset; since  $p$  the credit obtained by country R is ‘*real*’ (ibid.: 38). Moreover, these assets become net following A’s payment of its net imports. ‘*The asset of foreign lenders becomes net as a result of the payment of its deficit by country A*’ (ibid.: 40).

<sup>294</sup> Given that the object of R’s loan to A is a real (future) product of A (that it will produce and export to R in a later period), it is only logical that these borrowed currencies are *real* liabilities of A rather than *monetary* liabilities, hence why as well, they are *real* assets of R, the lending nation. ‘[T]he mere observation of facts requires compliance with the real object of this loan: it is and it can only be an import by and for R of one of A’s future exports, which will occur in  $p^0$ ’ (ibid.: 37).

<sup>295</sup> We next elaborate on our meaning through Schmitt’s own account. ‘Let  $p$  denote the period when the surplus import equal to one-dollar value is acknowledged and  $p^0$  the period when the external debt incurred in  $p$  is repaid. Since the set-lender, country R, obtains in  $p^0$  the reimbursement of its loan, it is not the dollar initially lent that it gets back, but the dollar

The preceding developments of Schmitt's argument culminate to an important and focal point of his single loan demonstration: the acknowledgment that '*the currency lent to finance surplus imports is in fact spent by the country where it originates, R, to pay for the import of a future product of A's economy*' (ibid.: 38). This is to say that *as of the initial period (p) that the foreign loan is sought by A*, a part of its future output is immediately appropriated by country R (as set)<sup>296</sup>. Country A, considered as the set of its residents, will have to *freely* relinquish real goods that its domestic economy will produce in the future to the benefit of country R, itself considered as a whole. That being the case, the double charge<sup>297</sup> in the payment of its net imports *through a foreign loan*, is the fact that it must, furthermore, spend<sup>298</sup> the acquired foreign bank deposit to finally settle the payment, in money terms. It thus loses the very counterpart (foreign bank deposit) of the loan that has already increased its external debt by a same amount of its net imports, and it is in losing this counterpart that its external debt doubles<sup>299</sup>. That said, the problem with our current 'system' of international payments starts with the fact that this duplication of the charge of countries' external debt, *which duplication truly manifests*, remains very much in the dark amidst traditional bookmen, economic and political alike. Precisely, with respect to two vital points: one being that in assessing the deficit country's international exchanges, only exports+ (current period,  $p$ ) are taken into account whilst exports\* (future period,  $p^0$ ) are not (considered integrally, R's imports are *simply* A's exports+)<sup>300</sup>; moreover, they omit to differentiate assets-liabilities as it regards the country's internal economy from assets-liabilities as it concerns the country as a

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that pays for an export of country A in period  $p^0$ . This clearly means that the dollar paid in period  $p$  is a *net* monetary asset obtained by country A's domestic economy' (ibid.: 37). And, given that it is effectively a **net** monetary asset in period  $p$ , it becomes logically clear why it is also considered a *real* liability, in period  $p$ . That is, as opposed to being a *monetary* liability.

<sup>296</sup> 'This is necessarily so, because country R as a whole becomes, by means of an external loan granted by its residents, the owner of real goods of 1-dollar value to be produced and exported by country A as a whole' (ibid.: 42).

<sup>297</sup> 'If A's surplus imports were paid only once, this country would retain ownership of the newly borrowed dollar. Its net purchases worth 1 dollar would nevertheless be paid by the future cession of real goods worth 1 dollar. Each country would obtain and give real goods of 1-dollar value' (ibid.: 42). In following with this laudable observation, Schmitt logically concludes that '[o]n no account would country A suffer an additional loss of foreign currency' (ibid.: 42).

<sup>298</sup> 'The current status of the payment of surplus imports is a 'non-system' precisely because the deficit country loses 2 dollars to pay a net import whose value is 1 dollar only. Country A must indeed spend the sum of 1 dollar borrowed abroad, a debit that adds up to the cession of real goods that its economy must produce and export later' (ibid.: 42).

<sup>299</sup> That is, the loss of a net asset being equivalent to an increase in debt.

<sup>300</sup> As Schmitt points out, in actuality, only the deficit country's exports of the current period (exports+) are acknowledged. 'The great scholars content themselves with thinking and saying that, in the exchanges between A and R, A's exports are R's imports. They only retain in this respect the exchanges between real goods and they are absolutely right in this respect. They are nevertheless seriously mistaken because ... imports of real goods positively carried out by country R are indeed of a value equal to country A's imports; their measure on both sides is of 11 dollars. This is necessarily so, because country R as a whole becomes, by means of an external loan granted by its residents, the owner of real goods of 1-dollar value to be produced and exported by country A as a whole' (ibid.: 42).

whole<sup>301</sup>. Essentially, in missing the first point, they inevitably miss the second. That is, if exports\* were actually taken into account, then the need to distinguish between *assets-liabilities*, depending at which level they occur, would naturally be understood. This is essentially where Schmitt's single loan argument delivers its full impetus. Specifically, in regard to R, considered as the representative set of its residents rather than as concerning its internal lenders (investors of R), the units of money that it lends to A are *real* assets in that it is *country R as a whole* (as opposed to the lenders themselves) that becomes owner of future goods of A that the latter will produce and export in a subsequent period<sup>302</sup>. As for nation A, considered *as a whole*<sup>303</sup>, the units of foreign currency that it borrows are *real* liabilities because they imply the giving up of part of the country's output, that it will export to the benefit of R, in a later period.

In sum, when the pertinent transactions are considered integrally, one readily observes that the deficit country incurs *two* debits, once in the loss of its future goods to R and again in the loss of the foreign bank deposit (loan-counterpart)<sup>304</sup>, each of an equal value of its net imports. On the other hand, the net imports consist of its *sole* credit<sup>305</sup>. The deficit country therefore incurs two external debt charges, each amounting to the value of its net imports, and this as a consequence of borrowing abroad only the single not double value of these very 'imports-without-exports'.

The problem with the current status of our international payment system is that money is unable to maintain its neutrality in international exchanges. Unlike the purely intermediary role that it plays out within nations, across borders it takes on a pathological aspect, behaving like a specious good, *as though it was truly a real good*. And this is inevitable, whenever the payment of a deficit country's net purchases (imports) involves a foreign income, as is implied in a net foreign borrowing. This is why no matter which approach is utilized to analyze the duplication problem of external debts, that is, through a double or single loan

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<sup>301</sup> '[W]hat present-day scholars forget is to distinguish the assets and liabilities as they occur at the level of countries themselves, that is, as set of all their residents, from the assets and liabilities concerning simply a part of their residents' (ibid.: 39). In essence, this is where the merit of Schmitt's distinction between two types of foreign loans comes in. That is, considered at the level of both A and R's internal economies, the foreign currency loans are mere *assets-liabilities* and *liabilities-assets*, respectively. But considered at the level of their respective countries, *each considered as a whole*, the foreign currency loans are *monetary* assets and *real* liabilities for A and *real* assets and *monetary* liabilities for R.

<sup>302</sup> 'Concerning country R as a whole and not merely its sleeping partners, the dollar lent is a real value because it means the appropriation of real goods that will be produced and exported in the future by country A' (ibid.: 41).

<sup>303</sup> 'This involves a consequence, also essential, for country A as a whole, as the set of all its residents. This set gives up a part equal to 1 dollar of its own future output' (ibid.: 41).

<sup>304</sup> 'Two debits of country A: future real goods of 1-dollar value + expenditure of the sum of 1 dollar borrowed abroad' (ibid.: 42). Now it should be observed that the *first* debit corresponds to the 'ordinary' debt as incurred by A's domestic economy, as a result of the 'ordinary' loan it obtains from R for the *real* payment of its (A's) net imports; this 'ordinary' debt is included in the balance-of-payments equality, attained by adding to A's exports+, its exports\*. As regard the *second* debit, it corresponds to the sovereign debt; the very reason for which it is a *sovereign* debt is because the loss of the foreign currency (FBD) that should otherwise increase country A's international reserves, public and private, is suffered by country A *considered as a whole*.

<sup>305</sup> 'A unique credit of country A: its net import of 1-dollar value' (ibid.: 42).

argument, it will always unveil the same circumstantial consequences that manifest given the procedural system infrastructure that currently governs inter-border payments.

***Whether from a single or double loan perspective, overall compatibility subsists***

No matter the approach of the analysis, whether based on a single or double loan argument, the same consequential result is ultimately demonstrated: that of an anomalous formation of a sovereign debt. This is inevitable given that *the underlying themes*, that form the basis of the theoretical claims that are advanced, *compatibly overlap*, irrespective of the perspective from which they are demonstrated.

Whether the duplication stems from the fact that a net foreign borrowing implies a foreign income or payment in both *real* and money terms or, payment in domestic and in foreign currency or, from the undeniable fact that a *sovereign* payment adds to that of an ‘ordinary’ payment, we evidently observe a same pathological result: the formation of a sovereign debt. Quite clearly, no matter from which perspective one studies the phenomenon of external debt duplication, all of the underlying themes come into play even if some do so more prominently in one argument than in an alternative demonstration. Moreover, this can also be said whether or not the argument is that of a single or double loan proof. Again, it will demonstrate the same infallible result of the double charge. Let us consider why.

Whether or not a deficit country borrows only once or, twice, the value of its net imports, it will ultimately incur a double cost such that in both case scenarios the result is the same. On mulling this over it becomes difficult to expect otherwise, for the very reason that all of the *underlying* themes that drive any one argument, even if subtly, are always compatibly at play, no matter the approach of the demonstration.

For example, in the single loan demonstration, it becomes obvious by mere virtue of the inevitable expenditure of the foreign bank deposit (very counterpart of the ‘ordinary’ loan) that the double charge arises from a second anomalous payment, in money terms and, this in addition to an initial payment, in *real* terms. An anomalous sovereign charge thus adds to that of an ‘ordinary’ charge. And, evidently, a foreign income is implied (part and parcel fact of the very problem). Moreover, we could say that the double cost ensues from the fact the net imports are firstly paid in domestic currency and once again in a foreign currency.

Now, some of these same elements are at play even if one or more, to a greater extent than others, in a double loan demonstration and, moreover the resulting *double charge* manifests, nevertheless. If we consider for example, the argument that illustrates the fact that net imports are paid both in *real* and in money terms, we see that Schmitt’s double charge claim is once again, reflected by overlapping themes. One underlines a more prominent one, that is, no matter that the main thrust of the argument is the fact that net imports are paid once in *real* terms and once again in money terms, another fact nevertheless fundamentally subsists: the net foreign borrowing implied, involves a foreign income<sup>306</sup>. And again, the second sovereign

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<sup>306</sup> We have seen that this means an additional costly payment for the deficit country. Contrarily to the case of its ‘imports-exports’ whereby the payment in foreign currency is provided *free of charge* via the deficit country’s exports, not to mention that the provenance of the income for these ‘imports-exports’ originates from its domestic economy, when it comes to its ‘imports-without-exports’ such is not the situation: the deficit country *will have to pay and at that a double charge*, to finally settle the payment of these very imports, with an income that originates from abroad.

*money* payment that ensues from the first ‘ordinary’ *real* payment<sup>307</sup> undeniably adds to the latter. We observe that no matter that, this time around, the approach is that of a **double** loan argument, the overall themes recur and, the result is the same: the pathological formation of a sovereign debt that should not ever exist. In sum, the deficit country’s domestic economy indebts itself a first time when it *spends* the ‘ordinary’ loan from R to finance its future production of real goods to the benefit of the latter. But given that this means that the payment of its net imports remains outstanding, it inevitably incurs a second indebtedness at the macroeconomic level (sovereign loan), in order to finally settle the payment of its net imports, which it does, only this time in money terms.

If we next consider the case whereby the central theme of the **double** loan argument is more the fact that net imports are paid with an income (foreign) that originates from the production of R’s domestic economy, we not only observe the same pathological result but also that other underlying themes again recur, thus evidencing this argument’s compatibility with other previous demonstrations, whether single or double loan arguments. By virtue of the fact that the net imports are paid with a foreign income *entails* yet another underlying point and one that has presided in other arguments already exhibited, both single and double loan demonstrations alike: the fact that these ‘imports-without-exports’ will ultimately cost the deficit country *two payments that undeniably add to each other*. This, on account of the fact that the reconstitution of R’s own domestic income, when A carries out<sup>308</sup> the payment of its net imports<sup>309</sup>, actually reduces its (A’s) exports-receipts from R *which means* that it will have to resort to yet another foreign loan to cover its now uncovered imports. The first payment is incurred by its domestic economy whilst the second by the country as a whole: the sovereign debt thus adds to the ‘ordinary’ debt. Again, we evidence the pathological formation of a sovereign debt that doubles the deficit country’s external debt.

No matter which approach the argument takes on, whether through a double or single loan demonstration, all are adequately compatible and lead to the same consequential result: the anomalous formation of a sovereign debt that doubles the deficit nation’s external debt.

Next, in a third and closing part of our work, we turn our attention towards reformation.

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<sup>307</sup> It is opportune to recall here that this first *real* payment, from which the very ‘ordinary’ debt materializes, is carried out by the deficit country in compliance with its balance-of-payments equilibrium. Yet, the deficit country uncaringly pays, once again and in addition to this *somehow unacknowledged* first real payment, only this time in money terms.

<sup>308</sup> It *spends* this first ‘ordinary’ loan in the payment of its net imports.

<sup>309</sup> Specifically that is, with an income from R.

**PART III    The Reform**

## 6 The single-country reform

### Introduction

In this chapter we concentrate on presenting a payment system reform that could easily be adapted by any world single-country. This revolutionary reform is a work that was engineered by Bernard Schmitt (see Schmitt 2014) in following with his in depth study of the double charge of countries' external debt. The reform aims at salvaging the domestic income of deficit countries that is unnecessarily lost to the benefit of a financial bubble<sup>310</sup>, whenever a net foreign borrowing is involved in the payment of these deficit nations' net imports. Schmitt's outline for a reformation of the payment system of net imports, primarily and decisively abolishes the double charge of external debt for the reforming countries and this, even if these nations single-handedly adapt the reform.

Again, our intent is not to reiterate every detail of Schmitt's pioneering and preeminent research that underlines his vanguard plan for a much needed payment system reform but merely to highlight its essential steps, as well as its advantageous and promising practical application. Schmitt himself readily admits to a work in progress that will require the devout attention of many field specialties and experts to ensure a sound implementation of the reform he advocates, such that it could yield the enhanced empirical results that it endeavors to produce<sup>311</sup>.

The first section of the chapter introduces this single-country reform through a brief coverage of yet another, particularly relevant, demonstration of Schmitt's proof of the very double charge of external debt.

An ensuing second section then enters the realm of Schmitt's reform plans that could beneficially modify the existing system of external payments for any endeavoring country even if the reform was implemented by these countries, on an individual basis.

### **A purchase unpaid in a foreign money is not necessarily unpaid in a country's own domestic currency**

In this proof of the double charge, which incidentally very relevantly sets the foundation from which Schmitt's reform make-up elaborates, he highlights the point that though a net expenditure forms an equivalent debt, the very debt is created in a specified currency. That is,

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<sup>310</sup> 'The desirable result is reached as soon as the domestic income spent for the payment of net imports remains the property of the deficit country itself, as if purchases (imports) were carried out between residents' (Schmitt 2014: 56). As our 'system' of international payments currently has it, this very income is lost to the benefit of the surplus country.

<sup>311</sup> 'To develop the reform in all its details will require the work of several weeks (possibly a month) of a number of experts. It remains that the reform's endeavour is to cancel the second charge of external debts, a task that will be fulfilled only if the reform's main lines are correctly proposed and applied' (ibid.: 52). 'We present here only a summary; it will be necessary to discuss it in a rigorously detailed way' (ibid.: 83).

the fact that it is unpaid in a foreign currency does not imply that it has not been fully paid in a country's own domestic money<sup>312</sup>. Moreover, given our current non-system of international payments, it is the country *as a whole* that is ultimately saddled with the cost of ensuring the payment of external net purchases, in foreign money. The argument of Schmitt's proof, tout ensemble, rests on the fact that the country's indebtedness is robbed of any, whatsoever, compensation<sup>313</sup>.

The problem compounds in that the very indebtedness is not differentiated, whether conceived as occurring at the level of the country considered as a whole or, at the level of its residents, that is, at the microeconomic level<sup>314</sup>. Apropos, Schmitt reminds us that it is not nations themselves who engage in international trade. After all, it is their inhabitants that initiate the purchase and/or sale transactions. Moreover, the fact is, that a country's resident does definitely pay, and this from the onset, the entirety of its foreign purchases. But somehow, for the most part, the economic community considers these imports unpaid until they are finally paid or settled in the exporters' currency. And, the infrastructure of our 'system' of international payments as it stands today, very simply, complements this belief<sup>315</sup>. In fact, if it were not for our defective 'system' of international payments, as it exists today, and were the likes of Schmitt's advocated reform already in place, external purchases fully paid in a country's domestic currency would no longer be thought of as outstanding *unpaid*

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<sup>312</sup> 'We can immediately see the mistake made as consisting in declaring unpaid precisely the difference between purchases (imports) and sales (exports) of the country. By erroneously confusing a country's debt with a debt held by its residents, many economists believe, just as falsely, that a purchase that remains unpaid in money R is also unpaid in money A' (ibid.: 93).

<sup>313</sup> 'Is it required by the facts, as they occur, that if the country gets indebted its debit is in no way compensated? Answers are well known ... the credit that the country should derive from it goes missing' (ibid.: 94).

<sup>314</sup> 'Everyone knows that a country, as the set of its residents, is not itself part of the people that it unites in the set. No country is a resident; no country is a person. Despite this evidence, even the most 'distinguished' economists conceive countries' indebtedness as though it were of the exact same nature as that of the debts incurred by their residents' (ibid.: 92).

<sup>315</sup> Schmitt comments on the misapplication of the 'free lunches' accusation: 'This is the explanation nevertheless retained: 'imports-without-exports' are totally unpaid, hence are 'free lunches', because they are paid in money A and are unpaid in money R' (ibid.: 93). But as he clarifies, 'it is export-surplus countries, not the deficit countries that get a free lunch. Deficit countries pay positively the totality of their foreign purchases, including their 'imports-without-exports'. And export-surplus countries obtain two times the payment of their net exports, first to the credit of their lenders, then, a second time, to the benefit of a 'financial bubble'. Only making the first payment is logically, morally and economically justified. The second payment is but an unwitting extortion' (ibid.: 56). To this he adds a clear distinction between 'imports-without-exports' and 'imports-without-payments' that should be heeded. We capture the essence of his warning in the following statement. 'If country A's 'imports-without-exports' were 'imports-without-payments' it would be correct to sentence it to finally pay them. Its unpaid purchases would indeed be the acquisition of goods produced by another country, values illegitimately lost by the holders of incomes formed within surplus countries. In reality, however, country A (representative of all other deficit countries) pays all its imports, through the expenditures of both a domestic income, formed in units of money A, and a sum of foreign currency, units of money R. Despite its deficit, the value of its expenditures to the benefit of R is therefore equal to the sum of all its purchases, including its 'imports-without-exports'. It would thus be patently false to say that surplus imports are *unpaid* purchases' (ibid.: 83).

purchases. Moreover, no debt would correspond to them and this, for neither the country *as a whole*, neither its inhabitants<sup>316</sup>. The issue comes down to determining whether or not a domestic economy actually forms a debt whilst *paying the entirety of its purchases*. And, this means that much depends on how we define the very payment, that is, versus its actual reimbursement<sup>317</sup>. We will return on this, further on.

What we need to keep abreast of, is whether or not, a purchase unpaid in foreign money is thus definitely an outstanding debt, very simply<sup>318</sup>, even if fully paid in a country's own domestic currency<sup>319</sup>. An observation of what actually transpires *in practice*, would quickly remind us that, whether a question of 'imports-exports' or 'imports-without-exports', both these imports are effectively paid *primarily in a country's domestic money by its affected inhabitants*, who moreover, are not concerned with carrying out their external payments in foreign money. And so, from the perspective of the deficit country's residents, no foreign indebtedness should subsist. And therefore logically neither should it, for its country as a whole<sup>320</sup>. But the fact is that in actuality the deficit nation, considered as the set of its residents, is nevertheless implied in the settlement of these payments in foreign money. And this even if the source of the *foreign* debt is born with the deficit country's residents, themselves. That all said it remains that the reason the situation becomes problematic is that the foreign debt that is carried out by the country as a whole *is not compensated*<sup>321</sup> and as such its very cost is ultimately incurred by the deficit nation, as a whole<sup>322</sup>. We will see, in a next section, that this is a factor that Schmitt's reform endeavors to address<sup>323</sup>. The solution<sup>324</sup>

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<sup>316</sup> 'We observe, however, that several countries, such as A, have contracted substantial external debts, in several years, which they are often unable to settle fully. This is because external debts do not fail to form even if the logical analysis that we have just summarized states their impossibility. This contradiction is only apparent because, as they exist in our eyes, external debts have been formed by the 'non-system' of international payments. If the reform had always been applied, external debts would not exist nor would, therefore, the crisis that is defined by the impossibility to serve them fully' (ibid.: 93).

<sup>317</sup> 'It is the repayment of the sum lent that defines, before the reform, the external debt of country A' (ibid.: 97). Schmitt's reference to country A intends the *deficit* country.

<sup>318</sup> As Schmitt expresses it, '*tout court*' (ibid.: 93).

<sup>319</sup> Schmitt ascertains that it is certainly **not** and explains just why that is. 'It is crystal clear that this debt is defined only in units of foreign currency and not at all in units of the national currency of the country whose expenditures exceeds its receipts, since the difference mentioned does only concern debits and credits in money R (dollar) ... It is certain, therefore, that the debt so subscribed is null because any purchase already paid is a zero debt' (ibid.: 93).

<sup>320</sup> 'As the country's residents do not incur any external debt, it is necessarily the same for the country itself, the set of its residents' (ibid.: 94).

<sup>321</sup> '[T]he credit that the country should derive from it goes missing' (ibid.: 94).

<sup>322</sup> But moreover, as we have pointed out many times over, in addition to the *real* cost that is borne by the country's residents.

<sup>323</sup> 'Is it required by the facts, as they occur, that if the country gets indebted its debit is in no way compensated' (ibid.: 94)?

<sup>324</sup> That is, the solution as advocated by Schmitt's reform whereby '[c]ountry A gets effectively indebted for 4 dollars to the rest of the world, but an equal credit, equivalent in dollars of the domestic income spent for the net imports, is collected by the country whose net debt does therefore not increase' (ibid.: 94).

lies with balancing the country's debit (*net* as it results in reality and, as incurred by the deficit nation as a whole) with a credit that, today, becomes lost<sup>325</sup>.

Now, the idea of the *missing compensation*<sup>326</sup> is essentially the whole trust of Schmitt's argument here, in that it is logically inconceivable that the country as a whole, 'considered separately from the sum of all buyers and sellers', should incur an 'external debt now net' (*ibidem*). But what is just as dysfunctional, moreover adversely consequential<sup>327</sup>, and this on account of today's international 'system' of payments, is the fact that this debt adds to that of the deficit nation's internal economy, therefore doubling the initial cost-value of its net imports: *the double charge of external debt*. And, the reason that **it adds** is that, the very compensation that the nation *as the set* should generate from its acquired net<sup>328</sup> debt, is lost. The payment process infrastructure that underlines the current system of international payments actually robs the said nation of its compensation that, in effect, is totally absorbed by the payment in money terms, that is, the payment in foreign money. Consequentially, this is an internal income of the deficit country that is forever lost *for the country as a whole*, to the benefit of the surplus country, itself considered as a whole<sup>329</sup>. This **lost** domestic income that manifests in the deficit country's net external debt, is essentially what Schmitt's reform intends to recover<sup>330</sup>.

In essence, the aim of Schmitt's reform is twofold in that in counterbalancing the deficit nation's first loan/debt<sup>331</sup> (second period), not only does it neutralize this latter debt but also in so doing, it annuls the nation's (as a whole) sovereign debt<sup>332</sup>. Ultimately, it effectively counteracts the formation of net external debts<sup>333</sup> for the deficit nation.

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<sup>325</sup> Schmitt explains the situation, as it stands today, in that in as much as 'it does not become the owner of the domestic income (equivalent to 4 dollars) spent in the 'purchases-without-sales' of its domestic economy, country A gets nevertheless indebted for 4 dollars to the rest of the world' (*ibid.*: 95). 'It' or, 'country A' is understood by Schmitt to be the 'deficit country as a whole' (see *ibid.*). As well, his reference to '4 dollars' intends the value of the deficit: the net imports of his example-country, A.

<sup>326</sup> 'It is totally wrong that a country, considered separately from the sum of all buyers and sellers – which is the general case without exception – be forced to assume, without the slightest compensation, an external debt now net. In this respect, the only correct position is to assert that external debts incurred by countries should not even exist' (*ibid.*: 95).

<sup>327</sup> 'It is illogical that countries get indebted, but – and this is much more serious – it is terribly unjust that net imports are submitted to the double payment of their value: in order to pay its purchases (of 14 dollars) exceeding its sales (10 dollars), thus for the payment of that difference whose value is of 4 dollars, the deficit country has to pay twice 4 dollars to the rest of the world' (*ibid.*: 95).

<sup>328</sup> 'As this debt, defined in units of foreign currency, is not balanced by any credit, it is net in all likelihood' (*ibid.*: 94).

<sup>329</sup> '[E]xport-surplus countries obtain two times the payment of their net exports, first to the credit of their lenders, then, a second time, to the benefit of a 'financial bubble'' (*ibid.*: 56).

<sup>330</sup> Specifically, by ensuring that this 'domestic income spent for the payment of net imports remains the property of the deficit country itself, as if purchases (imports) were carried out between residents' (*ibid.*: 56).

<sup>331</sup> It should be noted that pre-reform, this first foreign loan/debt of the deficit country (A) is referred to as the 'ordinary' loan/debt by Schmitt.

<sup>332</sup> That is, considering the *double* effect of the counter-loan of the 'Bureau' in that it compensates two loans of R to A. We will cover this again, in more details.

<sup>333</sup> The end all effect is that though the deficit country borrows abroad twice, the first loan is neutralized with a counter-loan such that when it borrows a second time around, this second

In sum, this demonstration of Schmitt's claim of the double charge of external debts centers about the simple fact that deficit countries do indeed primarily pay their net imports with an income formed domestically. They do so in mere compliance of the balance of payments' equality, hence the formation of the 'ordinary' debt. But the problem is that this first *real* payment of their deficit (the net imports) ultimately adds with the final settlement of these surplus imports in money terms: that is, in foreign money. And the inevitable result is that the domestic income that is finally spent in this second monetary payment of its net imports is decisively lost and never recovered<sup>334</sup>. It all boils down to the fact that prior to finally settling the payment of its net imports in foreign money, the deficit country has already fully paid these very net imports with an equal sum of its own domestic income, in the form of its national money. This essentially, is what leads to the double charge. So indeed, we should heed the fact that a deficit country's net expenditures *unpaid in foreign money are not necessarily unpaid in its own domestic money*. In fact, this point alone, underlines the very reason that a reform of our current system of international payments is so indispensable if it is to, unwaveringly, address the built-in contradictoriness that firmly characterizes it. After all, as Schmitt points out, 'even imbalances and not only the 'purchases-sales' are positively and 'actually' paid. Debts logically arise only because of *unpaid* acquisitions' (ibid.: 97). All the more then why we should, without a doubt, bear in mind his claim of the ***double and unnecessary*** charge of external debts. This calamitous and unrighteous duplication, in itself, clearly vindicates the practical advantage that Schmitt's reform could bring to deficit countries in not only neutralizing the duplication but as well, the economical and financial woes that associates with it.

In a following section, we begin our study of reform alternatives by examining Schmitt's proposal with regard to the **single-country** reform.

## Countries could reform independently

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loan is simply the reproduction/replacement of the very first loan. The analysis will be elaborated such as to consider consecutive periods. We simply point out at this stage, that the *real* payment of net imports of the deficit/reforming country (A) actually takes place from the second period onwards. At the end of the first period, A's 'Bureau' has a debt of 1 MR (result of a sole foreign borrowing in this first period); at the end of the second period, the only debt of A is the one (third loan of the period) incurred because of the loan it contracts to cover its net imports of the second period, in money R, moreover this loan is compensated: *complement of the reform*. We will elaborate these details when we actually cover Schmitt's single-country reform, in a next section.

<sup>334</sup> Simply, '*it does not remain available within the deficit country*' (ibid.: 96) it is definitely lost to the benefit of the surplus country. Moreover, what is just as *malsain* is the fact that this disappearance is, today, complacently considered as a natural and, expected occurrence. 'Nobody has ever made the mistake of saying that the payment of net purchases abroad should not be carried out in foreign currency. Every economist agrees that the payment is made in foreign currency abroad and takes place in national money at first; it is indeed in domestic income that importers pay their purchases. But a second error is most often made in this regard: concerning surplus imports economists consider in general as 'normal' that the incomes formed and spent in domestic money disappear following their expenditure. This is wrong and something the reform will make impossible' (ibid.: 98).

Nations, worldwide, could protect themselves against the adverse effects of the double charge of external debts<sup>335</sup>, by *single-handedly*<sup>336</sup> undertaking a reform of their respective systems of external payments. Let us examine this single-country reform proposal of Schmitt's.

First and foremost, it must be said that Schmitt is correct in saying that the reform 'will finally institute the true logic of the payment of external debts' (ibid.: 42). As they are today defined and, paid, clearly does escape logic<sup>337</sup> and more so when one is reminded of the dire, costly to say the very least, consequences that ensue from this 'normality'. It is more complacency, rather than logic, that definitely overrides, as though the situation were a normal and expected result of international payment transactions that, after all, are processed within a regime of *relative* exchange rates. Perhaps, but as Schmitt advocates, it doesn't have to be that way, even if that is the very regime with which the system of international payments is currently saddled with. The single-country reform he proposes, undoubtedly, offers a clear hegira towards a more positive outcome, and this even if the basis of this *relative* exchange rates regime were to remain in place, that is, for the time being.

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<sup>335</sup> From the very onset Schmitt's reform clarifies that 'external debts are formed only by surplus imports' (ibid.: 42). In fact, the recognition of this particular point will be primarily emphasized by the reform. Schmitt explains the importance regard this stipulation as he notes what the reform will change. 'The current method of external debt calculation will be rejected. Today the total external debt of a country is measured adding the debts as incurred by the country's residents. This is fundamentally wrong because the true criterion concerns the country as a whole and not merely its residents of the private or public sector. The question therefore belongs to macroeconomics, just as the law of international trade balance between each country's earnings (exports) and expenditures' (ibid.: 42). Now Schmitt does indeed recognize that what happens at the microeconomic level is, after all, reflected at the macro level. 'It remains true, of course, that the set is affected only by its residents' (ibid.: 42). But the point that is asserted, particularly in reference to the measure of a nation's external debt, is that the *foreign currencies* that are brought into a country as a result of its inhabitants' external borrowing, may stay accessible within the deficit nation's domestic economy and their sum is thus maintained in the official reserves of its central bank or, even private reserves. And, '[t]o this extent external borrowings are not *net*, because the currencies that are available are 'liabilities-assets' and not net liabilities' (ibid.: 42). Now at the *macroeconomic* level: 'the foreign currencies that are both received *and spent*' (ibid.: 43) not only form *net* liabilities but this for the country as a set. 'In macroeconomics, where the measure of external debts is scientifically accurate, only matter the foreign currencies that are both received *and spent* by the country as a whole' (ibid.: 43) Hence from which stems the bench mark by which the entirety of a nation's external debt should be measured. 'The correct criterion is therefore consistent with the balance of payments: external debt increases by the exact value of the difference between international expenditures of foreign currencies and their gain' (ibid.: 43).

<sup>336</sup> The reform is clear on its sovereign application, its very specific aspect that we next encapsulate with Schmitt's own description. 'The reform concerns a sovereign country. But a similar reform can be studied and implemented by several countries at a time. It is not necessary nor even recommended that a country asks a foreign authority, for example the IMF, to reform its external payments, even to the extent that they are made in foreign currency. On the contrary, every country implementing the reform is literally sovereign' (ibid.: 52).

<sup>337</sup> Admittedly, paying double the amount of one's net imports is **not** the most logical thing for a deficit country to do, let alone, financially sound.

One important feature that the reform will emphasize with regard the international transactions of trading countries is the element of symmetry, only this time, *instantaneous symmetry rather than deferred*<sup>338</sup>. As we have it today, the surplus country obtains the *real* payment of the deficit country's net imports by appropriating a part of its *future* output. As such, the deficit country loses this internal income, forever. The reform will change that. The *real* payment of its deficit will no longer imply a *future* production but instead an actual ceding of its current internal resources, that is, in the form of financial securities. But the important fact of this new development is that this will happen in such a way<sup>339</sup> as to counter the deficit country's double charge of its external debt and is so doing, it will save that part of its internal income that it otherwise loses through *an extra charge*. It will thus pay for its net imports only once.

### ***The idea behind the 'Bureau'***

Countries embracing the single-country reform will create their own, independent, internal institution that will have a key role in overseeing<sup>340</sup> the reformation of their respective, external payments. Schmitt refers to this institution as the 'Sovereign Bureau' or even simply the 'Bureau' (see *ibidem*). Now one brilliant yet simple stride to be brought in by the reform that he proposes is the fact that the 'Bureau' will be considered 'co-resident'<sup>341</sup> alongside the reforming country's importers. This way, the payment of its residents' *external* purchases will be carried out<sup>342</sup> as though these purchases were mere internal purchases, the likes of those transacted amongst nationals. The problem with how these payment transactions are processed today is that these foreign purchases end up being paid at two different levels: once at the microeconomic level, in the importing country's domestic currency and once again at

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<sup>338</sup> Prior to the reform, though the *real* payment of the deficit country's net imports occurred in a first period, *the actual reimbursement took place in a subsequent period*.

<sup>339</sup> We will examine this in more detail. For now, we will mention only that the deficit country will issue a counter-loan to the surplus country, as counter-balance to its own loan from the very surplus country; doing so, will neutralize one of the two charges of its external debt.

<sup>340</sup> 'An institution to be called 'Sovereign Bureau' will manage the new regime' (*ibid.*: 43).

<sup>341</sup> 'It is enough to make the sovereign Bureau, 'co-resident' of the importers, the final beneficiary of the domestic currency spent by importers. The payment of imports will then be, as far as domestic incomes are concerned, exactly similar to the purchases among residents of the importing country; indeed more than just similar, because the Bureau and the importers reside in the same country' (*ibid.*: 45).

<sup>342</sup> It is true that currently they are already *firstly* paid, at the microeconomic level, in the importing nation's domestic money, seemingly as any other internal purchases. Nevertheless, they are ultimately also paid in foreign currency at the macroeconomic level. And though this is carried out effortlessly and gratuitously with respect to the importing nation's 'imports-exports', given that it earns all of the units of foreign money that it requires to pay these imports through its equal amount of exports, such is not the case for its 'imports-without-exports'. To the extent that there is no matching sum of exports to cover the latter, the foreign currency that is required to pay for them has to be purchased and it is the nation as a set who inevitably bears the cost. The reform will have it that the 'Bureau' will counter this cost such as to effectively neutralize it. We will later examine the strategy that is planned in order to accomplish this.

the macroeconomic<sup>343</sup> level, in the exporting (surplus) country's currency. But moreover, as we have seen, it is the fact that the two payments add to each other such as to double the charge of the deficit country's net imports that is the very problem.

*Part of understanding* the underlying mechanics that continue to fuel the *external debt crisis*<sup>344</sup> that countries find themselves in today, *is to understand as well* the essential difference<sup>345</sup> that existentially subsists between microeconomic and macroeconomic levels of payments and, the dire consequences that result for deficit countries, from the addition of the two<sup>346</sup>. As these payments materialize today, indeed, the second *monetary* payment at the macroeconomic level is an added<sup>347</sup> cost that is incurred by the deficit nation as a whole and this, despite its inhabitants' *real* payment that has already taken place *at the microeconomic level*. The reform will modify this phenomenon such that the ultimate payment occurring at the macroeconomic level will be but a *mere translation* of its microeconomic counterpart.

The idea is to have the 'Bureau' at the helm<sup>348</sup> of the country's international payments, in their entirety<sup>349</sup>, at all times and in any given period. Clearly, its fundamental role will be to

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<sup>343</sup> 'The sum of imports (always in its broadest sense) is first paid by an income formed in the country's domestic economy; it is the only payment that falls on residents. All external payments of imports are macroeconomic: it is the country as a whole that is subject to the obligation to pay R in foreign currencies' (ibid.: 43).

<sup>344</sup> 'The problem of external debt crisis cannot be saddled on importing residents, even if they are members of the public sector. This 'crisis' is macroeconomic, because it is only the country considered as a whole that is sometimes unable to pay part of its external debts' (ibid.: 44). It is this anomalous part of its external debt, that is, the very formation of its sovereign debt that today forms part of its total external debt that, the reform will endeavor to eliminate. 'One of the main functions of the reform is to avoid the very formation of sovereign debts, and prevent economies from 'running into a crisis'' (ibid.: 44).

<sup>345</sup> 'The difficulty of understanding the crucial distinction between microeconomic and macroeconomic payments is one of the reasons for the error in which the present theory of imports' payment finds itself. Economists believe that imports are paid between residents of the world, in exporting countries as well as in importing countries. This is totally wrong, because only importers and exporters are residents, importing and exporting countries are entirely distinct from their residents' (ibid.: 44). As Schmitt points out, given the fact that they are finally settled 'by importing *countries*, the external purchases of their residents are 'multiplied by 2'' (ibid.: 44). The reform he proposes will bring in changes to the payment-process of net imports that will rectify the anomaly that is currently associated with it.

<sup>346</sup> 'Basically, the only payment of imports that is justified is microeconomic' (ibid.: 44).

<sup>347</sup> 'Let us repeat that the macroeconomic payment occurs at the expense of the importing country, even though its residents have paid all of their purchases. Logical consistency dictates that the 'macro-payment' does not get added to the 'micro-payment', but becomes its simple translation. This result of paramount importance, which is absent from today's system, will be achieved by the reform' (ibid.: 44).

<sup>348</sup> 'It is not necessary to define the periods during which the Bureau will fulfil its functions. From the implementation of the reform onward, the Sovereign Bureau will be responsible for the factual logic of all external payments of its nation *for any period*' (ibid.: 43).

<sup>349</sup> 'The sum total of the reformed country's expenditures (imports) can be entrusted to the Bureau. It would therefore be unnecessarily complicated to retain only the payment of surplus imports. In pure theory, 'imports-exports' do not require the intervention of the Bureau. These expenditures of the domestic economy are also and equally what it receives; in other words, their sum is zero. They thereby escape from any faultiness. But it would be a heavy and unnecessary charge to ask the Bureau to find and note the difference between the country's

reduce payment transactions<sup>350</sup> relating to imports to the likes of ‘exchanges between residents’ (ibid.: 53). But the ‘Bureau’ will also take on other vitally significant functions that will undeniably revolutionize the current payment method of deficit countries’ net imports. The breakthrough of the reform will not only rein in the double charge of countries’ external debts, it will abolish them altogether. We will eventually elaborate on just how, exactly, it will manage to achieve this, but first we briefly recapitulate Schmitt’s claim *regarding the double charge itself*.

In a particularly concise, though none the less convincing, demonstration of the *double charge*, Schmitt points out that if we could come to understand that ‘imports-exports’ are *also doubly paid*<sup>351</sup>, we would then more clearly conceptualize the double payment of ‘imports-without-exports’. Again, we see the fundamental, even if subtle, idea behind his conceptual construct of the ‘Bureau’ whose underlying purport he emphasizes through this very demonstration.

His argument sets about by reminding that if inhabitants’ payment of their imports were actually carried out as though these external purchases were transacted amongst themselves, that is intra-nationally, they would thus be paid in only one currency: their own domestic currency. But just the fact that foreign exporters can exact payment in their own internal currency or, some other foreign currency, makes it that the deficit country, inevitably, will have to honor the payment in a currency other than its own<sup>352</sup>. And, as we have already pointed out, though this is achieved cost-free when ‘imports-exports’ are concerned, it is an altogether very different and costly matter when it concerns ‘imports-without-exports’<sup>353</sup>. The main reason being, as we have also already observed, is that net imports imply a net foreign borrowing and thus, a foreign income<sup>354</sup>. And this inevitably *sets the stage* for the double<sup>355</sup>

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imports according to whether they are or not of a greater value than its exports. It is much easier and faster to enter all imports at the moment they take place’ (ibid.: 53).

<sup>350</sup> ‘One of the rules of the reform is to neutralize in some way the international expenditures of the domestic economy such as to render imports akin to exchanges between residents’ (ibid.: 53).

<sup>351</sup> ‘Even the ‘imports-exports’ are paid twice; it is enough to understand why to clearly grasp the reason why the macroeconomic payment of net imports adds to their microeconomic payment’ (ibid.: 44).

<sup>352</sup> ‘A conversion is necessary. Yet, the conversion of the domestic deficit in foreign currencies is a cost free transaction only to the extent that the country balances its imports and its exports. Indeed, exports bring the foreign currency needed to pay for imports. Within ‘imports-exports’ the payment for external purchases is therefore simple’ (ibid.: 44).

<sup>353</sup> ‘Things are radically different in the case of ‘imports-without-exports’. This time the foreign currency gain is zero, because the export that would have provided it does not exist. The foreign currencies that are not earned must be purchased’ (ibid.: 44). But what is of even greater importance is the fact that this payment-purchase entails a *double* payment with an end all result that ‘the payment in foreign currency adds to the cost in domestic currency terms’ (ibid.: 44).

<sup>354</sup> In this sense, it should be mentioned that the argument being advocated here, applies even in the case of EMU countries (seemingly of a ‘unique’ currency) given that it is the mere implication of a net foreign borrowing involving a foreign income that consequently leads the situation into that of a *double* charge, incurred once at the microeconomic level and once again at the macro-level. This is in following with our claim that the Euro does not befit the role of *unique* Euro zone currency. Rossi reminds us of this searing fact: ‘Euroland countries still have heterogeneous currencies, although the latter all have the same denomination since they were encapsulated in the European Monetary Union (EMU). Certainly, EMU is a

charge that ensues and the consequential loss of part of the deficit country's domestic income. Schmitt's reform proposal will prevent this loss<sup>356</sup> through the very idea of having the 'Bureau' operate as a 'co-resident' alongside the deficit country's importers. In particular, the progressive difference that the reform will bring, in addition to the beneficial element of *co-residency* that the 'Bureau' will assure, is that the latter<sup>357</sup> and not the creditor country will primarily obtain the external payments of its residents. Essentially, we will see that the all encompassing role that the 'Bureau' will assume, will have the effect of neutralizing the *double charge* that inevitably results from the fact that a deficit country's imports, 'imports-exports' and 'imports-without-exports' alike, are paid by both a domestic and a foreign income. We now return to our synopsis of the functions of the 'Bureau', that is, to the basic idea behind it.

