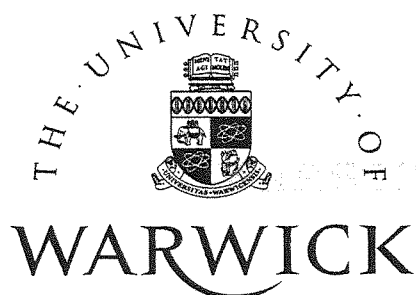


**KEYNES'S ROAD TO BRETTON WOODS - AN ESSAY IN
INTERPRETATION**

Robert Skidelsky

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INTERPRETATION

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'The delegates did not reach an 'agreement'. They merely signed a paper which looked like an agreement'.¹

1.INTRODUCTION

As the well-known story of Bretton Woods has it, there were two plans, the White Plan and the Keynes Plan. The White Plan, from the US Treasury, championed liberal internationalism'; the Keynes Plan, from the UK Treasury, tried to secure for Britain sufficient freedom from international pressures to be able to pursue full employment and other desirable social policies. The British saw internationalism as a constraint, the Americans as an opportunity. The Bretton Woods Agreement was a successful attempt to reconcile these two views; each country accommodated the requirements of the other, without sacrificing its own aims. The result was the 'golden age' of the 1950s and 1960s, so different from the interwar years. In 1946 President Truman called the Agreement 'a cornerstone upon the foundation of which a sound economic world can -and must -be erected'. And a leading historian of the Agreement wrote in 1978 that 'during a quarter of a century' it had stood as the 'foundation upon which world trade, production, employment and investment were gradually built'. ²

The trouble with this canonical text is that does not square with the facts. For the first fourteen years after the war, the Bretton Woods System was in virtual cold storage. Its cornerstone, currency convertibility at fixed, though adjustable, exchange rates was not restored in the main European countries till the end of the 1950s, by which time 'the golden age' was in full flower. It was

1. Commercial and Financial Chronicle, 14 September 1944, on the Bretton Woods Agreement, q. Armand van Dormael, Bretton Woods: Birth of a Monetary System, 1978, p.240

2. q. Dormael, p.289. Dormael's view is on p.307

not adherence to the Bretton Woods rules which rebalanced the economies of the United States and Europe, but a combination of large sterling, deutschmark and franc devaluations against the dollar and the huge outflow of American dollars on government account, particularly for military spending abroad. These events were reflected in the rundown in US, and the buildup of European (and Japanese) reserves. But this trend in the reserve positions of its leading members also meant that the System was in crisis from the moment of its 'completion' till it broke down in 1971.

I am not arguing that the 'rules of the game' agreed by forty-four nations in 1944 had no influence on the course of history. Like any international treaty, the Bretton Woods Agreement bound its signatories to follow certain rules and procedures. To the extent that the rules concerning fixed exchange rates, convertible currencies, etc, were accepted and followed they made for more stable and predictable monetary conditions. The fact that the System was not explicitly hegemonic - though it soon became a dollar standard - also made it more generally acceptable. But would the Agreement have 'stuck' without the special incentives provided by the United States and the general atmosphere of the Cold War? It was US overseas disbursements, which far exceeded the obligations which the United States had undertaken under the Bretton Woods Agreement, which made it relatively easy for the leading countries to follow, for a time, the 'rules of the game'. I agree with Stanley Hoffman that the post-war economic order was shaped by a 'more or less explicit deal between the United States and its Allies in Western Europe and Japan. The latter accepted Washington's favourite rules of the game in exchange for military protection, but Washington accepted certain exceptions to these rules to safeguard important allied interests...' ³ That is to say, the course of events was dominated by the logic of the Cold War, the fact of US power, the initial strength and the gradual weakening of the mighty dollar.

³. S. Hoffman, Primacy or World Order, 1978, p.13

So much I think would be widely accepted by historians of the postwar period.⁴The System set up in 1944 could not have produced, far less sustained, the 'golden age'. The argument of this paper is more radical. Its central contention, which cannot be fully established here, is that there was never enough agreement between Britain and the United States on the 'rules of the game' to make the Bretton Woods Agreement any more than a form of words to paper over the cracks. There were far too many contractual escape clauses and 'voluntary misunderstandings'. My contention is that the Agreement was kicked into touch in the act of setting it up, because both the British and US governments regarded it as marginal, or even antithetical, to their policy objectives. The economists' attempt to make it the centrepiece and showcase of a new world order failed to get off the ground.

