

## Keynes: Man of Peace

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*Michael Barratt Brown reviews Robert Skidelsky's John Maynard Keynes: Fighting for Britain 1937-1946 (Macmillan, 2000).*

*'But if nations can learn to provide themselves with full employment by their domestic policy... there need be no important economic forces calculated to set the interests of one country against that of its neighbours'*

J. M. Keynes, *General Theory of Employment, Interest and Money*, p.382

This is the third volume (another 580 pages) of Skidelsky's magisterial biography of Keynes. It is a worthy successor. It repeats the lucidity of exposition of complex economic ideas and the intimate interweaving of Keynes's personal and political lives. It is the story of a man confined to his bed from coronary disease at the start of this period of his life and for many days and even weeks of the remaining ten years. Yet during that period he crossed the Atlantic to the United States and back on ten occasions to engage as the leader of the British team in negotiations which lasted for weeks and sometimes months and on issues of the greatest technical complexity and political importance. Keynes was a big man and often appeared to his colleagues as somewhat larger than life. In this volume his wife Lydia Lopokova is given her rightful place as his constant companion wherever he went, his protector and nurse, sharing his impish love of life and art and human variety.

In the first two volumes Keynes was seen developing, from his First World War and post-war experience in government and from his teaching and management of finance at Kings College, Cambridge, the ideas which were to constitute the Keynesian revolution in economics. In this volume he is having to apply them to the real world. The passage quoted above taken from the last page of his *General Theory* provides the central motif that guided Keynes through the maze of conflicting interests from which the political and economic settlement emerged after the Second World War.

At the back of his mind, through all his economic argument and persuasive rhetoric, lay the firm conviction that there must not be a repetition after the Second World War of the inflation and unemployment in Britain and in Germany, and in the USA too, and throughout the world, that followed after the First World War. Every proposal that he made and every argument he considered had in the end to be judged by that one criterion. It was this that made it possible for him to cut through all the confusions and selfish interests that surrounded him.

None of this is to deny Skidelsky's central theme, that Keynes was 'fighting for Britain'. The military struggle was not his concern and after the Russians and then the Americans entered the war in 1941, the result was certain however long delayed. Keynes was concerned about winning the peace. The destruction that Britain suffered in the first years of the war and the expenditures incurred meant that Britain and the Empire could never again rival the power of the United States. But some means had to be found which would enable British finance and British industry to ensure full employment and a decent living for the British people after the war. As well as creating appropriate domestic policies, an international structure had to be established which would bind the wealth of the United States into maintaining full employment world-wide, or at least in Europe. It reads strangely today that 'full employment' appears so high among the aims of the Bretton Woods agreements. The avoidance of unemployment is said to be a matter 'not of domestic concern alone, but a necessary condition for the expansion of international trade.' It is put that way round.

### **How to pay for the war**

Keynes's first concern on emerging from his sick bed early in 1939 was how the war could be paid for. His fear was that the overwhelming demand for resources for the war effort combined with full employment and the cutting off of civilian supplies from overseas would soon lead to a build up of demand far beyond what could be met. Inflation would be inevitable, with the poor suffering the worst, unless goods were rationed and expenditure controlled. Keynes did not like this alternative, although when the submarine blockade tightened, he recognised that it had to be accepted. He sought for a 'Middle Way' and believed that he had found it in a scheme of compulsory saving. Along with their income tax demands, income tax payers would be levied a proportion of their incomes and receive 'post-war credit' notes, to be cashed only when national resources allowed. Keynes's book *How to Pay for the War* appeared in February 1940 and Kingsley Wood's budget a year later introduced an element of compulsory saving to cover 3% of expenditure. Keynes had proposed 15%.

The scheme was vehemently denounced by the trade unions and most of the Labour Party. I recall desperately trying to defend it at a meeting in 1940 with the Communists in the Oxford University Labour Club. It raised two issues of very contemporary interest. The first is that Keynes had required the Treasury to prepare national income and expenditure accounts and estimates for the coming year to reveal the scale of the borrowing gap. He believed that this should not be

greater than what could be regarded as capital investment. Gordon Brown is today following that advice. The second matter of interest is that of finding a scheme for deferred earnings in a period of full employment which could reasonably be regarded as acceptable by the workers. All attempts at incomes policies in Britain have failed because they applied only to wages and with no controls built in for the unions to exercise. Skidelsky quotes Richard Kahn saying that this was the 'stupidity of the leaders of the [British] trade unions', but where these policies have had more success in Scandinavia, profits as well as wages have been included and the unions involved.

In defence of Keynes's scheme, it has to be said that income tax, and the element of compulsory saving, was at that time progressively higher for higher incomes. The policy of subsequent Conservative Governments of increasing sales taxes would have been strongly opposed by Keynes as wholly regressive, bearing as they do most heavily on the poor. In the event prices rose between 1939 and 1945 by about 50%, most of this occurring before 1941. This is to be compared with the doubling of prices in the First World War, but there cannot be much doubt that this was more the result of rationing and price controls than of the compulsory savings. It was anyway a long time after the war was over that I opened a little envelope marked DO NOT LOSE and cashed what seemed to be a remarkably small sum of savings. I was not impressed and I am sure that others were not.