The 'Bureau' will fulfill a role of an accounting intermediary akin to that of an Exchequer, specifically managing the payment transactions of the country's importers and exporters. The reform will ensure that the country's 'Bureau' directly receive, *and not the international economy*, the entirety of its importers' domestic currency payments, that is all of the internal income that its inhabitants spend on imports. In turn, it will pay its exporters in domestic currency such that the left over difference relating to the internal payment of its residents' net imports will be its *net* profit, which gain it will pass over to its government<sup>358</sup>. Hence, unlike pre-reform, this internal income of the deficit country will be salvaged, rather than permanently lost to the international economy. And we remember that the reason for the loss was because it formed the very object<sup>359</sup> of the foreign borrowing that was sought by the deficit nation in order to obtain the foreign currency it required for the payment of its net imports. But the reform will change this so that this internal income remains with its domestic

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misnomer, since to date there is no currency union across the area' (Rossi 2012: 221). Thus, deficit countries of the Euro zone must, *in reality*, convert the domestic payment (e.g. Italian euro) of their net imports in a foreign currency (e.g. German euro), rather than pay with their own acknowledgment of debt. And, it is because this conversion is costly that they get *doubly* indebted.

<sup>355</sup> 'If the value of net imports is of 1 dollar, their total cost is of 2 dollars, importing residents pay half of it, equal to 1 dollar, while their country as a whole suffers the second debt, of 1 dollar more, purchase-price of this foreign currency' (ibid.: 44).

<sup>356</sup> 'The reform will make this abnormal loss of foreign currency units impossible. A simple measure will have that effect. It is enough to make the sovereign Bureau, 'co-resident' of the importers, the final beneficiary of the domestic currency spent by importers. The payment of imports will then be, as far as domestic incomes are concerned, exactly similar to the purchases among residents of the importing country' (ibid.: 45).

<sup>357</sup> Schmitt specifies just how the reform will change the payment of surplus imports. 'After the reform it is the domestic economy, represented by the Bureau, which will receive their payment in national currency' (ibid.: 45). He explains on how, today, this is clearly not the case: '[b]efore the reform, it is the external economy that receives the importers' payments in foreign currency' (ibid.: 45). He clarifies just why that is by his following emphasis. '*Before the reform the sum of domestic currency spent for surplus imports is the object of an external borrowing*' (ibid.: 45).

<sup>358</sup> '[T]he Bureau will receive any domestic income spent by the country's residents to pay for the sum of their imports, even compensated. Exports will be paid in national currency by the Bureau, which will therefore receive, as net gain, only the domestic payment of surplus imports. *This gain will be transferred to the State budget*' (ibid.: 45).

<sup>359</sup> '*Before the reform the sum of domestic currency spent for surplus imports is the object of an external borrowing*' (ibid.: 45).

economy, even if its ownership<sup>360</sup> will be acquired by the country's government, in following with the *transfer in* from the 'Bureau' who will re-direct to it, its *net gain* from the importers. This is the important difference that the reform will bring, in that the deficit nation will no longer be victimized<sup>361</sup> by an external debt that forms against it *whilst* the surplus country appropriates<sup>362</sup> part of its future output. Schmitt's reform plans will bring the answer to this problem through a counter-loan<sup>363</sup> of the 'Bureau': the latter will lend the entirety of the deficit country's own *foreign* loan such as to neutralize this very loan. The reform will comply with the identity of the balance-of payments in that the rest of the world, say country R, will obtain a portion of the deficit country's internal resources equal to that of its own output exported to the latter. The only difference, greatly beneficial at that, will be that the deficit country's *real* payment will no longer involve the appropriation, by the rest of the world, of part of its *future* production but will instead manifest through the cession of its *actual* resources ***in the form of financial securities***. In this way, the deficit nation will be able to salvage a part of its domestic income that, previously, it lost in the settlement of its net imports, on account of the double charge<sup>364</sup> that the payment of these imports, implied. Now the reform will also incorporate a repayment of debts from previous periods<sup>365</sup> such that it is inconceivable to expect that the rest of the world will incur a loss: past creditors will indeed be reimbursed. Simply put, the 'Bureau' will transfer an amount of the country's domestic *monetary* income<sup>366</sup> to its government *in addition to* the amount corresponding to the current period's net imports such that this net imports' amount is increased accordingly<sup>367</sup>.

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<sup>360</sup> 'The domestic income that is not absorbed by the payment of exports, that is, *z*' units of national currency, is the definitive property of the Government applying the reform without any compensation' (ibid.: 45).

<sup>361</sup> 'The 'anomaly' is manifest because the country whose imports exceed its exports suffers the increase of its external debts despite the fact that it provides R with the gain in domestic goods that it will produce in a subsequent period' (ibid.: 46).

<sup>362</sup> 'Now, the sum of income A that is spent by country A's national economy for the domestic payment of its surplus imports can still be appropriated by the rest of the world. This is precisely what has to be avoided. *For this, it is necessary and sufficient that the Bureau lends abroad, in foreign currency, the whole value of its country's net imports*' (ibid.: 56). Country 'A' is Schmitt's example-country, the deficit country A.

<sup>363</sup> 'This loan makes it entirely impossible for A's government to lose the property of the income A obtained from the domestic payment that finances economy A's surplus imports' (ibid.: 57). Here again, Schmitt's reference to 'A' is intent to mean the *deficit* example-country, A.

<sup>364</sup> In fact, '[t]he reform will reduce the external debts of these countries to zero' (ibid.: 47). That is, in neutralizing the deficit country's first loan/debt, R to A, (second period or, any subsequent period to the first period) *with a counter-loan* that will as well compensate A's second loan (R to A) of the period (given this second loan is the mere replacement of the first that has, after all, been neutralized), it will automatically do away with its *sovereign* loan and debt. It will then settle nevertheless the payment of its net imports, ultimately in money R, with a new foreign loan but which loan, *will this time be compensated*. '*External debts will form abroad towards foreign countries and no longer at the expense of the deficit country*' (ibid.: 46). We will explain in more details in a next section.

<sup>365</sup> '*The reform will radically alter the payment of previous debts*' (ibid.: 45).

<sup>366</sup> 'The rest of the world is not paid in the importing country's national currency. It is therefore certain that this currency remains available within the importing country' (ibid.: 45).

<sup>367</sup> 'If one applies the reform only to *new* external debts, the gain realized by the Budget is only one unit of domestic currency in each period. It is logical, on the contrary, to add each

This will enable the payment, in the current period, *as well of previous debts*. That is, the ‘Bureau’ will transfer (current period) to its government/Budget<sup>368</sup> an extra amount of domestic monetary incomes (4 MR<sup>369</sup>, for example), extra to the net imports of the current period (e.g., 1 MR), such as to incorporate the reimbursement of the country’s previous debts in the payment of net imports of the current period. Thus the new net imports amount increases to 5 MR and this is the amount that the ‘Bureau’ will transfer to its government/Budget as net gain (all current period).

### *More on the ‘Bureau’ and its essential functions*

*Presented broadly*<sup>370</sup>, Schmitt’s **single-country reform plan** aims at revoking the second<sup>371</sup> anomalous charge<sup>372</sup> of external debt for the reforming country. Just how it will endeavor to do this is where the chief role of the ‘Bureau’ comes into play. This internal ‘co-resident’ institutional department will be responsible for carrying out vital functions that will unravel the full impetus of the reform, in all its details. We next have a look at the reform’s principal lines and, the basic principles behind them.

The *prime objective of the reform* is to salvage the internal income that, today, is lost<sup>373</sup> by the deficit country through its net foreign borrowing. The ‘Bureau’ will play a central role in recuperating *as net gain* this domestic money<sup>374</sup> that, pre-reform, escapes nations which are encumbered with excess<sup>375</sup> imports: the loss being the result of a net borrowing from abroad.

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time the payment of previous debts to imports, which are therefore net for an amount of 5 units, and not merely 1 unit, of national monetary incomes’ (ibid.: 46). The ‘Budget’ hereby referenced by Schmitt, is intended to imply the deficit country’s government budget. ‘It thus results – and this is the correct solution – that the Budget gains 5 units of domestic incomes in each period, not just one unit’ (ibid.: 46). It should also be understood, for sake of clarity, that 4 MR (4 units of national monetary incomes value equivalency) is the assumed reimbursement amount of the country’s previous debts, which amount is added to the current period’s net imports of 1 MR (1 unit of national monetary incomes value equivalency), the Budget thus gaining 5 MR value worth of national monetary incomes; this, assuming that 1 unit of domestic currency is equivalent to 1MR.

<sup>368</sup> Our reference here to ‘Budget’ is in keeping with Schmitt’s (2014) own reference and which intends some particular department of the *reforming* country’s government that, for example, it would refer to as the/its Budget.

<sup>369</sup> Again, assuming that 4 MR is of equivalent value of 4 units of the deficit country’s domestic monetary incomes.

<sup>370</sup> ‘It remains that the reform’s endeavour is to cancel the second charge of external debts, a task that will be fulfilled only if the reform’s main lines are correctly proposed and applied’ (ibid.: 52).

<sup>371</sup> From the start, Schmitt is crystal clear in his emphasis that ‘[i]t is a matter of fighting against the double charge and not against imports as such’ (ibid.: 53).

<sup>372</sup> Specifically, ‘the second charge that would form because of the difference between the country’s imports and exports’ (ibid.: 53). That is, the second charge that anomalously ensues from a first charge related to this very difference. ‘[I]n the actual ‘non-system’ net imports are paid twice for the following reason: they are paid a first time in the country’s domestic currency and a second time in units of a foreign currency’ (ibid.: 53).

<sup>373</sup> Essentially, this loss is what contributes to the *double* charge.

<sup>374</sup> Schmitt clarifies his exact meaning, again with respect to his example-country, ‘A’: ‘[w]hen we speak of money A, as it is considered by the reform, we mean logically and

The *temporal intervention*<sup>376</sup> of the ‘Bureau’ will be characterized by a regular everyday coordination of its assigned tasks. In this way, it will ensure that any new country debt *will be captured and managed in the same period exactly* of its very formation. After all, the *raison d’être* of the ‘Bureau’ will be to prevent, *en avant*, the manifestation of the second pathological charge of external debts. Schmitt’s forward-moving way to achieve this is to primarily set up the reforming country’s system of external payments such that all of its internal economy’s foreign payments are processed *as though they were being transacted amongst national residents*<sup>377</sup>. This is where the ‘Bureau’ plays out its key role as sole and ultimate debtor representative on behalf<sup>378</sup> of its country residents. That is, it will be responsible for transforming<sup>379</sup> each and every payment of its internal economy, *destined abroad*, into a foreign payment over which the ‘Bureau’ will have sole debtor accountability towards the rest of the world, e.g. country R.

We should again mention, given its important relevance, that the entirety of the imports-expenditures of the reforming nation would be consigned to the ‘Bureau’. It would be too complex of a task to entrust it *only* with the payment of net imports<sup>380</sup>. Without a doubt, the

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uniquely the (domestic) *income* formed in money A. Considered as such, money is nothing other than a creation of banks, while income is produced by firms, which ‘manufacture’ real consumption and investment goods’ (ibid.: 54).

<sup>375</sup> ‘[S]urplus imports are net expenditures; the income in money A that is so ‘lost’ is not recovered’ (ibid.: 55). The reform will change just that: it will recover it.

<sup>376</sup> ‘The sovereign Bureau will look after, on a nearly daily basis, the external debit (imports) and credit (exports) payments of its country’s domestic economy. It would not be enough to obtain simple reports on the external debts incurred by its country, as released by the Bureau a mere few times a year. It is essential, on the contrary, that any new debt be seized in the very period it is formed’ (ibid.: 52).

<sup>377</sup> The principle behind this reform specificity relates to the ‘co-resident’ aspect of the ‘Bureau’: ‘Domestic payments to the credit of the rest of the world are carried out between residents, because the Bureau is itself part of its country’s residents’ (ibid.: 53). Moreover, concerning the external creditors themselves, Schmitt reassures that ‘[t]he domestic payments of the Bureau do not prevent payments of foreign creditors to be carried out at their full value. Put simply, it is the Bureau that carries out and obtains the payment of the transactions occurring between its country and the rest of the world’ (ibid.: 53–54).

<sup>378</sup> Our meaning is not to intend that the ‘Bureau’ will act as simple intermediate between the deficit and surplus country, say countries A and R, respectively. The reform would not bring marked changes if the ‘Bureau’ merely *transmitted* the external payments it was entrusted with. ‘The Bureau’s intermediation is not enough. Nothing changes if it simply passes on the payments it receives’ (ibid.: 54). Rather, we will see that not only is its role much more developed and complete in this regard, but that it will particularly guarantee that the internal (domestic) payments *in the deficit country’s own currency*, are strictly detached from foreign payments *in foreign money* (see *ibidem*).

<sup>379</sup> ‘It is enough to this effect that the Bureau transforms every domestic payment addressed abroad (by considering it its own) into an external payment of which the Bureau is itself personally the only debtor’ (ibid.: 53).

<sup>380</sup> To this regard, we remind the reader of Schmitt’s explanation, particularly in acknowledging that, ‘[i]n pure theory, ‘imports-exports’ do not require the intervention of the Bureau. These expenditures of the domestic economy are also and equally what it receives; in other words, their sum is zero. They thereby escape from any faultiness. But it would be a heavy and unnecessary charge to ask the Bureau to find and note the difference between the

reform is certain to progress successively if its steps, at least initially, are kept streamlined and effectively simplified.

Regarding the extent of the *intermediating intervention* of the 'Bureau', though we will further elaborate on the details of this, we will specify for the time being that it will actually annul<sup>381</sup> all external credits with respect to its internal economy's imports. In this sense, the 'Bureau' will point-blank inhibit its internal economy's net imports payment: the payment in domestic money will no more be the end toward obtaining an external loan. As regard the payment of its internal economy's exports, they will continue to be paid *in foreign currency* but with the difference that, following the reform, the conversion<sup>382</sup> to the deficit country's domestic currency will be handled directly by the 'Bureau'. In sum, the new external payment procedure of the reforming country would be organized such that with respect to its exporters, the 'Bureau' would be their sole debtor and their very claims would be specified in their own domestic currency; with respect to its importers, the 'Bureau' would be their sole creditor and their debts would be specified, as well, in their own domestic currency (see *ibidem*).

Now on returning to the reform's *prime objective* of salvaging the domestic income that, today, the deficit country loses *through its net foreign borrowing from surplus country R* to cover its net imports, the function<sup>383</sup> of the reforming country's 'Bureau' will be to **counter** the negative consequence of this loss. It will do this by capturing, itself, its country's domestic income that would otherwise be *spent* towards the surplus imports. Moreover, it will acquire it as a *net and final gain* (see *ibidem*). And legitimately so, given that the reform will guarantee that the *real* payment of the deficit country's net imports no longer involves a *future* production of its national resources but rather the immediate (current period) cession of part of its *actual* resources<sup>384</sup> (equivalent value of its net imports) *in the form of financial*

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country's imports according to whether they are or not of a greater value than its exports. It is much easier and faster to enter all imports at the moment they take place' (*ibid.*: 53).

<sup>381</sup> 'Nothing changes if it simply passes on the payments it receives. It is necessary and essential that the Bureau first cancels all foreign credits for its domestic economy's imports. It is not enough to *replace* the domestic payment; on the contrary it is necessary to *suppress* it entirely. Henceforth, from the reform onward, foreign purchases of country A's residents will be zero credits of R' (*ibid.*: 54).

<sup>382</sup> 'It is true that country A's exports will be paid, even after the reform, in money R. But the conversion of this payment into money A will no longer concern the rest of the world; on the contrary it will be carried out by the Bureau as if it was itself the national economy's exporter' (*ibid.*: 54). We reiterate that Schmitt intends some deficit country 'A' by his reference to 'country A'; as well, 'money A' refers to the domestic currency of the deficit country (A). The foreign currency is that of the rest of the world, e.g. country R, and is referred to as 'money R'.

<sup>383</sup> Specifically, it will aim 'to avoid that the monetary income spent for net imports be 'captured' by R to the detriment of A's national economy. The sovereign Bureau, which obtains and spends all the sums of income in money A defining country A's exports and imports, spends the equivalent of 10 dollars for the exporters and includes in its net income the sum of 1 dollar (in MA)' (*ibid.*: 55). Again, the case-scenario is that of deficit 'country A, whose net imports are of 1-dollar value each month' (*ibid.*: 53); the total of its imports amounting to 11 dollars, the value of its exports being 10 dollars. 'Its residents-importers spend 11 dollars, a sum that is thereby unavailable for the purchase of national output. It is replaced to the extent that there are exports; their value is assumed to be 10 dollars' (*ibid.*: 55).

<sup>384</sup> It is through the counter-loan of the 'Bureau' that the deficit/reforming country (A) pays its net imports (of the previous period), in each period; in so doing, country A gives R

*securities*. And indeed, the payment of external creditors is not in the least compromised as a result of the net profit of the ‘Bureau’, it will rather be executed *in full*. We will re-visit this accomplishment more elaborately as we continue our discussion on the role of the ‘Bureau’ and its vital functions. But let us simply mention that on account of the fact that the gain of the ‘Bureau’ is net and final, it will thus transfer this net profit over to its nation’s government<sup>385</sup>. Again, it is all about the idea of maintaining the deficit country’s domestic income *intact*<sup>386</sup> rather than losing a part of it, equivalent portion to its net imports, to the benefit of the surplus country *in a net foreign borrowing*. Schmitt’s reform aims at recovering this loss by setting up the reforming country’s imports payments such that they *do* occur amongst its residents. The reform accomplishes this through its simple yet effective measure of making the ‘Bureau’ ‘co-resident’ to the country’s importers and, ‘final beneficiary of the domestic currency spent by importers. The payment of imports will then be, as far as domestic incomes are concerned, exactly similar to the purchases among residents of the importing country’ (ibid.: 45). Schmitt reminds us that though this is an abnormal and unnecessary loss that does not occur with regard to ‘imports-exports’, it definitely manifests when it comes to ‘imports-without-exports’. This is the problem that needs to be rectified<sup>387</sup>, moreover the very reason why the profit of the ‘Bureau’ must be *net* (final) rather than with ‘counterpart’ (ibidem) as it would be were it to only transfer over, *as mere intermediate*, the payments it received.

This brings us to a crucial question<sup>388</sup> that Schmitt not only raises but as well proceeds to address in his explanation of how the ‘mechanics’ of the reform will operate in order to achieve its mission. It concerns, exactly, this net foreign loan that the deficit country resorts to, in order to cover the payment of its ‘imports-without-exports’. The way that this loan is today carried out, it inevitably leads to the surplus country’s *appropriation* of the deficit nation’s domestic income. Schmitt’s reform plan will ingeniously prevent this from

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(surplus country) part (equivalent MR value of its net imports) of its domestic resources (actual rather than future); this is the reason why the domestic income spent in excess by A’s residents is thus legitimately earned by A’s ‘Bureau’, in each period.

<sup>385</sup> In Schmitt’s case-example, the government being that of some deficit country ‘A’ which he sometimes refers to simply as ‘country A’s budget’. ‘In our example, country A’s budget obtains without any counterpart the equivalent of 1 dollar in the period considered. The government’s net gain, that is its profit, is of *n* dollars (in MA) if, in the periods concerned, country A’s net purchases (imports) are of *n* dollars’ (ibid.: 55).

<sup>386</sup> Specifically, that part of it that is spent towards the payment of its net imports ‘has to remain the domestic economy’s property’ (ibid.: 56). Schmitt refers to this point as a ‘*practical consequence*’ of the reform, that is, the fact that ‘*the domestic income of the deficit country is unchanged*’ (ibid.: 59).

<sup>387</sup> ‘[T]he solution consists in preventing the deficit country’s domestic income to be ‘gained’, even in part, by the rest of the world. This is a loss that is naturally impossible to the very extent of ‘imports-exports’, but the payment in domestic currency of net imports must be reformed; the income spent to this effect has to remain the domestic economy’s property. The desirable result is reached as soon as the domestic income spent for the payment of net imports remains the property of the deficit country itself, as if purchases (imports) were carried out between residents. The Bureau must thereby be credited with a net gain and not as a result of a simple intermediation’ (ibid.: 56).

<sup>388</sup> ‘A difficulty remains: how to be sure that foreign loans will not take possession, as is necessarily the case before the reform, of the gain in incomes A that the Bureau is supposed to transfer to the deficit country’s government’ (ibid.: 55)? His reference to ‘incomes A’ are that of the deficit country, namely A.

happening through a most notable function of the 'Bureau' who will *counter-loan*<sup>389</sup> the entirety of its own foreign currency loan of MR value of its surplus imports (*whilst maintaining*<sup>390</sup> *the very loan*), that it obtained from country R's lenders. That is, the 'Bureau' will *in turn* lend the total sum of it to R. Specifically, to distinct residents (borrowers) of R. Understandably, it might seem odd that the deficit country would borrow abroad the sum of its net imports only to then turn around and lend the entirety of this foreign sum, moreover to the original lending country, surplus country R. But the principle behind this reverse and automatic loan is its very effect<sup>391</sup>: to salvage the internal income that would otherwise be lost through the deficit country's *net* foreign borrowing for payment of its net imports. That is, if we stay abreast of the reality that it is through this net foreign borrowing (R to A) that the deficit country loses a part of its *future* output (equivalent portion to its net imports of the current period) to the benefit of surplus country R. *In fact this is how the internal income* (in the form of a payment *in its own domestic currency* of its net imports: issue of IOUs) *of the deficit country inevitably finds itself under the proprietorship of the surplus lending*

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<sup>389</sup> 'Now, the sum of income A that is spent by country A's national economy for the domestic payment of its surplus imports can still be appropriated by the rest of the world. This is precisely what has to be avoided. *For this, it is necessary and sufficient that the Bureau lends abroad, in foreign currency, the whole of its country's net imports*' (ibid.: 56).

<sup>390</sup> 'It would be pointless to directly discard the external loan of 1 dollar that country A obtains for its net imports of this value. We would simply go back to the starting position without a change. We thus maintain the loan as it stood before the reform. But the sovereign Bureau adds, as we have already established, a reverse loan. We thus have the coexistence of two equal-size financial transactions, which 'contradict' one another: the loan of 1 dollar granted by R to A is offset by the loan of 1 dollar granted by A's Bureau to non-residents. It is understood that borrowers and lenders in the economy of R are distinct residents' (ibid.: 62). Again, the reference to 'A' and 'R' intend the deficit country A and surplus country R, respectively. However, and matter-of-factly, the reform will effectively secure (same period as their formation) the *real* payment of the deficit country's net imports through the fruition (all same period) of the balance-of-payments identity between its *real* imports and *real* exports, (IM and EX). In effect then, this will render the deficit country (country A) deficit-free. That is, through the guarantee (same period) of the balance-of-payments identity, country A's *real* imports thus being effectively fully covered by its *real* exports, it will no longer be considered a deficit country, per se.

<sup>391</sup> 'If country A were satisfied to borrow foreign currencies abroad, it would certainly not become the owner of the equivalent in domestic money of the value of its net imports, to the benefit of its Bureau and then of its government. The loan of 1 dollar to the benefit of R has no other aim than to make sure of the gain in a domestic income of A of the equivalent of 1 dollar, measure of economy A's net international expenditures, by the deficit country. It is therefore not a matter of preventing the foreign loan of 1 dollar that country A could not avoid but to 'add', negatively, the loan of 1 dollar to R' (ibid.: 57). Schmitt reiterates the essential aim of this latter loan, from country A to surplus country R. 'This loan makes it entirely impossible for A's government to lose the property of the income A obtained from the domestic payment that finances economy A's surplus imports' (ibid.: 57). This is because, by effectively neutralizing its own foreign loan from R (through counter-loan A to R), the 'Bureau' succeeds in nullifying the *extra* sovereign debt (second foreign loan effect) which debt resulted, pre-reform, in the double charge. Today, very unfortunately, deficit country A's 'government is deprived of the profit in money A that should result from the domestic expenditure of the income A that finances the surplus import of the period considered' (ibid.: 57).

country<sup>392</sup>. We will see that the reform will change that, very simply, through the counter-credit that the ‘Bureau’ will grant to country R.

Let us step back and recall the reason for which a deficit country’s surplus imports are doubly paid, in our current ‘system’ of international payments<sup>393</sup>. Put simply, they are first paid in the deficit nation’s own domestic money and a second time around, in foreign money given foreign exporters expect to be paid in their own domestic currency (money R). The very problem with this situation is that it comes about at a net loss for the deficit nation (e.g. country A) whilst, at the benefit of the surplus country (e.g. country R). Through a loan<sup>394</sup> that it grants to the deficit nation A, country R literally gains ownership of a part of A’s domestic income (equivalent value of A’s net imports) that will be spent towards the payment of future goods that nation A will produce and export in a subsequent period. And as we know, this carries a dire consequence for the deficit nation in that this domestic income that its importers spend to meet the payment of its net imports is never recovered, it is forever lost and this, for the deficit nation *as a whole*. But nevertheless, this loan of foreign currency is indispensable for the deficit nation who requires it for the final settlement<sup>395</sup> in money R of its ‘imports-without-exports’. Still, the blatant fact remains: whatever foreign currency it does not acquire (automatically and freely) from its exports sales (‘imports-exports’), it must *purchase* it and, at a double<sup>396</sup> cost at that. The result is that of an *internal savings* for the lending country R that, undoubtedly, comes at an extra pathological cost for the borrowing country (A), hence, the very malaise of the financial bubble. The deficit country definitely and permanently loses ownership<sup>397</sup> of part of its domestic income in having to purchase, outright, the foreign

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<sup>392</sup> ‘[A]s a consequence of the loan of 1 dollar granted by R to country A, country R becomes the owner of real goods of 1-dollar value that economy A will produce in the future. It thus immediately follows that the domestic payment, in money A, carried out by the residents-importers becomes the property of the rest of the world with respect to country A. In real goods terms, country A loses ownership of a future good of its economy; in monetary income terms, country A loses the right to an equivalent sum in money A’ (ibid.: 57).

<sup>393</sup> ‘[I]n the actual ‘non-system’ net imports are paid twice for the following reason: they are paid a first time in the country’s domestic currency and second time in units of a foreign currency’ (ibid.: 53).

<sup>394</sup> ‘The payment of the net import in an income A would be definitely impossible. This is so because foreign sellers require to be paid in money R. The payment in money A occurs nonetheless, but the income A spent by importers is the monetary object of the loan granted by R, which will spend this sum of income A, equivalent to 1 dollar, to pay for the real goods produced in a future period and exported by A’s economy’ (ibid.: 59).

<sup>395</sup> ‘The two payments involved are clearly defined: even though it is a question of the payment of non-residents, A’s domestic economy carries it out using part of its national income, and therefore in money A, whereas, through its change in money R, the same imports are settled through the expenditure of a foreign income from the moment they are defined to the debit of country A, considered as a whole’ (ibid.: 58).

<sup>396</sup> ‘[E]xport-surplus countries obtain two times the payment of their net exports, first to the credit of their lenders, then, a second time, to the benefit of a ‘financial bubble’ (ibid.: 56). Schmitt elaborates his meaning, again through his example-countries, A and R, respectively: ‘income A spent for the domestic payment of surplus imports becomes the property of R’s economy. The loan of 1 dollar by non-residents has two effects ... It means the appropriation of a revenue A, equivalent to 1 dollar, by R ... This sum of income A will be spent toward the future export of a product of economy A’ (ibid.: 58).

<sup>397</sup> ‘Undeniably, therefore, there arises the problem of the acquisition of country A’s domestic income that its economy spends for the payment in national currency of its ‘imports-without-

currency it requires in order to cover its imports that are not covered by exports-revenues. And, the irrevocable loss of its domestic income is what amounts to the double charge with regard to its net imports<sup>398</sup>. The deficit country ends up paying for the latter both in real (payment in its domestic currency) as well as in money terms (payment in a foreign currency). Now, let us see how the single-country application of Schmitt's reform would unequivocally curtail the loss of this domestic income for the reforming country. The 'Bureau' will play an active role in facilitating the desired result; we could even say, in pun, it will *lend a hand*. In the strict sense, it will be responsible for carrying out<sup>399</sup> a counter-credit **loan** to the surplus country R, (the entirety of its own foreign loan obtained from R), destined to distinct residents of R, that is, to borrowers distinct from R's original lenders to A. In so doing, the 'Bureau' will neutralize<sup>400</sup> the deficit country's own external loan ('ordinary' loan and debt<sup>401</sup>) from R and consequently nullify the *double* charge of its net imports payment by avoiding the very formation of a *sovereign* debt<sup>402</sup>. More explicitly, the net<sup>403</sup> foreign borrowing (pre-reform)

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exports'. Who exactly is the new owner of the sum of 1 dollar spent by importers in addition to their foreign purchases balanced by economy A's exports of the same period? We have just acknowledged that this income A is not obtained by anybody within economy A, which does not export anything in the face of its net imports. It is also certain that foreign exporters obtain only an income formed in money R. There only remain the lenders of funds, non-residents of A's economy' (ibid.: 58). Again, Schmitt is clear regard the ultimate outcome: 'income A spent for the domestic payment of surplus imports becomes the property of R's economy' (ibid.: 58).

<sup>398</sup> 'The second cost of the difference between expenditures and receipts is therefore entirely defined by the loss of ownership over the amount of income formed in money A' (ibid.: 77).

<sup>399</sup> 'There is a possible move, but only one, which avoids the loss of income A spent by the domestic economy for the payment of surplus imports of 1-dollar value: that the country, mechanically, lends 1 dollar on the financial market of the rest of the world' (ibid.: 59).

<sup>400</sup> 'The deficit country thus obtains, in financial assets, an external credit of 1 dollar that compensates exactly the debt of 1 dollar formed by the foreign borrowing of this sum' (ibid.: 59).

<sup>401</sup> That is, as this first loan R to A of any subsequent period to P<sub>1</sub> (reform), is referred to by Schmitt (pre-reform).

<sup>402</sup> The counter-loan of the 'Bureau' has the *double* effect of neutralizing A's first foreign borrowing (R to A) as well as compensating A's second loan (same period) that it needs to recover the entirety of its export revenues (money R), part of which it used to reimburse its debt of the previous period. It is this *double* effect that ultimately avoids the very formation of a sovereign debt, for A.

<sup>403</sup> The reform even ensures that it is no longer a *net* foreign borrowing, rather this loan that subsists will effectively be compensated through the domestic income (equivalent value in money R of reforming country's net imports) that the 'Bureau' will receive directly from its country's importers, in each period. '[A]n equal credit ... is collected by the country' (ibid.: 94). Now it is important to understand that this loan/debt that subsists in each period relates to the debt initially incurred in period 1 and which debt is reimbursed and renewed in period 2 and in each successive period thereafter. And, even if it is said that it is compensated by the net gain (domestic income, equivalent MR of A's net imports) of the 'Bureau', it should be understood that it is not on account of the fact that it is so compensated that A's external debt is zero: A's external debt would be zero (asymptotically) even if its 'Bureau' did not obtain any net internal gain. Rather the mention/argument relating to the fact that this loan which subsists in each period is compensated by the gain of the 'Bureau' is merely to show that,

reduces to one loan versus two (pre-reform) if we remember nevertheless that the payment of its net imports, in foreign money R, is still outstanding and requires yet another foreign loan. But, the ‘Bureau’ having neutralized the first loan outright, the ‘second’<sup>404</sup> is now the mere replacement of the first. That is, rather than a *sovereign* loan, as it would be were it to arise and subsist as a *second* pathological loan considered to be situated at the level of the country *as a whole* and moreover *cumulative in time*. Specifically, by reducing the foreign borrowing to a single remaining loan, the second *sovereign* loan (as referred to pre-reform) and its associated debt is obliterated and with it, the double charge<sup>405</sup>. What remains, in each period subsequent to the *first* period, is a mere subsisting loan<sup>406</sup> that is compensated<sup>407</sup>. ‘The existence of only compensated debts of countries, as set of their residents, will be established by the reform’ (ibid.: 96).

The result of the intervention of the ‘Bureau’ with respect to its counter-credit loan and domestic income (equivalent MR value of net imports) retrieval is twofold. On the one part, net imports will be paid solely<sup>408</sup> in foreign money R, through the subsisting loan that the reforming country obtains from R to settle, in money R, its surplus imports of the period. On the other part, the reforming country’s internal income that its importers spend towards the net imports payment to the ‘Bureau’, in domestic currency (equivalent MR), is decidedly

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even if each single period is considered separately, A’s external indebtedness is perfectly balanced.

<sup>404</sup> It should be noted that in fact, in subsequent periods to P<sub>1</sub>, the ‘Bureau’ borrows from R *three* times (whilst counter-lending to R once only) such that depending on the analytic approach, this ‘second’ loan hereby referenced (mere replacement of the first loan of the period, e.g. P<sub>2</sub>) could intend the loan (R to A) that A obtains from R (same period) to recover the entire amount of MR (money R) deriving from its total exports to R (same period), which MR country A partially used to reimburse the debt formed in the previous period, e.g. P<sub>1</sub>. This being the case, the only remaining debt of A at the end of the period e.g. P<sub>2</sub>, would be the one incurred as a result of the third loan that A requires to cover the *monetary* cost of the net imports of the period, e.g. P<sub>2</sub>. Now this loan/debt, which nevertheless manifests as an external debt of the deficit/reforming country, does not increase in time and is thus asymptotically nil. Moreover the loan is *compensated* (see explanation in above footnote), as opposed to being *net*. ‘External debts will form abroad towards foreign countries and no longer at the expense of the deficit country’ (ibid.: 46).

<sup>405</sup> That is, considering (as previously mentioned) the *double* effect of the counter-loan of the ‘Bureau’ in that it compensates two loans of R to A.

<sup>406</sup> This is essentially the third loan that A borrows from R in order to cover, ultimately, its net imports in money R.

<sup>407</sup> Again, the reader should heed our explanation regard our meaning in that the fact that it is compensated is not what reduces A’s external debt to zero, which result is rather accomplished by the counter-loan of the ‘Bureau’ (A to R) that enables A to pay the totality of its net imports; in an elaboration based on the succession of periods, solely the loan obtained by A in the *first* period has a **cost**. In all other subsequent periods, the said loan is renewed but so is the reimbursement of the previous one, such that A’s external debt remains equal to 1 MR (on condition that its new net imports also remain constant). Still, this **cost** is reduced to zero (asymptotically) because when subdivided on a greater number of periods, this very cost tends (asymptotically) to zero.

<sup>408</sup> That is, rather than ‘being paid both by a domestic income and by a foreign loan, surplus imports are paid abroad only by R itself, which lends the necessary sum of money R to the deficit country’ (ibid.: 59).

salvaged<sup>409</sup>. The reform ensures that the surplus country receives singly the equivalence of country A's (reforming country) net imports expenditure, in R's currency. It becomes clearer as to where this is all headed for, that is, in regard to the reform's impact. The intervention of the 'Bureau' is undeniably all-inclusive in its endeavors to rectify the anomaly of the double charge of external debts for the reforming countries. More so, it succeeds in nullifying them, utterly<sup>410</sup>. Through its counter-loan to R, it not only manages to half its foreign borrowing to *one* subsisting loan, from *two* pre-reform (essentially reducing the *double* charge) but moreover, it ensures that it is *compensated*<sup>411</sup>. This simply means that the deficit country's external debts are effectively balanced<sup>412</sup>, that is, till they reproduce in a next period<sup>413</sup>. In sum, the combination of circumstances<sup>414</sup> that result from the intervention of the 'Bureau' have it that the latter manages to keep *intact* the internal income of the reforming country by retaining proprietorship over its entirety and furthermore a part of it, equivalent to its net imports value (MR), *is transferred as net gain to the country's government*. As well, the reform accounts for the principal of external debts payment<sup>415</sup> to be incorporated as part and parcel of the deficit nation's imports-purchases such that in each period, the totality of the net imports amount will include this payment. Accordingly, the net gain that will be transmitted to the country's government by the 'Bureau' will also reflect the incorporation of this payment in the net imports amount exactly transferred. But how does the reform affect

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<sup>409</sup> 'The fact remains that 'imports-without-exports' are first settled by a domestic income. Country A's importers spend, for the equivalent of 1 dollar, an income formed by their national economy. What is entirely new is essential: the income A thus spent remains the property of country A, the rest of the world obtaining only the equivalent of this sum, in money R. The sovereign Bureau obtains free of cost 1 unit of income A, a profit that it transfers directly to its country's budget' (ibid.: 59).

<sup>410</sup> 'The reform will reduce the external debts of these countries to zero' (ibid.: 47).

<sup>411</sup> 'Country A gets effectively indebted for 4 dollars to the rest of the world, but an equal credit, equivalent in dollars of the domestic income spent for net imports, is collected by the country whose net debt does therefore not increase' (ibid.: 94). The reference to country 'A' intends the deficit/reforming country whose net imports amount to 4 dollars (for example) for the period in question.

<sup>412</sup> 'Let us now complete the description of the financial Bureau's essential function, which consists in immediately cancelling the very formation of the (external) debt of deficit countries. To do this, it is enough that the Bureau credits the government of its country of the whole domestic income, formed in national currency, and spent for the payment of the 'expenditures-without-receipts'. Suddenly all the country's debt will be redeemed by this gain and countries' net external debts will be a thing of the past' (ibid.: 95).

<sup>413</sup> Our meaning being, if we remember Schmitt's clarification regard the formation of external debts: 'external debts are formed only by surplus imports' (ibid.: 42).

<sup>414</sup> 'The situation created by the sovereign Bureau is twofold ... The deficit country remains the owner of the totality of its domestic income, as if its imports were not in surplus ... The government of country A obtains, as a final profit, the total value, in a domestic income, of the surplus imports' (ibid.: 60).

<sup>415</sup> Schmitt provides an example of the workings of this advantageous feature of the reform. '[T]he payment of the principal of external debts is part of countries' purchases (imports). If the payment of the principal of country A's external debts is of 2 dollars...in the period under consideration, the total surplus of imports over exports is finally of 3 dollars. The profit of the government's budget is then of 3 dollars value taken out of a domestic product of a total value of 80 dollars' (ibid.: 60). His example assumes net imports to be of 1-dollar initial value.

country R (surplus nation) with respect to ensuring that it is duly paid its surplus exports? Let us next examine the situation from *its* perspective.

We will see that the reform actually guarantees its positive payment<sup>416</sup> and this, in the exact period in which the surplus exports manifest. One way to comprehend this is to first understand that what the reform does for the *deficit* country is to cover the *real* cost<sup>417</sup> of the *real* payment of its net imports *such that it guarantees this real payment* whilst it neutralizes the *monetary* cost of the *real* payment<sup>418</sup> (of its net imports) so as to annul the *double* charge. It curtails this double charge by enabling the deficit country *to avoid having to pay* its net imports both in ‘*substance*’<sup>419</sup> and in ‘*form*’<sup>420</sup>; it will do this by neutralizing the *monetary* cost of the *real* payment for the deficit country<sup>421</sup>. Now though the *monetary* cost of the *real* payment is neutralized by the counter-credit loan of the ‘Bureau’, it is not to say that the *real* payment of the net imports is omitted, rather the counter loan guarantees it by covering its

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<sup>416</sup> Schmitt sets up the details of his example-demonstration, which example shows that the reform actually ascertains the credit protection of surplus countries. ‘Let us consider again the analysis of countries A and R. Country A’s ‘deficit’ is of 1 dollar. Before the reform, A contracts an external debt of 1 dollar to cover its deficit. The sovereign Bureau’s action, on the contrary, will assure that country A’s external debt will increase by 0 dollars. At this point what is of interest to us is not country A, but country R. Will it be injured by the cancellation of the deficit country’s external debt? Quite to the contrary, country R is *fully paid* in the very period in which it is in surplus’ (ibid.: 61).

<sup>417</sup> In reality, the reform ensures that it covers (moreover, in the same period that the cost is incurred) this *real* cost if we consider that A does indeed pay this *real* cost through its *real* exports (effectively reducing A’s *net* imports to zero); moreover, what the reform brings is that it allows A to convey its *real* payment at zero cost. This result is specifically achieved by the counter-loan (A to R) of the ‘Bureau’.

<sup>418</sup> Specifically, it neutralizes the *monetary* cost of its *real* payment whilst guaranteeing its very *real* payment; in other words, it is not the *real* payment that it avoids, but rather its associated *monetary* cost: the counter-credit loan that the ‘Bureau’ will lend to R will neutralize that cost, which cost is essentially the ‘*form*’ (ibid.: 64) aspect (monetary payment in foreign currency) of the *real* payment; this development in itself will curtail the double charge of net imports. (See ibidem: 59, 64). The deficit country will retain only the *monetary* payment of its net imports in each period but the reform will reduce the cost of this payment to zero (asymptotically). ‘Instead of being paid both by a domestic income and by a foreign loan, surplus imports are paid abroad only by R itself, which lends the necessary sum of money R to the deficit country’ (ibid.: 59).

<sup>419</sup> Schmitt’s meaning regard the ‘*substance*’ of net imports payment: ‘[s]ince the deficit country imports what it does not export (in value), it does not have all the goods that it produces at its disposal. Finally, it imports what it loses (always in value terms). Country A has a foreign good of 1-dollar value and pays it through an equal ‘export-without-import’ (ibid.:64).

<sup>420</sup> Schmitt distinguishes the ‘*substance*’ aspect of the net imports payment from that of its ‘*form*’: ‘[t]his payment is positive in foreign currency and not in units of domestic money; to this effect country A spends dollars and not money A’ (ibid.: 64). Thus the ‘*form*’ aspect being the payment in the surplus country’s currency, money R (dollars), the ‘*substance*’ aspect being the payment in the deficit country A’s domestic income (money A).

<sup>421</sup> What the reform succeeds in doing (through the counter-loan of the ‘Bureau’) is to ensure that the ‘*form*’ aspect of the payment of net imports (*monetary* cost of their *real* payment) is neutralized and that only its ‘*substance*’ aspect (*real* cost of their *real* payment) remains. (See ibidem: 64).