There are exemplary accounts of the technical issues at stake in the Bretton Woods negotiations. One of them is by Don Moggridge.⁵ The key issue was creditor versus debtor adjustment. The fact that, under the gold standard, adjustment, as Keynes noted in 1941, was 'compulsory for the debtor and voluntary for the creditor' was the main reason for his hostility to it.⁶ Under the gold standard, the duty of adjustment fell on those countries losing gold; those countries gaining it were free to sterilize it. All Keynes's plans for a reformed gold standard were designed to make a degree of creditor adjustment compulsory or automatic. The Americans accepted that creditors had responsibilities. They were willing, during and after the second world war, to exercise them with unparalleled generosity. But they consistently upheld the doctrine of voluntarism. The Bretton Woods Agreement failed to bridge this divide. The USA retained discretion concerning the degree of creditor adjustment it would undertake. As a result, Britain secured for itself discretion to retain its 'discriminatory' prewar system.

4. For an account of the early irrelevance of the IMF see Harold James, International Monetary Cooperation since Bretton Woods, 1996, chs.3 and 4

5. D.E. Moggridge, 'Keynes and the International Monetary System 1909-1946, ?

6. JMK, CW, XXV, p.28

These technical debates are only fully understandable in light of the fact that Britain, the world's leading creditor before 1914, had become its leading debtor over the space of thirty years, and the United States had become the world's leading creditor. When Keynes talked about the duty of creditor adjustment he was generalising about Britain's particular problem, which was also the point of reference for his own economic theorising. Keynes's proposition could also be stated theologically. The doctrine of debtor adjustment had strong Old Testament overtones: justice demanded that the profligate should be punished for their extravagance. The doctrine of creditor adjustment was New Testament: debts, like sins, might be 'forgiven'.

Keynes and the British fought to institutionalise New Testament doctrine in international economic relations. The Americans upheld Old Testament doctrine. What I aim to do in a preliminary way is to try to understand how the two countries, particularly Britain, came to view the postwar problem in this way. This focusses the discussion on Keynes, who dominated the British approach, both intellectually and as de facto or actual leader of the two British missions to the United States which hammered out the Bretton Woods compromise in 1943 and 1944.

Before embarking on the story, I should set out my own methodological credo in telling it. I accept Schumpeter's verdict, that Keynes's advice 'was in the first instance always English advice, born of English problems..' ⁷ This does not mean that he argued his case in crudely nationalistic terms, or that the technical debates between Keynes and White were simply a cover for conflicting national interests. Economics often enables intractable political conflicts to be resolved by assuming (or the cynic would say, pretending) that political issues are technical at heart, and imposing a language of debate consistent with this assumption. The fact that technicians handled all the stages leading to the Bretton Woods Agreement meant that, by the time political opposition surfaced in both countries, it was too late to

⁷. J.A. Schumpeter, Ten Great Economists, 1952, p.274

scupper the actual Agreement. But there is no reason for the historian to follow this convention. His job is to explain why people acted in the way they did. To accept the convention that positions were adopted for technical reasons is to omit a large part of the explanation. It fails to explain, for example, why British and American economists were usually to be found on different sides of the technical argument. All this is well understood by most economists; but the fact that they are constrained to write, even about historical episodes, in the language of economics, does not make them very good historians. The ideal is to use technical language where that is necessary, and historical language where that is appropriate. But few people can do this well; and the danger is that one does both badly. But this is a risk I shall have to take, as indeed I have in writing about Keynes at all.

Emphasising the Britishness of Keynes's international thinking helps explain two things about his Clearing Union plan: first, why it was so readily accepted by the British Treasury; secondly, why it was so unpersuasive to the Americans. That part of Keynes's economics which insisted on the overriding importance of national monetary sovereignty was not at issue between Keynes and the Treasury after the collapse of the gold standard in 1931. Even today the notion unites many (perhaps most) British monetarists and Keynesians against Britain's membership of the EMU. As for the Americans, it seemed to them that Keynes was setting up the United States as Britain's milch-cow. The Americans were willing to be milked, but on their own terms.