It is often averred that Keynes was insufficiently aware of the danger of inflation in his proposals for government spending to offset a failure in aggregate demand and neglectful of the importance of manipulating interest rates. The scheme for compulsory saving shows that he was very well aware of the inflation danger, though he did not believe, as some of his monetarist opponents do, that government spending is the sole source of inflation. He was certainly an enthusiastic advocate of cheap money and looked forward to the euthanasia of the *rentier* in the not-too-distant future, as human needs became increasingly satisfied. He would have been appalled at current levels of greed, although it is hard to know how his enjoyment of the life and appurtenances of a Sussex country gentleman could have been universalised. He would certainly have approved of a Tobin tax on speculation, which he himself indulged in but disapproved of as a way of conducting an economy. What would have depressed him most, had he lived to see it, was the absence of any justice in the development of the international economy.

### **The post-war international settlement**

Keynes knew that post-war full employment could not be achieved by domestic policies only. There had to be an international framework within which these could succeed without the beggar-my-neighbour machinations of the inter-war years. Deficit countries (on their foreign payments) should never be forced to deflate their economies (by reducing demand for employment). Keynes did not believe in a protectionist self-sufficiency, although he sometimes glorified the

pleasures of what was home grown – as the modern protectionists like to quote him. He was a free trader, but within rules of the game that were ‘fair’ – a very English concept that has been adopted by the modern Fair Trade movement. He divided possible British policies in relation to American hegemony into three types: first, Austerity or ‘Starvation Corner’; second, Temptation or giving in to American demands in order to get a big loan; and, third, Justice or Aid for Britain’s and others’ sacrifices while the United States had stood aside.

Skidelsky draws out very clearly from Keynes’s many speeches, statements and cables that the American connection had in his view to be preserved. There was no future for the British people, Keynes believed quite passionately, in what he dubbed a Schactian policy. This was the policy of austerity and self-sufficiency plus bilateral trade agreements which Hitler’s Finance Minister Hjalmar Schacht had applied to Germany in the 1930s. Britain’s imports and exports had different origins and destinations. Britain needed a multilateral trade system and worldwide scope for its financial expertise. The possibility of a European Union, possibly to include even the Soviet Union, did not attract Keynes. He saw this as a continuation of the planned trade of the war years, which had its wartime justification but would prove to be a straitjacket in peace time. In this respect, Keynes was at odds with the majority in the unions and in the Labour Party.

To achieve justice the Americans had to be brought within a system that ensured that British purchases from the USA were paid for by the US, and that allowed Britain thereafter to balance her foreign trade without continuing to run a large dollar deficit. This was seen as a matter of justice, which he and nearly all the British public believed to be due to Britain and the empire after standing alone, running down their reserves, selling off assets to the Americans and in Britain’s case running up vast debts to Sterling Area members. By the summer of 1941 the system of Lend-lease had been established for Britain’s imports of war materials from the USA, but there were large debts left over from the previous two years. When the war ended with Germany Lend-lease would end, although it might be continued in part while the war with Japan continued. After that Britain must be free to re-establish export markets to pay her way. United States policy, however, was to force Britain to give up its imperial preference system and to free the sterling balances, so that Empire and Sterling Area members would all become free to buy American goods and invite American investment.

Keynes’s first proposal was for a Clearing Union which would allow free trade within the limits of each country’s balances of exports and imports, and freedom of capital movements, but each country would be granted an overdraft facility as in a bank. This would not be accounted in national currencies but in a new international currency later called *bancor*. The United States would be bound to become the largest creditor and the object of the exercise would be to persuade the Americans to spend their surplus balances. To make the Union work like a bank, each member would deposit a required amount of its currency. The United States would be the largest depositor. The whole scheme would depend

upon the size of the United States deposit and on the preparedness of the United States to wipe out the debts owed to it mainly by Britain. There wasn't a hope in hell that the Americans would fall for such a plan, but it forced them to produce something as an alternative, which emerged as a stabilisation fund and later a Monetary Fund and World Bank

What came out from the vast exchange of papers throughout the 1942 and 1943 discussions and the meetings at Atlantic City in 1944, which all led up to the agreement at Bretton Woods, was a very different animal than the one Keynes had thought up. The American alternative was largely the product of the brain of Harry Dexter White, who was later revealed to have been a Soviet agent passing back to Moscow all that was going on and having no desire to see a successful international order uniting British with American capital. In that respect he differed little from his American colleagues who hated and feared the Soviet Union; and Skidelsky argues that, while his actions were a betrayal of trust, White would not have thought that he was betraying his country. White's Stabilisation Fund and Reconstruction Bank were a part of his 'Grand Design', just as Keynes's Clearing Union, Relief Organisation, buffer stocks scheme and supra-national police force were part of his 'New Order'; and Skidelsky makes the point that White's Soviet sympathies would explain a desire to strengthen the Soviet Union at British and American expense.