*real cost* and, in the actual period in which the deficit arises (net imports); this means that the surplus country (R), is effectively paid *in full*<sup>422</sup> and, in the same period that its surplus originates. What explains this is the very outcome of the counter-credit loan of the ‘Bureau’ which loan has the effect of paying<sup>423</sup> a same value (MR) amount of the surplus country’s own imports<sup>424</sup>. In effect, what transpires is that the initial<sup>425</sup> credit-loan that the deficit country (A) obtains from the surplus country (R) in exchange for its financial securities, ‘serves’ as the foreign payment of its surplus imports whilst the loan in reverse of the ‘Bureau’ pays for an equal portion of R’s imports<sup>426</sup>. Moreover, what ensues from these two counter-balancing loans is that each country’s respective indebtedness (A’s and R’s) towards one another, cancels out<sup>427</sup>. Thus, not only does the counter-credit loan of the ‘Bureau’ guarantee the *real* payment of the deficit country’s net imports, it also, at the same time, neutralizes its cost. The only cost remaining and subsisting in each period and this period after period is the payment in money R, for which the deficit country will require another loan of same amount, in order to finally settle the payment of its net imports in foreign currency. It becomes obvious that, already, the reform has served to avoid the *double charge*<sup>428</sup> of these surplus imports, for the deficit country. Furthermore, it has achieved this without causing country R (surplus country) having to ‘suffer any loss of real income’ (ibid.: 62); the latter is

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<sup>422</sup> ‘[T]he credit of 1 dollar granted by the Bureau to non-residents consists, for R, in the external payment of an equal part of its own imports, exactly ‘symmetrical’ to the imports of A paid by the rest of the world’ (ibid.: 61).

<sup>423</sup> ‘In products of the period considered, country R imports real goods of 10 dollars value. Part of these purchases, a fraction of 1-dollar value, is paid by the Bureau of country A, which lends an income of this value to country R. This is an income R, object of the (first) loan granted by country R to country A’ (ibid.: 61).

<sup>424</sup> ‘Country R imports real assets equivalent to 10 dollars but it pays them only to the extent of 9 dollars, the difference being settled by economy A, of whom a product equal to 1 dollar is lent by the Bureau A to non-residents’ (ibid.: 61).

<sup>425</sup> More explicitly, in Schmitt’s own words: ‘country R obtains an external credit of 1 dollar. This is precisely the foreign credit of country A. Apart from the transfer created by the Bureau, this initial credit of country A is the external payment of its net imports’ (ibid.: 61). It is important to retain that nonetheless, the end all effect (*real* payment of A’s surplus imports) manifests *on account* of the counter-loan (A to R) of the ‘Bureau’ hence our referral to ‘serves’ *entre guillemets*. That is, the fact remains that the *real* payment of A’s net imports, is made through this counter-loan granted to R by the ‘Bureau’. If the payment of A’s net imports were actually financed, simply, through the initial loan from R, nothing would change with respect to the present situation.

<sup>426</sup> ‘[T]he credit obtained by R has exactly the same effect in the opposite direction: being of an external origin it brings to this country the payment of an import of equal value. This means that R’s imports of 1-dollar value are paid by country A and not by country R’ (ibid.: 61).

<sup>427</sup> ‘R owes A exactly what A owes R. As a consequence, if country R does not get indebted to country A, it is logical and perfectly correct and just that country A does not get indebted to country R’ (ibid.: 61).

<sup>428</sup> ‘The domestic economy pays its deficit by giving up real funds, in that it provides the rest of the world with the gain and possession of a part, equal to the external deficit, of its national product. If this expenditure of the domestic economy must be paid at an additional cost, in foreign currency while it has already been paid in national money, the ‘multiplication by 2’ of the country’s external debt is unavoidable’ (ibid.: 64).

duly paid, in full and, in the same period in which its surplus occurs<sup>429</sup>. In fact, the progressive step that the reform brings, through the counter-credit loan of the ‘Bureau’, is that it not only ensures, in each period and for each of the transacting countries (countries A and R), that the level of their respective imports and exports is equalized, *in terms of value*<sup>430</sup>, but more so it obtains the balance-of-payments identity<sup>431</sup> between IM and EX in a way akin to how it happens for countries’ ‘imports-exports’; for the deficit country this particularly means that the identity is guaranteed *cost-free*<sup>432</sup>, that is, by avoiding a *net* foreign borrowing<sup>433</sup>

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<sup>429</sup> The counter-credit loan of the ‘Bureau’ to R is what ensures this in that this very credit is the foreign payment of a portion of R’s *own* imports, a same amount as credited by R through its initial loan to deficit country A, for the external payment of its net imports.

<sup>430</sup> ‘This function of country A’s Bureau enables in every period the general conservation of each country’s imports at the level of its exports. According to the reform, even the deficit countries will import, in value terms, an amount exactly equal to their exports. Although its imports reach the value of 11 dollars, apparently 1 dollar greater than its exports, economy A imports a real income whose value is of 10 dollars only, at the same level as its exports. It is the loan of 1 dollar that the sovereign Bureau grants to residents of economy R that produces this outcome’ (ibid.: 62). The references to ‘economy A’ and ‘economy R’ intend the deficit country A and surplus country R, respectively. As regard country R, ‘[i]t actually imports goods worth only 10 dollars, its exports being equal to 11 dollars. But this gain is entirely compensated by the debit of 1 dollar defined by the loan of A’s sovereign Bureau. Given this debit, economy R is only credited with 10 dollars from abroad, the value exactly equal to the sum of its own imports’ (ibid.: 62).

<sup>431</sup> ‘Applied to countries, this means that a country’s imports are necessarily equal to, and simultaneous with, its exports, and vice versa. Thus, when a country is a net commercial exporter it is also a net importer of financial bonds, while a country whose trade balance is in deficit is at the same time a net seller on the financial market’ (Cencini and Citraro 2012: 267).

<sup>432</sup> ‘The reform creates, for surplus imports, what already exists for offset imports, namely, the gratuitousness of the foreign currencies, which only serve to convert the payments already carried out in national currency. By giving up part of its domestic product, the deficit country pays off R through the expenditure of a sum of foreign currencies. Through the counter-balancing debt, incurred by R as a result of the loan granted by the Bureau, the sum of gains in foreign currency is equal to the sum of its losses despite the fact that imports exceed exports. The equality between losses and gains means that the foreign currency that provides the final form to the payment of net imports is for *free* for the reformed country, as is the foreign currency used for the payment of offset imports’ (ibid.: 65). In effect, in nullifying the *monetary* cost of the *real* payment, *the purchase of the foreign currency is neutralized as well*, so that akin to its payment of ‘imports-exports’, the deficit country does not have to purchase the foreign currency it needs, to provide the accepted ‘*form*’ to the payment of its net imports: ‘the payment in money R, *the only one accepted abroad*’ (ibid.: 65). The payment of its surplus imports has effectively been reduced to one (remaining) single payment from that of a double payment (pre-reform); the only subsisting cost is the *second* foreign borrowing that the ‘Bureau’ still requires for the outstanding payment of its net imports *in R’s currency*, but this *second and only* loan ‘is now their *sole cost*’ (ibid.: 65). Again, our referenced above to the ‘*second* foreign borrowing’ could instead be the *third* foreign borrowing, depending on the analytic approach, as we have explained in an earlier footnote.

<sup>433</sup> ‘It is particularly advantageous here to compare the situation created by the reform to today’s state of affairs. In the present situation, A’s and R’s imports are nevertheless equal to

which, pre-reform, entailed an extra<sup>434</sup> purchasing-cost for the foreign currency required in the payment of its net imports. The reform goes beyond<sup>435</sup> achieving ‘the already verified parity of imports’ (ibid.: 62) between the deficit and surplus countries (A and R respectively) as it is established, today. We more easily understand this if we remember that the reform’s goal is to avoid the *double charge*<sup>436</sup>.

Let us backtrack on our explanation as to just *how* the reform provides for the reforming country, the foreign money (the ‘*form*’ aspect of the payment) that it requires for the payment of its ‘imports-without-exports’, **free of charge**. Understanding this essentially crystallizes one’s comprehension of just how the *double charge* (of net imports) is avoided. We start by recalling that pre-reform, the deficit country incurs the cost of its net imports, twice<sup>437</sup>. This is because, to the extent that it does not earn (through exports-revenues) the foreign currency that it requires to pay its net expenditures, it must ultimately purchase it. This means, in effect, that it incurs both the cost of the ‘*substance*’ and, that of the ‘*form*’. In other words, it incurs the cost of both the *real* and, that of the *monetary* payment<sup>438</sup>. For ‘imports-exports’ the *monetary* (foreign currency) payment of imports is provided *automatically and free of charge* through a same gain in exports-revenues. For ‘imports-without-exports’, the foreign currency required to finally settle their payment is obtained through a *foreign* loan. But the problem is that the implication of a foreign loan will actually duplicate<sup>439</sup> the payment of the

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one another although A carries out net imports. The equality between imports is maintained by the foreign loan that country A obtains in order to finance its surplus import. This loan provides an additional import to country R, which finally imports real goods of the same value as the goods imported by country A. It is the payment of A’s future exports that has this effect’ (ibid.: 62). The difference that the reform will bring is that not only will it comply with the balance-of-payments identity by allowing R to obtain a portion of A’s domestic resources, equal measure to that of R’s output exported to A (latter’s net imports), but moreover *all in the same period*. That is, if we consider that, today, the *real* payment of A’s net imports is obtained through the appropriation by R of part of A’s future output. The reform will see that, tomorrow, the *real* payment will no longer involve A’s future production, but will rather take place through the cession of part of A’s actual resources, *in the form of financial securities*.

<sup>434</sup> That is, extra, in that it ended up doubling the actual amount of its net imports.

<sup>435</sup> Our meaning: given that the *real* payment of A’s net imports implies the cession to R of a same portion of A’s *actual* resources, that is, of the *same current period that the surplus imports arise*, rather than a *future* production of a subsequent period; this feature of the reform, achieved through the counter-credit loan of the ‘Bureau’, is what actually prevents the duplication of the deficit country’s external debt (net imports), by avoiding the double charge.

<sup>436</sup> ‘It would therefore be useless for the reform to seek to establish the already verified parity of imports. The function of the Bureau is of an entirely different nature. It is a question of avoiding that the charge of surplus imports be increased to twice its value’ (ibid.: 62). Through its counter-credit loan, the ‘Bureau’ will achieve just that.

<sup>437</sup> ‘We understand the reason for this imposed ‘multiplication by 2’ of the charge of external debts before the reform: it is because the deficit country has not only to borrow abroad a sum of income equal to its ‘imports-without-exports’, but it is forced to pay two times this loan, both through the cession of goods that it will produce in the future and through the settlement of its net imports of actual goods’ (ibid.: 62).

<sup>438</sup> That is, ‘the foreign currency that provides the final form to the payment of net imports’ (ibid.: 65).

<sup>439</sup> ‘The reform allows us to avoid this duplication of the debt. It achieves this through the cancelling of the loan’ (ibid.: 62). That is, through the cancellation of the **loan** that the deficit/reforming country initially contracts to acquire the foreign currency it requires to pay

deficit country's net imports. This is because the deficit country will have to first cede the ownership of part of its future goods production (equivalent MR amount of its net imports) just to secure the loan of foreign currency it requires; moreover it will have to *spend* the foreign loan so obtained in order to settle the monetary payment (in foreign money) of its surplus imports, thus retaining no compensation whatsoever for its initial loan of foreign currency, whose payment has already been accounted for in domestic (deficit country's) income<sup>440</sup>.

Now, if we consider carefully *what* the reform fundamentally achieves<sup>441</sup>, in that it prevents that the cost of the payment of net imports be incurred both in *real* and in *money* terms, we soon realize just *how* it manages to do this<sup>442</sup>. Given that foreign exporters expect the totality

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its net imports (or simpler said, to allow it to counter-lend 1 MR to R), which initial **loan** the 'Bureau' cancels by its same MR amount counter-lending to R.

<sup>440</sup> '[T]he payment in money A takes place anyway, because it is confirmed by the sum borrowed abroad of the foreign currency necessary to finance net imports. By itself, *even before the sum obtained is spent to the benefit of R*, the currency borrowed is the transformation of payment A into a payment R' (ibid.: 65). The reference to 'money A' and 'payment A' intend the deficit country A's domestic money and payment, respectively. As well 'payment R' intend a payment in money R (surplus country's).

<sup>441</sup> '[W]e can easily understand the essential function of the reform. The goal is simply to avoid the surplus of expenditures over receipts of foreign currency being paid both by its substance and its form' (ibid.: 64).

<sup>442</sup> In effect, the reform creates a (transacting) situation for the reforming countries, such that the foreign money (currency R) implied in the *real* payment of their net imports 'is at the same time spent and earned' (ibid.: 65), as it happens in the situation of 'imports-exports' whereby the 'cost' of the foreign currency is always free of charge. Schmitt explains the effectiveness of the role of the 'Bureau' in this regard. 'The function of the sovereign Bureau could not be simpler or clearer: to prevent that the payment in foreign currency be costly and ensure instead that it is completely free. To the extent that expenditures and gains of foreign currency are equal, the foreign currency is indeed free. This is so because it is at the same time spent and earned. From the moment imports exceed exports, they define foreign currency expenditures that are not offset by any gain. These net expenditures of foreign money units are the second cost of net imports. The reform cancels this second cost; it is its entire *raison d'être*' (ibid.: 64–65). It is the counter-credit lending of the 'Bureau' that achieves this very effect. Schmitt elaborates on the precise function of this counter-loan. 'In order to cancel the cost in foreign currencies, which transform or give another *form* to the payment of the surplus import, the Bureau lends abroad all the sum of foreign currencies borrowed. In our numerical example, country A owes 1 dollar abroad; the payment in this form would cost it the value of 1 dollar if it did not lend 1 dollar abroad. As this loan reduces to nil or zero its initial borrowing of 1 dollar, its second borrowing of 1 dollar provides the sum of foreign currency it needs to give its final form (in foreign currency) to the payment of net imports. The second borrowing abroad of 1 dollar costs nothing more to the deficit country, because its only effect is to reproduce the first loan of 1 dollar' (ibid.: 65). Specifically, *it does not cost anything*: the *extra* pre-reform conversion fee (in regards to the foreign currency) has been nullified by the counter-loan of the 'Bureau' which counter-loan compensates both the first and second loans (R to A); the desired outcome as brought in by the reform is that the two loans (R to A) no longer add to one another, given that the second foreign borrowing (R to A) is simply the reproduction/replacement of the first initial borrowing (R to A) which loan was effectively neutralized by the 'Bureau'. This is the reason that the 'second borrowing abroad of 1 dollar costs nothing more' (ibidem). Explained

of their exports-payment in their own domestic currency, the 'Bureau' of the reforming country (A) *retains* the initial foreign borrowing (R to A) that provides it with the foreign currency (same value amount of its surplus imports) that it will ultimately require in order to settle the payment of its net imports, in money R. After all, it simply cannot avoid this loan of foreign currency, which foreign money it requires but was unable to earn through a same amount of exports-revenues. So the 'Bureau' maintains<sup>443</sup> this first foreign loan that is essentially the cost of the *real* payment<sup>444</sup> of its net imports, *whilst neutralizing its very associated cost*. As earlier explained, it manages to do this through its counter-credit loan to residents of country R. This counter-loan effectively cancels the cost<sup>445</sup> of A's initial foreign borrowing (first foreign loan of the second and, subsequent periods) such that the second<sup>446</sup> foreign borrowing of the 'Bureau' to pay its outstanding net imports *in foreign money*, defines its only cost<sup>447</sup> for its net imports. Hence, reducing the *double* payment of its net imports to a *single* one essentially means it obtains the foreign currency it requires for the payment of its net imports, cost-free<sup>448</sup>. The *double* charge is efficaciously curtailed.

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another way, the *real* payment of A's net imports (which incidentally are no longer net as a result of the *real* payment) which takes place in P<sub>2</sub> (period 2) and in any subsequent period thereafter, takes the form of the counter-loan of the 'Bureau' (A to R). Now, it is because it takes place through this counter-loan that the *real* payment does not add to the *monetary* payment, meaning that the *monetary* payment is costless.

<sup>443</sup> 'We thus maintain the loan as it stood before the reform. But the sovereign Bureau adds, as we have already established, a reverse loan. We thus have the coexistence of two equal-size financial transactions, which 'contradict' one another: the loan of 1 dollar granted by R to A is offset by the loan of 1 dollar granted by A's Bureau to non-residents' (ibid.: 62).

<sup>444</sup> It should be clear that the *real* payment of A's net imports (that, consequently, are no longer *net*) is on account of the counter-loan of the 'Bureau' (A to R) and not due to the first loan (in each period) of R to A (which is the case today and implies the cession of a *future* product of economy A).

<sup>445</sup> That is, the cost of the *real* payment of its net imports.

<sup>446</sup> Again, as previously explained, this could be the *third* foreign borrowing, depending on the analytic approach.

<sup>447</sup> 'The financial Bureau destroys the first loan, while maintaining it of course, by compensating it with an equal loan granted to non-residents. What remains for the external payment of net imports is the second loan only, which is now their *sole cost*' (ibid.: 65).

<sup>448</sup> Our meaning in that, in paying the very amount of its net imports *once only and not twice*, the 'Bureau' effectively obtains the foreign currency at no extra charge, rather it obtains it *free of charge*, akin to how it obtains it for its 'imports-exports', that is, *cost-free*. One notable and formidable factor, perhaps contrarily to what might have been expected as unattainable, the reform successfully achieves the cost-free charge of the foreign currency it requires, indirectly. That is, *indirectly* in the sense that it nullifies the cost of the net imports' *real* payment whilst retaining its (net imports) *monetary* payment and 'cost' (foreign currency payment). Our reference with respect to 'cost' is in regard to the fact that the *cost-free* result is so obtained not through directly nullifying the cost of the monetary payment but rather, through reducing a double payment to a single one, as nullifying the cost of the *real* payment indeed achieves. That said, if we were to elaborate on our meaning: in absence of a proper system of international payments, A is currently obliged to borrow the amount of money R that it requires to convey the *real* payment of its net imports; but the change that the reform will bring, in this respect, is that it will allow A to do so (borrow) *at zero cost*. This is achieved through the counter-loan (A to R) of the 'Bureau'. Even the cost of the *monetary* payment (in money R) of A's net imports (the *real* payment having not cancelled the need for

At this stage, the reform has already reached its prime objective<sup>449</sup> in that it has managed to salvage A's domestic income that pre-reform was captured by surplus country R through its appropriation of part of the deficit country's (A) future output (net foreign borrowing effect). The 'Bureau' has achieved<sup>450</sup> this through its counter-credit loan to R. But, still, one remaining foreign loan is required by the 'Bureau' in order to ultimately settle the payment of its net imports in R's currency. Let us consider then, the indebtedness-effect<sup>451</sup> of this ultimate foreign loan for the deficit/reforming country, regard its external debt. We remember that the foreign borrowing of the deficit country has been halved by the effect<sup>452</sup> of the counter-credit loan of the 'Bureau' which loan has the double effect of canceling the very formation of the debt arising from A's first<sup>453</sup> loan from R (2<sup>nd</sup> period or, any subsequent period to period 1) and of compensating the debt formed by A's second<sup>454</sup> loan from R. Now, there remains yet

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a *monetary* payment) will be reduced (asymptotically) to zero, by the reform. In an explanation built from an analysis of successive periods, solely the loan obtained by A for the *monetary* payment of its net imports in P<sub>1</sub> (the very first period) has a *cost*. In all subsequent periods, though this monetary payment loan subsists in that the loan is renewed, *so is the reimbursement of the previous one*, so that A's external debt remains constant and equal to 1 MR (assuming the new net imports are also constant at 1 MR, period after period). When subdivided on a greater number of periods, this *cost* (P<sub>1</sub>) tends to zero (asymptotically). Considering all parts and aspects of the reformation then, though it is true that the *real* payment does not cancel the need for a *monetary* payment and 'cost', still, the reformation facilitates the reduction of this monetary 'cost' (asymptotically) to zero. The reform is, quite simply, truly splendid in its accomplishments.

<sup>449</sup> 'The essential goal is thus reached, because the sum of 1-dollar value formed in a domestic income of economy A is no longer earned by the rest of the world. As we know well, it is the property of its Bureau and, ultimately, of its government' (ibid.: 63). The reference to 'economy A' is that of the deficit country (1-dollar being the value of its net imports) whereas that of the 'rest of the world' intends country R.

<sup>450</sup> 'The goal is thus achieved, because country R can no longer become the owner of real goods that country A will produce in the future; the loan made by R to A is of a zero sum. Thereby one precludes that country A's net import of 1-dollar value costs 2 dollars' (ibid.: 62).

<sup>451</sup> 'The last act really worth mentioning concerns the external debt that country A carries because of its second indebtedness of 1 dollar contracted abroad' (ibid.: 63). The reference to the 'second indebtedness' intends the second and only foreign loan that subsists for deficit country A, that is, with respect to the payment of its net imports, in money R. Moreover, our own reference to "the second and only foreign loan that subsists" could be inter-changed with "the *third* and only foreign loan that subsists", depending on the approach of the analysis, as explained earlier.

<sup>452</sup> The counter-credit loan of the 'Bureau' (A to R) cancels the first foreign loan of country A (R to A), such that the second foreign loan that it acquires no longer adds to the first external loan (now cancelled), it merely reproduces/replaces it: the double charge, as such, is avoided. 'It would be wrong to add to one another the two loans that country A contracts abroad in each period. The second loan is indeed only the reproduction of the first' (ibid.: 63).

<sup>453</sup> This first loan (R to A) is necessary for A so as to provide it with the amount of money R that it needs to finance its loan to R (the counter-loan of the 'Bureau', A to R). The occurrence of the loan is as of any subsequent period to P<sub>1</sub>, e.g. P<sub>2</sub>.

<sup>454</sup> This second loan (R to A) is required by A to recover the entire amount of money R (MR) deriving from its total exports to R (MR deficiency resulting from reimbursing the debt formed in the previous period, e.g. P<sub>1</sub>.) Again, the occurrence of this second loan is as of any

one more external loan which country A needs to obtain from R (to settle the payment of its net imports in money R), this is the third subsisting loan<sup>455</sup> which it contracts period after period, as well as reimburses, period after period. This remaining external borrowing that nevertheless manifests as an external debt<sup>456</sup> of reforming country A, is non cumulative in time, rather asymptotically nil<sup>457</sup>. Furthermore, as we have mentioned earlier, this remaining foreign loan is *compensated*<sup>458</sup> rather than *net*. It is effectively compensated, in each period,

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subsequent period to P<sub>1</sub>, period after period. Moreover, it manifests as mere replacement of A's first loan (R to A) which loan is neutralized by the counter-loan of the 'Bureau' (A to R). In effect, it is on account of the very fact that *it manifests always as mere replacement of the first loan* (which loan is neutralized by the counter-loan of the 'Bureau') that the counter-loan of the 'Bureau' is able to fully compensate it. Specifically, the counter-loan of the 'Bureau' has the double effect of compensating it (second R to A loan) in addition to neutralizing the first R to A loan.

<sup>455</sup> This loan/debt is incurred in each period, period after period, as a result of the *monetary* payment of A's net imports. It is firstly incurred in P<sub>1</sub> as A's sole foreign borrowing from R, (1 MR), such as to enable the *monetary* payment of its net imports, in money R, in this said period.

<sup>456</sup> 'The external debt does not increase at all: in the sum of periods elapsed, where imports are nevertheless 1 dollar in surplus in each period, country A's external debt is only equal to the current deficit of its imports, that is, 1 dollar only' (ibid.: 63). Now this outcome obtains, on condition that each new debt of this kind debt is reimbursed in the subsequent period and, if the counter-credit loan granted by the 'Bureau' to R, has the double effect of avoiding the formation of a *sovereign* debt (through neutralizing the *first* loan R to A) as well as compensating the *second* debt that derives from the need to recover the reduction of A's exports-revenues (MR) caused by the reimbursement of this kind loan, in each period. We will later elaborate on this double effect of the counter-credit loan of the 'Bureau'.

<sup>457</sup> Let us explain again on why this is by retracing our steps to the first period (P<sub>1</sub>): in this very first period, the 'Bureau' borrows abroad (1MR) only once. There is no second loan (R to A) that is contracted in the first period. This is so on account of the fact that the *real* payment of A's net imports takes place ***only from the second period onwards***. In the first period a revolving fund in MR, is obtained by A through a loan granted by R. This revolving fund is used in P<sub>1</sub> and, reconstituted and used up in each subsequent period, always, for the *monetary* payment of A's net imports. At the end of P<sub>1</sub>, the 'Bureau' of A has thus a debt equal to 1 MR. This is A's ***only cost, monetary***, with respect to A's net imports (the *real* cost being covered ***cost-free*** by the counter-loan of the 'Bureau', A to R), *still, the reform allows to reduce this very cost (asymptotically) to zero*. Specifically, considered on a succession of periods, only this very loan that A obtains in the first period has a *cost*. In all subsequent periods, the loan is renewed but so is the reimbursement of the previous one, such that A's external debt is maintained at 1 MR, period after period. Now, when this *cost* is subdivided on a greater number of periods, it tends (asymptotically) to zero.

<sup>458</sup> The reform will assure this through the assigned task of the 'Bureau' who will be responsible for collecting its country's domestic income (equivalent MR value of its net imports amount). In Schmitt's own words, '[t]he existence of only compensated debts of countries, as set of their residents, will be established by the reform' (ibid.: 96). Matter-of-factly, it is in this way that the reform will succeed in nullifying deficit countries' external debts, altogether. Specifically, it '*will reduce the external debts of these countries to zero*' (ibid.: 47). The novelty that the reform will thus bring is that '*[e]xternal debts will form abroad towards foreign countries' but 'no longer at the expense of the deficit country'*' (ibid.: 46). One point remains to be clarified: this is not to say that a country's external debt related

by the domestic income (equivalent MR value of reforming country's surplus imports) that the 'Bureau' receives, directly, from its country importers: A's external indebtedness is thus perfectly balanced.

### *The mechanism of the 'Bureau' in a snapshot*

We consider our example-country A (deficit/reforming). In the first period ( $P_1$ ) the 'Bureau' of A borrows **only once**, 1 MR, from R. There is no second loan (R to A) in  $P_1$ ; the reason being, A's *real* payment of its net imports takes place only from the second period ( $P_2$ ) onwards. In  $P_1$  a revolving kind of fund in money R (1MR) is acquired by A through a loan granted by R; the 'Bureau' of country A uses this fund to cover the *monetary* payment of A's net imports. At the end of  $P_1$ , the 'Bureau' of A has a debt equal to 1 MR. Now as previously indicated, the *real* payment of A's net imports takes place as of  $P_2$  and in each period thereafter and, it takes the form, always, of the counter-loan of the 'Bureau' (A to R). It is because it takes place through this counter-loan that the *real* payment does not add to the *monetary* one (as it did pre-reform): the *monetary cost of the real payment is costless*.

All develops and manifests as per the following. A's net imports of  $P_1$  are actually paid, in *real* terms, in  $P_2$ , through the counter-loan of the 'Bureau' (A to R). Likewise, A's net imports of  $P_2$  are effectively paid, always in *real* terms, in  $P_3$ , and so forth. Yet, if we assume A's net imports to be of the same amount period after period, the *real* payment occurring in  $P_2$  **corresponds** to the net imports of  $P_2$ , and so on. Still, the one point to keep abreast of is that the payment occurring in  $P_1$  is financed **only** by a loan obtained from R. But, asymptotically the debt formed in  $P_1$  is zero, so that this potentially problematic point (regarding the sole financing in  $P_1$ ) is thus re-absorbed. Given the said conditions then, one can indeed conceptualize that from  $P_2$  onwards A's net imports are paid in the very period in which they actually form. The distinction between a first period where A's net imports are not yet paid in *real* terms and all of the successive periods, has been introduced by Schmitt (2014) such as to

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to its deficit, its very *net* imports, is reduced to zero (in each period subsequent to  $P_1$ ) on account of the net gain of the 'Bureau'; rather the deficit/reforming country's external debt is reduced to zero, very simply, because the said country (A) pays the totality of its imports and it achieves this through the counter-loan of the 'Bureau' (A to R) via which the reforming country cedes a portion of its actual resources (equivalent of its net imports in MR value). Moreover, the result of this counter-loan (A to R) is that the reforming country's *net* imports are thus no longer net per se and, the said country, therefore, is no longer a deficit country. **What has to be understood, is that the deficit/reforming country's external debt would be reduced to zero in each period subsequent to  $P_1$  (complement of the counter-loan of the 'Bureau'), even if the 'Bureau' did not obtain any net gain of domestic income (equivalent MR value of its net imports) from its country residents.** To say it again, this is because it is the counter-loan of the 'Bureau' that has the effect of rendering the deficit/reforming country a non-deficit country: its *real* imports being fully covered by its *real* exports (A's *actual* internal resources), its external debt (deficit relating to net imports) is thus reduced to nil. That all said, only the external debt related to the **cost** of the *monetary* payment (in money R) of its *net* imports is what is compensated by the net gain of the 'Bureau'. And, we have seen that the debt related to this **cost** is initially incurred in  $P_1$  and then cancelled and renewed in each successive period; it is a debt that is asymptotically equal to zero being that it does not increase in time. Still, A's external indebtedness related to the monetary payment in money R of its net imports, is perfectly balanced in each single period, on account of the net gain (domestic income, equivalent MR value of its net imports) of the 'Bureau'.

present the more pragmatic aspect of the reform, by specifically demonstrating how it could actually be implemented in practice.

Let us consider for example, what transpires in  $P_2$ . In this second period, the 'Bureau' of A borrows 1 MR from R; this first loan of  $P_2$  is such that A can obtain the amount of money R that it needs to finance its own loan to R (the very counter-loan of the 'Bureau', A to R). A (its 'Bureau') borrows again 1 MR from R, this time, to recover the entire amount of MR deriving from its total exports to R of  $P_2$  (MR deficiency resulting from reimbursing the debt formed in the previous period due to its monetary payment of its net imports of  $P_1$ ). The 'Bureau' then counter-loans (A to R) 1 MR. Through this counter-loan of  $P_2$ , the 'Bureau' conveys *cost-free* the *real* payment of A's net imports of  $P_1$  (or, we could say of  $P_2$  if we keep in mind our previous explanation on this point), of 1 MR value: it is because this *real* payment takes place through the loan granted by the 'Bureau' (A to R) that indeed, it does not add to the monetary payment *in money R* of A's net imports of the same period ( $P_2$ ) (the *monetary cost* of the *real* payment being reduced to zero, complement of the counter-loan). Now, the fact that the *real* payment no longer adds to the monetary payment (as it did so pre-reform) precludes the very formation of a sovereign debt, for A: the double charge (pre-reform) of its external debt is thus already effectively curtailed. But moreover, the counter-loan of the 'Bureau' bears a **double** effect in that by neutralizing A's first loan of the period ( $P_2$ ), it is able to fully compensate the debt related to A's second loan of the period ( $P_2$ ) with the credit that it (A's 'Bureau') obtains from its counter-loan to R. The explanation behind this **double** effect stems from the analytical argument based on the logical distinction between 'imputation' on a result versus 'imputation' on a formation. In other words, if a debt is incurred as a result of a deficit and, an equivalent credit is obtained to balance the debit, the impact is that of 'imputation' on the result; however the situation is different if the credit so obtained has a direct impact not on a debt already incurred, but rather on the very formation of this debt, in which case the credit cancels the formation of the debt itself. This is exactly the impact of the counter-loan of the 'Bureau' (A to R): it impedes the very formation of the debt related to A's first loan from R ( $P_2$ ), so that the only debt formed is the one following from A's second loan from R ( $P_2$ ), which debt is therefore fully compensated by the credit<sup>459</sup> deriving from the counter-loan of A's 'Bureau' (A to R).

What the counter-loan (A to R) effectively enables A to do is to pay (in *real* terms) the totality of its imports. In so doing, it reduces A's external debt to zero. Specifically, the counter-loan of the 'Bureau' allows A to convey the *real* payment of its net imports at zero cost, it also allows it to offset the *monetary* cost of the second loan that is required to recover the entire MR amount initially deriving from its total exports to R of the same period (e.g.  $P_2$ ), this on account of the very credit-compensation<sup>460</sup> that this counter-loan of the 'Bureau' obtains from R. This specific end all result is achieved through the double effect of the counter-loan of the 'Bureau'.

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<sup>459</sup> Schmitt defines this credit as the 'financial assets' obtained from R, result of the counter-loan (A to R) of A's 'Bureau': '[t]he deficit country thus obtains, in financial assets, an external credit of 1 dollar that compensates exactly the debt of 1 dollar formed by the foreign borrowing of this sum' (ibid.: 59).

<sup>460</sup> 'Deficit country A is therefore subjected by its second borrowing to the only debt created by the first. Country A's external debt is initially of  $(1-1=)$  0 dollars since the Bureau lends also 1 dollar. Finally, the debt incurred is of 1 dollar because of the second loan. Since the credit that adds to it is of 1 dollar, the 'experts' of the Bureau do not have the choice but to add  $-1$  dollar to  $+1$  dollar, which gives the value of their country's indebtedness, at 0 dollars, an excellent conclusion, although a little unexpected' (ibid.: 63-64).

Now, the only debt remaining in each period (subsequent to  $P_1$ ) is as a result of A's need for yet a third loan to cover its net imports payment of the period, which cost remains outstanding in money terms. For this reason it will borrow again 1MR from R. This is the debt that is effectively reimbursed in each new period (subsequent to  $P_1$ ) such that even if A renews its net imports deficit each new period (assuming the renewal amount of its net imports deficit remains the same, e.g. 1 MR) so is the re-imburement of a same amount renewed. Consequently A's external debt is *maintained* at 1 MR, period after period. This in itself is a major feat brought in by the reform if compared with today's situation whereby A's external debt is doubled through the pathological formation of a *sovereign* debt that moreover, is cumulative in time (each new sovereign debt adding to the preceding one, period after period). The counter-loan of the 'Bureau' precludes the very formation of this anomalous sovereign debt<sup>461</sup> by effectively neutralizing one of the double charges (pre-reform) associated with the payment of net imports: it neutralizes outright the *monetary* cost of the *real* payment (whilst maintaining the *real* payment<sup>462</sup>) such that the double charge is reduced, in each period, to a single *monetary* cost associated with its net imports (monetary) payment (in money R) of the said period. And, the cost associated with this outstanding debt derives from the only loan that A obtained from R in the very first period, for the *monetary* payment (in money R) of its net imports of  $P_1$ ; still, the reform allows for this cost to be reduced (asymptotically) to zero. Now, it is true that even with the reform in place, the *real* payment of A's net imports does not cancel the need for its monetary payment in money R, which will remain necessary in each period. But the debt<sup>463</sup> related to the loan (third loan R to A) that A will need to cover it, is nevertheless counterbalanced<sup>464</sup> in the sense that an equivalent credit

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<sup>461</sup> Specifically, it is the *double effect* of the counter-loan of the 'Bureau' that avoids the sovereign debt formation in that this counter-loan is able to compensate two loans (R to A): it impedes the formation of the first debt (first loan of the period, R to A), such that the only debt formed is the one following from the second loan of the period from R (needed by A to recover the entire MR amount deriving from its total exports to R, which MR amount A has partly used to reimburse the debt formed in the first period), debt that is thus fully compensated by the credit resulting from the counter-loan (A to R). This means then, that only one loan (third loan R to A) subsists for A, period after period; the double charge of net imports (pre-reform) is effectively curtailed in that the charge is reduced to a single sole monetary cost (monetary payment in money R, the very third loan of the period, R to A) and, which cost the reform asymptotically reduces to zero.

<sup>462</sup> Complement of the reform, the only cost of the reforming/deficit country's (A) net imports will be *real* (its actual internal resources: through the loan (A to R), A will pay for part of R's imports *whatever their form*, e.g. form of financial securities); meaning that the surplus imports of country (A) will be paid in *real* rather than in *money* terms. Obtained through A's counter-loan of the 'Bureau', this result means that the reform will neutralize the *monetary* cost of the *real* payment and not the cost 'tout court' (see *ibidem*); the *real* payment has still a *real* cost (the domestic resources, *actual* instead of *future*, given up by A), but its *monetary* cost is neutralized/nullified (reduced to zero) by the counter-loan of the 'Bureau' (A to R). The reform (through the counter-loan of the 'Bureau') thus ensures that the 'form' aspect of the payment is neutralized and that solely its 'substance' aspect remains (see *ibidem*: 64).

<sup>463</sup> Specifically, the debt is its sole subsisting external debt (same 1 dollar value as its net imports of the period, assuming the latter are constant period after period) of the period under examination.

<sup>464</sup> 'The deficit country remains the owner of the totality of its domestic income, as if its imports were not in surplus' (*ibid.*: 60). In effect, what the reform brings is that it facilitates a special payment transaction platform for net imports in that it is as though the latter were

‘equivalent in dollars of the domestic income spent for net imports, is collected by the country whose net debt does therefore not increase’ (ibid.: 94). This credit is essentially the very domestic income that the reform is able to salvage, which income was forever lost, pre-reform, to the benefit of R at the expense of the deficit country (A). Let us re-visit, in a next section, just *how exactly* this internal income of A is lost prior to the reform. Clearly understanding this, will not only help hone in on the reality of the double charge of net imports, but more so, the advantage that the reform will bring in this regard. For this reason, we turn our attention to the international rule that governs external payment-transactions of trading countries from which derives the reciprocal parity of expenditures between these commercially exchanging countries, the very ‘*equality of im (R) and im (A)*’ (ibid.: 67). We will see that it is the adherence to this necessary reciprocal parity that, in effect, consequently *doubles* the cost of net imports, for the deficit country.

***The governing rule that drives international exchanges: the necessary reciprocal parity of expenditures between trading countries***

It all begins with what defines the *finality*<sup>465</sup> of a payment-transaction in that, ‘international transactions for every country involved in external exchanges are paid off through the equality between acquisitions and disposals of real values’ (Schmitt 2014: 70). This sterling<sup>466</sup> rubric renders it inconceivable<sup>467</sup> then, that a deficit country (A) could ever expect to acquire from a surplus country (R) *real* goods of a value in excess of what R could equally expect as an acquisition from A. The ‘equality of international accounts’ (ibid.: 66) would very simply, clearly oppose it. But this is not to suggest that this expected adherence could even be the source of the problem, quite contrarily, as we have it today the *double charge*<sup>468</sup> of surplus

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purchased/transacted as any other internal purchases of the deficit/reforming country, that is, ‘as if purchases (imports) were carried out between residents’ (ibid.: 56). And, in remaining proprietor of the entirety of their internal income this means, with respect to the payment of the reforming countries’ net imports, that ‘*the reform will reduce the external debts of these countries to zero*’ (ibid.: 47), that is, through the establishment ‘of only compensated debts of countries, as set of their residents’ (ibid.: 96).

<sup>465</sup> Through Rossi’s re-cap we are reminded of how Goodhart once qualified ‘the finality of a payment’. ‘[T]he finality of a payment requires that the ‘seller of a good or service, or another asset, receives something of equal value from the purchaser, which leaves the seller with no further claim on the buyer’’ (Rossi 2012: 221; see also Goodhart 1989).

<sup>466</sup> In meaning simply, of greatest importance: overriding.

<sup>467</sup> ‘The doctrine that a country (such as A) can, in its relations with the rest of the world, obtain real goods without giving up other real goods is, however, extremely dubious from the outset, because it reduces net imports to amounts of unpaid goods. It is legitimate to qualify net imports as ‘import-without-exports’. But it is preposterous to claim that net imports are *unpaid* purchases’ (Schmitt 2014: 66). Matter-of-fact, ‘surplus imports are paid without delay, at the very moment they are obtained’ (ibid.: 66). As Schmitt pointedly clarifies ‘surplus imports have never been ‘purchases-without-payments’: to still owe them is to owe them a *second time*’ (ibid.: 67).

<sup>468</sup> Schmitt distinguishes between periods ‘*p*’ and ‘*p\**’, current and future respectively, as he sets out to explain why that is. ‘It is in period *p* that country A’s imports exceed its exports; in *p* it is therefore  $im(A) > im(R)$  that is the exact comparison of the two imports. It is also in *p* that country A borrows this difference abroad’ (ibid.: 67). But nevertheless, what particularly needs to be heeded is his following observation. ‘In reality, that is to say, in fact, the object of

imports very much ‘results from the equality of reciprocal imports’ (ibid.: 70). It is definitely not the adherence to the rule, then, that is avoided. On the contrary, and evidently, as we will re-examine, ‘imports-without-exports’ are *not* ‘purchases-without-payments’ (see *ibidem*). It would be illogical to expect otherwise as it would go against the international dominion of payment-transactions. This is the reason that *what* the reform needs to address is ***the way in which reciprocal expenditures uphold their equality*** rather than the very ‘application of the rule governing international payments’ (ibid.: 68). It is ***the manner in which this rule is adhered to*** that is the source of the anomaly rather than the rule<sup>469</sup> itself or, the lack of adherence to it. And Schmitt’s single-country reform<sup>470</sup> addresses just that, that is ***the way*** or, to use Schmitt’s own wording ‘the framework’ in which ‘the equality of reciprocal imports’ (ibid.: 70) is upheld, such that it will no longer entail a ‘double charge of net imports’ (ibid.: 70) and therefore, a loss of domestic income for the deficit nation.

Now since, according to the way things<sup>471</sup> are today, it is ***the way*** that is the culprit, let us next re-visit then this very ***way***, that is ‘*the method by which the payments of country R are brought to the level of the payments, in surplus, of country A*’ (ibid.: 68). Clearly understanding *the how it happens today* of this method should, in turn, crystallize our understanding of *how the reform will alter the process by which parity of reciprocal imports is attained* such that the double charge of net imports is forever eradicated.

We begin by considering the foreign loan (pre-reform) that the deficit country requires from R on account of its net imports, that is, we consider it from the perspective<sup>472</sup> of R. We

the sum borrowed is an export of country A since period  $p$ , therefore an import of country R, which does not need to wait for a successive period ( $p^*$ ) to bring the payment of its purchases to the level of its sales. Unless they remain partially unpaid, the law that triumphs is therefore that which states that international transactions always require the equality of  $im(R)$  and  $im(A)$ . It is gravely regrettable, however, that the cost of surplus imports is thus ‘multiplied by 2’ (ibid.: 67). The *double* charge being thus the very consequence of the next point, which point, Schmitt draws our attention to. ‘Country A gives up first, through an ‘actual’ payment and not through a promise of future payment, a product of its domestic economy in  $p^*$  and, in addition to this first payment, country A spends the sum borrowed in order to finance the difference in money R between its expenditures and its receipts’ (ibid.: 67).