II. THE POLITICAL ECONOMY OF THE 1930S

To state the conflict between Britain and the United States in this way is to be alerted to a paradox. Historically, Britain was internationalist, the United States protectionist and isolationist. In the 1930s these historical attitudes started to shift. Britain became more 'nationalist', the United States more 'internationalist'. Generalized reference to the background of the Great Depression cannot itself explain this shift. The interwar years were differently experienced by the two countries, and the

Great Depression itself figured differently in their respective mythologies.

The shift in values should not be exaggerated. In the 1930s Britain still retained a sense of responsibility for the health of the international economy: the only 'world economic conference' of the 1930s took place in London, in 1933. By contrast, the USA practised a policy of monetary nationalism and political isolationism. These attitudes reflected vastly different historical experience. Britain had virtually created the 'world economy' in the 19th century; it was its lynchpin as well as its main beneficiary. The United States, by contrast, was a largely self-sufficient periphery, with a founding myth of freedom from foreign entanglements. By the 1930s these historical perspectives were no longer viable. Because of its great size, the US economy could affect economic conditions in the rest of the world, without itself being much affected by them; Britain, by contrast, was still highly vulnerable to external shocks, but could no longer 'conduct the international orchestra'. The 1930s was thus a decade of transition -but transition to what was unclear. The ostensible trend was towards the economics of blocs and regions. This reflected the breakdown of international cooperation during and after the Great Depression. But the hope of a revived internationalism was never quite extinguished in Britain, and was stirring in the United States. This was to make the Bretton Woods Agreement possible; it did not guarantee that the Agreement would be put to work.

The interwar years presented themselves very differently to the Americans and the British. The 1920s were a 'good' decade for the United States; its troubles started only with the catastrophic collapse of 1929-1933. Although Herbert Hoover claimed -naturally enough - that 'the hurricane that swept our shores' was of European origin⁸, this was not the majority view of the New Dealers, who attributed the depression to structural weaknesses in the US economy and banking system. The New Deal was essentially a domestic reform programme, with a neo-Keynesian 'recovery' element tagged on. Unlike in Britain, there was no lasting reaction

⁸. Herbert Hoover, Memoirs: The Great Depression, 1952, pp. 79-80

against the gold standard. For most of the interwar years, the USA held the largest share of the world's monetary gold, and the gold standard was viewed as a constraint on recovery -probably wrongly - only in the eighteen months following the downward float of sterling and its allied currencies against the dollar in September 1931. Roosevelt's aggressive gold-buying policy of 1933 deliberately drove down the international value of the dollar, restoring the dollar-sterling rate in January 1934 to what it had been before September 1931, and wiping out Britain's temporary competitive advantage. Though the gold-dollar rate was fixed at \$35 to an ounce of gold in January 1934, Roosevelt kept open the threat of currency retaliation to prevent sterling from depreciating again.⁹

The monetary events of 1931-33 highlighted the fact that the gold system lacked an agreed set of adjustment rules. Deliberate exchange rate depreciation was ruled out. Suspending convertibility into gold was allowed only in grave emergencies. Britain argued that the 1931 sterling crisis was such an emergency: as Keynes quipped, sterling did not leave gold, gold left sterling. Americans did not agree. Britain should have deflated, they argued, and raised fresh loans. Because the United States refused to accept sterling's devaluation as involuntary, it forced down the value of the dollar to restore the previous rate of \$4.86 to the £. The lack of an agreed set of adjustment rules opened the way to competitive devaluations and 'dirty floating'.

Why did the USA refuse to accept a sterling devaluation? The answer lies in a combination of interest, suspicion, and ignorance. Although America still ran a current account surplus between 1931 and 1933, it had one large and influential class of debtors -food and raw material producers, whose incomes had been catastrophically hit by the collapse of world food and raw material prices. Farmers and miners welcomed currency inflation as the route to higher prices at home and increased exports abroad. Politically, Roosevelt's tirade against the 'fetishes of international

⁹. Ian M. Drummond, The Floating Pound and the Sterling Area 1931-1939, 1981, p.257

bankers' pandered to a rural paranoia dating back to William Jennings Bryan and even earlier. A related paranoia gripped parts of his Administration. US Treasury policy under Henry Morgenthau was dominated by a grotesque overestimation of Britain's financial strength and a corresponding suspicion of Britain's motives. Vigilance against British Machiavellianism rather than the production of constructive ideas was the watchword of US Treasury policy in the 1930s, a tendency reinforced by British secretiveness. These attitudes did not disappear with the war; they were overshadowed by more urgent imperatives.