The fundamental difference between Keynes's proposals and those that were agreed at Bretton Woods was the replacement of Keynes's semi-automatic banking system, supervised by international civil servants owing no national loyalties, by White's Fund and so-called Bank whose payments were managed and policed by boards of US appointed officials. It was even to be sited in Washington near to the seat of the US Government and not in New York near to the world's financial centre. Worst still, the resources at the disposal of the two institutions were agreed at \$3.5 billion instead of Keynes's \$25 billion. In place of Keynes's buffer stocks plan, which would have stabilised producers' incomes as well as prices, an International Trade Organisation was proposed to encourage trade exchanges. This was never ratified and in the end was replaced by the General Agreement on Tariffs and Trade, which simply agreed tariff reductions. Without any protection for commodity producers, mainly in the colonial territories, their prices and incomes were bound to collapse after the initial post-war shortages had been made good. Had the Keynes plan ever been accepted the disasters that have faced Third World countries over the last two decades could have been averted.

Keynes was fighting a hopeless battle. How hopeless it was becomes abundantly clear from Skidelsky's story of the negotiations that led up to the United States loan made to Britain in 1945. Keynes's battle with the Americans had always been about money. The Americans would give just enough to keep Britain afloat, but not enough to make her strong again. Keynes could call up all the rhetorical powers at his disposal and win the consciences and hearts of his ministerial adversaries one day, but the very next day their advisers and lawyers

would return with documents that in no way reflected verbal understandings. Keynes would explode at 'a great nation being treated as if it were a bankrupt company', but that is just how the Americans saw Britain. The loan – a smaller sum in the end and with higher interest payments than had at one point been agreed – illustrates Keynes's dilemma. If he would not have Britain go it alone in austerity without the US, and he could not get payment in justice for Britain's war-time contribution, then he had to accept the 'temptation' of a loan. He had no fallback position and failed even to get the amount he wanted (\$5 billion; he got \$3.5 billion) and interest free or with waivers (the rate was 2% for 50 years with the possibility of deferments). For this the Americans on their side got agreement to the ending of imperial preference and the freeing of the sterling balances. Within a few months the sterling debts were being paid, exports were growing, but not fast enough to pay for the backlog, and the loan was exhausted.

It is not too much to say that the loan negotiations killed Keynes. He survived to defend the agreement in the House of Lords and to make one last journey to America to agree the final details of the Bretton Woods twins – the International Monetary Fund and World Bank. Keynes tried to reduce the political control of the US and failed. His comment afterwards was that 'I went to Savannah to meet the world and all I met was a tyrant'. During the train journey to Washington on the morning of March 19, 1946 Keynes collapsed. He and Lydia managed to return home, but within a month he was dead. Skidelsky writes very warmly of the man with whom he has been living as a biographer all these years. But he is less than euphoric about the contribution of the 'Keynesian revolution' to the post-war recovery in Europe. Here I think he is wrong, and I have the authority of the Clare Group of economists writing in the National Institute *Economic Review*, who see the post-war commitment of governments to full employment as critical. Skidelsky argues correctly that nationalisation and increased social services were not part of Keynes's scheme for slump control, nor American expenditure on armaments. The fact is that governments felt free to spend in circumstances where pre-Keynes they would have cut back.

As for the international framework, Keynes was largely defeated. There is no doubt that his defence of his proposals was heroic and brilliant, but Skidelsky doubts whether it made any difference. The Americans had in the end to come up with the sort of money Keynes was looking for – in the Marshall Plan. But by that time Britain and the empire had been downgraded. The loan was running out and the Sterling Area was fading. The rhetoric gave Britain a special relationship with the United States. In the reality of needing a bulwark against the Soviet Union, the Americans felt able to sponsor a European Union with Britain safely inside it, as a stalking horse if required. Keynes was always anxious to keep the Soviet Union within the comity of nations, he was opposed to the division of Germany and never seems to have used the anti-Soviet card in negotiating with the Americans. That is perhaps why his personal relations with Harry White seem mainly to have been happy. But, it cannot be denied that it was the existence of the Soviet Union and fear of Soviet power that encouraged governments to

follow Keynes's ideas for ensuring full employment and expanding international trade.

As a tail-piece I should record the fact that Roy Harrod, Keynes's devoted follower and biographer, was active during the 1960s in the promotion of a Britain-Commonwealth-European Free Trade Association having some links of planned trade with the Soviet Union as an alternative to the European Common Market. As I sat on a committee with Harrod in this promotion, I asked him one day whether Keynes would have supported us. He said that he believed that he would and reminded me of one of Keynes's favourite put-downs: 'When circumstances change I change my mind. What do you do?'

Keynes was not opposed to planning, but it should involve as many participants as possible. What he hated about capitalism was the system of *laissez faire*, not the system of private property and enterprise.