<sup>469</sup> That is ‘the law governing international exchanges’ (ibid.: 68) which law ‘states that international transactions always require the equality of  $im(R)$  and  $im(A)$ ’ (ibid.: 67). ‘According to this law, any country that pays the totality of its purchases cannot obtain in real goods what it does not immediately give up, equally in real goods’ (ibid.: 68). Nevertheless, given the current operational status of our international system, it is unfortunately on account of how this very law/rule is adhered to ‘that the cost of surplus imports is thus ‘multiplied by 2’ (ibid.: 67). This is why it is ***the way*** in which this law is adhered to that must be reformed such that its application no longer entails, for deficit nations, a double payment of its net imports and thus, an unnecessary loss of internal income.

<sup>470</sup> ‘In other words, the mistake is not in the law requiring that A’s surplus imports immediately create R’s additional imports, because this law can only be found logically in the distinction between imports paid and imports whose payment is merely promised: what needs to be reformed is the framework in which reciprocal imports maintain their equality, between R and A, even though country A increases its imports beyond its exports’ (Schmitt 2014: 70).

<sup>471</sup> In reference simply, to the current status of our international ‘system’ of payments.

<sup>472</sup> ‘More precisely, what is the exact meaning, for country R, of the loan granted to country A? It is an expenditure of country R; but is this expenditure a purchase of that country or simply a monetary credit granted to non-residents? This question is fundamental, because the rule governing international payments applies to the real values and not to purely monetary

remember that this loan, R to A, indeed ‘an expenditure of country R’, is very much a purchase of *real* values and not ‘simply a monetary credit’ lent to residents of country A. And this fact matters all the more so, given that the application of the law that presides over international payment-transactions is in respect to *real* values rather than to ‘purely monetary transactions’. On mulling this over, one can’t but find it only logical that the loan of R to A would be a purchase of *real* values; after all, it is only in this sense that it would truly be able to *finance*<sup>473</sup> country A’s excess purchases (net imports). Moreover, just the fact that this foreign loan (R to A) will be re-paid (to lenders of R) in a *future* period ( $p^*$ ) to the first period ( $p$ ), means that an external debt<sup>474</sup> for the deficit country (A) forms as of  $p$  and therefore the surplus country (R) does indeed augment<sup>475</sup> its own imports (purchase of financial securities) from A (by a same amount of A’s net imports), also, as of  $p$ <sup>476</sup>. We know as well from this

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transactions. Simple factual observation provides the final answer ... it is a question of real values and not of units of money’ (ibid.: 68).

<sup>473</sup> ‘If the loan of 4 dollars did not provide economy A with the financing of its purchases, the sum borrowed would merely be money and its repayment would only be the inverse of its borrowing: the 4 dollars borrowed would not be part of country A’s imports. The foreign currency thus obtained, albeit from abroad, would certainly be an economic object, but distinct from any real value, of consumption or saving’ (ibid.: 68).

<sup>474</sup> If the re-imburement of the loan R to A only takes place in a next period ( $p^*$ ) from when it was initially incurred (period  $p$ ) a new debt is unavoidable, thus renewing A’s external debt. What is important to understand is that the newly formed debt (result of loan R to A, period  $p$ ) can be written off as finally paid only through a future ( $p^*$ ), free-of-charge, exportation of A (equivalent MR value to its loan amount of period  $p$ ). This results in an internal savings for country R as a whole, notwithstanding, at an extra unnecessary expense for country A that as a whole, incurs the cost of this *double* charge. ‘Indeed, the entire question is to exactly comprehend the repayment of the debt ... This debt can be paid, that is cancelled, only through the export of products of a total value of 4 dollars formed in  $p^*$  by economy A ... But what is the result of this comprehensive observations? It is that the debt formed by the difference between expenditures and receipts of economy A is double ... Economy A gives up values formed in  $p^*$  on top of the payment to R’s exporters. The first of these payments is real (real value to be produced in  $p^*$ ); the second payment is monetary (settlement of net expenditures)’ (ibid.: 74).

<sup>475</sup> ‘[L]enders will recover these 4 dollars only in a period subsequent to  $p$ . We immediately deduce with certainty that the repayment of the sum lent will be the payment carried out by country A *of an import of country R*. The loan of period  $p$  calls for a repayment necessarily situated in a successive period, noted  $p^*$ . Once this obvious fact is recognized we know that country R increases by a value of 4 dollars its imports in period  $p^*$ ’ (ibid.: 68). Schmitt’s reference to the 4 dollars amount implies the first loan amount (R to A) that the deficit country (A) borrowed in relation to its deficit: the net imports amount of a same 4 dollars value.

<sup>476</sup> ‘It is true – we have acknowledged it – that the repayment of these 4 dollars borrowed in period  $p$  will take place only later. However, it would be illogical to conclude that this debit forms only at the moment of its repayment; it is, on the contrary and quite obviously, at the formation of the loan itself that the corresponding debit is formed. It is therefore in period  $p$ , and not in  $p^*$ , that country R increases its imports by the full value of the sum of 4 dollars newly lent to A’ (ibid.: 68–69). Thus, ‘the equality of  $im(R)$  and  $im(A)$ ’ does indeed, invariably, manifest. ‘Unless they remain partially unpaid, the law that triumphs is therefore that which states that international transactions always require the equality of  $im(R)$  and  $im(A)$ ’ (ibid.: 67). The reference to ‘they’ implies R’s purchases (imports) whose payment it

fact that the re-imburement in  $p^*$  necessarily implies a payment by A (in  $p^*$ ) of a part of its own exports (imports of R, of a same amount as A's net imports of the previous period). Hence, the evidence of the *double* charge: as of period  $p$ , the deficit country (A) loses ownership of part (equivalent MR value of its net imports) of its domestic resources (internal income) to the benefit of R's economy.

The interconnectedness of facts soon becomes obvious in that the deficit country's external debt forms as of period  $p$ , the very period that it incurs a debt as a result of its first loan from R; the latter's imports (R's), meanwhile, increase accordingly<sup>477</sup> (by a same amount as A's net imports) and as well as of this first period  $p$ , on account of its loan to A (A's exports of financial securities forming the very object of this loan), such that 'the equality of reciprocal imports' (ibid.: 70) does indeed manifest between trading countries (A and R in the case-example). So it is that, whether a case<sup>478</sup> of 'imports-exports' or 'imports-without-exports' the deficit country's imports, in either case scenario, will always equal that of the surplus country's imports<sup>479</sup>. It is inevitable<sup>480</sup>.

Having bore witness to, and this in the same period, the parity of reciprocal imports between the deficit and surplus country, as a natural consequence following from the 'application of the rule governing international payments' (ibid.: 68) we now have a closer look as to why exactly it leads, today, to the *double* payment of net imports.

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thus brings to the same degree as that of its (R's) sales (exports), result of the first loan (R to A).

<sup>477</sup> 'The loan located in  $p$  increases in this same period country R's imports, the products of economy A to be delivered to the economy R being part of the goods that A will produce in  $p^*$ . To claim that the formation of the external debt of 4 dollars incurred by A will define an import of R only later, in  $p^*$ , is to commit an obvious error, which consists in canceling, for period  $p$ , the loan of 4 dollars that economy R grants since period  $p$ . It is enough to realize that country R increases by 4 dollars its imports of period  $p$  to avoid this elementary mistake' (ibid.: 69).

<sup>478</sup> 'In the two cases country R's imports are equal to country A's imports. Imports of economic values are always equal amongst each other. In accordance with the rule of countries' international payments, set R increases its imports to the exact extent set A increases its own' (ibid.: 69).

<sup>479</sup> 'Owing to the fact that in period  $p$  economy A's expenditures exceed its receipts by the value of 4 dollars, country R adds to its imports of this period, beyond the values already produced, economic values that will be produced only later, in  $p^*$ , by economy A' (ibid.: 69). The important factor to retain from Schmitt's observation/wording here, is that *country R adds to its imports of this period*, meaning as of period  $p$ . This is because, indeed, 'net imports are positively paid from onset of being formed, at the same time of offset imports' (ibid.: 66). As such 'expenditures of surplus countries are in reality equal to the simultaneous expenditures of their partners' (ibid.: 68).

<sup>480</sup> Schmitt explains the infallibility of this equality and, an infallibility that subsists *at all times*. 'This equality is valid without the slightest exception, because it does not depend on any willingness, either of country A or of country R. The equality of reciprocal imports is only the direct and unavoidable consequence of the factual rule governing international payments. Country A's deficit would indicate an insufficiency of country R's imports only if economy A paid merely its 'expenditures-receipts', allowing itself to leave its surplus imports unpaid during an unlimited period. In reality, country A *pays the totality of its purchases* whose value is of 14 dollars, of which 4 dollars are borrowed abroad' (ibid.: 69). The 4 dollars amount also implies the amount of the deficit, the net imports amount.

***Today's double charge: effect of the method through which the parity of reciprocal imports is attained***

The problem with today's international payment 'system' is that it causes the *deficit* country to bear the brunt<sup>481</sup> of upholding the parity of reciprocal imports between itself and the surplus country. Quite simply, the situation leads to a sinister twist of fate in that it evolves to an internal savings for the surplus nation that inevitably comes at a *double and unjustifiable* cost<sup>482</sup> for the deficit country. Yet, as already emphasized though we will mention it once again, it is not the parity<sup>483</sup> itself that needs to be addressed<sup>484</sup> by the reform but the method through which it is attained<sup>485</sup> such that it does not entail a double payment of net imports.

Let us consider Schmitt's case-example whereby some deficit country's (e.g. Greece) net imports amount to a value of 4 dollars. The problem today<sup>486</sup> with the payment of this net expenditure, is that given that it implies a net foreign borrowing the reimbursement<sup>487</sup> of this external debt/loan, in a subsequent period, will in fact, simply renew the debt. Any time an

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<sup>481</sup> More precisely, we could even say that the deficit country bears the cost 'tout court' (of the attained parity), to use Schmitt's notable coined expression (*ibidem*).

<sup>482</sup> 'Let us suppose we refer to the political establishment of Greece. The actual 'non-system' of international payments forces you to pay both your own deficits (why would you object to that?) and, in addition, the equalization by R of its own imports with yours' (*ibid.*: 70). In Schmitt's case-example, Greece is implied as the deficit country, also referred to as country A, and R is intended as the surplus country. As Schmitt moreover points out, the realization regard this payment anomaly can't but cause the political authority of any deficit country (Greece, according to his example-country) to profoundly examine the following question. '[H]ow are they to prevent the equality between A's and R's imports from inflicting the *double* payment of surplus imports' (*ibid.*: 70)? That is, their dilemma being very clear: they are after all bound to the adherence of this equality according to the governing body of international payment transactions but nevertheless realize that the very equality bears dire consequences for them.

<sup>483</sup> 'The equality between the payment of Greece, country A, to the rest of the world, country R, and the payment of R to A is certain, imposed by the rule according to which any real value purchased and paid is the counter value of real goods purchased and paid. This rule is stronger than the reform itself, which must thus conform to it. Therefore, let us repeat it, the goal is only to avoid that the equality of reciprocal expenditures doubles the charge of surplus imports in external transactions' (*ibid.*: 70). Schmitt's reference to country A, his example-country (e.g. Greece) implies the deficit country; country R is implied as the surplus country.

<sup>484</sup> '[I]t is not a question of fighting against the equivalence of imports between countries A and R carrying out international transactions' (*ibid.*: 72). A and R, intend the deficit and surplus countries respectively. Rather, Schmitt is very clear on his reform mission: 'it is necessary to completely change the method by which country R's expenditures become immediately equal to the expenditures of country A. The equality is necessary, but it is permissible and remains possible to give it an entirely different form' (*ibid.*: 72).

<sup>485</sup> 'The time has come to explain, clearly and simply, how Greece, for example, will prevent the additional import of R, engendered by its own, to impose the double charge of its external debt' (*ibid.*: 70). The reference to 'external debt' intends the deficit itself, that is, the net imports of the deficit country, e.g. Greece.

<sup>486</sup> That is, given the current deficient status of our 'system' of international payments.

<sup>487</sup> As Schmitt points out, '[i]t is the repayment of the sum lent that defines, before the reform, the external debt of country A' (*ibid.*: 97). Country A intends some deficit country.

old sovereign debt (pre-reform) is reimbursed<sup>488</sup>, a new gap is created between the deficit country's total expenditures and its total receipts, the payment of which, returns<sup>489</sup> its sovereign debt to its previous level. As such the deficit country loses, forever, a part of its domestic income, equivalent MR value of its net imports (4 dollars) and this in addition<sup>490</sup> to an expenditure of same value already spent (in  $p$ ) for the final settlement of its net imports in money terms, to the benefit of R's exporters. Only *one* of these payments should be sufficient not its *double* charge. Though, a *double charge rather than a single charge* is what unfortunately, manifests today. Again, to clearly understand this requires a firm comprehension of what the repayment of the first foreign loan, R to A (in following with the occurrence of A's net imports of period  $p$ ) actually implies. The reimbursement of this debt<sup>491</sup> incurred as of period  $p$ , can only take effect in a subsequent period  $p^*$ , through A's export of products produced in  $p^*$  and, that it relinquishes to R *free of charge*. This means, that the actual reimbursement effectively serves as an internal savings for R as a whole, in that it pays for an equivalent amount of R's own imports (in essence A pays, itself, that part of its very exports of the period,  $p^*$ ). The very repayment<sup>492</sup> of the loan (incurred in  $p$ ), thus renewing A's external debt in that A must again borrow abroad to recover the loss of export revenues (used to repay the loan incurred in  $p$ ) to cover/pay its now uncovered imports of the period ( $p^*$ ), the resulting new gap.

Now, we have mentioned earlier that only one payment should suffice with respect to the deficit country's (A) net imports, rather than a *double* charge. But, international payment transactions happen in such a way today, that in fact, *two*<sup>493</sup> *distinct and additive expenditures* (same MR value) are indeed required to finally pay A's net imports. It is irrefutable<sup>494</sup>. The

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<sup>488</sup> '[T]he pathological impact of the transfer of goods of 4 dollars value is simply to restore immediately the sum of foreign currency spent' (ibid.: 71).

<sup>489</sup> '[I]nstead of being actually paid through the expenditure of 4 (billion) dollars, the external debt is merely reproduced by an amount equal to itself' (ibid.: 71).

<sup>490</sup> 'Economy A gives up values formed in  $p^*$  on top of the payment to R's exporters. The first of these payments is real (real value to be produced in  $p^*$ ); the second payment is monetary (settlement of net expenditures)' (ibid.: 74). But most importantly the fact is, that **both** payments take place as of period  $p$ , the very period in which the net imports under examination initially manifest: a double charge/debt is thus incurred in one same period, by the deficit country (A).

<sup>491</sup> 'This debt can be paid, that is cancelled, only through the export of products of a total value of 4 dollars formed in  $p^*$  by economy A' (ibid.: 74). The reference to 4 dollars is the actual amount of the loan R to A (in  $p$ ), same MR amount of A's net imports ( $p$ ).

<sup>492</sup> Any time an old sovereign debt is repaid (which payment takes place in  $p^*$ ) a new gap is formed between A's total expenditures and receipts, the very payment of which brings back A's sovereign debt to its previous level.

<sup>493</sup> 'The total cost is of 8 dollars, because country R becomes the owner of A's domestic goods that this economy does not pay through its exports. The monetary cost of this appropriation by country R is of 4 dollars, expenditure whose sole effect is to enable a payment in money R that would otherwise have occurred only in money A. We thus understand that the transfer to economy R, outside A's exports, of a real product of A of 4 dollars value has a total cost of 8 dollars, which economy A firstly incurs in order to transfer outside equilibrium (and therefore through a loan) real products of 4 dollars value and, secondly, to transmit them in units of money R (4 dollars) instead of through a payment in money A' (ibid.: 75).

<sup>494</sup> Schmitt, very clearly, explains why indeed 'each of the two payments is as necessary as the other' (ibid.: 75). 'R's exporters require to be paid off by products of  $p$ , worth 4 dollars ...

reason being is that it is not enough that the surplus country (R) be credited<sup>495</sup> with *real* goods (equivalent MR value of A's net imports, e.g. 4 dollars), there remains the problem that A can only convey these *real* goods by the *expenditure*<sup>496</sup> of the 4 MR obtained as counter-part from R, through the latter's lending to A. When particularized, it amounts for A, to an expenditure of 4 MR equivalent value, just so R's domestic economy can acquire ownership<sup>497</sup> (*as of period p*) over the *real* goods that are clearly absent from A's exports of period (*p*), which *real* goods will be produced and exported *free of charge* by A in *p*\*, to the benefit of R *as a whole*; and in addition, a further expenditure<sup>498</sup> of 4 MR is required of A such as to enable the transfer of these *real* goods to R, in money R. It is this second *additional* payment-expenditure that effectively loses for the deficit country (A), as a whole, a part of its domestic income (equivalent MR value to its net imports), in that the very compensation/counter-part

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R's lenders require to be paid by the equivalent of the 4 dollars that their country (R) would have added to its import expenditures of *p*\* (ibid.: 75).

<sup>495</sup> Schmitt elaborates his explanation in this regard by distinguishing between 'expenditures-without-receipts' versus those expenditures of the deficit country that have reciprocally equivalent receipts. 'As long as expenditures are equal to receipts, it obtains, in foreign currency and for free, the equivalent of what it earns. Equal to 10 dollars value, expenditures cost the country 10 dollars in real exports. It is true that this exchange between equivalents takes place through the intermediation of money. But, as a consequence of the real balance the monetary exchange is also balanced ... Things are obviously different with regard to the sum of 'expenditures-without-receipts', equal to 4 dollars, that economy A carries out in period *p*. Even if country R is already credited for real goods of 4 dollars value, in addition to the goods already exported by country A within the equality of its receipts, country A can only transmit these goods by the expenditure of 4 dollars, a sum that it does not obtain from its exports' (ibid.: 75).

<sup>496</sup> Country A, as a whole, thus retains no compensation whatsoever from the said loan R to A (period *p*). What this effectively translates to, is that, country A as a whole loses *unjustifiably and forever* a part (equivalent MR value of its net imports of same period) of its domestic income: hence, the *double* charge of net imports, for the deficit country (A). 'The sum obtained from fund providers should remain available in A's economy, which is already forced to later export gratuitously domestic goods to a value of 4 dollars that are the real objects of the loan of 4 dollars' (ibid.: 76). The fund providers are intended to mean lenders of R; the reference to the value of 4 dollars implies the amount of A's (deficit country) net imports for which the loan (R to A) is initially contracted.

<sup>497</sup> 'The total cost incurred by country A for the difference between its payments (of 14 dollars) and its receipts (of 10 dollars) is hence of 8 dollars: 4 dollars for economy R to become the owner of the goods missing from economy A's exports and 4 additional dollars for country A to transmit these goods through the expenditure of a foreign currency' (ibid.: 75).

<sup>498</sup> 'Let us now analyze the second payment inflicted on country A: the value of its domestic income that becomes the property of country R. We posit that the domestic income of economy A is the equivalent of 150 dollars in period *p*. 'Normally' this product must be fully preserved in the assets of country A. Indeed, economy A borrows 4 dollars abroad so that R obtains the full payment of country A's imports. It is unfair and even dishonest to require that, in addition, economy A gives up ownership of a domestic income of 4 dollars value to country R. Yet this is the case; mere observation of the facts confirms it' (ibid.: 76). Specifically, the deficit country (A) gives up ownership of this domestic income, *forever*, when it loses all compensation related to the loan (R to A) by *spending* the very loan to pay its net imports ultimately, in money terms (money R).

of the loan (R to A) *is spent* in transferring over to R the *real* goods (very object of the loan R to A) in a foreign currency. This loss is essentially the *double* charge for the deficit country (A), in regard to its net imports. Country A, never recovers this, forever lost, domestic income. Yet, it still owes the reimbursement of this very loan in a subsequent period ( $p^*$ ). And, to add insult to injury, this exact reimbursement will have the only effect of actually renewing A's external debt incurred as of  $p$ . Indeed A will, in effect, call forth solely the **renewal**<sup>499</sup> of its external debt through the very reimbursement of the loan/debt that it has incurred in  $p$ . This is because on reimbursing the debt in a next period to  $p$  (in  $p^*$ ) with the foreign currency (MR) obtained from its (A's) exports-revenues of  $p^*$ , the only effect of this reimbursement is to leave country A with a gap in MR for which it will have to obtain yet a new loan from R. It will require this new loan in order to be able to cover in money R, its now uncovered imports of period  $p^*$ , result of having used some of its exports-revenues (money R/MR) to carry out the reimbursement of its loan/debt incurred, as of period  $p$ .

Now, we should discern that though A's domestic income is decisively lost through its second expenditure (period  $p$ ), that is, through its payment in money terms (MR) to the benefit of R's exporters, the **ownership**<sup>500</sup> of this domestic income of A is lost<sup>501</sup> as of the latter's very first *real* payment (period  $p$ ) to the benefit of R's lenders who purchase it (A's internal income) in the form of financial securities<sup>502</sup>. In fact, it is *as of this appropriation by R* of A's internal

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<sup>499</sup> 'We thus face again the important question of who is the beneficiary of the purely pathological reproduction of debts apparently settled through the expenditure of 4 dollars. If, instead of being actually paid through the expenditure of 4 (billion) dollars, the external debt is merely reproduced by an amount equal to itself, it must be at the ultimate profit of 'somebody'; who is this 'person'? It is essential to know that' (ibid.: 71). In fact, it is at the profit of country R, as a whole: and in this sense, we could more precisely say that ***it is at the profit of a financial bubble***. Schmitt elaborates on the paradoxical meaning of this by explaining the 'double effect' of an *expenditure* of foreign currency for the deficit country, e.g. Greece in his example-case. 'When a country like Greece spends 4 dollars, there is a double effect ... *First effect of the expenditure*: payment of the creditors = 4 dollars ... *Second effect of the expenditure*: payment to a 'financial bubble' = 4 dollars ... Only the second effect must be countered; the first payment is maintained as a debit of Greece and a credit of the rest of the world' (ibid.: 72). His reference to 'the rest of the world' intends some surplus country R.

<sup>500</sup> 'The product concerned changes owner since period  $p$ , when the loan is granted; the additional import of country R belongs therefore to period  $p$ , whereas the product that is its object will be provided only in  $p^*$ ' (ibid.: 76).

<sup>501</sup> 'The transfer of an income of A is carried out through the borrowing of 1 dollar abroad' (ibid.: 81).

<sup>502</sup> 'Once the necessary equality between A's imports and R's imports in each period is acknowledged, it is known with certainty that the deficit country (A) is deprived, period after period, of the possession of the part of its current product whose value is equal to its 'imports-without-exports'. The surplus of country A's imports is thus already fully paid even before its economy spends, in favour of R, the sum of foreign currency borrowed abroad' (ibid.: 80). As such we could say that in period  $p$ , country A loses twice over, its domestic income: a first time in that it loses, in  $p$ , the ownership of a future part of its internal resources (A's payment, in  $p$ , to R's lenders) and, a second time in that it loses, in  $p$ , an actual product through the very ***expenditure*** (A's payment, in  $p$ , to R's exporters) of its foreign borrowing (loan R to A). Specifically, the first loss relates to the *real* goods that it will produce *free of charge* in a subsequent period to  $p$ , to the benefit of R as a whole; the second deprivation is the loss of an actual product (of period  $p$ ), result of the external debt incurred by the deficit country (A)

income (country A's financial securities being the very object of the loan R to A) that **the parity of reciprocal imports**, between the two countries, **is attained** (always same period  $p$ ). And, **this very parity is what leads to the double charge** in that even though the actual *reimbursement* of the loan/debt incurred in  $p$  will only take place in period  $p^*$ , the debt is indeed incurred as of period  $p$  (the parity of reciprocal imports, itself, is evidence of this), **in addition** to the second expenditure in money terms of the same period  $p$ .

Schmitt explains the significance of the two additive expenditures in his analysis of the *double charge* that results from it for the deficit country (A) in regard to its net imports. He does this by distinguishing between two distinct beneficiaries of A's *double payment/expenditure*, that of 'foreign lenders' and, 'foreign exporters'. He begins by clarifying that, the first payment of A (to the benefit of 'foreign lenders'<sup>503</sup>) of an amount, MR equivalent to A's net imports, takes the form of financial securities that are essentially the object of the loan that A receives from R. He points out that even if this was A's sole<sup>504</sup> expenditure, it *should* indeed serve as sufficient payment of its debt incurred, result of its net imports of  $p$ . That is, given that the expenditure/payment after all involves the transfer over to R of *real values*, notwithstanding *real values* that it will produce and export to R, only in  $p^*$ . Still, R appropriates this internal income of A, as of  $p$ . Most importantly, he reminds us that this first expenditure of A is what, in fact, guarantees<sup>505</sup> the parity of reciprocal imports for the two countries A and R respectively, and this<sup>506</sup>, as of period  $p$ . In particular, the parity is the consequential effect<sup>507</sup> of paying A's net imports *via an external borrowing*. Schmitt then

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following its *monetary* payment of its net imports. This debt itself also defines a loss of A's domestic resources to R.

<sup>503</sup> 'These fund providers will only be repaid in a period,  $p^*$ , subsequent to that of the formation of country A's net expenditures,  $p$ . A loan that is repaid in  $p$  could not serve to justify A's deficit in  $p$ . Being repaid in  $p^*$ , this loan constitutes a free import of country R' (ibid.: 76). The reference to 'fund providers' intends R's lenders or, the 'foreign lenders' that lend to A.

<sup>504</sup> 'If this expenditure existed alone, the deficit country would already pay the totality of its debt to the rest of the world. Formed in  $p$ , the debt of country A, a value of expenditures and receipts in international trade of 4 dollars in our numerical example, is entirely paid by the transfer to country R of economic values of 4 dollars, which economy A will produce in  $p^*$ ' (ibid.: 76).

<sup>505</sup> 'The first expenditure is important for a second reason, because it maintains the equality of countries R's and A's imports ... In  $p$  the expenditures (imports) of country A are equivalent to 14 dollars while the imports of R are only equal to 10 dollars. However, the loan of 4 dollars means ... the purchase by country R in period  $p$  of an additional product of A's economy. This additional purchase of foreign goods is, by definition, a surplus import. Consequently, in period  $p$  country R's imports reach the value of 14 dollars, the same exact amount of country A's total imports. The equality of  $im(R)$  and  $im(A)$  results from the payment, through a foreign loan, of country A's net expenditures' (ibid.: 76).

<sup>506</sup> '[T]he additional import of country R belongs therefore to period  $p$ ' (ibid.: 76).

<sup>507</sup> 'The equality of  $im(R)$  and  $im(A)$  results from the payment, through a foreign loan, of country A's net expenditures' (ibid.: 76). The crucial difference that the reform will bring with respect to this equality (parity of reciprocal imports between A and R), is that it will achieve it through the counter-loan (A to R) of the 'Bureau' whereby R will obtain from A an equal MR value of A's net imports amount, in the form of financial securities (or whatever other form), thus increasing its own imports from A (moreover in  $p$ ) by a same amount. Said another way, the reform will allow R to obtain (via the counter-loan of A's 'Bureau') a measure of A's domestic resources equal to that of its (R) own output exported to A. Today,

carries on with his analysis by explaining the essence of the second payment/expenditure of A's (to the benefit of 'foreign exporters'<sup>508</sup>). On thinking about it, it is here that the evidence of an anomaly<sup>509</sup> (the *double* charge) becomes undeniable. Through this second expenditure, in money terms, A settles the payment of its net imports, to the benefit of R's exporters<sup>510</sup>. It suddenly becomes obviously odd that, yet, country A still bears a second owing cost with regard to its net imports of  $p$ , the reimbursement (nonetheless legitimate) to lenders of R (in  $p^*$ ), for the *related* loan granted by R to A in  $p$ . It becomes clear that through its second expenditure (to the benefit of R's exporters) country A, as a whole, loses the counterpart of its first expenditure/payment, the domestic income (financial securities) that was spent to the benefit of R's lenders (loan R to A). Yet regardless of this loss, it still owes and quite understandably, R's lenders in a future period  $p^*$ : it is the reimbursement of this first loan (R to A) that will create an internal savings for R as a whole, at the time of reimbursement in  $p^*$ . Though both beneficiaries of A's *double* payment, exporters and lenders of R respectively, are legitimate in that A does legitimately and respectively owe them both (at least from their perspective), it is undeniably at an illegitimate extra cost for country A. The *double* charge is a fault that results from the method that is resorted to, today, by the deficit country in order to pay its deficit, the net imports. It is a fault that stems from the currently deficient infrastructure of our international 'system' of payments: the very method by which the parity of reciprocal imports between the commercially exchanging countries (deficit and surplus countries, specifically) is upheld. Schmitt sums it up very simply by distinguishing<sup>511</sup> the two

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the *real* payment of A's net import is achieved through the appropriation by R of part of A's *future* output. Tomorrow, the *real* payment will no longer involve A's future production, it will instead take place through the cession of part of A's *actual* resources (in the form of financial securities, for example).

<sup>508</sup> That is, R's exporters.

<sup>509</sup> 'What explains the state of affairs is the formation of two distinct debts of 4 dollars, and therefore of a total debt of 8 dollars, caused by a single external borrowing. This is clearly a serious anomaly. It is to avoid it that introducing the reform becomes necessary' (ibid.: 77). It should be noted that the '4 dollars' reference relates to the MR amount of some deficit country's net imports.

<sup>510</sup> Schmitt sums up the double cost of the deficit country's (A) net imports in that its payment is owed twice, that is, to the both of two distinct beneficiaries of R. 'Country A borrows 4 dollars abroad. We quite naturally conclude that country A's external debt increases by 4 dollars. This is correct but not enough. The first effect of the new debt is to give country R the ownership over goods that country A will have to produce and export in order to pay its debt. This is, for country R, the very object of its loan. But the new debt has a second effect: it adds 4 dollars to the expenditures of economy A. The debt incurred would still be equal to 4 dollars, if the expenditure for A's imports were the reimbursement to the foreign lenders. As this is not the case, lenders have still to be reimbursed; this is the second external debt of country A' (ibid.: 77).

<sup>511</sup> 'The simplest way to express these two debts is to distinguish between them as follows. The first debt of 4 dollars is an amount of real goods that economy A will have to export to obtain the 4 dollars it owes to foreign lenders. The second debt of 4 dollars is explained in a totally different way, because it means that economy A owes its own domestic product, up to 4 dollars, to country R' (ibid.: 77). The reference to 'economy A' intends that of the deficit country A; the 4 dollars is the amount of the deficit/net imports. What needs to be clear is that the second expenditure loses (in that it retains no 'counterpart' to the loan from R, in  $p$ ) for country A *as a whole*, an equivalent part of its domestic income/resources (MR equivalent value to its net imports of  $p$ ), to R; the second expenditure is effectively the loss of an actual

resulting debts incurred by A: the *first* is an amount (MR equivalent of its net imports of  $p$ ) of *real* goods that the deficit country's (A) domestic economy will have to produce as well as export (free of charge) in a subsequent period  $p^*$  such as to convey to lenders of R the payment (which payment translates into an internal savings for R, as a whole<sup>512</sup>) it owes them for the loan (R to A) obtained in  $p$ ; the *second* debt<sup>513</sup> that A incurs has a special meaning in that in itself it defines a loss of A's domestic resources to R: a loss of an actual product (of period  $p$ ) caused by the external debt incurred by A following the *monetary* payment of its net imports, the very expenditure of which effectively leaves ***no compensation whatsoever remaining for A*** (this compensation is expended, in  $p$ , in the payment of its net imports in money terms). Country A retains no 'counter-part'<sup>514</sup> whatsoever (in  $p$ ) for its initial loan from R and yet, it still owes a reimbursement in  $p^*$  in relation to this very loan (R to A). The deficit country *as a whole* thus loses, forever<sup>515</sup>, a part (always MR equivalent value to its net imports of  $p$ ) of its domestic income to the benefit of R.

The pathological situation with regard to the payment of net imports is clearly captured in two of Schmitt's figures (Figures 27 and 28; see Schmitt 2014). We have reproduced them exactly by including two diagrams numbered 6.1 and 6.2, which diagrams represent Schmitt's Figures 27 and 28, respectively.

Diagram 6.1 (adapted exactly from Figure 27 of Schmitt 2014) evidences the double effect that the payment of country A's external debt, the very deficit brought about by the mere fact of its net imports, actually implies. We see from Schmitt's clear depiction that the double charge manifests as a result of a payment (of same value, each of an equivalent MR value of the deficit country's net imports) that is paid to two distinct beneficiaries of R, thus paid ***twice***

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product (***of period p***) caused by the external debt incurred by A following its *monetary* payment of its net imports.

<sup>512</sup> It is country R *as a whole* that will benefit from an internal savings in  $p^*$  when A will effectively carry out its reimbursement of the loan it received, in  $p$ , from R's lenders. This cause, the very reimbursement means that A pays for a part of R's own imports, hence a part of A's very exports of  $p^*$ ; A pays these exports itself, that is, *in lieu of* R paying for them.

<sup>513</sup> 'The expenditure by country A of the sum borrowed abroad is ... the *second* cost of its net imports' (ibid.: 80).

<sup>514</sup> Schmitt describes the case scenario with country A, the deficit country, as his case-example. 'The income created in money A by the domestic production of economy A is equivalent to 150 dollars. Yet, to the extent of 1 dollar, the first effect of the surplus import is to limit to 149 dollars the ownership of this income by country A's residents. This decrease is at first offset, because country A's economy owns 1 dollar as a 'counter-part'. The second effect of the surplus import deprives country A of this 'counter-part'. From that point on, it is certain that the cost of the surplus import is *double*, because country A additionally gives up an amount of real goods that its domestic economy will produce in a subsequent period ( $p^*$ ). The loss of future products is equivalent to 1 dollar. The net loss of a current income is also equivalent to 1 dollar. The total transfer amounts to the equivalent of 2 dollars, that is, to the value of the net import 'multiplied by 2' (ibid.: 81).

<sup>515</sup> 'What has to be fully understood in this regard is the fact that the expenditure of the sum borrowed has only one effect: it means that *country R appropriates a domestic income of economy A worth 4 dollars*. Although country A brings its exports to the level of its imports, by adding the value of the domestic goods given up at zero cost in  $p^*$ , it loses in period  $p$  the ownership of its own domestic income to the extent of 4 dollars value. *The second cost of the difference between expenditures and receipts is therefore entirely defined by the loss of ownership over the amount of income formed in money A*' (ibid.: 77). The reference to '4 dollars' intends the MR value amount of some deficit country's (A) net imports.

*in total* and as such resulting in a *double* charge of A's net imports. An external debt of 4 MR (dollars) is '*confirmed*' as of period  $p$  (see Schmitt's bold line representation), notwithstanding, with the actual reimbursement (see Schmitt's dotted line representation) of its associated loan to the benefit of external lenders ('Lenders in R'), set for some later period  $p^*$  ('export of goods equal to 4 dollars'); still, a sum of 4 MR (dollars) is '*paid*' as of period  $p$ , to R's exporters. Clearly, two distinct expenditures are necessary, today, in relation to a deficit country's net imports.

Diagram 6.2 (adapted exactly from Figure 28 of Schmitt 2014) merely confirms Schmitt's claim of the *double* charge of the deficit country (A)'s net imports, the very deficit that doubles its external debt, on account of the fact that it implies a net foreign borrowing. The *double* charge being that the deficit country (A) loses, forever, a part of its internal income when the latter (object of R's loan to A) is decisively *spent*<sup>516</sup> in order to finally settle, in money terms, the payment of its net imports. And this, on top of the 4 MR (dollars) value that is still owed to the benefit of R's lenders, and that A will reimburse in a future period through the relinquishing of an equivalent MR value of its exports, free of charge, to country R as a whole.

We have included a third diagram (Diagram 6.3) to show the greener side of a potentially future situation, that is, as Schmitt's single country reform would bring. His reform will radically modify the way by which the parity of reciprocal imports is attained such as to counter the double charge currently implicated in the payment of net imports. Specifically, the appropriation by R of the deficit country's (A) internal income will be definitely curtailed. As depicted in our diagram 3, the counter-lending<sup>517</sup> loan of A's 'Bureau' (A to R) of same MR value<sup>518</sup> of its own loan from R (R to A), will effectively neutralize the *monetary* cost of A's *real* payment such that it is conveyed *free of charge*. The parity of reciprocal imports is thus attained whilst avoiding the *double* charge; the reform's (Schmitt 2014) method of upholding the very parity impedes the appropriation by R of A's domestic income. This is achieved given the net imports are paid through the ceding of A's *actual* resources rather than through a future export as it currently (pre-reform) happens. That is, whereby the parity of reciprocal

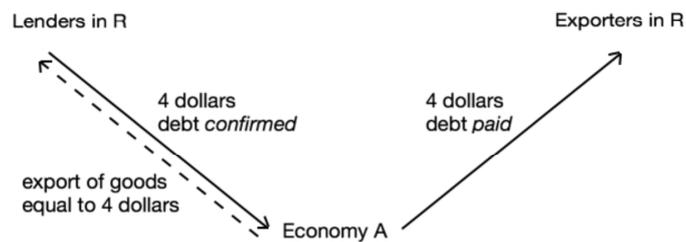
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<sup>516</sup> 'The sum of money R that country A borrows in  $p$  is definitely spent, and therefore lost to it from this very period on, because it is added to the payments of its purchases of  $p$ ' (ibid.: 77).

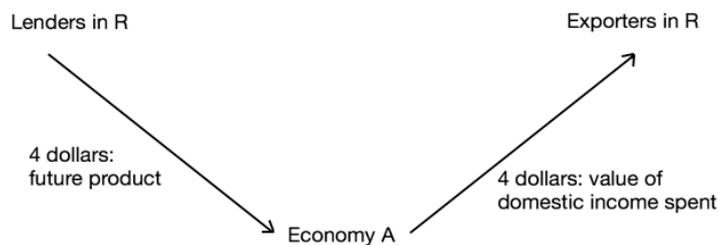
<sup>517</sup> '[T]he sovereign Bureau adds, as we have already established, a reverse loan. We thus have the coexistence of two equal-size financial transactions, which 'contradict' one another: the loan of 1 dollar granted by R to A is offset by the loan of 1 dollar granted by A's Bureau to non-residents. It is understood that borrowers and lenders in the economy R are distinct residents' (ibid.: 62). A intends some deficit country A and, R some surplus country.

<sup>518</sup> In keeping with Schmitt's description (ibidem: 62), we refer to an example amount of 1 dollar. More importantly, it should be clarified that though the diagram (3) representation shows a nullification-effect (depicted by the Xs crossing over the first loan that A receives from R's sleeping partners) that the counter-loan (A to R) of the 'Bureau' has with respect to the first loan (R to A), **both** loans (R to A and A to R, respectively) are necessarily maintained. The obvious reason for this is that each of the two loans implicates particular residents of R, that is, the borrowers of R (loan A to R) are different citizens of R than the lenders of R (loan R to A). Otherwise, the counter-loan of the 'Bureau' would be nonsensical. 'It is essential to observe that the two loans ... both subsist; they cannot cancel each other out. It is true, of course, that the foreign currency borrowed and lent is a zero-sum; yet the initial borrowing and the lending that follows it are two positive transactions even though one is the inverse of the other. This is the case simply because the Bureau lends 1 dollar to residents of R distinct from the initial lenders' (ibid.: 78).

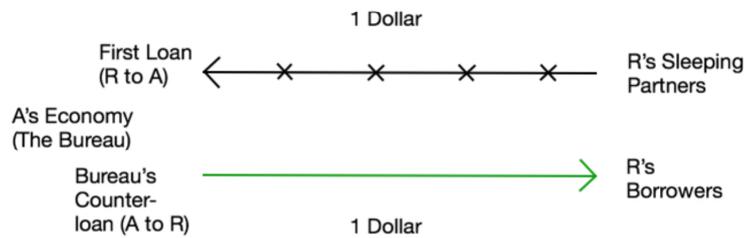
imports is, today, obtained through the payment of net imports (A's) *via an external loan*. The significant difference that the reform will bring is that it will attain the parity of reciprocal imports in such a way as to avoid today's *double charge*. It will achieve this through the counter-loan (A to R) of A's (deficit country) 'Bureau' whereby R (surplus country) will obtain (in  $p$ ) from A an equivalent MR value of A's net imports amount, *in the form e.g. of financial securities*, thus increasing its own imports from A (moreover still in  $p$ ) by a same amount as that of its own *net* output exported to A (A's net imports of  $p$ ). The parity of im (A) and im (R) will thus be obtained (in  $p$ ) through the counter-loan (A to R) of A's 'Bureau'.



**Diagram 6.1:** Adapted from Schmitt (2014, p. 74: 'Figure 27 The repayment of A's external debt')



**Diagram 6.2:** Adapted from Schmitt (2014, p. 76: 'Figure 28 The double charge of A's external debt')



**Diagram 6.3:** Monetary cost of A's real payment is neutralized (reform effect)

### **Comparing today's way of attaining parity of reciprocal imports with tomorrow's way**

The first aspect to note in what the reform will bring in regard to the new attainment of this parity is a change in the basis of comparison, that is, specifically regard the *measure*<sup>519</sup> of reciprocal imports. The significant change is that no longer will the deficit country's output (A's) of a *future period*  $p^*$  be implicated. In this way<sup>520</sup> the reform assures that none, of A's internal resources (income), is appropriated by R (surplus country). The effect being that the monetary worth (value) of the surplus (R) country's imports does not ultimately increase as it did pre-reform. And this *non-increase* effect<sup>521</sup>, itself, derives exactly from the neutralizing

<sup>519</sup> 'The equality of reciprocal imports is always maintained but its measure is profoundly changed' (ibid.: 82).

<sup>520</sup> In Schmitt's own words, the following is what the reform will establish. Once again, his reference to 'A and R', intend some deficit country (A) and some surplus country (R), respectively. 'In each period  $p$  all payments involved belong to this period, no product of a later period ( $p^*$ ) being involved. In the example of A and R, no domestic product of economy A becomes the property of the rest of the world, R. The sovereign Bureau acts in such a way that R's imports in period  $p$  relate all to the period  $p$  itself. The value of R's imports is thus equal to 10 dollars and no longer to 11 dollars, as is the case before the reform. This reduction in the value of R's imports is a direct result of the cutting out of the first external loan of country A' (ibid.: 81).