Roosevelt's monetary policy was regarded as bizarre by many at the time -even Keynes described his gold-buying policy as 'the gold standard on the booze' - and a longer perspective has not altered this verdict. It did nothing for US recovery, and strengthened the trend to currency and trading blocs abroad by failing to address the problem of America's unbalanced creditor position. Carried to its logical conclusion it would have prevented three out of four continents from trading with the United States, leaving its huge gold stock largely redundant.

This realization was starting to break through in the later 1930s. A Tripartite Monetary Agreement was signed on 25 September 1936, by which the USA and Britain accepted the need for a devaluation of the franc, and agreed to promote stable exchange rates between themselves. On 13 October, the United States agreed, subject to revocation at 24 hours' notice, to sell gold for immediate export at \$35 an ounce or earmark it for exchange equalization funds willing to reciprocate. These monetary arrangements soon embraced the core Western democracies. The United States also negotiated a series of stabilization arrangements with Latin American countries; while the Bank for International Settlements in Geneva offered central banks facilities for granting one another reciprocal credits in their own currencies or in gold. All this marked the end of the era of competitive exchange depreciation, though it fell far short of a full-blooded return to the gold standard. Harry Dexter White's

Plan for a Fund which would stabilize currencies and avoid devaluations and payments' restrictions directed at the United States harks back to these tentative steps.¹⁰

The economic problem posed by America's overwhelming creditor position was better appreciated by the State Department. Secretary of State Cordell Hull understood that the United States must be prepared to import if it wanted to export. Although his particular animus was directed at Britain's Ottawa Preference system, which he called 'the greatest injury, in a commercial way' to the United States in a long career.¹¹ , he recognised that it was Britain's response to the Hawley-Smoot tariff put up by America in 1930. The Hull programme required reciprocal tariff reductions and the ending of discrimination against American goods. Hull regarded currency stabilization as the essential condition for trade liberalization, and embraced it accordingly, colliding thereby with the monetary nationalism of Roosevelt and Morgenthau.¹² His successes were the Trade Agreements Act of 1934 and the Anglo-American Trade Agreement of 1938, the latter bringing 'a marked benefit to American agriculture'.¹³ However, Hull's free trade outlook was vitiated by an economic determinism which even Cobden would have blanched at: namely, that political conflicts were the result of trade barriers, and that their removal was therefore a necessary and sufficient condition for a harmonious world. The attraction of this doctrine for American opinion in general, and for exporting and banking interests in particular, was obvious: it extended America's economic reach, while preserving political isolationism. This combination made it unattractive to the British, especially in the run up to the second European war.

The lessons the British drew from the interwar years were very different. Despite the huge changes in the relative positions of

¹⁰. For a summary, see J.K.Horsefield, The International Monetary Fund 1945-1965, vol.1, 1969, pp.6-7

¹¹. q. Arthur Schlesinger, Jr., The Coming of the New Deal, 1959, p.253

¹². Benjamin Rowland, ch.5, in Benjamin Rowland ed. Balance of Power or Hegemony: The Interwar Monetary System, 1976, p.203

¹³. Cordell Hull, Memoirs, i, 1948, p.530

Britain and the USA wrought by the first world war, Britain still attempted to play its traditional role in the 1920s, repegging the pound to gold in 1925 at its prewar parity with the dollar, allowing unlimited capital exports, and maintaining a virtually unmodified free trade system. Although sterling was forced off gold in 1931, official British policy at the London World Economic Conference of 1933 was to re-establish an international gold standard purged of its previous defects.¹⁴ Britain would not join the gold bloc led by France, but 'MacDonald and Chamberlain were eager for a temporary de facto stabilization of the pound, dollar, and franc vis-a-vis one another'.¹⁵ Roosevelt, however, refused any commitment to limit dollar depreciation, and the Conference collapsed. After 1933, British policy was 'to manage sterling so as to suit our own economy...' ¹⁶