<sup>521</sup> In fact, the reform effect with regard to R's imports from A, is that country R does not increase them but instead, it (R) pays less for them; that is, if we grasp the very effect of the deficit/reforming country's counter-loan (A to R): what this loan accomplishes is that A pays for a part (MR equivalence of its net imports value) of its (A's) own exports, in lieu of R. Thus, the result being that R pays less for its total imports from country, A. This is why R also receives less (MR value of A's net imports) for its total exports to A. In today's non-system of international payments, the equality between IM and EX with respect to each trading country (e.g. A and R) is complied with, as is the parity of reciprocal imports between the said countries, because R (surplus country) increases its imports from A and thus, likewise, A increases its exports to R. In tomorrow's *reformed* system, the equality (between IM and EX,

effect that the counter-loan of the 'Bureau' has on A's initial loan from R. We remember that though this loan (R to A) guaranteed (pre-reform) the parity of reciprocal imports between R and A, it did so in such a way as to allow R's appropriation of a part (same portion MR value amount as A's net imports) of A's internal resources. What the counter-loan (A to R) of A's 'Bureau' will do is that, in neutralizing<sup>522</sup> the first loan that A receives from R, it will essentially arrest the very appropriation effect of this first loan (R to A) and not to mention along with it, the first charge (pre-reform) of A's net imports (monetary cost of the *real* payment of its net imports); country A will retain only the *real* cost of the *real* payment of its net imports and this, through the counter-loan of the 'Bureau' (A to R) which will effectively transfer to R a part (equivalent MR value of A's net imports of *p*) of A's *actual* domestic resources. The difference brought in by the reform being that by allowing R to acquire a part of A's *actual* versus *future* domestic resources (as it happened pre-reform given the net foreign borrowing that was implied in A's payment of its net imports), it avoids for the deficit country (A), a **double** charge of its net imports. Now the resulting effect of the counter-loan of the 'Bureau' regard the maintaining of the parity of reciprocal imports is that the equality is indeed safeguarded though, *arrived at*, in a different yet non-detrimental way<sup>523</sup>, particularly when considered from the perspective of the deficit country. Let us next examine this more closely.

We have already mentioned that in neutralizing A's initial loan from R, the counter-loan of A's 'Bureau', in effect, precludes the value of R's imports (from A) from increasing. This is because in neutralizing R's loan to A, it essentially neutralizes R's *purchase (appropriation) of a real value from A*, precisely, of an import from A (a part of its domestic income). What the reform will change is that the payment of the deficit country's net imports will no longer imply a net foreign borrowing (initial loan, pre-reform, R to A). The counter-loan of the 'Bureau' will have the effect of canceling out this loan (R to A). This essentially means then that no more will a *foreign* loan (R to A) be **the purchase thus the import** of a *real* value (output) of A's. So the new situation (reform) has it that instead of increasing the value of its

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for each respective country, A and R) will be respected without increasing R's imports, but by 'reducing' A's imports; more precisely said, by reducing the amount paid by A for its imports, which imports will, in effect, be paid by R to the same extent that A will pay for R's imports. It is the counter-loan (A to R) of the deficit/reforming country's 'Bureau' that is able to render this result.

<sup>522</sup> 'The Bureau has no trouble getting this cancellation. To this effect it is enough, as we well know, that it maintains the first external loan of 1 dollar but add to it the loan of 1 dollar to the benefit of R. It follows, without any difficulty, that the entire current income of economy A remains the property of country A. The 'expropriation' of an income of A exists in the current situation; this is undeniable for the simple reason that it is the effect of the net foreign borrowing of 1 dollar. As this borrowing is now offset by a loan, the loss of a domestic income is reduced to zero, because the 'import-export' balance amounts to a zero-sum debt. The resulting progress is of great importance, as country A will no longer lose a fraction of its domestic income to the benefit of R' (ibid.: 81).

<sup>523</sup> The benefit that the reform brings (through its counter-loan of the deficit country's (A) 'Bureau') is that it goes beyond maintaining the parity of reciprocal imports (the very equality is in fact also attained, pre-reform, via the external loan that A receives from R): it achieves the maintenance in such a way as to avoid the *double* charge of A's net imports. It is the counter-loan (A to R) of the 'Bureau' that is able to render this favorable result. 'It would therefore be useless for the reform to seek to establish the already verified parity of imports. The function of the Bureau is of an entirely different nature. It is a question of avoiding that the charge of surplus imports be increased to twice its value' (ibid.: 62).

imports from A (as it did pre-reform), R actually experiences a *value*-reduction (in comparison with pre-reform) of its imports from A in following with the countering-effect of the loan (A to R) of the ‘Bureau’. Now, this is R’s side of things. What happens then, from A’s side of it, with respect to maintaining the parity of reciprocal imports, the very equality that the international rule obliges, overall, of exchanging countries A and R respectively, in ours and Schmitt’s example-countries? Well, on examining Schmitt’s elaboration concerning this, we observe that the counter-loan of the ‘Bureau’ also affects how the deficit country upholds its side of the bargain (with respect to the parity of reciprocal imports between A and R, that is): the very *countering effect* of A’s counter-loan (A to R), simply and effectively, reduces the *value* of A’s total imports from R, by a same MR value amount of its (A’s) net imports. This is because the counter-loan of the ‘Bureau’ decisively conveys to R (in *p*) the *real* payment of A’s net imports (of *p*), thus effectively reducing the MR value amount of the totality of its imports from R (in *p*). In fact, the guarantee<sup>524</sup> of the *real* payment of A’s net imports **in the same period** that they actually originate (counter-loan of the ‘Bureau’ effect) **has the result of canceling A’s very deficit**: the net imports are no longer *net* and thus the previously *deficit* country (A) is no longer a *deficit* country per se. And, we observe that the parity of reciprocal imports is effectively maintained<sup>525</sup> between countries A and R (simply its measured dimension changes): the reform has it that A, through the counter-loan (A to R) of the ‘Bureau’, reduces the MR *value* (the quantity remains the same) of its total imports to the level of R’s total imports from A. The only difference being that the reform attains the parity in such a way as to curtail any adverse effect that pre-reform, lead to a *double* charge for the deficit country. Specifically, the reform (through the counter-loan of the ‘Bureau’) is able to maintain the parity without entailing a *double* charge by avoiding the very net foreign borrowing<sup>526</sup> that, pre-reform, obtained the parity *though not without* leading to a costly and unnecessary double payment for the deficit country.

Now, though we have shown how the reform maintains the parity of reciprocal imports, something has yet to be said about the respect of the balance-of-payments identity<sup>527</sup> between IM and EX of each of our example-countries, A and R respectively. This identity is also

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<sup>524</sup> Thus, in effect, the guarantee of the respect of the balance-of-payments identity between IM and EX is attained in *p* and moreover, with a product (A’s) of *p*. Pre-reform, it was the reimbursement in *p*\* of A’s net imports, with a product of A *also of p*\*, that not only defined country A as a *deficit* nation but more importantly, it entailed a *double* charge with regard its deficit incurred in *p*: that is, its very net imports of *p*.

<sup>525</sup> ‘[E]ven though country A runs a deficit, R’s imports are equal to and not less than A’s imports. R’s imports are always equal to A’s imports, even when country A runs a deficit’ (ibid.: 82). Specifically, the reform ensures that the parity is preserved, only ‘its measure is profoundly changed’ (ibid.: 82).

<sup>526</sup> ‘It is particularly advantageous here to compare the situation created by the reform to today’s state of affairs. In the present situation, A’s and R’s imports are nevertheless equal to one another although A carries out net imports. The equality between imports is maintained by the foreign loan that country A obtains in order to finance its surplus import. This loan provides an additional import to country R, which finally imports real goods of the same value as the goods imported by country A. It is the payment of A’s future exports that has this effect’ (ibid.: 62).

<sup>527</sup> We recall Cencini’s elaboration regarding this identity: ‘the current financial capacity of a country, and what it needs to finance all its external transactions, the necessary equality between its total imports (commercial and financial), IM, and its total exports (of goods, services and financial assets), EX’ (Cencini 2012a: 18).

guaranteed by the reform, particularly through the role<sup>528</sup> of the deficit country's counter-loan of the 'Bureau'. Considering the respect of this identity from R's perspective, we remember that the very counter-loan (A to R) precludes R's appropriation of A's internal resources (output) thus effectively reducing its level of external purchases, precisely, imports from A as enabled *pre-reform* through its loan to A. For example, the reform's effect (the 'Bureau's) has it that country R imports, say for a value of 10 MR versus 11 MR as the parity of reciprocal imports attained, pre-reform. But, if R's exports were originally of a value of 11 MR, then how is it that the reform also guarantees, for R, the respect of the balance-of-payments identity between its imports and exports (between IM and EX)? Quite simply, that is, if we consider that 1 MR value of its exports is counter-balanced by the 1 MR debit-value effect that the counter-loan (A to R) of the 'Bureau' achieves. The result being that on the very account of the counter-loan (A to R), country R effectively receives from A, for its exports, a credit of a mere<sup>529</sup> value of 10 MR: the very value of the entirety of its own imports from A, also now of a value of 10 MR. On the other hand, considering the respect of the identity between IM and EX from the deficit country's (A's) vantage point, we point out that yet again, the very identity is guaranteed. This is once more on account of the effect of the counter-loan of A's 'Bureau'. Though country A's deficit extended its (A's) imports to a net value of say, for example 11 MR (seemingly 1 MR in excess of its exports of 10 MR value), in reality, the reform has the effect of reducing this 11 MR value (of A's imports) to 10 MR, thus to a matching amount of its total exports, also of a value of 10 MR: it is the very effect<sup>530</sup> of the counter-loan (A to R), of a same MR value of its (A's) net imports, that is able to bring about this result<sup>531</sup>.

So the *circumstantial state of affairs* that the reform brings about is that not only does it maintain the parity of reciprocal imports between the deficit and surplus country, A and R respectively, it does so ***without entailing a costly and unnecessary double charge*** for the deficit nation. Moreover, it guarantees the respect of the balance-of-payments identity between each country's IM and EX in such a way (as effected through the mechanism of the counter-loan of the 'Bureau') as to guarantee the *real* payment of the deficit country's (A) net

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<sup>528</sup> 'This function of country A's Bureau enables in every period the general conservation of each country's imports at the level of its exports' (ibid.: 62).

<sup>529</sup> Schmitt describes the distinct circumstances that the reform will establish. '[C]ountry R does not suffer any loss of real income. It actually imports goods worth only 10 dollars, its exports being equal to 11 dollars. But this gain is entirely compensated by the debit of 1 dollar defined by the loan of A's sovereign Bureau. Given this debit, economy R is only credited with 10 dollars from abroad, the value exactly equal to the sum of its own imports' (ibid.: 62).

<sup>530</sup> In fact, what the reform attains (through the counter-loan, A to R, of the 'Bureau') is that it guarantees the respect of the balance-of-payments identity between IM and EX through the guarantee of the *real* payment of A's net imports (in  $p$  and, with a product of A from period  $p$  rather than from  $p^*$ ). It is not surprising then, to verify that A (through the reform) no longer incurs any sovereign debt and that its external debt is simply reproduced period after period (on condition, *bien sûr*, that its net imports remain constant). Specifically, the respect of the balance-of-payments identity (through the *real* payment guarantee of A's net imports, in  $p$  and with a product of  $p$ ) makes it that country A is no longer a *deficit* country per se: its *real* imports being fully covered by its *real* exports (in  $p$ ).

<sup>531</sup> 'According to the reform, even the deficit countries will import, in value terms, an amount exactly equal to their exports. Although its imports reach the value of 11 dollars, apparently 1 dollar greater than its exports, economy A imports a real income whose value is of 10 dollars only, at the same level as its exports. It is the loan of 1 dollar that the sovereign Bureau grants to residents of economy R that produces this outcome' (ibid.: 62).

imports and this, *in one fell swoop*, in  $p$ . Pre-reform, the deficit country's net imports were financed through the implication of an external loan (R to A) which meant that though an actual payment was contracted in  $p$  (country A precisely incurring an initial debt as of  $p$ ), the very reimbursement of this payment took place only in  $p^*$  and this entailed, for the deficit country, a *double* charge of its net imports. The counter-loan<sup>532</sup> (A to R) of the 'Bureau' effectively cancels this initial external loan (R to A) and along with it, the negative consequence (*double* charge) that it poses for the deficit country (A). More so, it does this whilst maintaining the necessary parity of reciprocal imports, as well as guaranteeing<sup>533</sup> the respect of the balance-of-payments identity between each nation's respective IM and EX.

### *Some correlating evidence and concluding observations*

In this section, we endeavour to show why, at the time of writing, two countries in particular might find solace in adopting Schmitt's single-country reform: The United Kingdom<sup>534</sup> and, Greece. Though both are currently members of the European Union (EU), the former is not a member of the euro area. This distinguishing factor may be a good starting point for the UK with respect to embracing the single-country reform: having never opted for the euro to replace its national currency, it would certainly be one step ahead in the reforming process. And, considering its increasingly growing disenchantment with the EU to the point of holding an upcoming referendum (currently planned for 2017) on its very membership of the union, Schmitt's reform may prove to be a timely and appealing outlet. Undoubtedly, it would protect the UK from the calamitous effect that the double charge of external debt has on its domestic economy and ultimately on its internal employment<sup>535</sup>, thus paving the way for a sound and fortified economic and financial rebound, independently of a union (EU) that, by

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<sup>532</sup> The counter-loan (A to R) of the 'Bureau' obtains, for the deficit country's (A's) 'imports-without-exports', the same *foreign currency intermediary role* that oversees the payment of its offset (ibidem) imports, such that the *real* payment of its net imports is effectively carried out free of charge. This result is attained through the 'debits-credits' effect that the counter-loan (A to R) creates with respect to the foreign currency (MR) that is implicated. 'Debits-credits formed in money R define this foreign currency as mere object of intermediation between real goods, whereas *net debits* of country A as a whole, scientific definition of its *sovereign debt*, lead to the use of *money R* as a specious real good' (ibid.: 30). We recall Schmitt's own description as to the overall beneficial aspect of the reform in this regard. 'The reform creates, for surplus imports, what already exists for offset imports, namely, the gratuitousness of the foreign currencies, which only serve to convert the payments already carried out in national currency ... Through the counter-balancing debt, incurred by R as a result of the loan granted by the Bureau, the sum of gains in foreign currency is equal to the sum of its losses despite the fact that imports exceed exports. The equality between losses and gains means that the foreign currency that provides the final form to the payment of net imports is for *free* for the reformed country, as is the foreign currency used for the payment of offset imports' (ibid.: 65).

<sup>533</sup> As previously indicated 'country A's Bureau enables in every period the general conservation of each country's imports at the level of its exports' (ibid.: 62).

<sup>534</sup> We intend all four constituent countries of the United Kingdom: England, Wales, Scotland and Northern Ireland.

<sup>535</sup> '[T]he charge imposed by surplus purchases is at first the equal decrease of domestic employment' (ibid.: 89). We will explicitly cover this effect as we elaborate on the role of a reforming country's 'Bureau'.

and large, strives to take the wind out of its sails. Let us begin then by considering the UK's case.

According to elaborated data<sup>536</sup> from the World Bank (2011) and the IMF (2011), the UK's gross external debt had spiraled to some 9.7 billion dollars by 2010 from an approximate substantially lesser amount of 5.4 billion in 2003. Though the evolution of the amounts is no doubt seriously alarming, the exactness of the numbers in the respective years under observation, is not as important *as is* the point of the following argument we wish to stress: the fact that a portion of the very amounts manifests, unnecessarily as well as cumulatively, as a consequence of an international payment system anomaly<sup>537</sup>. On analyzing further related data, Cencini (2012a) was able to evidence the existence of a substantial discrepancy between a *justified* and *unjustified* augmentation in the external debt of a country. The simplicity of his method is nonetheless efficient in corroborating his claim of an anomalous *unjustified* augmentation: very simply, he compares the *justifiable*<sup>538</sup> augmentation with that of the existing increase such as to detect any unjustifiable portion. As it turns out, his analysis of the pertinent data<sup>539</sup> concerning the UK, for the period in question, revealed an *unjustifiable* augmentation in its external debt by approximately 4,000 billion dollars compared with a *justifiable* amount of a mere 300 billion dollars. On considering it, unjustifiable amounts of this level, consists of a huge and unnecessary loss of internal resources for any deficit<sup>540</sup> country and which loss can't but impoverish it, in time, beyond sustainability. Not to mention the positive gains that its economy could benefit from, where it able to prevent this very costly and unwarranted loss of domestic income. Let us see how Schmitt's single-country reform could help a country such as the UK, not only eradicate the double charge of its external debt but as well, salvage the loss of domestic income that this *double* charge currently entails.

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<sup>536</sup> See Cencini 2012a: 17 and 29, Tables 2 and 10, respectively.

<sup>537</sup> '[T]he evaluation of the effects of such a destabilising increase in countries' external debt is far more negative once it is realised that part of it is of a pathological origin' (Cencini 2012a: 17).

<sup>538</sup> 'It is easy to establish that an increase in external debt is unavoidable insofar as a country's purchases of goods, services, and financial assets exceed its sales of goods, services and financial assets. Variations in official reserves have also to be taken into account, since every increase in a country's official reserves defines an acquisition of bank deposits denominated in foreign currencies, which has to be financed like any other acquisition of financial assets. Hence, the justifiable variation in external debt is determined by the difference between the acquisitions, commercial and financial, which a country needs to finance, and its capacity to finance them through its commercial and financial sales. A deficit in a country's current account and an increase in its official reserves require to be financed, while a current account surplus and a positive amount of foreign direct and portfolio investments increase a country's current financial capacity. If a difference is found between the current financial capacity of a country, and what it needs to finance all its external transactions, the necessary equality between its total imports (commercial and financial), IM, and its total exports (of goods, services and financial assets), EX, is restored through a loan obtained from the rest of the world' (Cencini 2012a: 17–18).

<sup>539</sup> See Cencini 2012a: 18, Table 3. 'Table 3 shows the difference between the variation of these countries' external debt that should have been observed, and the actual variations, a difference, entirely pathological, which measures the extent of the *unjustifiable increase in debt*' (Cencini 2012a: 18).

<sup>540</sup> We intend any country resorting to a foreign loan to cover, for example, the cost of its net imports.

In keeping with Schmitt's analysis<sup>541</sup>, let us first point out that whenever, in any period, a nation's exports are equivalent to its imports, the *monetary* income created in the said nation is preserved<sup>542</sup> within its economy. This is because its exports-revenues simply replace an equivalent monetary income spent. But such is not the case when it comes to its *net* foreign expenditures<sup>543</sup>: a discrepancy arises between its *real* and monetary incomes. And, it is on account of this discrepancy<sup>544</sup> that the value of the said deficit nation's *real* income is consequently reduced to the level of the value of accessible **monetary** income within its economy, which income is needed to purchase the country's product (output). The result being that, in effect, the very discrepancy between the deficit nation's monetary and *real* income reduces<sup>545</sup>, by a same amount, the value of the deficit nation's output: essentially, its internal employment<sup>546</sup>. Very simply, a deficit country's internal employment is reduced *in tandem* with its net expenditures of foreign currency (e.g. MR), hence by a same amount (MR value) of its net imports. This is a loss of domestic income for the deficit country that is no more available for the purchase of its country product (output): it is forever lost to the benefit of the surplus country (e.g. R) in that it *ultimately* serves to pay for a same portion of R's imports from A (deficit country), A's own exports<sup>547</sup>. In fact, this domestic income of country A, is lost as of the initial period in which it incurs a debt related to its net imports (effect of foreign loan from R) because it is *as of then* that A's domestic income is appropriated by R, and is thus no more accessible for the purchase of A's output (initial period). A's *real* income (its production<sup>548</sup> output), hence its internal employment, is thus diminished accordingly.

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<sup>541</sup> 'We analyze, with reference to a given period, an outflow of foreign currency equal to 14 dollars and an inflow equal to 10 dollars ... We give the two definitions of national income. In each period the new product is the real income produced, denoted  $inc(A) P$ ; the corresponding monetary income is  $inc(A) M$ . We first show that the country's income would be 4 dollars higher if country A's exports were equal to its imports ... Domestic income = 154 dollars if  $exp(A) = imp(A) = 14$  dollars' (Schmitt 2014: 88).

<sup>542</sup> 'To the extent that there is equality between country A's exports and imports, the monetary income formed in money A remains fully available in economy A: the income A spent is replaced by the income A obtained' (ibid.: 88).

<sup>543</sup> 'Yet, with respect to the net expenditures of foreign currency, 14 dollars are spent while only 10 dollars are earned ... *Difference between monetary and real incomes caused by the net expenditures in dollars ...  $inc(A) P - inc(A) M = 4$  dollars*' (ibid.: 88).

<sup>544</sup> 'If this difference were not taken into account, the value of the national product of each period would be  $inc(A) P = 154$  dollars. Yet, the income produced in real goods cannot remain at this level; on the contrary it falls in line with the value of the monetary income available for the purchase of national output' (ibid.: 88).

<sup>545</sup> 'As this value is reduced by 4 dollars, the level of real production is reduced accordingly, from the value of 154 to the value of 150 dollars. The value of the national product of each period is thus  $inc(A) P = 150$  dollars' (ibid.: 88).

<sup>546</sup> '[C]ountries experience a decrease in their domestic employment to the extent that their expenditures exceed their receipts' (ibid.: 88).

<sup>547</sup> 'The whole sum of income in money A that is spent in the purchase of dollars is thus obtained by A's exporters instead of being in part (4 value units) added to the income available for the purchase of national output' (ibid.: 89). The reference to money A intends the currency of the example-country, deficit country (A).

<sup>548</sup> 'This explains why the domestic income of economy A, formed in money A, is reduced by 4 MA relative to real income, which is therefore also reduced accordingly. If, over time, country A's production were of 154 units of value per period, it would only be equal to 150 units owing to the effect caused by its surplus imports' (ibid.: 89).

Thus, A's domestic unemployment increases in any period, *in accordance* with its net imports (all same period), that is, *in line with its net expenditure of foreign currency*. The reform will prevent this outcome<sup>549</sup> for the deficit/reforming country, that is, this loss of domestic income<sup>550</sup> that today the deficit country loses to the financial bubble. And the fact that the reform will aim to do this, will not only benefit A's economy but the overall welfare of R (any of its trading counter-parts in the rest of the world) as well. The rest of the world (R) has everything to gain from a mutually enhanced trading partnership, such as the healthier<sup>551</sup> (financially and economically more **sustainable**) climate that the reform<sup>552</sup> would, without doubt, bestow upon the economies with whom it trades.

Let us have a look then as to how exactly the reform will carry out its mission of salvaging<sup>553</sup> the domestic income that is currently robbed from a deficit country's economy whenever it contracts a *foreign* loan to cover the cost of its net imports or, simply, the difference between its expenditures and receipts of foreign currency. The process<sup>554</sup>, by which it will achieve this, is not at all complicated. Importers of A will direct the payment (in MA) of the totality of their imports to the 'Bureau' of its deficit/reforming country (A). The 'Bureau' will then pay (in MA) what is owed to A's exporters and, forward the difference (amount of MA that has no exports of A to cover, thus no exporters of A to pay) as *net gain* to its nation's government. Now the crucial factor here is that A's government must imperatively not utilize this gain as an income (of A's) **merely** to be spent on the purchase of already existing output within its economy. Doing so would not change<sup>555</sup> the pre-reform status of things. Instead, what the

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<sup>549</sup> '[U]nemployment in the economy should in no way increase because of the highly undesirable but certain effect of its net expenditures of foreign currency (dollars). Thanks to the reform, the production of economy A will remain at the level of 154 units of value instead of being reduced to the value of 150 dollars by the (pernicious and not yet corrected) effect of the net expenditure, in each period, of a value of 4 dollars' (ibid.: 89).

<sup>550</sup> In this sense, we can indeed agree with Schmitt that 'the charge imposed by surplus purchases is at first the equal decrease of domestic employment' (ibid.: 89).

<sup>551</sup> '[T]he reduction of the employment of country A's domestic economy is harmful to the rest of the world. The reform is therefore necessary both for deficit countries and for their partners of the rest of the world' (ibid.: 89). Country (A) intends some deficit country.

<sup>552</sup> 'The essential action of the reform will be – we have already noted it – to prevent the pernicious effect of the surplus of foreign currency expenditures over receipts, that is, the decrease in the deficit country's employment. It is obviously favourable to countries whose sales exceed their purchases on the international scene that unemployment does not increase in their partners' economies. This is precisely the aim of the reform' (ibid.: 89).

<sup>553</sup> 'Country A gets effectively indebted for 4 dollars to the rest of the world, but an equal credit, equivalent in dollars of the domestic income spent for net imports, is collected by the country whose net debt does therefore not increase' (ibid.: 94).

<sup>554</sup> Specifically, '[t]he situation will therefore be as follows in the example of country A ... The domestic settlement of 'expenditures-receipts' will be, as today, the payment in income A of exports by imports ... The domestic settlement of net expenditures will be, as it is not at all the case today, the profit in income A of country A's government ... In figures, the flows will be the following: of the total expenditure of 14 dollars, 10 dollars will be obtained by exporters, the value of 4 dollars, always in the form of an income in money A, being given free to country A's government' (ibid.: 96).

<sup>555</sup> 'Nothing is nevertheless modified if the government is satisfied with using this profit as an amount of income A corresponding simply to an income already waiting to be spent. The reform requires that the government's profit finances a new production, additional, of economy A' (ibid.: 90).

reform obliges is that the government spends its net gain by *financing yet an additional production to that of its domestic economy*. So that, for example<sup>556</sup> (in keeping with Schmitt's elaboration), if the deficit/reforming country (A)'s output was initially 154 dollars and, was subsequently reduced by 4 dollars (consequential effect entailed by the differential between its expenditures and receipts of foreign currency for which a net foreign borrowing is sought), A's government, through investment of its gain, will see that its country production is fully restored to that of the original level of 154 dollars. Thus, through its government investing into a new production whose products will not be sold onto A's already existent product market, the deficit/reforming country is able to, render to R the *real* payment<sup>557</sup> of its (A's) net imports in the same period in which they arise and, whilst **maintaining** all of its national (A's) income intact. We next elaborate on our meaning. We recall how the reforming country's 'Bureau' will counter-loan (A to R) the totality of its own loan (R to A) of foreign currency from R. In doing so, the 'Bureau' conveys the *real* payment<sup>558</sup> of A's net imports, to R (in same period in which they arise), all the while canceling the *double* charge that country (A) would otherwise incur with regard its net imports. But, the domestic income of A that is yielded to R, in conveying the *real* payment of its (A's) surplus imports, is nevertheless

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<sup>556</sup> 'Thanks to the reform, national production remains equal to 154 dollars. This gain provides a real advantage for both countries, R and A. Regarding country R, ... it is good for it to become the owner of the value of 4 dollars that increases economy A's national production at the level of 154 dollars instead than 150 dollars. Concerning country A, this increase of its domestic production, being entirely due to the additional employment generated by the government's action, decreases in the proportion of 4/150 the level of unemployment of the country' (ibid.: 90). Schmitt's wording with regard country R becoming 'the owner of the value of 4 dollars...' should be heeded, particularly with respect to the word *value*, in that what R actually gets for the *real* payment of its excess exports is simply the equivalent *value* of the amount pertaining to the new production of A's government. What is important to understand is that through the investment of its *net* gain (in MA, though equivalent MR value of A's net imports), A's government is the final purchaser/owner of the very goods and services produced through its government new production (4 dollars worth, in keeping with Schmitt's case example), for example, by the formerly unemployed youth (again to refer to Schmitt's example-case suggestion). In no circumstances are these goods and services produced for country R or, in order to be sold again on the reforming/deficit country's (A's) product market. ***What R obtains in payment (real) for its excess exports is part (equivalent MR value of A's net imports) of economy A's internal resources*** (conveyed through the counter-loan (A to R) of the 'Bureau').

<sup>557</sup> Again, this is not to say that the government's new production consists in the *real* payment of A's net imports, not at all; rather what R (surplus country) receives from A as *real* payment of its net exports, is the equivalent MR *value* of government A's new production, that is, an equal part of A's actual resources as produced by its domestic economy, in the form of, e.g. financial securities. '[C]ountry R becomes the owner not of the 'personal' product of A's government, but of the equivalent of this product in any of the goods of 150 dollars value produced by economy A in addition to its government' (ibid.: 91). And, we remember that this *real* payment of A's surplus imports is conveyed to R, through the counter-loan (A to R) of A's 'Bureau'. That is, the very 'loan in reverse that takes place at the moment country A sends 4 dollars to country R as payment of the equivalent of the domestic production of country A's government' (ibid.: 92).

<sup>558</sup> This *real* payment of country (A) could be, for example, in the form of financial securities.

maintained<sup>559</sup> in that it is gained in each period, by A's government who obtains from its 'Bureau', in money A, the equivalent of a same MR value amount of this *real* payment which, as already noted, the government invests in a new production<sup>560</sup>: the investment having an effect on A's production (e.g. thus its employment level) without increasing its current level of output<sup>561</sup> that is *available for purchase on its product market*. That is, the reform's idea behind the deficit/reforming country's (its government) new production (equivalent MR value of its deficit, the net imports) is not to increase the level of output (goods and services) to be sold **again** on its (A's) product market<sup>562</sup>. Through the investment of its *net gain/profit* in MA (money A), the government of country A is the **final purchaser** of these newly produced goods and services. For example, A's government might invest the *net gain* (MR equivalent to its net imports amount) transferred to it by the 'Bureau' in indispensable infrastructures the likes of roads, harbors, hospitals, schools, etcetera; as well, in safeguards of the environment such as forests and lakes; then again, in systems for the production of energy, free medical care and other social assistance programs. Ultimately, the aim of the reform (through its government's investment of its gain from the 'Bureau') is to raise the level of the reforming country's employment<sup>563</sup> rather than to add to the current level of goods and services that

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<sup>559</sup> Hence, it is here that the two main functions of the 'Bureau' evidence the double advantage that the reform will bring to the deficit/reforming country. That is, on the one hand through the counter-loan (A to R), it will avoid the double charge that, pre-reform, was inherently implied in the foreign loan (R to A) sought for the payment, in foreign currency, of its net imports; on the other hand, the reforming country (e.g. A) will avoid a decrease in its level of employment, as entailed **pre-reform** from the loss of a part of its domestic income (equivalent MR value amount of its net imports). 'This reduction of under-employment will add to the advantage already obtained through the cancellation of external debts' (ibid.: 90). In fact, in the new system that the reform would establish, the deficit/reforming country (e.g. A) would no longer lose a single fraction of its national income. Payments would be internalized and occur between residents (the 'Bureau' itself being a resident); so that, in this way, no *monetary* payment would add to the *real* one: this overall result, made possible by the counter-loan (A to R) of its 'Bureau'.

<sup>560</sup> 'It is the implementation of a completely different method of intervention that allows the reform to maintain national production at the value of 154 dollars. The solution presents no difficulty. It is necessary and sufficient that the domestic income spent for the payment of *net* expenditures be the gain of the government, a sum to be used only towards an addition of national production' (ibid.: 91).

<sup>561</sup> 'Let us explain in some detail ... how the reform will work, the domestic income of the deficit country affecting *production* and not the national *output already produced*' (ibid.: 90).

<sup>562</sup> Neither is the idea that the government's (A's) net gain of recuperated domestic income, which income it receives from its 'Bureau', enable, for it, a power of expenditure over actual output. 'It would be awkward if the income spent in domestic currency on the surplus import purchases of economy A were to be held as straightforward purchasing power by the government. In this truly inefficient case, country A's national production would remain reduced by the value of the net purchases of foreign assets' (ibid.: 91).

<sup>563</sup> 'In order to maintain the domestic production of its national economy unchanged at the level of a value equal to 154 dollars, it is imperative that its government or its budget obtains more than a mere purchasing power: it must obtain the power to produce and not just to buy. It is certain that the power to produce is legitimate and effective, and avoids inflation, only if the money available to this purpose defines, despite everything, a perfectly legitimate purchasing power. Properly defined, a 'power of production' is, at the same time, a positive purchasing power. The profit of 4 dollars value in national money (A) obtained by the

would *them too become also available* for purchase. The important point to retain is that, in as much as this salvaged domestic income is transferred to A's government from its 'Bureau' as a *net gain/profit*, the investment of this profit (by the 'Bureau'/its government) in a new production, means that the new 'product is already purchased at the moment the profit of the Bureau pays for new employment' (Schmitt 2014: 98). This is the reason for which the newly produced goods and services that stem from the investment of the reforming government's new production cannot be resold on A's product market<sup>564</sup>. Nevertheless, the outcome<sup>565</sup> achieved is indeed in line with the aim of the reform<sup>566</sup>: the investment of the government's net gain restores the deficit/reforming country's level of *monetary* income<sup>567</sup> to its initial value, that is, to the level that it stood at prior to the country's foreign borrowing (R to A). Incidentally, which foreign borrowing that, pre-reform, granted R<sup>568</sup> the ownership of part

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government of the deficit country is the power to purchase, to this extent, the domestic product unchanged. This, however, does not prevent the government from spending this amount of money A to employ people who would otherwise remain unemployed' (ibid.: 91).

<sup>564</sup> Schmitt elaborates on the reason as to why that is. '[I]t is necessary that the profit spent by the Bureau does not produce any goods for consumption or investment, which are themselves part of the goods to be sold. The reason is that this product is already purchased at the moment the profit of the Bureau pays for new employment. Unlike all other productions, the expenditure of the Bureau's or the government's profit is an expenditure that is active both on the production and on the sale of goods: at the very instant this profit is transformed into new incomes, it is precisely an income already spent for the final purchase of the corresponding output. In other words, the holder of this very special profit becomes the final owner of newly and additionally produced goods. Let us recall in this regard the most interesting example: the profit of the Bureau can be spent to decrease youth unemployment. There can be no question to ask the Bureau or the government to recover its profit, that is, to sell the goods produced by the new employees' (ibid.: 98).

<sup>565</sup> 'The sole effect of surplus imports is to provide, through the reform, to the Bureau and through it to the government, the income in domestic currency whose expenditure increases the national product. The ensuing external debt is zero, because the deficit country gives immediately, to R, an equal part of its available product' (ibid.: 99). Specifically, it is through the deficit/reforming country's (A's) counter-loan (loan A to R) of its 'Bureau', in each period subsequent to the first, that the country (A) gives to R part of its (A's) national resources, which is the reason why the national income spent in excess by A's residents (importers) is *legitimately* earned by A's 'Bureau' (its government). Moreover, the respect of the balance-of-payments identity means that country A is no longer a deficit country: its *real* imports being fully covered by its *real* exports.

<sup>566</sup> 'Country A upholds the property of the total value, undiminished, of the income formed by its national economy; it is true that it 'loses' the 4 dollars that it spends in payment of its net imports, but in fact it obtains 4 dollars from this 'loss', the value of the foreign goods that it acquires through its zero export' (ibid.: 92).

<sup>567</sup> '[T]he incomes of the new employees raise the national income to a monetary level equivalent to 154 dollars, exact value of the product to be sold' (ibid.: 99). Schmitt's reference with regard 'incomes of the new employees' intends, specifically, the incomes as generated from the deficit/reforming country's (its government) investment in a new production (e.g. 4 dollars worth), *in addition to* that of its internal economy's production (e.g. 150 dollars worth).

<sup>568</sup> Though the reform will prevent this appropriation by R of part of A's domestic income (MR equivalent value of A's net imports amount), this is not to say that R will be in any way compromised by the changes that the reform will bring. 'Country R is not in the least harmed,

(equivalent MR value of its net imports amount) of its (A's) internal resources (domestic income). This previously lost domestic income of A, is thus decisively salvaged, complement of the reform. The new internal production of the reforming country (e.g. some country-example A, whether UK, or Greece, whose case we will next examine), as produced by its government<sup>569</sup> in addition to that produced by its domestic economy, is sound evidence that this previously lost domestic income is definitely upheld<sup>570</sup> by any country embracing the reform. Considered in a nut shell, the overall impact of Schmitt's single-country reform, with regard to any deficit/reforming nation adapting it, is twofold and inter-linked<sup>571</sup>: not only does it salvage, legitimately<sup>572</sup>, a part<sup>573</sup> of its domestic income that, in turn, can be invested towards reducing its country unemployment **but as well**<sup>574</sup>, in guaranteeing the *real* payment of its net imports (the deficit) through the counter-loan of its 'Bureau', it curtails the double charge previously associated with its deficit (the net imports) and, ultimately cancels its external debt altogether<sup>575</sup>. That is, the effect of the reform<sup>576</sup> has it that the reforming/deficit

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because on one side it gives up real goods out of its own real product, while on the other side it cancels this expenditure, because it obtains the equivalent of the additional goods produced by the government of country A' (ibid.: 92).

<sup>569</sup> In sum, the mechanics and intent of the reform are straightforward. 'A's importers pay the totality of their purchases, 10 for the imports balanced by exports of A, and 4 to the benefit of their government. R's exporters are paid in money R by R's importers, the missing payment being replaced by the loan of 4 dollars. This loan of R to A is cancelled by the loan in reverse that takes place at the moment country A sends 4 dollars to country R as payment of the equivalent of the domestic production of country A's government' (ibid.: 92).

<sup>570</sup> This salvaging of its domestic income that the reformation will enable for the reforming/deficit country is, contrarily, to what happens today. 'In the present 'regimen', imports balanced by exports are actually paid by every deficit country in its own domestic money. However, this is not the way the domestic income spent for net imports, which are in surplus of exports, is used, *because it does not remain available within the deficit country*' (ibid.: 95–96).

<sup>571</sup> The impact is inter-linked in the sense that the amount (MR value of the net imports of the deficit country, e.g. A) of A's counter-loan to R is essentially 'the equivalent of the domestic production of country A's government' (ibid.: 92).

<sup>572</sup> In each period (subsequent to the initial period), the reforming/deficit country gives to R part of its national resources (conveyed through the counter-loan, A to R, of its 'Bureau'); this is the reason why the national income (equivalent MR value of the nation's net imports amount) spent in excess by the reforming nation's residents (its importers), is legitimately earned by the said nation's 'Bureau' or, ultimately by its government.

<sup>573</sup> Specifically, we intend an equivalent MR value of the amount of its net imports.

<sup>574</sup> 'This reduction of under-employment will add to the advantage already obtained through the cancellation of external debts' (ibid.: 90).

<sup>575</sup> 'Let us now complete the description of the financial Bureau's essential function, which consists in immediately cancelling the very formation of the (external) debt of deficit countries. To do this, it is enough that the Bureau credits the government of its country of the whole domestic income, formed in national currency, and spent for the payment of the 'expenditures-without-receipts'. Suddenly all the country's debt will be redeemed by this gain and countries' net external debts will be a thing of the past' (ibid.: 95). The key word to retain from Schmitt's reference to 'countries' net external debts' is: **net**. That is, in that he intends the foreign loan/debt (R to A) that the reforming/deficit country (e.g. A) incurs, in each period, in order to pay its net imports, ultimately, in foreign money (MR). The reform has it that in the very first period under observation, this foreign loan/debt (R to A) is the only

country's external debt is simply reproduced<sup>577</sup> period after period (on the assumption/condition, of course, that its net imports remain constant).

Finally, let us recapitulate the main aspects of the reform. Apart from canceling today's **double** charge with regard to deficit countries' external debt, the latter will (per our earlier mention), also be merely *reproduced*<sup>578</sup> rather than augmented cumulatively period after period, such as it did pre-reform (consequence of the second<sup>579</sup> anomalous charge related to a sovereign debt that added to that of an ordinary debt: in effect, the **double** charge). Moreover, the reform will prevent the loss of domestic income that, pre-reform, definitely vanished from

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foreign borrowing that the reforming/deficit country contracts with regard to the payment of its net imports (in money R). In subsequent periods to this initial period (all *reform* periods), this foreign/loan debt (R to A) is contracted by the reforming/deficit country as a *third* foreign loan (R to A), ultimately, such as to enable the payment of its net imports, in foreign money (MR). In both cases, whether consisting of the initial period or any subsequent period thereafter, this very foreign borrowing (loan R to A with which the reforming/deficit country, ultimately, pays its net imports in MR) is **the** loan (external debt, e.g. 4 dollars) that, as of the application of the reform, will be **compensated**. 'The deficit country's external debt, 4 dollars, will thus be entirely compensated by an income formed and acquire in money A. Logic will thus be respected: a country does not carry any debt distinct from the debt of its residents, so that a country whose residents have fully paid their debt does only carry 'debts-credits', that is, zero sum debts ... The existence of only compensated debts of countries, as set of their residents, will be established by the reform' (ibid.: 96).

<sup>576</sup> 'The sole effect of surplus imports is to provide, through the reform, to the Bureau and through it to the government, the income in domestic currency whose expenditure increases the national product ... The deficit country borrows nothing because it pays immediately its 'purchases-without-sales'. Despite the cancellation of external debts and credits, surplus imports and surplus exports retain nonetheless the indisputable utility characterizing international transactions' (ibid.: 99).

<sup>577</sup> '[T]he external debt of country A does not increase and ... country R does not suffer any loss because of its external credit being strictly zero ... The ensuing external debt is zero, because the deficit country gives immediately, to R, an equal part of its available product' (ibid.: 99). And, we know already from previous stipulations, that the deficit country conveys this *real* payment ('equal part of its available product') of its net imports, through the counter-loan (A to R) of its 'Bureau'. 'The rest of the world (creditor country) obtains this product as the object of its external loan' (ibid.: 99). The product intended 'as the object' of R's loan (R to A), could be in the form of financial securities, for example.

<sup>578</sup> We recall, as earlier elaborated, that this amounts to saying that the deficit/reforming country's (e.g. A) external debt is asymptotically equal to zero.

<sup>579</sup> 'The payment of the second debt has the only effect to reproduce it intact' (ibid.: 97). Schmitt describes, very accurately, a deficit country's **pre-reform** problem with regard to the payment of its net imports *with a foreign borrowing from R* (loan R to A), in that, in any period subsequent to the initial period in which its deficit (net imports) arises, the following manifests. 'The second payment ends up to the financial bubble, while the first payment is nothing other than the reimbursement of a debt that should never have existed' (ibid.: 96). Now as he points out, '[i]t is the repayment of the sum lent that defines, before the reform, the external debt of country A' (ibid.: 97). Country (A), intends any deficit country. More importantly, what needs to be retained from Schmitt's explanation is that it is the repayment/reimbursement of the borrowed sum that creates a whole in A's economy (MR deficiency) that, itself, has to be ultimately covered or, paid, hence his meaning when he says '[t]he payment of the second debt has the only effect to reproduce it intact' (ibid.: 97).

the deficit country's economy, whenever it implicated a foreign borrowing (R to A) to cover its deficit (net imports). The reform will ensure, through the role of its 'Bureau' and ultimately its government that this previously *abnormal*<sup>580</sup> disappearing of internal income will, no longer, manifest. Now, what needs to be emphasized once again is *how* the reform will go about salvaging this internal income and, the reason *why*. Let us simply recall that to the extent of its net purchases in MR (money R), the deficit country will suffer an equivalent reduction<sup>581</sup> in its employment level<sup>582</sup> given that, as previously explained, the implied foreign borrowing will create a *monetary* deficit for its domestic economy, that is, in comparison with its *real* income. And therefore, logically, the latter<sup>583</sup> is also reduced in accordance to the level of **available** *monetary* income (MA) *to finance the purchase of output (domestic)*.