This retreat from internationalism reflects, above all, the British experience of the 1920s, when Britain slumped while the United States boomed. The Great Depression was not the defining event for Britain as it was for the United States, but was viewed as superimposed on the difficulties of the British economy dating from the first world war. It therefore gave rise to no New Deal, but was rather seen as an opportunity to liberate monetary policy from from a long-standing external constraint. Britain's abnormally high unemployment in the 1920s was largely concentrated in the export sector, and was attributed both at the time, and subsequently, to the malfunctioning of the gold standard, particularly to the failure of the United States and France to play by the 'rules of the game'. France was believed to have deliberately undervalued the franc in 1926; the USA had discouraged imports with its high tariff, while insisting on payment of its war debts. Britain's departure from the gold standard in 1931 was seen not just as having directly helped British exports, but as having made possible the 'cheap money' policy of the 1930s, which laid the basis of home market recovery. Thus a British return to the gold standard was premised

¹⁴. Drummond, op.cit. p.163

¹⁵. Ibid. p.173

¹⁶. S.G. Waley, 1936, q. ibid. p.205

on the removal of these structural imbalances. Roosevelt's hostility to a realignment of the two currencies strengthened Britain's resolve to manage the exchange rate in its own interest.

The Sterling Area was anathema to Morgenthau, but its role in British thinking, or recovery, before 1939 is uncertain. It took shape in 1931 when twenty or so countries followed sterling in a downward float against the dollar. It consisted of countries, mainly in the British Empire, but including a varying number of others with strong trade links with Britain, which held their reserves in London and kept their currencies freely exchangeable and virtually stable in terms of sterling, either because they were compelled to, or from convenience. It protected most of Britain's external trade against exchange risk, and, with freedom to export capital within the Area, preserved the role of the City of London as banker and lender, though on a much reduced scale. The accumulation of sterling balances in London, which reached £780m. early in 1938, also offset Britain's deteriorating current account balance. But few Englishmen before 1940 regarded the sterling area as a permanent system. It compromised British monetary independence without securing the much larger advantages of a stabilized international monetary system.

Nor, except for a minority of Imperialists, was the Ottawa Preference System, set up in 1932, regarded as a permanent replacement for free trade. The inspiration behind it, which went back to Joseph Chamberlain's tariff reform campaign of 1903, was to convert an empire of sentiment into a commercial and political union, on the basis of reciprocal tariff preferences for each other's products granted by the mother country and its colonial offshoots. Neville Chamberlain, the British Chancellor of the Exchequer, to whom it fell to implement his father's grand design, found little warmth in the imperial bargaining at Ottawa. The theory was that Britain would use its quasi-monopsonist buying power in foodstuffs and raw materials to secure preferential tariffs for its manufactured exports in Empire countries heavily dependent on exporting to Britain. The basic flaw in this strategy, which Ottawa exposed, lay in the notion of a 'natural' division between British

manufactures and Dominion primary products. In practice, Canada, Australia, South Africa and India were all interested in developing their manufactures, while Britain, for many different reasons, wanted to protect its agriculture. An additional problem was how to reconcile the imperial vision with Britain's trade relations with third countries, many of which were members of the sterling area. The Ottawa Preference System turned out to be a device for tariff increases all round-the preferences taking the form of lower tariff increases for empire products - coupled with a complicated duty and quota system to protect British agriculture and preserve third party entry into the British market. Judging by results, the British were comprehensively out-negotiated at Ottawa: a classic case of the weak exploiting the strong. Britain achieved only a tiny increase of exports to the Dominions; its exports to third countries were restricted, as it was deprived of bargaining flexibility and suffered increased competition in non-empire markets; and empire and foreign countries benefitted largely from Britain's home-market based recovery. As a result Britain's trade deficit soared, while income from 'invisibles' shrank. What is important to note, in this context, was that the Ottawa System did not solve Britain's balance of payments problem; it almost certainly worsened it. Although Hull might rail against 'discrimination', differential tariffs were a very inefficient form of discrimination. They antagonised everyone else, without in fact doing the job.