On considering then the negative impact, that a deficit country's net foreign purchases, have on its economy's employment, the reform's intent<sup>584</sup> becomes very clear: it must reestablish<sup>585</sup> the destabilized equality between the said economy's *monetary* and *real* income. The sure way to accomplish this is to have its country government invest its net gain in a *new* production of *other than consumer or, investment goods* (such that the *newly*

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<sup>580</sup> 'Nobody has ever made the mistake of saying that the payment of net purchases abroad should not be carried out in foreign currency. Every economist agrees that the payment is made in foreign currency abroad and takes place in national money at first; it is indeed in domestic income that importers pay their purchases. But a second error is most often made in this regard: concerning surplus imports economists consider in general as 'normal' that the incomes formed and spent in domestic money disappear following their expenditure. This is wrong and something the reform will make impossible. These incomes will be earned, intact, by the sovereign Bureau' (ibid.: 98).

<sup>581</sup> 'Countries experience a decrease in their domestic employment to the extent that their expenditures exceed their receipts' (ibid.: 88).

<sup>582</sup> '[T]he surplus of foreign currency purchases is an equal decrease in employment. For country A, for example, in its international transactions, the expenditure of 14 dollars confronted to the gain of only 10 dollars decreases by exactly the same amount (4 dollars) the production of its domestic economy. The reason is that the value of 4 dollars spent to cover the difference between expenditures and receipts is no longer available for the selling of a domestic product' (ibid.: 98).

<sup>583</sup> '[T]he income produced in real goods ... falls in line with the value of the monetary income available for the purchase of national output. As this value is reduced by 4 dollars, the level of real production is reduced accordingly, from the value of 154 to the value of 150 dollars' (ibid.: 88). The varying value-amounts that Schmitt refers to are simply in reference to some example-case that he is using to demonstrate his argument.

<sup>584</sup> 'Country A's deficit decreases its domestic production, from a value of 154 dollars to a value of 150 dollars. The expenditure of its gain by the financial Bureau restores to the level of 154 dollars the total production of its domestic economy. The conclusion is simple but compelling: the gain of the Bureau can only be spent to benefit new production' (ibid.: 98). Schmitt describes the terms of the situation through an exemplary case. 'Ultimately, domestic production of private and public firms has a value of 150 dollars and that of the Bureau, which spends the profit yielded by the reform, has a value of 4 dollars ... At the beginning the production of firms has a value of 154 dollars ... The domestic payment of net international purchases reduces to 150 dollars the value of firms' production ... Finally, the Bureau's expenditure of its profit of 4 dollars value adds this value to national production' (ibid.: 98).

<sup>585</sup> 'In order to restore the balance between real and monetary income of economy A it is therefore absolutely necessary that the profit of the Bureau finances additional production' (ibid.: 98).

*produced goods* are not also sold on its product market, along with its *actual* output already available for purchase). Thus the reform, through the venue of its 'Bureau' and ultimately its government, has the ability to positively affect the level of its national employment by simply investing its net gain, as transferred over from its 'Bureau', into a new country production. More so, the beneficial result being that in financing a production extra to that of its domestic economy, it not only enhances the level of its country employment (from that of a pre-reform restrained level) but as well, that of its standard of living.

Let us now consider Greece's case. It is true that were it to embrace Schmitt's single-country reform, it would not be doing so from a vantage point as favorable as that of the UK. Though at this stage, it might have that much more to gain from adapting the said reform than the UK, given the destitute state of its economic and financial status, there is no doubt that the transition would be that much more taxing. The main reason being, that of the extra hurdle of having to break from the entanglement of its current euro zone membership, such as to reclaim monetary sovereignty. Still, opting for the single-country reform would at least provide the buffer and safety net that it will most certainly require in order to begin a structured rehabilitation towards a sound and, sustainable economic and financial recovery.

If we have a look at some of the available<sup>586</sup> data, we observe that for the period of 2003 through to 2012, Greece had a **total deficit**<sup>587</sup> of 270,920<sup>588</sup> (billion dollars). Now, as Schmitt points out, were our current system of international payments be devoid of any 'duplication'<sup>589</sup> anomaly, its (Greece's) external debt should of increased accordingly; instead, it amounted to some 420,586 billion dollars: *a near doubling of its total deficit*<sup>590</sup>. What is evident from this data is that it shows the extent to which Greece could of benefited, in avoiding this loss of internal income, had it been under the regimen of Schmitt's single-country reform, for the period in question. Even without exactness of statistical data given past debt repayment/forgiveness<sup>591</sup>, the numbers are, no doubt, staggering.

In closing, it is worth noting the merit that Schmitt's single-country reform would bring to countries the likes of the UK and Greece, both countries evidently on the brink of considering alternate options to their respective dilemmas. It is a fact that in the reform that Schmitt

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<sup>586</sup> 'Even though a full statistical proof cannot be presented, because of a lack of official data on debts cancellation and owing to distortions caused by exchange rate fluctuations, it is interesting to observe that IMF and World Bank statistical data confirm the existence of a totally unjustified external (sovereign) debt' (Schmitt 2014: 47).

<sup>587</sup> '[T]he IIP being negative, total deficit corresponds to the current account deficit' (ibid.: 48). IIP intends the 'international investment position' (ibidem).

<sup>588</sup> 'The amount of Greece's total deficit between 2003 and 2012 has been of 270,920 billion dollars' (ibid.: 48); 'Sources: World Bank (2014) and International Monetary Fund (2011, 2013)' (ibid.: 49).

<sup>589</sup> 'In the absence of any pathological duplication, the Greek external debt should have increased by this amount. In reality, it has increased at least by 362,086 billion dollars + 58,5 billion dollars (only known amount of debt stock reduction) = 420,586 billion dollars. We therefore observe that the actual increase in external debt is very close to the double of total deficit, that is, 2 times the amount of surplus imports' (ibid.: 48).

<sup>590</sup> 'The data that interest us are those concerning the increase in each country's external debt position and the amount of its total deficit, where total deficit is the measure of the country's net or surplus imports' (ibid.: 47).

<sup>591</sup> That is, on account of the fact that 'Greece has benefited from an important reduction of its external debt. Following the October 27<sup>th</sup> 2011 agreement on debt restructuring, finalized February 21<sup>st</sup> 2012, Greek external debt has been cut by 58,5 billion dollars by the end of 2012' (ibid.: 48).

advocates, no true system of international payments can be effectively created. This is obvious, no doubt, given no single country on its very own can establish such a system. But still, his reformation plan would offer the proper venue with which a reforming country could obtain *free of charge* the foreign currency it needs to convey its total purchases through a loan that does not increase its external debt; that is, the reform would offer a payment processing mechanism that would enable the deficit/reforming country to obtain a foreign loan, in each period, without any increase in its external debt, rather the latter would be simply reproduced<sup>592</sup> unchanged period after period. It is, something to mull over.

Next, we consider a reform that could be implemented by a group of countries, thus allowing for the creation of a partial system of international payments.

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<sup>592</sup> On condition, as we have mentioned earlier, that its net imports remain constant.

## 7 The multi-country reform

### Introduction

Lastly, we consider the multi-country reform. It particularly opens the door to a reformation much more comprehensive in scope. We have shown that any single nation can single-handedly protect itself from the anomalies of our current non-system of international payments without having to envision the creation of a new international payment system shared globally. Thus, the political motive to embrace a more global system of payments would no doubt invite in-depth deliberations within any country seriously considering its potential participation within such a system. That is understandable.

Yet, if a reform were implemented by a group<sup>593</sup> of countries, it would facilitate the creation of a partial, at least initially, system<sup>594</sup> of international payments, with the same favourable end results as provided for any country adapting the single-country reform. That is, within such a system<sup>595</sup>, a deficit country's domestic income would remain available internally and the country would incur an external debt equal to zero. More specifically, the deficit/reforming country's net imports would be instantaneously matched with equivalent exports. This is because the new payment mechanism would be that of a multilateral real-time gross settlement system, based on a regime of absolute versus relative exchange rates, as is the case today. Undoubtedly, a multilateral mechanism would offer, not less than, a better chance for any country of the group to match its net imports or, net exports. And, that much more so, the greater the number and the relevance of the countries involved as active members of this multi-country reform. Again, even if initially, a smaller group of reasonably economically and financially sound countries ventured the multi-country reform project, it would not be difficult to anticipate that many more neighbouring countries would eventually follow suit.

We present but a skeleton version of how a multi-country reform could effectively work. We fully acknowledge that, realistically, a team of specialized experts from varied faculties, whether accounting, computational linguistics, together with several payment systems or clearing house program specialists would, ultimately, have to oversee the complete developments of any proposed plan for a new international payment system, such as the multi-country reform could establish, even if just partial at the onset. It is thus not our intent

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<sup>593</sup> The decision to implement a payment reformation as a group could be taken, of course, by any number of nations agreeing on the necessity of this multi-country reform. Though there is no optimal group size, it goes without saying, that *the more the merrier*, in that a larger and more compatible group whether in similarities or diversities, or both, operating on a multilateral mechanism, is certain to generate more operating power for any one participant country.

<sup>594</sup> Specifically, such a multi-country reformation as adopted by a group of countries, has the goal to create for the group, a new system of international payments with which to replace the current *non-system*.

<sup>595</sup> That is, a partial system of international payments, such as we advocate in our presentation of the multi-country reform: a multilateral real-time gross settlement system based on *absolute* exchange rates.

to belabour the details of a payment system reformation plan that only a group of diversified experts could, in the end, refine towards a viable implementation. In this chapter we merely introduce it, conceptually, focusing rather, on its underlying strength for potentially providing the stronghold from which countries could build economically and financially sound partnerships.

As a final point regard our introduction of the multi-country reform, let us ponder a statement of Schmitt dating back some forty years ago, whereby he'd already endeavoured a plan for a global *monetary* reform. It is clear that his reasoning, even as early as then, laid the conceptual foundations that still underline the basic idea behind a multi-country reform such as we advocate in this paper.

Under the new plan, full convertibility will be restored. The very concept of convertibility is meaningless in the present world. The fundamental meaning of convertibility stands out in the new proposals. Any holder of a nominal income should be enabled to spend it anywhere in the world.  
(Schmitt 1973: 19)

We now turn our attention to the multi-country reform.

## **On the workings of a system of international payments based on absolute exchange rates**

We will begin this section by elaborating on our meaning of a system of absolute exchange versus that of a relative exchange. We will attempt to show how the latter is not conducive to exchange rate stability. And while on the issue, readers will be reminded that countries need not expect that a return to their respective monetary sovereignties would necessarily entail the return to erratic exchange rate fluctuations. That is, of course, providing they concurrently replace the non-system of international payments, based on relative exchange rates, that they currently belong to, with a system that is instead based on absolute exchange rates. In such a payment system as the latter, a country's currency is simultaneously<sup>596</sup> offered and demanded<sup>597</sup>, thus curtailing<sup>598</sup> the fluctuation of exchange rates.

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<sup>596</sup> This is because in a payment system based on absolute exchange rates, money is used in a strictly **intermediary** or, expressed differently, *in a circular way*, thus figuring as the term at *both* ends of a payment transaction rather than being only *one* of the end terms of the very payment transaction. 'LA MONNAIE EST UN OBJET D'INTERMÉDIATION ET NON UN BIEN FINAL DANS LES ÉCHANGES' (Schmitt 1984: 49). Thus, operating in this *circular* way, money can't but be a pure *means* of payment rather than pose as the form of payment 'tout court', to use Schmitt's coined expression (see Schmitt 2014).

<sup>597</sup> As Schmitt explains, money does not own up to its proper role unless its user (trader in a commercial or financial exchange) earns and, spends it *in one and the same movement* such that any fluctuation of exchange rates is avoided. 'La monnaie ne joue parfaitement son rôle que si l'échangiste la gagne et la dépense dans le même mouvement, de telle sorte qu'aucune partie ne connaisse ni accroissement ni diminution de sa dotation monétaire initiale' (Schmitt 1984: 49). Specifically (and, paraphrasing Schmitt), in non-anomalous exchanges, money evolves not in a single but rather in a double move or said another way, in a forward *and* backward move, that is, *from the buyer to the vendor and reciprocally from the vendor to the buyer*. 'Dans les échanges non pathologiques, la monnaie est présente (si elle l'est) en son

A comparison will be drawn between the two systems of international payments (current and reformed) to explain, again, how the one based on a system of relative exchange is what today loses for the deficit country, a part of its domestic income whereas the other based on a system of absolute exchange avoids this very loss. At the same time, we will remind on how the one system (*relative*) leads to the double charge of a country's external debt whilst within the other system (*absolute*) the country would incur an external debt equal to zero.

### *An absolute exchange versus a relative exchange*

If we were to try to understand the difference between the two by perceiving it very simply, we could imagine the action<sup>599</sup> of throwing one object against another. That would consist more of a swop<sup>600</sup>, that is, of a barter or trade of one object for another e.g. one country currency for another; this is what essentially transpires in a payment system based on relative exchange rates. In an *absolute* exchange, the *same* product defines both end terms of the exchange, such that the very exchange<sup>601</sup> is the equation of its terms, *this because of the reason that the same object/product defines them both* (ibidem). And, in this sense, the exchange (absolute) is not established other than in the *identity*<sup>602</sup> of its end terms; imagine for example, a *same* country currency being the term at both ends of the equation. In so doing, we begin to comprehend that in such an *absolute* payment system, different country currencies would obviously have to be represented *in terms of*<sup>603</sup>, *or exchanged through* a third counter-party *supra* currency. Now we should also understand that this would not mean that the purchasing power of the respective nation-currencies (to purchase *real* commodities<sup>604</sup> produced globally), would be lost to this *supra*<sup>605</sup> currency which currency we

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*double mouvement*, de l'acheteur au vendeur et réciproquement, du vendeur à l'acheteur' (Schmitt 1984: 50).

<sup>598</sup> Of course, complete obviation could only be attained through a more comprehensive system of international payments (based on absolute exchange rates), involving all the countries of the world.

<sup>599</sup> Our English paraphrase of Schmitt's own words: '[s]i l'action était de "jeter" un objet contre un autre, il ne s'agirait pas d'un échange mais, encore une fois, d'un troc' (Schmitt 1984: 139).

<sup>600</sup> See ibidem.

<sup>601</sup> Our explanation consists of a paraphrase of Schmitt's French text. 'Le prix absolu est le résultat d'une action elle-même absolue. En clair, l'échange est l'équation de ses termes parce que *le même produit les définit tous deux*' (ibid.: 139).

<sup>602</sup> Again, we have paraphrased from Schmitt's French text. 'L'échange n'est constitué que dans *l'identité* de ses termes' (ibid.: 139).

<sup>603</sup> 'The various national currencies must be expressed in terms of a general standard' (Schmitt 1973: 5).

<sup>604</sup> The multi-country reform that we advocate in this paper follows in Schmitt's footsteps as per his earlier plan for a new global *monetary* reform. 'The power to buy real commodities produced in the world belongs to the various *national* currencies. The international dollar simply *borrow*s its purchasing power from all national currencies to which it is related by conventional exchange parities. Importers pay for all their purchases by drawing on their bank accounts in domestic currency. At the same time, commercial banks credit the National Bureau (NB)' (Schmitt 1973: 8). In our study, we substitute the intermediary *supra* currency, which currency we choose to call the NG, in lieu of Schmitt's international dollar; the NG connotation implying, simply, the New Group currency. Likewise, we refer to Schmitt's

have chosen to call, very simply, NG. In the multi-country reform that we advocate, this purchasing power would definitely remain attached to the currency of each participating country: the supra currency (NG) would obtain it *only on loan for temporary use* (ibidem 1973), from each respective currencies of countries, members of a new partial system of international payments.

### ***Exchange rate fluctuations curtailed***

The problem with an international payment system based on *relative* exchange rates, as we have today, is that in such a system, money usurps the role of a **final** good<sup>606</sup>. This is because, instead of being used in a circular<sup>607</sup> (intermediary) way such as to ensure that it always returns to its original point of issue, it is rather used in a straight line fashion, as though it could somehow be a *real* flux counter-part<sup>608</sup>. Consequently, when used in such an erroneous way, it ends up on the currency exchange market to be bought and sold as if it were, itself, a

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National Bureau (NB), as the Sovereign Bureau (SB) of a country's (participating member) central bank; we sub-divide the SB into two operating sections, that of the International Bureau (IB) and, the Domestic Bureau (DB). The distinction between the two sections is merely attributed to role and function and it should thus be clear that the two sections define two individual parts of one and the same Sovereign Bureau.

<sup>605</sup> In the reform that we intend, this *supra* currency should carry out none other than a purely **intermediary** role in any commercial or financial exchange between countries, that is, rather than be, itself, one of the end terms of the transactional exchange, as it happens today given that the 'system' of international payments is based on a regime of relative exchange rates. This means that this supra currency should have no inherent value per se: 'its only value springs from the series of exchange rates between domestic currencies and the \$<sub>i</sub>' (Schmitt 1973: 13). Again, it should be noted that in the multi-country reform that we present in this paper, we substitute Schmitt's international dollar (\$<sub>i</sub>) for the NG, the New Group currency, that is, the 'general standard' that each of the different country currencies would be defined *in terms of*: '[t]he various national currencies must be expressed in terms of a general standard' (ibid.: 5). Moreover, in following with Schmitt's earlier global *monetary* reform plan, likewise in the reform that we here introduce, it should be 'that the exchange rate between any two currencies be defined by the relationship of the absolute exchange rates of each national currency and the international monetary unit (\$<sub>i</sub>)' (ibid.: 15). As previously indicated, we will substitute the New Group currency unit (NG) for Schmitt's 'international monetary unit (\$<sub>i</sub>)'. The international currency unit (NG) that we will refer to, in our reform presentation, would be issued by a World Intermediary Bank (WIB), to be used amongst the participating members of the New Group *strictly for the settling of their international (external) payments*; each country, part of this reforming group, would continue to use their own respective currencies, for all of their national (internal) payments.

<sup>606</sup> Our explanation is an English paraphrase of Schmitt's own explanation. 'N'importe l'origine des monnaies lancées dans les paiements entre les nations, elles usurpent toutes le rôle de biens finals, car elles sont, à tort bien sûr, libérées de la définition contraignante de toute monnaie véritable: au lieu de s'écouler dans les mouvements circulaires, elles sont utilisées *en ligne droite, contrepartie des flux réels*' (Schmitt 1984: 135).

<sup>607</sup> That is, as in a 'flux-reflux' movement. See Schmitt 1984.

<sup>608</sup> See ibid.: 135.

*real* good. This effect, undoubtedly, fuels speculation that, in turn, leads to erratic fluctuations<sup>609</sup> of exchange rates.

Now, as Schmitt has always advocated, the problem with the anomalies related to our current system of international payments does not lie with importations or, more precisely, *net* importations. What we need to address is, more justifiably, the false<sup>610</sup> monetary payments that they entail, not to mention the economic and financial havoc that deficit and surplus countries alike<sup>611</sup>, consequently endure. Thus, the focus should not be that of protectionism<sup>612</sup> but rather that of rectifying a *monetary* disorder such as our system of international payments is currently plagued with.

It is true that no country can pay, in a final or conclusive manner, its importations (*net* including) other than through its commercial or, financial exports. Specifically put<sup>613</sup>, in a non-pathological system of international payments, money *per se* can never be the final

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<sup>609</sup> See Cencini 2000.

<sup>610</sup> Our explanation is a paraphrase of Schmitt's own description regard the problem. 'Le vrai problème n'est pas dans l'ouverture des frontières aux flux réels, mais dans leur fermeture aux faux paiements monétaires' (Schmitt 1984: 137).

<sup>611</sup> Our meaning is that the disorder escapes no country in the end, that is, if we remember the inflation damage that key-currency countries cause the rest of the world (R), by settling their net imports (the deficit) from R (rest of the world) with a mere acknowledgment of debt, their very own: the domestic money (R's), created against it (as it sits on the asset side of R's banks) within the respective surplus countries (in R) is thus demanded without being simultaneously offered. If instead, international payments were carried out, overall, in a more orderly and pathologically-free manner, these key-currencies (e.g. dollars) would fall under the governing rule of the 'flux-reflux' such as a regime based on *absolute* exchange rates would oblige: the commercial and financial goods purchased by key-currency countries would thus integrally be paid by the said countries, through their own respective sales of commercial and financial goods. We next capture some of Schmitt's own words regard our paraphrased explanation of his thinking on the issue. 'Si la démarche décrite était rigoureusement suivie, on constaterait que les paiements extérieurs en dollars seraient tous soumis à la loi du flux-reflux, les produits et les titres achetés par A étant intégralement payés par le pays dans ses ventes de produits et de titres' (Schmitt 1984: 57). 'A' is intended as some key-currency country (e.g. US).

<sup>612</sup> In his explanation of the problem, as being that of a *monetary* one (versus that of a country-agent's overindulgence e.g. fact of having *net* imports), Schmitt points out that the solution, therefore, does not lie in protectionism. 'Dès que la France aura intégré dans son propre circuit économique le flux de ses paiements créditeurs et débiteurs face à l'étranger, elle pourra lever tout protectionnisme, car le désordre est monétaire et il ne l'atteindra plus' (Schmitt 1984: 137–138). His reference here to France, is simply intending some deficit example-country. In other words, the solution for such a country is not to draw rein with regard its importations but rather in internalizing its external payments. 'Une seule mesure est efficace: internaliser les paiements extérieurs' (Schmitt 1984: 136).

<sup>613</sup> Or, as expressed in Schmitt's own words as per the following. 'Un pays ne peut en aucun cas payer ses importations sinon par ses exportations de biens réels et de titres financiers. Le lecteur n'en doute plus, aucune monnaie ne peut constituer la contrepartie *finale* d'une importation. Et dans le régime du change absolu de sa monnaie, la France paiera ses importations non en francs, ni en aucune autre monnaie, mais par ses exportations de biens, de services produits, de titres, sans excepter les transferts financiers (paiements d'intérêts, de dividendes, de royalties, d'aides économiques)' (Schmitt 1984: 144). His reference to France intends some example deficit country.

counter-part to an importation. But this is essentially what happens in an international payment system that is based on *relative*<sup>614</sup> exchange rates. The reason being, as we have earlier evidenced, is that within such a system the external payment of a deficit country's net imports through its financial exports (*foreign* loan and income) is carried out in two distinct stages: the first obtains for the deficit country the foreign income it requires with which to pay its net imports, though not without R's (rest of the world) appropriation of part (MR equivalence of its net imports amount) of its own domestic income; in the second stage, the deficit country ultimately pays its net imports in money terms (foreign currency). The two subsistent and distinct stages means, as we have earlier explained, that the deficit country unnecessarily pays its net imports twice, once in *real* and once again in money terms, thus losing, forever, an equivalent portion of its internal income (equivalent MR value to its net imports) in the process. In other words, instead of paying its net imports, once in real (e.g. **via** an intermediary supra national money), the deficit country pays them twice, in *real* and in money. And, paid (net imports) in this manner, money inevitably and, pathologically becomes one of the end terms of the exchange (as though it were itself a *real* good) rather than being merely utilized in a circular and neutral way that would naturally befit its purely **intermediary** nature, as a means of payment. And, as we have already pointed out, the problem with money being one of the end terms of an international exchange<sup>615</sup> is that it (money as such, a 'specious' real good) eventually finds its way to the foreign exchange market where it fuels a pathological capital, 'currency-goods' that 'are exchanged one against the other' (see Cencini 2000: 17 and 18), driving speculation that, in turn, fuels erratic fluctuation of exchange rates (see *ibidem*).

If a system of international payments were, instead based on absolute exchange rates, money per se, would be precluded from ever being able to be the final counterpart to a purchase. And, in such a system, exchange rate fluctuations would be curtailed, accordingly. That is, as already clarified, complete obviation of fluctuations could only be attained through a comprehensive system of international payments to which all world countries were participant members.

### ***More on a system of international payments based on absolute exchange rates***

It is probably clear by now, having elaborated the nature of bank money as *a means rather than an object of payment*, that transactional *real* exchanges between nations should be reciprocal<sup>616</sup> if we are to avoid that the external payment by any one nation is but a mere

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<sup>614</sup> 'In a regime of relative exchange rates, currencies are exchanged one against the other and exchange rates are defined as the ratio of this very exchange' (Cencini 2000: 17).

<sup>615</sup> Thus, becoming clearly, an object of payment rather than merely a means of payment. 'It is also easy to understand that, in this case, currencies are actually transformed from *means* into *objects* of payment' (Cencini 2000: 18).

<sup>616</sup> Our meaning is not at all that a nation should always aim to balance its *commercial* exchanges but simply that its *real* exchanges should be balanced, as per need, through transactions on either or both of two distinct markets, that of the commodity market *as well as* the financial market. 'Trade balance equilibrium is neither a necessary nor a desirable requirement of international transactions. On the contrary, a sound monetary system should allow industrialized countries to increase their commercial exports (thus exploiting fully their productive capacity) and less developed countries to increase their imports (which they so terribly need to do in order to increase the material standard of living of their population and speed up their economic growth). Applied to international payments, the principle of clearing

acknowledgement of its own debt<sup>617</sup>. We have shown that this only leads to a *monetary duplication phenomenon*<sup>618</sup> whereby mere currency duplicates are considered as viable objects of payment, as positive assets in themselves<sup>619</sup> who, moreover, find their way to the foreign exchange market to wreak serious havoc as ‘speculative capital’<sup>620</sup>: traded *as though they were real goods*, they fuel erratic exchange rate fluctuations through speculative<sup>621</sup> supply and demand. We have furthermore mentioned the inflationary effect that manifests in any surplus country (e.g. non key-currency country A) whenever the *duplication* of a reserve currency (e.g. MR) serves as the final payment of a key-currency country’s (R’s) net imports from country A. The effect can be explained in that, simultaneously deposited with R’s banking system and, on the assets side of A’s banking system, the reserve currency is thus duplicated; specifically, what is entered in A’s banking system is a mere *duplicate*<sup>622</sup> that moreover, anomalously increases the capital available within A. That is, not being

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implies the balancing of the transactions occurring *on the commodity and on the financial markets*. This means that a net commercial surplus must be counterbalanced by an equivalent net purchase of securities, the country whose balance of trade is in surplus being a net importer on the financial market’ (Cencini 2000: 19).

<sup>617</sup> It might be useful to recall here Cencini’s elaboration on the creation of *bank* money as an acknowledgement of debt. ‘Let us start from the creation of bank money. Made possible by the discovery that zero is the first number in the series of integers, double-entry book-keeping is based on the principle of the perfect balancing of positive and negative numbers. Now, double-entry book-keeping is also the instrument by which banks create money as their acknowledgement of debt (‘I owe you’, or IOU). If we were to isolate money creation from any other transaction, we would quickly realize that what banks can create is only a magnitude that is simultaneously positive and negative, a debit and a credit or, according to Schmitt’s (1975) definition, an ‘asset-liability’”(Cencini 2012: 55).

<sup>618</sup> See Cencini 2000.

<sup>619</sup> ‘Known as euro-currencies (though it would be preferable to use – as suggested by Triffin – the expression ‘xeno-currencies’), these duplicates are considered as positive assets on their own and become proper objects of trade’ (Cencini 2000: 13).

<sup>620</sup> ‘[S]ales and purchases of xeno-currencies pertain essentially to the category of speculative transactions. What has to be clearly understood is that speculation has reached such an enormous extent because the xeno-market has been increasingly fed by the process of duplication described above. Speculation is the effect and not the cause of speculative capital, and speculative capital is the direct result of currency duplication. As soon as currencies are transformed from *means* into *objects* of exchange their exchange rates vary according to their sales and purchases, and speculation arises from the possibility of capital gains resulting from these variations’ (Cencini 2000: 13).

<sup>621</sup> Moreover, the fluctuations (result of *supply and demand*) affect not just the currency traded as a ‘xeno-currency’, as Cencini next explains. ‘Any net purchase of money R in terms of money A affects both currencies, even if MR alone is a xeno-currency’ (Cencini 2000: 14). In this case-example, R is considered as the key-currency country and A, as the surplus country (non key-currency).

<sup>622</sup> ‘Resulting from a process of duplication, euro or xeno currencies are totally dissociated from any national output. They are duplicates of no value, and yet traded on the foreign exchange market as if they were real assets, and thus become the main cause of exchange rate erratic fluctuations. Indeed, money is a flow, a pure means of payment. Its transformation into an object of exchange is unnatural, and a clear symptom of the pathological state of the current system of international payments’ (Cencini 2012: 65).

*explicitly*<sup>623</sup> refluxed to its original point of issue (R's banking system) through the purchase of R's financial securities<sup>624</sup> by A's investors, it thus remains available in A and at that, as a

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<sup>623</sup> 'If the system of international payments were founded on the circular use of an international currency – as suggested by Keynes in his plan for monetary reform presented at Bretton Woods –, no duplication would occur. In exchange for its net commercial imports a key-currency country would have to give up an equivalent amount of securities (shares or bonds), so that the instantaneous reflux of its currency would be explicitly recorded, thus avoiding the book-keeping duplication of financial claims taking place today. If this were the case, currencies would no longer be denatured, that is, transformed into objects of trade. Things being what they are, in the present system of international payments the process of duplication described by Rueff feeds a speculative capital market, and the transactions taking place on this market inevitably lead to fluctuations in exchange rates' (Cencini 2000: 14).

<sup>624</sup> R being a key-currency country it pays for its net imports with a mere acknowledgement of debt (its own currency, MR), rather than through the sale of financial securities. In this way, 'it apparently can settle its trade deficit by transferring a sum of money... to its foreign creditors. Yet things do not work out this way. As confirmed by double-entry book-keeping and by what IMF experts have defined as the international investment position (IIP)' (Cencini 2012: 61), the key-currency nation's external creditors receive, specifically, a bank deposit (R's) claim rather than an amount of money R. Thus, it could be said that the key-currency nation (R) does 'finance' its *net* commercial imports through a *net* financial claim sale. It is true that though the exchange, even in this case, is *seemingly* equitably reciprocal in that A becomes bank-deposit owner of a deposit originating in nation R, it is not without evoking the calamitous effect of **monetary duplication**; the inherent *flow* nature of money will indeed ensure that money R infallibly returns to its point of issue, the banking system of R. As such, 'the sum entered on A's banking system should be immediately replaced by an equivalent amount of financial claims. This is indeed what happens, since A's banking system becomes the owner of a bank deposit formed in country R' (Cencini 2000: 13). But this is one clear example whereby a system of international payments **based on relative exchange rates**, which system particularly caters to the privilege of key-currencies, will ultimately evidence serious anomalies (e.g. monetary duplication phenomenon) given neither its infrastructure nor the principle (key-currency partiality) underlining it is, after all, mindful of the inherent flow nature of bank money. Cencini describes how our international payment system that is currently based on such a regime of *relative* exchange rates exactly facilitates the **monetary duplication phenomenon** and explains how the said phenomenon, in turn, fuels exchange rate instability. '[T]he duplication arises from the fact that the same claims on R's bank deposits are simultaneously at the disposal of the debtor and the creditor countries. Since the national output defining the object of these claims is not itself doubled, only the claims circulating within country R have a real content, the others being mere duplicates. Now, while R's banking system lends within country R the totality of its deposits, the banking system of country A is free to lend its duplicates on the foreign exchange market' (Cencini 2000: 13). This means that these monetary duplicates will eventually find their way to the Forex market to be traded as 'currency-goods', no doubt driving speculation and thus fuelling erratic fluctuation of exchange rates. Moreover, as Cencini further points out, it is in such a system as that based on *relative* exchange rates that an asymmetry between non key-currency and key-currency nations is able to entail a monetary duplication that is clearly responsible for transforming bank money into a payment object when, inherently, bank money is a mere *means* of payment. 'Since in a regime of relative exchange rates currencies are considered as real goods, it is not surprising that exchange rates are taken to define the prices of the currency-goods traded on the foreign exchange market. It is also easy to understand that, in

mere duplicate of the income still deposited with R's banks, therefore, anomalously increasing the amount of capital in country A. Specifically, inflation consequently manifests in A on account of the presence of a duplicate, of an amount of money R (key-currency) deprived of any real content that increases *pathologically*, the amount of capital<sup>625</sup> available in nation A.

The forte of an international payment system based on *absolute* exchange rates is that it will **assure** the vehicular use of money through 'the necessary equality between the balance of trade and that of financial transactions' (Cencini 2000: 19). Specifically, in such a system, deficit countries (key-currency and non key-currency alike) would have no choice but to trade an equal amount of financial goods (e.g. securities) in exchange for their *net* imports. This necessary *transactional* condition, part and parcel of a system of international payments based on a regime of *absolute*<sup>626</sup> exchange rates, is particularly important to ensure that the said

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this case, currencies are actually transformed from *means* into *objects* of payment. It is through a duplication that this transformation becomes effective and that the regime of relative exchange rates has its full impact' (Cencini 2000: 17–18).

<sup>625</sup> 'If the residents of a country are paid in a foreign reserve currency for their net commercial exports ... the sum of foreign currency obtained from abroad is first changed into an equivalent sum of national currency – with which exporters are paid – and then transferred to the country's foreign reserve account at the domestic central bank, where it defines the net gain of the country as a whole' (Cencini 2012: 59). It should be understood that, not at all, does inflation arise in country A (surplus country) on account of the money A (MA) that it creates against the sum of money R (MR) that it (A) enters on the asset-side of its (A's) banking system each time a key-currency country (R) pays its net imports from A with its own domestic currency (R's); rather, the equivalent amount of MA that is created as counter-balancing effect to the sum of MR that is entered on the asset-side of its (A's) banking system, is in fact necessary to avoid deflation that would otherwise settle in if this creation did not take place. The reason for this stems from the mercantilist gain that nations can realize through their net exports and, in the necessity to monetize it; thus, the creation of MA specifically represents the monetization of A's external gain of mercantilist nature. So that though the money R entered on the asset-side of A's banks is at the origin of a demand for money A which is created against it (MR), the actual creation is not itself at the origin of inflation; the supply of MA by the banks of A 'being infinitely elastic' (Cencini 2000: 16) it does not even affect the exchange rates. Moreover, this creation (of MA) is non-cumulative in time: it takes place, rather, through an initial emission (of MA) that forms a sort of revolving fund that can be used/reformed repeatedly, in successive periods, without any need for a new emission of MA; that is, unless the gain of mercantilist nature increased, in which case scenario a new emission would be necessary (equal to the difference between the new gain amount and the *initial* revolving fund amount). That all said, the inflation arising in surplus country A is due to the perpetual presence of a duplicate (an amount of MR deprived of any real substance) that increases, anomalously, the amount of capital available in country A; that is, since this capital is not being absorbed by A's investors for the purchase of R's financial securities, it thus remains *pathologically* available in A (amassing cumulatively in time). The manifestation of internationally originated inflation in surplus nations (result of key-currency countries, e.g. R, paying their net imports with a mere acknowledgement of debt, MR) is on account of this pathological increase of capital that is thus perpetually available in their respective nations.

<sup>626</sup> A regime of *absolute* exchange rates is naturally conducive to the circular or vehicular use of money, contrarily to a regime of *relative* exchange rates that, quite evidently, rather works against the *vehicular and neutral* use of money. Specifically, a system of international

countries' individual domestic currencies are instantaneously refluxed to their original point of issue (respective national banking system), hence indeed ensuring that money is utilized but in a circular manner. In fact, bank-money<sup>627</sup> will always return to its original point of issue, its very *flow aspect*<sup>628</sup> will compel it to do so; this vehicular (flow) nature of bank-money stems from double-entry bookkeeping. That said, the problem with a system of international payments based on *relative* exchange rates is that not only does this very regime's (*relative* exchange) partiality to key-currency countries lead to the occurrence of monetary duplication that, in turn, fuels global exchange rate instability, the said partiality also leads, ultimately, to internationally originated inflation, as we have shown.

Furthermore, on discussing the issue of exchange rate instability, it is also worth mentioning that monetary duplication is not the only occurrence that might lead to the fluctuation of exchange rates, in a system of international payments *based on relative exchange rates*, external debt servicing is yet another venue by which exchange rates are subject to destabilizing pressures. For example, when a deficit country (e.g. A) carries out<sup>629</sup> its net

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payments based on *absolute* exchange rates would not only guarantee reciprocally equitable *real* exchanges but more so, it would do so in a way that would complement the inherent *flow nature* of bank money, such as to avoid the monetary disorders (e.g., monetary duplication, exchange rate instability, external debt *double* charge) that otherwise manifest in a *non*-system (such as we currently have) of international payments as well as in the respective national economies that it links.

<sup>627</sup> 'The discovery of double-entry book-keeping marked the outset of modern economies as well as that of modern economics. From then on, the basis was laid for the emission of bank money, and for the birth of capitalism' (Cencini and Citraro 2012: 261). And, moreover, on the vehicular/flow aspect of bank-money, the authors are specific on pointing out what exactly ensures it, that is, non other than adherence to double-entry bookkeeping. 'Compliance with double-entry book-keeping guarantees the vehicular use of bank money' (Cencini and Citraro 2012: 266).

<sup>628</sup> To be clear, our meaning is not that money flows, but rather that, it is a flow, an instantaneous flow. As clarified by Cencini, '[m]oney cannot logically be exported, because, in its circulation, money can only act as a means of exchange and thus cannot become itself the object exchanged through its circular flow' (Cencini 2012: 60). And, as he further points out, given that the *flow aspect of money* does not vary whether it is operating within a national (*production* economy) or international framework (*exchange* economy), this marks the principle by which the *balance-of-payments of a nation must therefore naturally be in an equilibrium state*. After all, it (balance-of-payments) 'is construed according to the rules of double-entry book-keeping' (Cencini and Citraro 2012: 272), from which the very flow nature of bank-money stems from. Cencini specifically explains. 'Because of its necessary circular flow, money cannot finance any net purchase, either within a single banking system or between countries. This clearly means that purchases have to be matched by simultaneous sales carried out through the circular flow of money. At the international level, a country's purchase of foreign real goods, services, and financial assets is necessarily balanced by its sales of domestic real goods, services, and financial assets' (Cencini 2012: 60).

<sup>629</sup> 'In order to pay for the interest on its external debt country A must earn an equivalent amount of country R's bank deposits, which it does through its net sale of goods and services. Increased by the positive inflow of money R (or, more precisely, by the claims on R's bank deposits), country A's official reserves are then reduced by the outflow of money R (i.e. of the claims on R's bank deposits) paid as interest to country R' (Cencini 2000: 15). Now though money R is here considered as a key-currency, it should be understood that it could intend *any foreign* currency, reserve currency or, not. This is because it is the effect of a *unilateral*

interest payment in a *foreign* currency<sup>630</sup> (key-currency or, not), the process might lead to a devaluation<sup>631</sup> of its domestic currency; that is, if the pressure on exchange rates is not neutralized by a second payment as is imposed on the deficit nation *as a whole* and which implies a decrease in its official reserves.

And regard external debt servicing, we have also shown that this payment transaction by a nation's indebted inhabitants inevitably implicates the nation *as a whole*, which implication ends up *doubling* the net interest payment for the respective nation, *given the current state*<sup>632</sup> *of our system of international payments*. That is, operating within a framework of *relative* exchange rates, not only do payment transactions fail to complement the vehicular<sup>633</sup> aspect of bank money and rather work against it<sup>634</sup>, but moreover, the payment system neglects to account for the explicit recognition of nations existing as their own entity<sup>635</sup>. The result being that the net interest payment exactly doubles in that its payment by the nation's residents actually creates a monetary deficiency in foreign currency (unrequited exports: see Schmitt 2012) which amount is ultimately covered by the nation as a set: the payment of the latter thus adding to that of its inhabitants. The multi-country payment reform that we advocate<sup>636</sup> should

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*transfer*, which transfer defines this very payment transaction *occurring in a system based on relative exchange rates*, that causes a net demand for the foreign currency (e.g. MR), in terms of MA (e.g. some deficit country A currency); the demand for MR to meet A's net interest payment cannot be matched by an equivalent supply of MR by A's banking system, the latter being in the impossibility to ever create a foreign currency (e.g. MR), the result thus enabling a *net* demand for money R, in terms of MA.

<sup>630</sup> Our meaning that is, having earned through its exports, an equal amount (equivalent to its net interest payment) of foreign bank deposits (e.g. R's) it then relinquishes them (e.g., to R) in order to carry out its (A's) net interest payment.

<sup>631</sup> 'The banking system of country A has no means to create money R. Therefore, the demand for the amount of money R required to pay for interest on A's external debt puts a pressure on money A's exchange rate, which, if not neutralised, gives rise to a process of devaluation' (Cencini 2000: 16). That is, if the pressure on exchange rates were not neutralized by a second payment (as it surely is) imposed on the deficit country *as a set*, which second payment decreases its official reserves: the anomalous double charge.

<sup>632</sup> '[T]he payment of net interest by a country's indebted residents necessarily involves the country itself, whose payment – in the present system of international payments – adds up to that of its residents' (Cencini 2012: 65).

<sup>633</sup> 'At the international level, disorders are also due to the existence of a payments system at odds with the vehicular nature of money. As we already observed, Ricardo was the first economist to realize that – because of its circular flow – a national currency can never leave the banking system from which it originates' (Cencini 2012: 64).

<sup>634</sup> That is, for example, as the occurrence of monetary duplication evidences. 'By its own nature, money is simultaneously created and destroyed in an instant each time it is used as a means of payment. If, nevertheless, we do find amounts of domestic currencies outside their banking system, this is because – as clearly shown by Rueff (1963) – in the present system reserve currencies are duplicated: while entirely deposited in their banking system, they are also entered in the banking system of the creditor country' (Cencini 2012: 64).

<sup>635</sup> 'The double charge of net interest payments could be avoided only if the macroeconomic existence of countries were explicitly accounted for, and payments carried out respecting the flow nature of money' (Cencini 2012: 65).

<sup>636</sup> That is, in the spirit of Schmitt et al. who have diligently followed in Keynes's footsteps to lay the foundations for a viable reform plan that would transform our international payment system such as to disencumber it from its many and serious malfunctions. 'Rejected by the

explicitly account for nations as macroeconomic entities, operating *on behalf* of their residents (more so, within the realm of their respective monetary sovereignties<sup>637</sup>) and, in conjunction with an international intermediary bank, such as to curtail indelibly the monetary disorders that currently fester within our actual system of international payments. It is fully understood that when the practical application of a system works in harmony<sup>638</sup> with its proper theoretical development, anomalies are thus avoided. But unfortunately the reality is rather that the many deficiencies of our current ‘system’ of international payments definitely attest to the contrary. The global account ‘mysterious’ imbalances<sup>639</sup>, specifically the global current account deficit and, global capital account surplus that are both the result (as earlier demonstrated) of external debt servicing<sup>640</sup> can also be explained on account of a lack of

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American representative at the Bretton Woods conference in 1944, Keynes’s plan has been revised and completed by Schmitt (1973), who clearly perceived the need to create both a bank acting as a central bank of national central banks, and a series of accounting entities – each operating autonomously in a given country – allowing for the countries to be explicitly and functionally involved in each payment carried out by their residents ... such a reform would allow countries to benefit from their unlimited monetary sovereignty, while providing them with an international currency playing the role of a common standard and of an international *means* of payment’ (Cencini 2012: 65).

<sup>637</sup> ‘The passage from the present system of *relative exchange rates*, implied by the use of national currencies as international objects of exchange, to a system of *absolute exchange rates*, in which currencies are no longer traded, will guarantee costless the stability of exchange rates without forcing countries to abandon their monetary sovereignty’ (Cencini 2012: 65–66).

<sup>638</sup> ‘When the working structure of the system conforms to its logical structure no pathology arises, which clearly shows how important analysis is in determining the causes of, as well as the remedies against, the pathological state of the economy’ (Cencini 2012: 48).

<sup>639</sup> ‘[T]he present ‘non-system’ fails to account for the macroeconomic aspect of international payments, which leads to the formation of a monetary deficit each time an LDC pays its net interest on debt. The decrease in LDCs’ official reserves necessary to restore equilibrium defines a dramatic loss of resources suffered by debtor countries, and accounts for the global discrepancies affecting the world current account and the world capital and financial account’ (Cencini and Citraro 2012: 283). See also *ibid*: 284 for further elaborate specifics. It should also be noted that though LDC intends least developed country, it has been shown that this specific ‘non-system’ deficiency affects, in this way, any deficit country at the time of external debt servicing.

<sup>640</sup> ‘[N]et interest payments are indeed the cause of both the world current account deficit and the world’s net capital inflow’ (Cencini and Citraro 2012: 263). Specifically, it is the fact that the second additional payment is not only superfluous but, that it is particularly *macroeconomic* that eventually unravels the enigma regard the discrepancy at the level of global accounts: the ‘missing surplus’ and, ‘missing capital outflow’ (see *ibid*.: 261). This indeed confirms ‘the existence of macroeconomic transactions’ (*ibid*.: 283). ‘At the microeconomic level the payment of interest is single, not double: country A’s residents pay their due only once, and R’s residents are not paid beyond their due. But the second, redundant payment is macroeconomic. It affects country A as a whole and benefits the macroeconomy of country R. The outflow corresponding to A’s second payment is thereby not entered into R’s current account. Only the microeconomic payment of interest is reported in R’s current account; the macroeconomic interest payment does not accrue to any particular residents of country R, and hence it fails to be reported in R’s balance of payments’ (Cencini and Citraro 2012: 284). This thus explains the ‘missing surplus’ and, the deficit of the global

respect for the inherent macroeconomic element<sup>641</sup> of external payments, which lack is characteristic of *a system of international payments based on relative exchange rates*. On thinking about it, it is indeed interesting that discrepancies should arise within the global accounts (current and, capital and financial) given that after all, adherence to double-entry bookkeeping<sup>642</sup> simply does not allow for ‘any discrepancy between debits and credits’ (Cencini and Citraro 2000: 279). But still, it is not surprising given that our actual external payment system is based on *relative exchange rates*, a regime that leaves much to be desired. Our current international payment system would operate much more efficiently were it instead based on a regime of *absolute* exchange rates combined with an international intermediary bank (central bank of domestic central banks) that would intervene as ‘monetary intermediary’<sup>643</sup> on behalf of the countries themselves (as macroeconomic entities); as such it would be in a better position<sup>644</sup> to curtail serious payment anomalies that otherwise inevitably manifest in a double charge of net interest (external debt servicing), not to mention the ‘mysterious’ world account imbalances.

The situation being what it currently is<sup>645</sup>, international payment transactions operate within a system that is based on relative exchange rates; in such a system though a country’s external deficit is paid within the period that the net imports arise, the actual reimbursement only takes place in a subsequent period and this is a true source of malfunction that leads to the double

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current account when the two countries are considered in their ensemble, country ‘A’ intending some debtor country whilst country ‘R’ some creditor country. Now regarding the imbalance at the global capital and financial account level, the very ‘missing capital outflow’, let us note the following specifics regard the debtor country’s net interest payment that results in an internal savings for the creditor country. ‘[B]ecause of the pathological payment of net interest carried out by A, R pays for part of its purchases with the income of country A obtained free of cost. As this specific gain benefits the macroeconomy of R, no outflow of capital is entered into R’s balance of payments’ (Cencini and Citraro 2012: 285) that would match the ‘capital inflow in A’s balance of payments’ (ibid.: 284), which inflow accounts for the reduction in its (A’s) official reserves, the latter evidently making up for the foreign monetary deficiency that results from the net interest payment.

<sup>641</sup> Specifically, that is, the inherent macroeconomic element of international payments that should naturally account for nations existing as ‘macroeconomic entities’ (Cencini 2012: 58).

<sup>642</sup> As Cencini and Citraro remind us, ‘[a]t the global level this means that no discrepancy should exist either in the world current account or in the world capital and financial account’ (ibid.: 279).

<sup>643</sup> ‘Economists and experts alike are perfectly aware that the identity between overall exports and imports applies to countries. Yet the absence of an international central bank acting as a monetary intermediary for nations does not allow for countries being simultaneously credited and debited each time a payment is carried out on their behalf. Instead of being ‘coupled’ thanks to the mediation of money, a country’s sales and purchases are separated. In these circumstances a country’s overall exports and imports are no longer the terms of an identity. It is still claimed that they must be equal, but the autonomy of exports with respect to imports opens the way to a possible inequality, which leads to the world discrepancies affecting the global current account as well as the global financial and capital account’ (Cencini and Citraro 2012: 282).

<sup>644</sup> Our meaning is that it should be structured in such a way as to logically complement its conceptual/theoretical construct, that is, rather than work against it.

<sup>645</sup> Specifically, ‘that the system of international payments adopted since Bretton Woods has been based on a regime of relative exchange rates and that the change from disorder to order requires its replacement with a regime of absolute exchange rates’ (Cencini 2000: 17).

burden of external debts, both with respect to payment of net interests and, with respect to the formation, itself, of external debts. As we have shown, each time a deficit country (non key-currency) pays for its net imports with a *foreign* loan, it ends up doubling its external debt. This is because, in the absence of monetary homogeneity as is the case in an international payment system based on relative exchange rates, the deficit country inevitably pays for its net imports twice; that is, it settles the said deficit (net imports) once at the level of foreign exporters, in money terms and **once again** in *real* terms, at the level of foreign investors (see Schmitt 2014).

A system based on **absolute** exchange rates operating in conjunction with a third counterparty world intermediary bank that issues its own currency standard<sup>646</sup>, could instead make all the beneficial difference. In such a system, a nation's comprehensive imports and exports would remain 'the terms of an identity' (Cencini and Citraro 2012), the nation's purchases and sales being properly linked through the **intermediary** intervention of an international standard instead of being intercepted in time. The lack of such an intermediary standard, today, leads to the double burden of countries' external debts, not only in formation but as well regard the net interest payment. If a system of international payments **were based on absolute exchange rates and complemented with a multilateral real-time gross settlement mechanism**, it would immediately match<sup>647</sup> a country's net imports with equal exports and as such the country's external debt would be nil, consequently ending the need for a payment of net interest<sup>648</sup>, let alone a *double* one, as is currently evidenced from the world account imbalances; moreover, the entirety<sup>649</sup> of the deficit country's domestic income would be spared.

Having emphasized the multi faults of a system of international payments based on a regime of *relative* exchange rates, it should now be clearer as to what features we would hope to avoid or gain, in an alternate system such as one based on **absolute** exchange rates; that is, so as to enable the new reformed system to function in a more orderly fashion: devoid of pathologies that bear serious consequential effects on the economic and financial health of national economies.

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<sup>646</sup> The idea behind an international currency standard is such as to bring in the element of monetary homogeneity that is required in external payments, but without the need for participant reforming countries having to renege from their own respective monetary sovereignties; the international standard would be resorted to strictly to carry out external payments between the relevant reforming countries which countries would retain their respective distinct currencies for all their internal payments.

<sup>647</sup> In such a system, a reforming country would pay for its net imports with an equal part of its *actual* resources rather than an equal part of its future resources which factor, in our current defective system of international payments, enables the creditor country's appropriation of a part of the deficit country's internal resources (equal MR amount to the latter's net imports), thus implying a definite loss of domestic income for the deficit nation.

<sup>648</sup> This is not to say that a reform of international payments would not honour interest payments that remain due; in fact, the multi-country reform that we advocate will account for their proper and gradual repayment but, the reform process will definitely prevent them from even arising at all.

<sup>649</sup> We have seen how, in a system based on *relative* exchange rates, a deficit country loses a part (equal MR amount of its net imports) of its domestic income when a net foreign borrowing is implied in the payment of its net imports.

Undeniably, we need to progress<sup>650</sup> towards a system that would facilitate the orderly transactions of countries' external payments by ensuring that its theoretical construct conceives of bank-money solely as an intermediary means of payment<sup>651</sup> and that it allows for the concurrent<sup>652</sup> supply and demand of currencies interacting within the said system<sup>653</sup>; precisely, the system based on absolute exchange rates, should be equipped with a real-time gross settlement mechanism that would streamline the immediate match of a country's net imports with equal exports, which mechanism would be managed by a world intermediary bank that would issue an international currency, its own intermediary standard.

Now, one of the most distinguishing features of a system based on absolute exchange rates is that it allows for the separation of bank-money flows<sup>654</sup>, that is, it is able to effectively keep the *external currency flow* (international money flow) apart from that of the *internal currency flow* (national money flow). Operating in such a way and through the particular function that the international intermediary currency would carry, the system would be able to properly internalize<sup>655</sup> its external payments. That is, it would afford a reforming country the manner by which to integrate within its own economic circuit, the flux of its payments (creditor and debtor), in respect to the international economy<sup>656</sup>.

Though the reasoning behind the internalization of external payments may not be readily evident, it might be better understood once the distinct role of the international standard is explained. Let us first remember the role of national money: it vehiculates *real* goods and services (commercial and, financial) amongst its country residents; it does this, very simply, 'by lending its form to physical output' (Cencini 2000: 19). By the time money transgresses to an economy of exchange (international economy) from that of an economy of production (national economy), in order to exchange *real* goods (commercial/financial) internationally, these very goods 'have already been monetised in their countries of production' (ibid.: 19). Now keeping this in mind, it is easier to bring into focus the role<sup>657</sup> that the international

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<sup>650</sup> 'The transition from relative to absolute exchange rates is therefore that from a system in which money is an *object* of payment to one in which money is a *means* of payment; from a system in which money is itself an asset to one in which real and financial assets are 'circulated' by money. It is the circular use of money that, as in Keynes's plan of reform, allows for the stability of exchange rates' (Cencini 2000: 18).

<sup>651</sup> '[T]he time has come to abandon the 'materialist' conception of money and to work out a system of payments in which money is used only 'vehicularly'. When this is done, the present regime of relative exchange rates will be replaced by a regime of absolute exchange rates in which each currency is exchanged against itself' (Cencini 2000: 18).

<sup>652</sup> 'It is obvious, in fact, that if every time money R is demanded by money A, money A is demanded by money R, no net demand can ever be exerted that may lead to a fluctuation of MA's or MR's exchange rate' (Cencini 2000: 18–19). Money 'R' and money 'A' intended simply as the respective currencies of two example-countries.

<sup>653</sup> As Cencini clearly explains it, 'each currency is simultaneously offered against and demanded' (Cencini 2005: 325) by some chosen international standard, thus leaving 'its exchange rate unaltered' (ibid.: 325).

<sup>654</sup> 'Absolute exchange rates define a regime in which the international monetary flow is kept separate from the flow of national currencies that takes place within each country' (Cencini 2000: 19).

<sup>655</sup> See Schmitt 1984: 136, as per earlier referenced.

<sup>656</sup> Our paraphrase of Schmitt's French text, see Schmitt 1984: 137–138, as per our earlier reference.

<sup>657</sup> '[A] regime of absolute exchange rates is one in which, by taking the place of national currencies, the money chosen as the international means of payment lends its form to the

currency (*intermediary* standard) might, itself, have; it is none other than to lend ‘its form to the goods, services and financial claims exchanged between countries’ (ibid.: 19). Here then, is how, in a system based on absolute exchange rates, international exchanges (commercial/financial *real* goods and services) would actually transpire. By way of the intermediary standard (international currency)<sup>658</sup>, an amount of national (e.g. A’s) output (commercial or financial) is transported from its original currency *shell* (MA) to that of the *shell* of another country’s currency (e.g. MR) where there, it takes the place of that currency shell’s substance<sup>659</sup> (real goods/services, commercial or financial), which substance exchanges its currency shell (MR) for that of MA’s. What is important to retain, is that in the end, it is not the shell of a country’s currency that is exchanged for another but rather, only its monetary substance is what is actually transferred, that is, from its original monetary shell (country currency) to that of another country currency’s monetary shell. In this way, a country’s very currency, specifically its monetary shell/form, never ventures from its country boundary, only its monetary *substance* is what is ever actually transported across and thus internationally exchanged; this is how in a regime of absolute exchange, a currency is, in the end, exchanged against its very self (instantaneously), albeit through an intermediary standard.

In fact, it is only within such a regime of *absolute* exchange rates that bank-money could ever properly make use of the logical and, necessary distinction between its form (shell) and substance (*real* content). As Schmitt (2014) has pointed out in his proposal of the single-country reform, understanding this important distinction, essentially establishes the *raison d’être* for a reform<sup>660</sup> of international payments, in that the aim<sup>661</sup>, ultimately, is to ensure that the payment of a deficit country’s surplus imports is no longer paid both in substance and in form.

## **An international payment system based on absolute exchange rates and with a multilateral dimension**

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goods, services and financial claims exchanged between countries. Under this regime, each national currency is *changed into* the international money and not *exchanged against it* or against another national currency’ (Cencini 2000: 19–20).

<sup>658</sup> Cencini provides a clear description of an exchange, as it would exactly transpire within a system based on absolute exchange rates. ‘Through the intermediary of the international money, a part of present and future output of a country (say country *A*) is thus transferred from a (national) monetary form to another, where it replaces the goods and services (present or future) given in exchange by country *R*’ (Cencini 2000: 20).

<sup>659</sup> With regard to our reference to the monetary shell/form of a country’s currency (Cencini 2000) see also Schmitt 2014; as well, see the latter with respect to the use of the expression ‘monetary substance’.

<sup>660</sup> Be it single or, multi-country.

<sup>661</sup> ‘[W]e can easily understand the essential function of the reform. The goal is simply to avoid the surplus of expenditures over receipts of foreign currency being paid both by its substance and its form’ (Schmitt 2014: 64).

We begin our explanation of how such a system would work under the multi-country reform, with an illustration of a ‘delivery-versus-payment mechanism’<sup>662</sup> which mechanism<sup>663</sup> would form an integral part of the system.

In our illustration, we attempt to evidence the circular flow of bank-money, specifically that of the respective country (reforming) currencies as they interact with the intermediary standard of the WIB (World Intermediary Bank), the NG. Our exemplary-diagram depicts a simplified illustration of how the payment transactions might actually occur between three specific countries<sup>664</sup>, represented here, only figuratively.

If we examine diagram (7.1)<sup>665</sup>, two distinct circular paths can be discerned: they represent clockwise and counter-clockwise circuits<sup>666</sup>. We start our analysis from the left-hand side of

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<sup>662</sup> See Rossi (2007a); see also Committee on Payment and Settlement Systems (2003). ‘At this stage, the recent advances made by domestic banking systems in the management of settlement risks can provide the missing element to forge ahead Keynes’s plan. In short, it is possible to link together funds transfers and securities transfers at the international level to make sure that delivery of a financial asset occurs if, and only if, the corresponding final payment occurs, too (this is the delivery-versus-payment mechanism by means of which both actions take place at the same time; see Committee on Payment and Settlement Systems 2003: 492)’ (Rossi 2007a: 105).

<sup>663</sup> The settlement method that this *procedural* mechanism offers would assure the simultaneous co-ordination of payment (*real* goods: commercial/financial) with, or more precisely, versus delivery (*real* goods: commercial/financial); its protocol is specifically oriented towards avoiding that payment would not accompany delivery.

<sup>664</sup> The example-group of the multi-country reform that we advocate actually consists of seven countries: UK (England, Wales, Scotland, Northern Ireland; could also include Crown dependencies e.g. Jersey, etcetera), Denmark, Iceland, Norway, Sweden, Liechtenstein and Switzerland. In order to keep the explanation and representation simple (triangle versus hexagon), we have incorporated all four Scandinavian countries, simply, under Scandinavia with currency symbol (kr); in real-life application, each of their own country currency would be represented. As well, Switzerland and Liechtenstein being both on the Swiss franc (CHF), we have grouped these two countries together in our illustration. UK and its constituent countries are grouped under the pound sterling (£). The intermediary currency standard of the WIB, which we have chosen to call, NG, is represented by way of simple currency symbol (g) and operates at a higher hierarchic level than that of the national currencies, *as an intermediary*. Also for sake of simplification, our scenario description assumes:  $w \text{ £} = x \text{ CHF} = y \text{ kr} = z \text{ g}$ . In the actual context of a multi-country reform, the currency value of the respective member countries, with respect to the intermediary standard, would be established at the onset though it could be re-adjusted in time, if deemed required by the World Intermediary Bank’s collective members (as per the similar intention under the single-country reform, see Schmitt 2014).

<sup>665</sup> Our diagram is an elaboration of Rossi’s own figure 7.1: ‘Figure 7.1 The two circuits of international money’ (see Rossi 2007a: 108).

<sup>666</sup> Though our explanation is much in keeping with Rossi’s (see Rossi 2007a) illustration-style of the role that an international central bank might assume as well as how it might function, our exemplary illustration varies slightly, in that its focus is on evidencing how a reformed payment system could operate such as to be more compatible with the inherent circular aspect of bank-money; we highlight this feature and how the reform could work to complement it, through our explanation of how the ‘delivery-versus-payment mechanism’ (ibidem) might function in a multi-country reform.

our illustrative diagram so as to observe how, for example, Scandinavia's currency<sup>667</sup> would be used in a purely circular way, which way would guarantee its use as a mere means of payment in a system based on absolute exchange and operated multilaterally<sup>668</sup>. The case scenario we next describe is but a mere example of many others that might evolve within a multilateral real-time gross settlement system, based on absolute exchange.

Let us suppose that, in the period under examination, one of the countries grouped under Scandinavia (see diagram 7.1) e.g. Iceland, has net imports from the UK. It (Iceland's residents, State included) sells financial securities in order to finance its net commercial purchases from the UK. If it should be the case, that the latter country is not interested in purchasing Iceland's financial securities, Iceland would have the option to sell them to another member country within the multi-country reform group (e.g. Switzerland), as would be enabled by the multilateral mechanism of a partial system of international payments, based on absolute exchange. In such a system, all the transactions that we describe would occur simultaneously and instantaneously. Ideally, Iceland's net imports would be immediately matched by an equal export (sale) of financial assets to e.g., Switzerland, in the event that the UK was not interested in purchasing its (Iceland's) financial (real) goods. In looking at our diagram 7.1, we can envision<sup>669</sup> the simultaneous supply against and demand<sup>670</sup> for the respective country currencies by the WIB's intermediary currency standard (g) as it mediates the international exchange of real goods (commercial/financial) between the interacting countries. In our specific case, Iceland's currency (kr) and that of Switzerland's are simultaneously supplied against and demanded by the WIB's intermediary standard (g) as evidenced by the clockwise and counter-clockwise circular paths (between Scandinavia and Switzerland) that evolve *instantaneously and simultaneously* just as it would in a real-time gross settlement system; moreover, we can observe or, imagine how Iceland's currency (kr), is temporarily changed into the intermediary standard (shell/form of international homogeneous space) such that its (kr) substance/*real* content can then be transferred over to the currency shell of the Swiss franc (CHF) in exchange for the latter currency's *real* content, following which exchange it (kr) is instantaneously returned to its original currency shell/form<sup>671</sup>, only with a different *real* content, to wit: Switzerland's financial assets that have been exchanged for Iceland's own financial securities in a sale/purchase transaction<sup>672</sup>.

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<sup>667</sup> Again, it should be kept in mind that our reference to Scandinavia as an example-country is merely intended to simplify the illustration; the four Scandinavian countries, chosen as member-examples of the multi-country reform that we advocate, are thus incorporated under one single country in our diagram.

<sup>668</sup> As earlier pointed out, the multilateral dimension would, ideally, consist of a larger group of interacting countries; our representation here of only three countries is merely to simply our presentation and accompanying explanations.

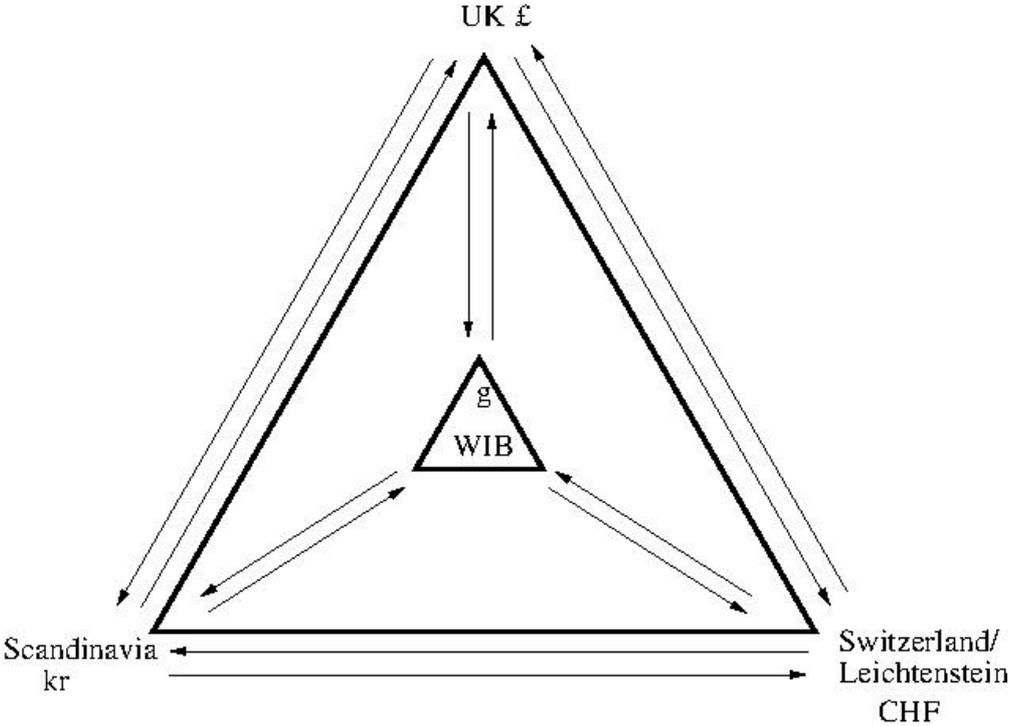
<sup>669</sup> That is, in following the arrow directions to and from the WIB's intermediary currency.

<sup>670</sup> We remind that the simultaneous supply and demand for the respective country currencies (reform members) would leave their individual exchange rates unaltered. This would certainly contribute towards restoring exchange rate stability, to some extent; as earlier pointed out, curtailing instability altogether would require a much grander impact that only an international payment reform encompassing all world countries could aim to achieve.

<sup>671</sup> Hence how, in the end, it (kr) is exchanged against its very self, such as currencies are exchanged in a system based on absolute exchange; it is also important to note that as soon as the sale/purchase transaction (between any two countries) is complete, the intermediary standard vanishes.

<sup>672</sup> For its part, the Swiss currency's (CHF) *real* content has been exchanged for Iceland's financial securities.

The transaction<sup>673</sup> allows Iceland (its residents) to balance<sup>674</sup> its commercial imports from the UK with financial sales to Switzerland and as such guarantees the identity between its (Iceland) purchases and sales.



**Diagram 7.1** The simultaneous supply against and demand for national currencies by an intermediary standard, in a delivery-versus-payment process based on absolute exchange and operating multilaterally.

<sup>673</sup> In other words, the sale/purchase transaction between Iceland and Switzerland enables Iceland to obtain the necessary credit with which to finance its net imports with the UK.

<sup>674</sup> An international payment system based on absolute exchange rates and complemented with a multilateral dimension, would enable any participating member country to balance **at once** its total purchases/imports (commercial/financial) with equal sales/exports (commercial/financial); this would be particularly enabled by the real-time gross settlement mechanism mediated by the WIB in conjunction with the International central bank Bureau (IB) of the respective reforming countries (multi-country reform). The instantaneous guarantee of the identity between a country's exports and imports (EX and IM) essentially means that international exchanges will be defined by exchanges of real actual goods; that is, countries would exchange actual real goods (commercial/financial) for actual real goods (commercial/financial) of equivalent value. Countries of the multi-country reform (as those of the single-country reform, see Schmitt 2014), would no longer balance their purchases of **actual real** goods with sales of **future real** goods, thus curtailing the anomaly of our current international payment system whereby the payment of a country's net imports with a foreign loan implies the payment of its net imports with a **future real** good: source of the double charge of external debts. In a new reformed system, the instantaneous exchange of real actual goods between the countries will effectively render any deficit country, non-deficit. That is, given its very deficit (net imports) will be immediately balanced by equal exports.

The objective behind a multi-country reform<sup>675</sup> of international payments is that it would guarantee *at once*, the identity between EX and IM for each country adopting the reform; this would be achieved through the real-time gross settlement mechanism operated by the intermediary institution (e.g. WIB) in conjunction with the reforming countries. For example in our case scenario, Iceland would balance its purchase of commercial assets (net imports) from the UK with an equivalent sale of financial assets<sup>676</sup> to Switzerland, thus instantaneously securing the identity between its imports and exports; as such it would no longer run a deficit and, matter-of-factly, it could not be considered a *deficit*<sup>677</sup> country. For its part, the UK could balance its net sale of commercial assets to Iceland (surplus exports) with, for example, an equivalent purchase of financial assets from Switzerland. In which case<sup>678</sup> and continuing in the same way, Switzerland would balance its purchase of financial assets from Iceland with an equivalent sale of financial assets to the UK.

We have mentioned that the multi-country reform that we uphold consists of an international payment system (partial initially) that would be based on absolute exchange rates and, enhanced with a real-time gross settlement mechanism, operating multilaterally and according to a DVP protocol. We have particularly pointed out that the real-time gross settlement mechanism would be mediated by the WIB<sup>679</sup>; specifically, the daily functioning of the new

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<sup>675</sup> Our intent is with respect to an international payment reform based on absolute exchange rates and complemented with a real-time gross settlement mechanism operating multilaterally according to a DVP (delivery-versus-payment) protocol.

<sup>676</sup> For example, bonds or shares (*real* financial goods) as issued by a country's domestic economy, Iceland in this case.

<sup>677</sup> Now, the same result could have been achieved had Iceland instead sold its financial assets to the UK (should the latter have been interested in purchasing them) or, to some other country adopting the reform.

<sup>678</sup> In each case, the instantaneous respect of the identity between EX and IM as the reform would guarantee, means that each country balances *at once* (real-time gross settlement mechanism) its purchases/imports (commercial or financial) with equivalent sales/exports (commercial or financial). That is, in any one period, each country gives up actual *real* goods (commercial/financial) and in return, it receives actual commercial/financial goods of equivalent value; in this way the reform would preclude the onus relating to net imports (which imports are important to secure the sound development of both the deficit as well as that of the surplus country's domestic economy) from falling entirely onto **deficit** countries (as it did pre-reform and more so, pathologically, if we account for the *double* charge). Both deficit and surplus countries would instead, equitably share the responsibility for their respective growth and development, in that the guarantee of the identity (between each country's EX and IM) and precisely the manner in which the reform would attain it, would facilitate as well as foster foreign investment. The sustainability of surplus-oriented countries can't but be safeguarded if their trade counterparts (importing countries) are also developing soundly and, in a sustainable way. See Schmitt 2014, as well Rossi 2012. 'Indeed, as pointed out by Keynes (1942a/1980), the international rebalancing should be symmetrical rather than relying on deficit countries only: a substantial decrease of imports in the latter countries could potentially lead them as well as surplus countries into a (prolonged) recession or depression. Rather, the rebalancing mechanism should be so designed as to induce surplus countries (like Germany) to increase their commercial imports from deficit countries (such as Greece), which need to boost their exports' (Rossi 2012: 235).

<sup>679</sup> By WIB (World Intermediary Bank), we intend some chosen international intermediary bank operating at a higher hierarchic level than that of the reforming countries' respective national central banks. Alternatively, we could have chosen to call this intermediary bank, the

system would be based, as it is for national payment systems, on a mechanism of real-time gross settlement, with the distinction that at the international level it would be managed by a supranational bank (e.g., the WIB, in our study-module), that is, a central bank of national central banks. The payments made by the country's residents (with respect to their foreign purchases) would be in the country's domestic currency and would be addressed directly to its Domestic Bureau (DB), which bureau section of the SB<sup>680</sup> would be responsible for paying its country exporters, also in domestic money. Now, whereas every payment<sup>681</sup> made by the country's residents would be in domestic currency<sup>682</sup> and moreover addressed to the country's DB, the International section of its country's Sovereign Bureau<sup>683</sup>, in conjunction with the supranational bank (e.g. the WIB), would guarantee the external payments, in foreign currency.

In the case scenario that we have, thus far, elaborated, the analysis of the suggested reform is more centered on the function of the new intermediary bank (e.g., WIB) as mediator of the countries' external payment transactions, even if it is recognized that its role is carried out in association with the countries' respective Sovereign Bureaus. Nevertheless, it is the daily operation of the new international payment system based on a real-time gross settlement mechanism, which mechanism the supranational bank effectively manages, that is essentially emphasized. For its part, the Sovereign Bureau (say of one member<sup>684</sup> country, Iceland) merely acts as a monetary intermediary. In the period taken as reference, its residents' purchase and sale transactions via the WIB's real-time gross settlement mechanism is enough to guarantee the balance-of-payments identity.

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EIB, to intend European Intermediary Bank; however we choose, for the time being, to refer to it as the WIB.

<sup>680</sup> The SB intends the country's single Sovereign Bureau that is subdivided into two sections: the Domestic and International sections, represented by DB (Domestic Bureau) and IB (International Bureau) respectively.

<sup>681</sup> Our meaning is again with reference to its foreign purchases.

<sup>682</sup> Though the payment of Iceland's residents is in domestic currency and directly addressed to the country's Domestic Bureau, it is always of an amount equivalent to that of the sum ultimately paid by the country's International Bureau, in NG; that is for example, if (at the reform onset) the Icelandic Krona (kr rather than ISK, in our study-module) had a currency value with respect to the intermediary standard (the NG) of 0.75 kr to 1 NG (1 kr = 1.333 NGs) then, for a sum worth 1000 NGs, the Icelandic residents would have to pay 750 kroners (equivalent value to the sum paid by its IB, in NGs, to the WIB). Now if the (net) payment (Iceland's) was, for example, destined for the UK and for a purchase amount of 500 pounds and, assuming the UK pound had a currency value of 0.50 £ to 1 NG (1 £ = 2.0 NGs), then the WIB would mediate an exchange of a value amount of 1000 NGs with the UK, for Iceland's purchase (worth 500 pounds). In this example case scenario, 750 kr = 1000 NGs = 500 £; the payment/exchange is in NG value and in the form of real goods, financial/commercial (e.g. Iceland financial securities vs UK commercial goods) and intending amounts in billions, for example.

<sup>683</sup> That is, the International section of the country's Sovereign Bureau: specifically, the International Bureau (IB), though not to be confounded as a separate Bureau of its own but rather as a separate section (International) of the country's single Sovereign Bureau. Ideally, in the multi-country reform that we here represent, each of the member countries' central bank will have a Sovereign Bureau (SB) that will be subdivided into two separate sections: specifically, the Domestic Bureau (DB) and the International Bureau (IB); both sections defining distinct parts (according to role and function) of one and the same Sovereign Bureau.

<sup>684</sup> That is, a participant member of the multi-country reform that we advocate.

Now if however, in the period under consideration, Iceland's overall purchases (commercial/financial) by its residents were to be greater than its overall sales (commercial/financial), then its SB<sup>685</sup> could take on a more active role, more akin to that of a financial intermediary, such that it could secure its country's balance-of-payments identity, ultimately. We will next consider this special case that particularly highlights the intervening (financial) role of a reforming country's Sovereign Bureau.

But before we do, let us sum up the similarities of both case scenarios: the one that we just covered and, the one that we are about to elaborate. In both cases, the infrastructure of the multi-country reform is basically the same. In particular, in both cases, each member country would be expected to create its own Sovereign Bureau (SB); the payments of the country's residents would always be addressed to its SB. The WIB would then carry out the payments between countries, on behalf of their respective SBs. In both case scenarios, the member country's international payments would be mediated by its Sovereign Bureau (its IB), albeit, in association with the WIB. And, as previously stipulated, the payment system of the latter would be based on absolute exchange rates, operating with a real-time gross settlement mechanism of *multilateral* clearing<sup>686</sup>.

We now turn our attention to the role of the Sovereign Bureau as financial intermediate.

### ***The Sovereign Bureau as financial intervener***

Before we begin our analysis, let us recapitulate the facts concerning both case scenarios. The conceptual construct of the multi-country reform is basically the same in both cases. It is rather the role emphasis that shifts, in that whereas in the first case it is centered more on the supranational bank, our second case study elaborates a more active role that could be taken on by the reforming countries' respective Sovereign Bureaus<sup>687</sup>. Otherwise, the procedural and

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<sup>685</sup> As always, its Sovereign Bureau considered as representative of the country itself, set of its residents.

<sup>686</sup> We refer the readers to a numerical example that straightforwardly exemplifies how the mechanics of such a system of international payments would work: see Cencini 2012a (21–24). Though, in his numerical illustration, Cencini uses the specific example of the ECB as the international/European settlement institution, which institution mediates the payment transactions between some country 'A' and other European countries 'RE' implementing the reform, we can easily see how his case-example would apply to our example-group of countries adopting the multi-country reform. For instance, we would substitute the ECB for the WIB and the euro for the WIB's currency, the NG; as well, our chosen country currencies would be represented accordingly. See in particular tables 7 and 8 (pages 23–24).

<sup>687</sup> Though we have situated a reforming country's Sovereign Bureau (SB) within its Central Bank, it should be noted that this is not an indispensable requirement of a multi-country reform; the reform could successfully operate whether or not, the SB is integrated within a country's Central Bank. On first considering this point, it would seem natural to situate it there given that the international payment transactions of a country's residents ultimately imply the country as a whole, as represented by its national Central Bank. However, we do acknowledge that there could be valid reasons not to incorporate the SB within a country's Central Bank, for example, to stay clear of potential political conflicts on the role and relevance of a nation's Central Bank. The matter would certainly have to be deliberated by an appointed committee of the group of reforming countries but whichever way it might be decided, the actual function of the reform should not be affected if, in all other respects, it is diligently implemented.

transactional protocol remains intact. The payments of the reforming countries' residents would always have to be addressed, in domestic currency, to their respective Sovereign Bureaus, specifically to the latter's Domestic section, referred to as the Domestic Bureau. It is this Bureau-section that would also be responsible for paying the country's exporters, again in domestic money. The International section (the IB) of a country's Sovereign Bureau would, for its part, guarantee the external mediation of payments (foreign currency) in conjunction with the supranational bank (WIB). The WIB would ultimately be responsible for actually carrying out the payments of *real* exchanges between the countries, on behalf of their respective International Bureaus; all would transpire through the WIB's real-time gross settlement mechanism operating within a system based on absolute exchange rates. Now, the distinguishing aspect that separates the second case scenario from the first is that in the second case, which case we are now elaborating, the sale and purchase transactions of a country's residents (e.g., Iceland) are not enough to guarantee the country's overall balance-of-payments identity. The country's Sovereign Bureau, particularly its DB, would thus obtain *as a net gain* the amount<sup>688</sup> of domestic currency spent by its residents for the payment of their imports, specifically their net imports. As far as the country's International Bureau is concerned, it consequently incurs the responsibility, as representative of its country as a whole, to perform a sale of an equivalent amount of financial assets<sup>689</sup> in order to comply with the balance-of-payments identity: it must essentially balance the country's overall purchase of foreign resources with a sale of current domestic resources. The role of the country's International Bureau, as such, becomes more involved<sup>690</sup>; it no longer acts merely as a monetary intermediary.

We deliberate the analysis starting from the Sovereign Bureau<sup>691</sup> of one of the countries implementing the multi-country reform.

We again consider Iceland, one of the reforming countries of our example case-scenario. We suppose that in the period<sup>692</sup> under examination, Iceland's residents (State included) import more than they export (both commercially and financially). We consider the net gain in *domestic* currency (kr) that the Sovereign Bureau, in particular its Domestic section (the DB), will derive from the payment of net imports (equivalent NG value) by its country residents.

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<sup>688</sup> The net gain amount received by the country's Domestic Bureau is equivalent to that of the sum ultimately paid by the country's International Bureau, in NGs (sale of financial assets that would secure the balance-of-payments identity and effectively pay for the country residents' net imports with current domestic resources, e.g., a part of Iceland's current domestic production, equivalent NG value of its net imports).

<sup>689</sup> That is, financial assets that have part of the nation's current resources (domestic production) as their very object.

<sup>690</sup> As it does in Schmitt's (2014) single-country reform, the Sovereign Bureau thus takes on an essential center role as well in the multi-country reform that we advocate (second case scenario); in so doing, it allows a country adapting the multi-country reformation to take one further step towards the internalization of its external payments, particularly given the fact that though the Sovereign Bureau is considered as a representative of the country itself (set of its residents), its very subsistence nevertheless falls under the same residential umbrella as that of its country residents.

<sup>691</sup> We recall that in the reformation that we present, when we refer to the Sovereign Bureau, we intend it as forming an integral part of a country's Central Bank and specifically as one and only one Bureau, which Bureau is sub-divided according to individual tasks into two distinct sections: a Domestic and an International section, the DB and IB, respectively.

<sup>692</sup> Any length of period could be observed; we choose a period of one year.

Specifically, Iceland's exporters would be paid (domestic currency) and the difference, the very net gain (in domestic currency; NG value of net imports) would be forwarded to the country's Treasury by the Domestic Bureau, such that it could be invested in a *new* production. For its part, Iceland's International Bureau would perform an equivalent sale of financial assets<sup>693</sup> (NG value of net imports) to secure the country's balance-of-payments identity. We will also consider including the reimbursement<sup>694</sup> of previously incurred debts, in our analysis.

Now it is conceivable that in the multi-country reform which we present, that the WIB could also intervene to help Iceland finance its net imports. This is certainly an additional role<sup>695</sup>

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<sup>693</sup> It should be noted that the financial assets sold by the IB do not have as their object, the *new* production of its country's Treasury, but rather, part of Iceland's current domestic production; this was also the case in Schmitt's single country reform (Schmitt 2014, part II).

<sup>694</sup> The reimbursement of previously incurred debts would increase the country's expenditures and as such could be the cause of net imports (much will ultimately depend on the amount of the country's total sales); as regard the exact reimbursement amounts (NG equivalent value) and due dates, they would remain those as contractually agreed upon by lenders and borrowers: they would not be amended in any way by the implementation of the reform, as adapted by the countries.

<sup>695</sup> Should the international settlement institution (e.g., the WIB) assume the responsibility of financial mediator/credit purveyor, in addition to its main role as *monetary* intermediate for the participant reforming countries, it might choose to enact from the onset, some cautious rules with respect to overall eligibility for countries seeking its financial assistance. For example, it might establish optimum quotas in regard to a trade-deficit country's bond selling (with respect, specifically, to the WIB's purchase of them) so as to ensure that the undertaking remained sustainable; as pointed out by Rossi, the chosen international settlement institution could 'provide some limit (as a percentage of GDP) beyond which no country might finance its trade deficit through a sale of bonds' (Rossi 2012: 235). It might also set specific eligibility standards in regard to a country's solvency and/or the array of financial assets that could qualify for equitable payment. But it should be clear that none of the prudent measures that the WIB may consider undertaking, should it be asked to act as financial intermediary, form any basis of the reform itself; this is not to say that there could not be valid reasons (political or other) to limit the sale of financial assets but rather that this is not an economic problem to be taken on by the multi-country reform. And moreover, if the WIB should adhere to any precautionary measures, it should only be with respect to its *own* purchase of financial bonds, as issued by any deficit/reforming country. In regard the member countries' residents (Sovereign Bureau included), they must be as free as possible to sell/purchase what they indeed wish to/are capable of, and on either or, both of the international commodity and financial markets. In this respect, we recall Schmitt's intent with regard to his single-country reform proposal; it is as well what we intend with respect to the multi-country reform (in regard the member countries, their respective SBs included). 'It is really important to note that surplus exports of 'rich' countries will in no way be affected by the reform. The purpose and intended result do not lie in suppressing net imports of countries that consider them advantageous. Symmetrically, there is no question of fighting against the net receipts in foreign currency of countries that are looking for them. What is 'detestable' is not the imbalance of international payments but the external debts that result from it. The research advocates the following: let countries be free to purchase and sell whatever goods they like in whatever proportion, within equilibrium or disequilibrium, but let them incur no foreign credit and no foreign debt as a result' (Schmitt 2014: 96–97). On the other hand, should the WIB agree to act as a financial intervener if asked to perform this function, under

that it could itself take on, as financial intermediate. It would involve selling its own financial securities to residents of any country, Iceland included, which country might be interested in purchasing them. In turn, the WIB could buy financial assets from deficit countries (e.g., Iceland) that might have encountered difficulty<sup>696</sup> selling their financial bonds through the WIB's multilateral system. Not discounting that the WIB could indeed incorporate this vital function under its range of responsibilities so as to afford the reforming countries another avenue by which to secure its compliance with the balance-of-payments identity, there is nevertheless a distinct advantage to having a participant reforming country's Sovereign Bureau in the picture. Let us further consider this, retrospectively.

The fact that an international settlement institution (e.g., WIB) could potentially intervene as financial intermediary<sup>697</sup> among a group of nations implementing a multi-country reform, does not add any new dimension to what has already been diligently put forward, world-wide, by serious proponents<sup>698</sup> of a payment system reform as could be applied at a global/European level. What could, however, turn a multi-country payment system reform into a whole new ball game, would be to merge existing proposals with some of the unique features as Schmitt (2014) has advanced in his single-country reform project. In particular, if we prioritized the role that a *co-resident* Sovereign Bureau could play and the benefits that could be derived from it, for any of the reforming countries, each considered as a whole. It is not only about the fact of establishing a Sovereign Bureau within each of the reforming countries but, more precisely, about the co-resident<sup>699</sup> element that it brings in: a definite step towards the

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no circumstance should it ever be forced to purchase the financial bonds of any country, in any amount/type; this should remain its own prerogative.

<sup>696</sup> Rossi describes this situation and the role that an international settlement institution, the likes of the WIB (he refers to it as the 'European settlement institution'), could take on in such instances 'when (as is often the case) the residents in the trade-surplus country do not purchase those bonds that the (private or public sector's) residents in the deficit country need to sell in order for them to finance their net imports. In this case, the European settlement institution must intervene and act also as a financial intermediary. Beyond issuing the number of money units that are necessary to pay finally the transaction between the two trading countries ... the European settlement institution acts also as an international financial intermediary when it buys those bonds that residents in a trade-deficit country are not able to sell to residents in any trade-surplus country, who, by contrast, may be interested in buying those bonds that are sold (and perhaps issued) by the European settlement institution itself' (Rossi 2012: 232–234). But as already mentioned, just how exactly the WIB might perform this function, that is, under what precautionary steps might it carry out the role if it agreed to do so, should fall under its own jurisdiction.

<sup>697</sup> That is, such as to assist any one of them in securing the necessary credit it might require for its balance-of-payments identity.

<sup>698</sup> A range of authors have written on the subject, we reference here only a mere few, particularly some of the authors that have written substantially on it: see in particular Schmitt (1973 and 1984), Rossi (2007 and 2012), Cencini (1995, 2001, 2005, and 2012a); see as well some of these same authors' other related writings on the topic.

<sup>699</sup> As Schmitt has pointed out in his single-country reform, it would 'guarantee that the external payments of the domestic economy are all carried out between residents. It is enough to this effect that the Bureau transforms every domestic payment addressed abroad (by considering it its own) into an external payment of which the Bureau is itself personally the only debtor' (Schmitt 2014: 53). He next elaborates on the precise intent regard the co-resident aspect of the Sovereign Bureau and how the latter would (in the single-country reform) take over the mediation of its country's external payments 'Domestic payments to the

internalization of a country's external payments. A Sovereign Bureau<sup>700</sup> would mediate the external payments of its co-residents in association with the WIB; it would distinctively set apart a country's internal payments from that of its external payments and effectively ensure, in conjunction with the WIB, the vehicular use of its country currency. And, should the situation<sup>701</sup> dictate a need for it, the Sovereign Bureau (its IB), acting as co-resident representative of its country (set of its residents), could perform a sale of financial assets to secure the country's balance-of-payments identity. Admittedly, on considering it all, the multi-country reform emerges that much more involved and all-encompassing through the incorporation of a Sovereign Bureau that would, moreover, be co-resident. It opens the door to yet another co-coordinated effort as would be implicated, this time between the SB's Domestic section (the DB) and the country's Treasury (co-resident of the SB); after all, it is the Treasury that would receive (from the DB), as net gain, the amount of domestic currency that the country residents will have spent towards their net imports, which net gain amount it will invest in a new production. We next elaborate this (second) case scenario.

In the situation whereby the sale and purchase transactions of a member-country's residents, are not enough to guarantee the country's overall balance-of-payments identity, then, by having a Sovereign Bureau in place, the latter (its DB) would thus receive, as a net gain, the amount (equivalent NG value) of domestic currency spent by its residents for their net imports. The Sovereign Bureau (its IB) would then undertake, as representative of the country itself, the task<sup>702</sup> of securing the balance-of-payments identity, by selling abroad financial assets. Moreover, the essential aspect of it all is with regard the amount of domestic currency that the country's Treasury would obtain from its Domestic Bureau, as net gain. This is where the multi-country<sup>703</sup> reform could make an important difference<sup>704</sup>. The reason lies in the use that the reforming country, its Treasury, could make of this net gain once it receives it from the Sovereign Bureau. Particularly, in this regard, it should be noted that there would not be much point to the reform if a country's (its Treasury) net gain were otherwise applied as 'straightforward purchasing power'<sup>705</sup> towards the country's current output; the financial

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credit of the rest of the world are carried out between residents, because the Bureau is itself part of its country's residents. The domestic payments of the Bureau do not prevent payments of foreign creditors to be carried out at their full value. Put simply, it is the Bureau that carries out and obtains the payment of the transactions occurring between its country and the rest of the world' (ibid.: 53–54). In the multi-country reform, the Sovereign Bureau (its IB) would also mediate the external payments of its country residents (co-residents), nevertheless in conjunction with the WIB.

<sup>700</sup> We have in mind a Sovereign Bureau akin to the Bureau as intended by Schmitt in his elaboration of the single-country reform. See Schmitt 2014.

<sup>701</sup> Specifically the situation (our second case scenario) whereby, the sale and purchase transactions of a member country's residents are not enough to secure the nation's overall balance-of-payments identity.

<sup>702</sup> The task, that is, of selling abroad financial assets (equal amount to its country residents' net imports, in equivalent NG value) on the country's current production (assets having part of the nation's current resources as their object) in order to balance the total purchase of foreign resources, in compliance with the balance-of-payments identity.

<sup>703</sup> As it was also the case for the single-country reform, see Schmitt 2014.

<sup>704</sup> To wit, much of the marvel would be found in the co-resident attribute that the SB would inherently carry.

<sup>705</sup> We recall Schmitt's heeding as he considered this very point in his development of the single-country reform. '[I]t would be awkward if the income spent in domestic currency on the surplus import purchases of economy A were to be held as straightforward purchasing

assets that the Sovereign Bureau will undertake to sell abroad in order to secure the identity, (which financial assets have part of the country's current output as their object) have not a purchasing power that is, after all, double.

We begin by recalling that a country's domestic production diminishes<sup>706</sup> according to the value amount of its net imports and remember how Schmitt (2014) countered this negative effect in his single-country reform proposal; the same remedy could be applied to the group of countries adapting the multi-country reform. It is here that as co-resident representative of the country itself that the essence of the Sovereign Bureau's dual role reveals itself, as evidenced by the inter-connected, though distinctly separate, functions of its Domestic and International sections. Its IB secures the balance-of-payments identity and in so doing, it guarantees the *real* payment of net imports: its *real* imports being fully covered by its *real* exports (sale of financial assets) of the period; moreover, as the *real* payment no longer involves the appropriation by the creditor country of part of the deficit/reforming country's future output, the domestic income (same value of net imports) that pre-reform, was decisively lost to the *double* charge of external debts, is in fact salvaged by the reforming country. Now, given that the Sovereign Bureau (its IB) has guaranteed the *real* payment of net imports with an equivalent part of national resources, *on its other hand* it (specifically, its DB) thus legitimately earns the net gain received in domestic currency from its co-resident importers for the payment of their net imports. And, in the DB transferring the net gain to its Treasury (co-resident) in order that it is invested in a new production, the multi-country reformation can, as it did in Schmitt's (2014) single-country reform, go one further step in its accomplishments: it can reduce its country's unemployment<sup>707</sup> by restoring the level of domestic production to what it initially was prior to the country's net imports payment. Precisely then, the reforming country not only salvages the domestic income that, pre-reform, it lost to the double charge, it can even restore its domestic production to its initial level (specifically, to the level that it was prior to its net imports payment), through the net gain that is legitimately earned<sup>708</sup> by its DB/Treasury. The increase in domestic production is

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power by the government. In this truly inefficient case, country A's national production would remain reduced by the value of the net purchases of foreign assets' (Schmitt 2014: 91). The reference to country/economy A is with regard to some deficit country, A, in Schmitt's example.

<sup>706</sup> 'The reason is that the value ... spent to cover the difference between expenditures and receipts is no longer available for the selling of a domestic product' (Schmitt 2014: 98).

<sup>707</sup> '[T]his increase of its domestic production, being entirely due to the additional employment generated by the government's action, decreases ... the level of unemployment of the country' (Schmitt 2014: 90). Schmitt's reference to the government's action implies its Treasury's (or, its Budget's, as Schmitt referred to it, in his 2014 presentation of the single-country reform) investment of the net gain in a new production. 'This reduction of under-employment will add to the advantage already obtained through the cancellation of external debts' (Schmitt 2014: 90).

<sup>708</sup> '[C]oncerning surplus imports economists consider in general as 'normal' that the incomes form and spent in domestic money disappear following their expenditure. This is wrong and something the reform will make impossible. These incomes will be earned, intact, by the sovereign Bureau' (ibid.: 98). Though Schmitt's reference in regard to 'the reform' is with respect to his single-country reform project, the investment of the net gain as earned by a country implementing the multi-country reform, can equally achieve the same results: a country's domestic income will remain *intact* (restored to its initial level). It is the Treasury's investment in a new production (non-consumption goods), additionally to that of its country co-residents, that will be responsible for this; it will effectively 'restore the balance between

particularly achieved by its Treasury's investment of the net gain/profit into a *new* production (in addition to that of its country's residents). However, needless to point out, the new production should be that of non-consumption goods<sup>709</sup> if we remember that the investment of a profit (net gain) into a new production means that the resulting output is already outright purchased<sup>710</sup> at the very moment that new wages are paid out. With this in mind, the country could invest the net profit towards any infrastructure that the country might be in need of, for example, road/water works, even in the construction of public schools and/or any other government owned institutional buildings (hospitals) or, public works. The country could thus enhance its overall standard of living whilst reducing its level of unemployment.

Now, we have mentioned that in fully paying its net imports with *real* exports, through a sale (equivalent NG amount of net imports) of financial assets<sup>711</sup> as undertaken by its Sovereign Bureau (IB), the deficit/reforming country not only eradicates the *double charge*<sup>712</sup> of its external debt, it actually reduces it to zero, in the period taken as reference. As such, the country is effectively rendered *non-deficit*; its deficit (net imports) having been paid in full and, in the same period in which the net imports originated. The question that should next be considered is what will the multi-country reform do with regard to a country's previously<sup>713</sup> incurred external debts, which debts remain due and rightly require to be paid to external creditors. In revisiting Schmitt's (2014) single-country reform proposal in this respect, it is soon realized that the same procedure can be applied such that these external debts that have materialized in the past, can be gradually re-paid. In fact, what will simply happen is that their re-imburement amounts<sup>714</sup> will form part of the country's expenditures, increasing them accordingly and as such, potentially be the cause of *net* imports, depending on the said

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real and monetary income' (ibid.: 98). Moreover, the country-residents' transactional exchanges will transpire as though their external purchases were *national* purchases; this because, the residents' international purchases will, after all, always be paid to a co-resident: the DB of its country's Sovereign Bureau. 'Domestic payments to the credit of the rest of the world are carried out between residents, because the Bureau is itself part of its country's residents' (ibid.: 53).

<sup>709</sup> '[I]t is necessary that the profit spent by the Bureau does not produce any goods for consumption or investment, which are themselves part of the goods to be sold. The reason is that this product is already purchased at the moment the profit of the Bureau pays for new employment. Unlike all other productions, the expenditure of the Bureau's or the government's profit is an expenditure that is active both on the production and on the sale of goods: at the very instant this profit is transformed into new incomes, it is precisely an income already spent for the final purchase of the corresponding output' (ibid.: 98).

<sup>710</sup> 'In other words, the holder of this very special profit becomes the final owner of newly and additionally produced goods' (ibid.: 98).

<sup>711</sup> Financial assets, that is, that specifically has a part of the country's *current* resources, as their object.

<sup>712</sup> We recall that pre-reform, the deficit country paid its net imports twice: once in *real* terms and once again in money terms; the multi-country reform enables a country to pay its net imports, once only, in *real* terms: specifically, with a part of its *actual* domestic resources.

<sup>713</sup> As it is the case with regard to Schmitt's single country reform, we intend the same with respect to the multi-country reform: '[t]he reform will radically alter the payment of previous debts' (Schmitt 2014: 45).

<sup>714</sup> The exact amounts and date of reimbursements would remain those contractually agreed upon by the lenders and borrowers; the reform would not modify anything in this regard.

country's total sales. We next consider a simple numerical example<sup>715</sup>, to illustrate how it would work.

We consider again Iceland as our example deficit-country. We suppose that, in the period taken as reference, our said deficit country imports for 13 units (always billions) and exports for 10 units, in domestic money; initially, expenditures exclude previous debts which debts amount to 2 units (domestic money) for the period in question. Next, we include the reimbursement, exactly 2 units (national money) in debts *outstanding*, to the imports amount: expenditures thus amount to a total of 15 (domestic money, in billions) units. Now, assuming that the total amount of the country's sales, for the said period, does not alter the net imports amount, the latter would therefore equal 5 units. Country importers would thus pay, in the period, to the Domestic section of their Sovereign Bureau, a total amount of 15 (billions) units in domestic currency; the DB would then pay its country exporters the sum of 10 units out of this 15 units sum and forward the difference, 5 (billion) units to its Treasury, as *net gain*<sup>716</sup>. As previously mentioned the gain/profit is *net* given, for its part, the Sovereign Bureau's International section would undertake a sale of financial assets for a same sum amount, exactly 5 (billions) units (NG currency) such as to secure the country's balance-of-payments identity<sup>717</sup> (sale of current domestic resources to balance the purchase of foreign resources/total expenditures), for the said period.

### ***Some comparative notes***

In closing this chapter, we think it opportune to highlight some of the main differences and similarities between the two types of reform that the countries could adopt: single-country versus multi-country. Primarily, it is worth pointing out that both open the door for a substantial role to be played out by a country's Sovereign Bureau<sup>718</sup>. This is even the case in

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<sup>715</sup> Our example is based on one as illustrated by Schmitt in his single-country reformation project (see Schmitt 2014: 45–46, also 81–82), but that could easily be implemented, as well, by a group of countries adapting the multi-country reform.

<sup>716</sup> The intent of the reform (multi/single country) is that this net gain amount (e.g. 5 units, billions, in domestic income) would be earned as pure profit by the country's Treasury who would invest it in a *new* production of non-consumption goods, with a view to restore the nation's initial level (previous to the net imports payment) of domestic production whilst reducing its unemployment.

<sup>717</sup> Once again the intent of the multi-country reform with respect to the member countries' respective deficits (net imports) would be that of the single-country reform. We next capture Schmitt's reflection on this essential point. 'The progress achieved by the reform is of an unexpected importance. We will come back to it. It is first necessary to understand that the difference between today's situation and the reform is not at all to make it possible for countries' deficits to create a positive difference between the imports of goods from the rest of the world and imports that are reciprocal. In our example, even though country A runs a deficit, R's imports are equal to and not less than A's imports. R's imports are always equal to A's imports, even when country A runs a deficit' (Schmitt 2014: 82). The reference to 'A' (country) and 'R' imply some deficit country A and the rest of the world as represented by, R.

<sup>718</sup> In both types of payment reformation, whether single-country or multi-country, it would be expected that the countries implementing the reform (single/multi) would create a Sovereign Bureau, that would act as a representative of the country itself (set of its residents), and which Bureau would mediate the payments of its national residents (State included), both internally and externally; in the case of the multi-country reform, it would particularly

the multi-country reform where the additional feature of an international settlement institution having the faculty of issuing its own currency standard, takes nonetheless center stage in operating an international payment system of *multilateral* clearing. As regard levels of complexity, the multi-country reform could be viewed as more engaging and politically sensitive by the mere fact that the reform would encompass a potentially expanding group of countries that would implicate their respective governments in the decision-making process. Nevertheless, the multi-country reform option does have the striking advantage of facilitating growth (economic/financial) amongst the interacting group of reforming countries and, most likely, even increasingly over time. The single-country reform, for its part, is certainly not without its own merits; brilliantly engineered, it offers countries the option of single-handedly reforming their respective system of external payments such as to counter the double charge of external debts that they currently suffer; it is clearly an *individual and at the ready* option for any country decisively wanting to better their current predicament, both from an economic and financial stand point, in that it is entirely up to the said country, itself, to undertake the initiative.

Moreover, the end result for both reforms, whether single-country or multi-country, is the same. In both, not only is the pre-reform *double* charge of external debts eradicated, even more, zero external debt is achieved; as well, the domestic income remains available within the reforming country. Now, when individually compared, we can sum up the following. The reform adopted by a group of countries allows for the creation of a partial system of international payments, based on absolute exchange rates and with a real-time gross settlement mechanism managed by an international/European settlement institution (e.g., the WIB). Within such a system, countries' net imports would be immediately matched by equal exports, their respective domestic income would remain intact (internally available) and the countries would respectively incur an external debt equal to zero. In the single-country reform, no system of international payments, per se, can be created (no individual country alone could ever create such a system); it is thus necessary to enable any individually reforming country *to obtain free of cost the foreign currency that is required to convey its external purchases*, through a loan that must not increase its external debt. The end effect must always be the same, regardless of the reform undertaken (single or multi-country): zero external debts; the only difference being that this end result can only be obtained (in the single-country reform) through a mechanism that allows the reforming/deficit country to gain access, for e.g., to 1 MR (foreign currency, money R, in billion dollars), in each period, without any increase in its external debt.

### ***More on reformation options***

Next, in the spirit<sup>719</sup> of reform, we examine schematic blueprints of reformation options that could be implemented by any one group of countries decisively committed to enhancing its member countries' current system of external payments. We begin with diagram 7.2<sup>720</sup>, which

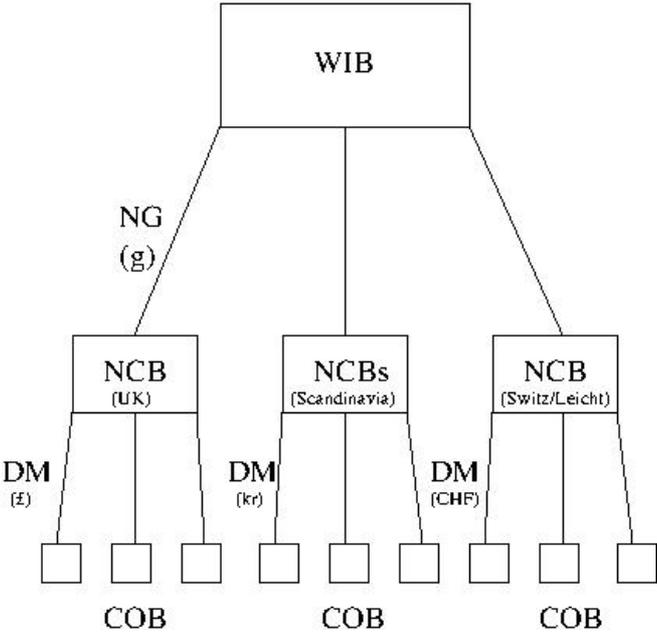
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mediate the residents' external payments in association with a chosen international settlement institution, e.g., the WIB.

<sup>719</sup> Our schemata are specific adaptations (with slight variations) from Cencini (2001, p. 22: 'Figure 1') whereby he illustrates what a global reformation undertaking could intend.

<sup>720</sup> Our diagram 7.2 is adapted from Cencini (2001, p. 22: 'Figure 1'); it is particularly an adaptation-excerpt of Cencini's 'Figure 1' in which we illustrate the partial system of international payments that our chosen group of seven countries could implement in association with the WIB (our e.g. of an international settlement institution). We remind that

provides a hierarchical layout of a partial system of international payments as could be adopted by our chosen exemplary group of nations. At the helm, we find the WIB (World Intermediary Bank): the Central Bank<sup>721</sup> of the NG (New Group: our chosen group of seven), which group's individual Central Banks<sup>722</sup> are represented at the middle level (the individual Central Banks of each of the four Scandinavian countries have been grouped together under NCBs, for simplification); the bottom level depicts an array of secondary<sup>723</sup> banks (represented as COB in keeping with Cencini 2001) operational within each of the currency areas that we represent (UK £, Scandinavia kr, Switzerland/Leichtenstein CHF)<sup>724</sup>. The WIB's own currency standard is denoted by 'g'.



**Diagram 7.2:** Adapted from Cencini (2001, p. 22: 'Figure 1')  
*A partial system of international payments as could be mediated by the WIB*

the nations of our chosen group of seven intend: the UK (primarily England, Wales, Scotland, Northern Ireland); Denmark, Iceland, Norway, Sweden; Liechtenstein and Switzerland.

<sup>721</sup> It provides a homogeneous monetary zone for our chosen group of seven 'through the emission of a monetary standard used as vehicular currency by member countries in all of their reciprocal payments' (Cencini 2001: 22); moreover, it (the WIB) affords 'a mechanism for the financial settlement of transactions by operating a system of clearing in collaboration with national central banks' (ibid.: 22). That is, in our case study we specifically intend the national Sovereign Bureaus (SBs) situated within and forming an integral part of the reforming countries' respective NCBs.

<sup>722</sup> 'They act as clearing agents of commercial banks and guarantee national monetary homogeneity' (Cencini 2001: 22).

<sup>723</sup> Each carry out payment transactions in their own national money given that the reform intends, for member countries, the upholding of their respective monetary sovereignties.

<sup>724</sup> DM in our diagram 7.2 intends, as it does in Cencini's 'Figure 1', 'the domestic money used in each country' (Cencini 2001: 22-23).

In diagram 7.3 we illustrate (along the lines of Cencini's 2001 elaboration) a more comprehensive system of international payments<sup>725</sup>. In this particularly more intricate schema, we have, in variation to Cencini's 'pyramidal structure' (ibidem), incorporated the ECB alongside other NCBs, as though the current Euro zone nation members had opted to unite under a United States of Europe<sup>726</sup>, its own sovereign country. In its previously assigned slot<sup>727</sup>, we have instead inserted a new European central bank, which bank we denote by EIB (European Intermediary Bank)<sup>728</sup> and which substitutes our earlier denomination of WIB (World Intermediary Bank); the new global/world Central Bank of Central Banks is represented at the very top of the diagram: the ICB (International Central Bank)<sup>729</sup>. Although our hierarchal schema mainly brings together three distinct world areas<sup>730</sup> (Europe, The Americas, and Asian countries)<sup>731</sup>, we envision that it could, in time, encompass more distinct regional monetary unions or, many more countries coming in under the umbrella of any of the three monetary areas as depicted in our diagram 7.3<sup>732</sup> (second horizontal line from the top). Now, as to why we might have incorporated the current members of the Euro zone under a single sovereign country of its own, our reasoning is unadorned. It is simply that in regard the European political arena's current state of affairs, specifically that of the Euro zone, there appears to be no intention of ever<sup>733</sup> turning back to embrace, once more, one's (any Member States) forsaken monetary sovereignty, despite the strain of financial, economic and political hardship that some<sup>734</sup> have encountered since the onset of EMU's monetary 'union'. It seems

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<sup>725</sup> Our diagram 7.3 is adapted from Cencini (2001, p. 22: '*Figure 1*'); it is a globally oriented schema that groups a larger number of countries under a more comprehensive system of international payments. As a variant to Cencini's '*Figure 1*' we have incorporated the ECB alongside other NCBs (on the second horizontal line from that of the very bottom one which features the COBs), as though the current country members of the Euro zone were united under a single sovereign nation, the United States of Europe.

<sup>726</sup> We suppose the Euro as the unique country currency that could be adapted by the United States of Europe were they (Member States) to primarily undergo a reform of payments that would truly render their newly formed country a **single** currency country, referred to as the United States of Europe (USE).

<sup>727</sup> That is, as depicted by Cencini (2001) in his 'pyramidal structure of the new system' (*Figure 1*: p. 22).

<sup>728</sup> We have kept the name, NG, for the currency standard of the EIB (European Intermediary Bank).

<sup>729</sup> In keeping with the designation/layout of Cencini's (2001) '*Figure 1*'. Also, in our diagram 7.3, again in keeping with Cencini (2001), we refer to IM as intending the international money/currency of the ICB; as well, DM intends 'domestic money' and COB, the countries' 'commercial banks' (ibid.: 22).

<sup>730</sup> Specifically: three regional monetary unions representing Europe, the Americas and Asia with their own respective regional currency standards, that of the NG and, as in Cencini's (2001) case, the Dollar and the Yen; the NG being issued by the EIB and the Dollar and the Yen, being issued by the AMCB (American Central Bank) and the ASCB (Asian Central Bank), respectively.

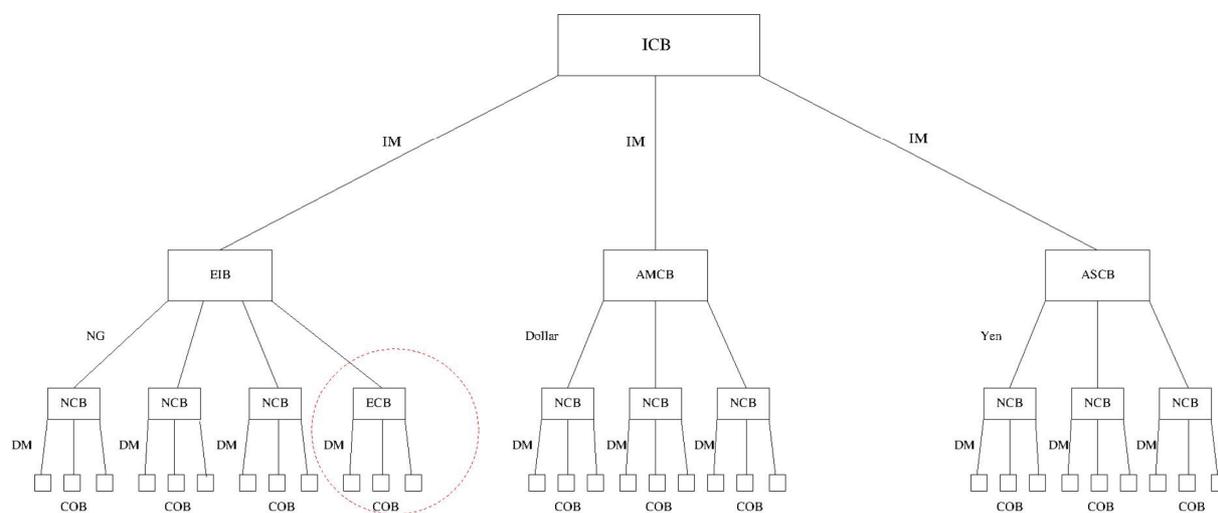
<sup>731</sup> Except for a few minor variations, we have kept our schematic layout, overall, much in line with that of Cencini's '*Figure 1*'. Our diagram 7.3 is a very slight variation of it.

<sup>732</sup> Or even under the schematic umbrella as exactly depicted by Cencini's (2001) '*Figure 1*'.

<sup>733</sup> Our meaning: least of all in the foreseeable future.

<sup>734</sup> We refer to some in the sense, that is, of more so than other Member States; for the most part, the effect of the monetary 'union' has not been overly positive and, for some Member

more likely, realistically, that the Euro zone Member States will eventually succumb to uniting under a single sovereign country (e.g., the United States of Europe). On this subject, we caution however, on the risks of such an endeavour<sup>735</sup>. Let us next consider this further.



**Diagram 7.3:** Adapted from Cencini (2001, p. 22: 'Figure 1')  
A more comprehensive system of international payments

One risk that readily comes to mind is the issue of free mobility of capital<sup>736</sup> that could (as it happens in a unique currency region) very likely fuel already competing economic interests. Another is the disadvantage of a single monetary policy, as evident from the ongoing saga of financial turmoil within Euro land, that is simply not conducive to a vastly divergent<sup>737</sup> group

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States on more than one level, e.g., Greece and other peripheral countries the likes of Spain, Portugal, Italy.

<sup>735</sup> That is, the endeavour of Euro zone Member States eventually uniting under a single sovereign country; hence, the reason we have red-circled its insertion position (within our diagram 7.3), as simply one other **national** Central Bank, the ECB, situated alongside other NCBs and, under the EIB umbrella in the hierarchical set up.

<sup>736</sup> 'Indeed, free capital mobility in a single currency area means that capital moves from the less interesting member countries (with respect to the return on investment) to the more interesting countries in that area. Obviously, both short-term (speculative) investment and long-term (foreign direct) investment are directed into those economies where the yield is highest among the countries of the currency area, a return on investment that is positively correlated with the rate of real growth. If so, then economic divergence may increase among member countries, giving rise to higher rates of unemployment in those member countries ... that offer no interesting rate of return on investment compared to some other countries of the same currency area' (Rossi 2007: 101).

<sup>737</sup> '[T]he experience of European monetary unification proves that levelling the playing field is a pre-condition rather than an outcome of monetary integration. The process of convergence at the world level appears insurmountable, economically and above all politically. Furthermore, one monetary policy applied to vastly heterogeneous countries is

of Member States, whether considered from an economical, financial, political or, cultural perspective; it is not surprising that, more often than not, it is the steady self-interest of each that eventually despairingly pulls them apart rather than unite them on a progressive common front. Were the Member States instead opt to recover their respective monetary sovereignties, it would enable their individual governments to stir the country's economic and monetary policies (e.g., regard interest rates) according to their specific requirements and, country make-up; the Member States would have a better chance at evolving more progressively, in all aspects, if their very country profile was particularly kept abreast in national policy making. That said, the return to their respective monetary sovereignties would, without doubt, have a more certain and sustainable chance to succeed were it accompanied with some form (single/multi-country) of external payment system reform. Otherwise, as we have elaborated in this paper, the Member States' vulnerability to the double charge of external debts, with respect to both its formation and the net interest payment, would continue to take its toll.

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inefficient and amplifies divergences between strong and weak countries' (Alessandrini and Fratianni 2008: 25).

## 8 Day's end

### Looking back and onwards

It is true that life in general is very much a process of evolution. A template that was formed from past individual experiences<sup>738</sup> marks even the way that we view and assess things on a day-to-day basis. If we consider Keynes, just for example, his progressive efforts<sup>739</sup> in monetary policy stemmed from his apprehension regard a serious lack of global institutional regulation that dated prior to the Great Depression. And yet again, there is the other situation of critical exchange rate instability that was a driving force behind the 1992 Maastricht Treaty and the eventual creation of the European Monetary Union. The fact is, not all of our consequential responses to our past leads to a better alternative. But fortunately the template that colours our very outlook on life has, itself, the faculty to evolve over time, much in accordance with our ongoing experiences, be they positive<sup>740</sup> or, negative. One individual that would likely attest to this is Dini<sup>741</sup>. A brilliant and fascinating mind in the fields of civil and

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<sup>738</sup> 'It is often said that man judges the facts that occur in non-human environments nevertheless according to his own experiences' (Schmitt 2014: 92).

<sup>739</sup> 'Keynes' work is a response to the institutional weaknesses at international level that have characterized the first era of globalization, and his work is foremost aimed at international institution-building. Keynes monetary thought was elaborated in the 1920s, preceding the depression, and was chiefly devoted to understanding the nature of bank money (which proved to be very different than metallic money) and of modern banking activity. Keynes' main legacy lays in his analysis of the adequacy of the institutional arrangements underlying both the national and international system of exchanges. The Keynes Plan is an attempt to ground the international system of trade in a sound monetary institutional framework' (Piffaretti 2009: 52).

<sup>740</sup> After more than forty years of working on the issue of the external debt problem, not only did Bernard Schmitt's research experience and perseverance lead to a solution for the eradication of the *double* charge, it ultimately evolved to zero external debt for the deficit/reforming country: more than he'd even gambled for. 'By abolishing the sovereign debt, the Bureau will also enforce the cancellation of any external debt formed by net imports' (Schmitt 2014: 64). A result to which he, himself, admits 'an excellent conclusion, although a little unexpected' (ibidem).

<sup>741</sup> Enrico Dini is a civil engineer by trade; he is probably better known as 'The Man Who Prints Houses' (see [3Dprinting.com](http://3Dprinting.com) The Story of Enrico Dini – The Man Who Prints Houses by Robert Dehue, July 9, 2013) though he currently is the man who, amongst other genial and most interesting projects, prints houses for fish, precisely 'artificial lifelike coral reefs from sand' (see <http://www.isplora.com/news/print-houses>). He is currently Chairman of Monolite UK Ltd, having founded the company in 2007. The London based company invented a new robotic technology for application in the construction building industry, which revolutionary process was branded as D-Shape. 'His D-Shape machinery is capable of creating, from sandstone, full-sized buildings without the need for human intervention. The 3D printing process Dini's machine uses requires nothing more than sand and an inorganic binder to

robotics engineering, Dini ceaselessly strives to think in uninhibited ways that allow his intellect to attain the pinnacle of creativity and perfection. As a youngster, the love of his life was building sandcastles by the sea. Today, he is the man behind a revolutionary new kind of architecture that has the potential to create buildings out of sandstone using an innovative technological process and a 3D printer (D-Shape). Interestingly enough though not surprisingly, he likes to describe his D-Shape printing machinery not as a machine<sup>742</sup> but rather as a tool<sup>743</sup> with which to create architecture. At a particular event presentation<sup>744</sup>, he candidly recounted not only how a basic idea<sup>745</sup> had become a vision but also how one fateful incidence<sup>746</sup> had seriously set him back on his heels; steadfastly resolved in his quest to

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function, and Dini believes D-Shape has arrived at a methodology sure to upset the architectural design and building construction trades' (see <http://www.3dprinterworld.com/article/descent-into-genius-enrico-dini>); (see also <http://w3.bwk.tue.nl/fileadmin/bwk/ade/workshops/17.2.pdf>).

<sup>742</sup> The machine (D-Shape 3D printer) runs in conjunction with an algorithmic software tool; it effectively prints algorithms.

<sup>743</sup> The following are some excerpts of an interview with him that was published on the 12<sup>th</sup> of January, 2015: '... a new tool to make a new architecture ... the genius is not to produce a 3D printer but what to do with it ... the advantages of 3D printing are endless, the only limit really, is the imagination' (Audi Stories of Greatness: Enrico Dini challenges the limits of 3D printing; see <https://www.youtube.com/watch?v=LNCK4huhbUE>). Although he'd originally designed his 3D printer to specifically build houses, he came to realize that its current construct best suited as an instrumental tool with which to create a vast array of any kind of architectural designs, particularly that of 'archinature' (environmentally friendly man-made marine creatures) to use his coined expression; one experience led to another and he thus became actively involved, amongst other interesting and ongoing ventures, in worldwide projects concerned with coastal ecology.

<sup>744</sup> His talk was held at Bocconi University in Milan, at a TEDxBocconiU events 'Large Scale 3D printing: Enrico Dini at TEDxBocconiU'. It was published on the 21<sup>st</sup> of May 2013 (see <https://www.youtube.com/watch?v=L65QKBDQ6mc>).

<sup>745</sup> He once had a Zcorp 3D printer that was developed by the Zcorp Corporation in Burlington Massachusetts based on a principle originating at the MIT in Boston; it was with this 3D printer that he once printed out a scaled down model of a house, simply in jest. In doing so, however, he got the idea that a house could be built in an unconventional way, that it could actually be printed out, using a 3D printer; he thus set out to build the 3D printer that he would require in order to attempt to do this.

<sup>746</sup> The story begins with the collapse of a Radiolaria-like shell that he'd created, but for Dini it turned out to be 'the story of an inventive process' that 'produced a completely different outcome' and as he particularly points out 'the outcome of an inventive process that is still moving on'. (See *ibid* for 'Large Scale 3D printing: Enrico Dini at TEDxBocconiU'; published 21<sup>st</sup> May, 2013). Though Dini had initially set out to invent a machine that would print houses he came to realize in the aftermath of this set-back (shell creation collapse) that his invention had inadvertently evolved into the creation of a 3D printing tool that had the potential to redefine architecture altogether, to take it to a whole new level, not only in methodology but also in applications. In positive retrospect, he decided it was a definite 'signal of a different way to think of architecture' (see *ibid*); he elaborates on his very experience 'not being able to make a fantastic machine but being able to make very rough objects I found a solution to use my machine as is and not as I be willing it to be: archinature. Shaping in demolition and also shaping in addition, in growth' (*ibidem*). 'It opened the way to use this 3D printing immediately in a certain environment, the sea for instance. So you see

revolutionize the world of architecture he set out to positively transform the experience into a new undertaking: he opened the door to the realm of archinature<sup>747</sup>. Whenever recounting the varied missions that he has in the making, Dini speaks with a captivating and most contagious enthusiasm; his storyline is simply enthralling, a true breath of fresh air.

It would be invigorating, certainly encouraging, if we could sense a same enthusiasm applied to turning the European project (EU/EMU), as it stands today, towards a newly found and sound direction. Though the original thrust behind its development may have been to sow the seeds for a strong and prosperous European unification with which to hit the ground running, the project seems to have since fallen into a stagnant pond. Perhaps the best and sure way out of its quandary would be to attempt to escape it, in small steps.

Let us consider, for starters, the European Monetary Union. The ECB has already in place the entire basic institutional infrastructure that could serve well, albeit provided some custom alterations were implemented, should the Member States be willing to embrace the multi-country reform. In this case scenario, the Member States would be the very group of countries implementing a partial system of international payments with the ECB at the helm and, with the understood proviso that the said countries would regain their respective monetary sovereignties. This is the only way that the Euro Zone Member States could properly be set up as a truly functional and authentic monetary union. Otherwise, in the absence of a third counter-party international settlement institution (which the ECB currently falls short of) to mediate all of the external payments of its respective Member States, the latter remain without a true monetary union or, unique currency, for that matter. Moreover, they have not yet fully embraced, at least not concertedly, the idea of forming together a new sovereign country, e.g., the United States of Europe, which country could effectively issue its own national currency. And until they do so, which seems likely that they just might (even if only in the long run) given the current state of affairs, the Member States will remain in limbo, having neither a unique currency as would befit an authentic monetary union or, a national currency that they could call their own, were they united together within a newly formed sovereign country.

Now, with all due respect to the Founding fathers who ardently fought for the establishment of a European Monetary Union (EMU) complemented with its ‘unique’ currency, the idea of Member States regaining their respective monetary sovereignties, at this stage of the game, would probably feel like they’ve been dealt a wallop. After all, it wasn’t in the cards. Fair enough, but just the same, this is where Dini’s positive approach could make all the difference. If instead of muddling along in a state of perpetual denial, the Member States were to bite the bullet and simply embrace the spirit of reform<sup>748</sup>, be it single or multi-country, they could very well be pleasantly surprised; free from an otherwise precarious situation with no end in sight, they could turn over a new leaf and in the event of adopting a multi-country reform, the ECB could even apply its existing infrastructure (with some custom modifications) and the whole paraphernalia of its working mechanism towards a newly found *raison d’être* as a true international settlement institution. It would be, undoubtedly, a fine

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that I started supposing to invent a printer and then I invent a new concept of the architecture; I suppose going to print houses and I print houses just for a fish’ (ibid).

<sup>747</sup> Dini explains how ‘our sense of esthetics is something that is related to an evolution process’ as he describes his artistic creatures as ‘petrified algorithms, digital manufacturing based on computational designs’; he provides an example of what can be created out of this concept: ‘a digital model of a coral reef’. (See ibid for ‘Large Scale 3D printing: Enrico Dini at TEDxBocconiU’; published 21<sup>st</sup> May 2013).

<sup>748</sup> That is to say, presumably with a return of their respective monetary sovereignties in the cards.

way for the ECB to re-invent itself. In an analogy to Dini's own experience<sup>749</sup>, the genius doesn't have to be all about the original threads that went into the creation of a currency 'union', nor in what it might have initially been designed for, but rather, in what it can best deliver at day's end.

That all said, if the Member States think that regaining their respective monetary sovereignties<sup>750</sup> is too risky or, simply frightening, then the choice of uniting into a single sovereign country could be contemplated as another alternative; though certainly not without considering, in depth, its unique consequences. Then again, if neither undertaking is thought to be worthy of having a shot at, then perhaps the only thing left to do is for them to wait it out and let nature take its course. Of course, that would be like putting the cart before the horse.

As for the non-Euro zone European states, their individual prospects are a little easier from the start; by the mere fact that their respective monetary sovereignties are already existent, they are definitely ahead of the game: it is just a matter of weighing out the best way to play it. Once again, if the bigger picture of joining other non-Euro<sup>751</sup> countries in implementing a partial system of international payments (multi-country reform) seems too daunting, then these countries (non-Euro) would really have nothing to lose to solitarily adopt the single-country reform, even as an initial<sup>752</sup> step. On considering it, the creation of a Sovereign Bureau within each of their respective countries, in either case scenario (single or multi-country reform option) is a necessary requirement of the reformation, be it single or, multi-country. Thus this initial step, part and parcel of either payment system reform, will most certainly have not been carried out in vain. If, in time, they aspired to a more comprehensive undertaking, then a reform implicating a group of countries in a partial system of international payments could always be considered at that point; the Sovereign Bureau in each of their respective countries would already be in place. There would remain only the task of consorting amongst them on the setting up of an international settlement institution (the likes of the WIB or, the EIB, for example) that would mediate the reforming countries' external payments, in association with the individual country Sovereign Bureaus. In fact, it may be that if a group of non-Euro zone countries consorted on adopting a partial system of international payments, this could be the fateful catalyst to get the ball rolling with regard the Euro zone Member States, eventually, succumbing to the trend.

On considering the laboring of the Founding fathers of the European project and the energy spent in their idealistic endeavours, and moreover, in fairness to all that are currently implicated, it becomes clear that the ailing situation warrants not only an acknowledgement of shortfalls but also a sincere desire to reach an equitable solution. After all, learning from our mistakes and being able to move on, is far more important than the fact that we might of stumbled along the way.

This paper presents a compilation of the works of some of the most prominent authors who have written intensively on our subject. Still and all, at day's end, we nevertheless face a work

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<sup>749</sup> '[T]he genius is not to produce a 3D printer but what to do with it'. See Audi Stories of Greatness: Enrico Dini challenges the limits of 3D printing; published on the 12<sup>th</sup> of January 2015.

<sup>750</sup> That is, along with adapting some form of external payment reform (single/multi-country).

<sup>751</sup> Assuming, that is, that joining the existent EMU (European Monetary Union) is not considered a viable proposition.

<sup>752</sup> In time, as they regain sound economic and financial growth from having, in the least, protected themselves from the double burden of external debt, they may feel better ready to consider a more encompassing form of reform such as the multi-country reformation would entail.

in progress. It is one thing to be in the know of our quagmire, yet quite another to be able to muster up the courage to do something about it. Will our nations be up to it? *Affaire à suivre...*

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