By the end of the 1930s, the monetary and commercial relations between Britain and the United States had reached something of an impasse. In Kindlebergian terms, the United States would not, and Britain could not, take the lead in reconstructing a functioning world economy -this despite the growing realization that the state of their economic relations put a limit on the ability of both countries to recover from the Depression. It took another world war to break the deadlock, and then only partially.

III. KEYNES AND THE INTERNATIONAL MONETARY ORDER

Writing in 1943, Keynes said that there were two main objections to the old gold standard. The first was that it 'does not provide the appropriate quantity of money'. The second -and more modern-complaint was that it failed to deal with the problem of differential wage movements except by 'creating unemployment'. A new international currency scheme should aim therefore to prevent those evils resulting from 'a chronic shortage of international money due to the draining of gold into the creditor countries' and to provide an orderly exchange-rate adjustment mechanism to reconcile national differences in wage movements.¹⁷ This was economic-speak for saying that Britain must have freedom to 'choose' its own rate of wage inflation. Thus Keynes and the British Treasury at Bretton Woods sought an agreement which would 'combine an international system with the maximum of national monetary independence'.¹⁸

The fact that Keynes had been saying much the same things in the 1920s alerts us to the dominant source of the policy problem which preoccupied him over his professional lifetime: namely, how to deal with the effect on the British economy of the unbalanced creditor position of the United States. In most of his writing on international monetary arrangements, Britain and the United States can be substituted for debtors and creditors. Only at the end of his life, did he foresee that dollar scarcity would eventually give way to dollar glut.

Bearing this perspective in mind, the highlights on Keynes's road to the Clearing Union can be summarily listed as follows:

1. His 'Grand Scheme for the Rehabilitation of Europe' (1919) This was the first of Keynes's ingenious plans for channelling American savings to Europe through a quasi-automatic mechanism. It provided for the issue by the Germany and its defeated allies of bonds to a present value of £1,445m.. Of the sum raised, £1bn. would go to the European Allies on account of reparations, to finance reconstruction of their devastated areas and to

¹⁷. JMK, Economic Journal, July-September 1943, repr. in CW, XXVI, pp.30-3

¹⁸. Moggridge, op.cit. p.80

discharge inter-ally war debts, and £445m. would be retained by the Central Powers to buy food and raw materials and pay off debt to neutrals. The plan was accepted by the British Treasury and the Prime Minister, Lloyd George, on the understanding that American investors would take up about 90 per cent of the issue. It foundered on the refusal of the US Treasury to underwrite an unconditional transfer of American funds abroad. As Thomas Lamont observed, American credits should be extended through 'normal commercial and banking channels'.¹⁹

2. The Tract on Monetary Reform (1923). This was Keynes first assertion of the doctrine of national monetary sovereignty, as against the consensus view that Britain should return to the gold standard as quickly as possible. Keynes claimed that a restored gold standard was bound to be a managed standard, and managed by Washington, not London. 'With the existing distribution of the world's gold, the reinstatement of the gold standard means, inevitably, that we surrender the regulation of our price level and the handling of the credit cycle to the Federal Reserve Board of the United States'. The American monetary authorities would determine their monetary policy by reference to domestic conditions, not to the requirements of countries like Britain. ²⁰ In the short-run the Federal Reserve Board's policy of sterilizing gold gains to prevent inflation would impose deflation on the rest of the world if it returned to the gold standard. In the longer run, Keynes feared that the eventual dishoarding of America's gold stock would lead to world wide inflation - as it did, but not till the 1960s! The best solution was to divide the world into 'managed' sterling and dollar currency blocs. 'So long as the Federal Reserve Board was successful in keeping dollar prices steady the objective of keeping sterling prices steady would be identical with the objective of keeping the dollar-sterling exchange steady'. Keynes's unwillingness to entrust Washington with de facto responsibility for managing a restored gold standard reflects in part his disappointment at the way the USA had shuffled off its

19. q. R. Skidelsky, John Maynard Keynes: Hopes Betrayed, 1983, p.370; see also D.Moggridge, Maynard Keynes: An Economist's Biography, 1992, p.309

20. JMK, CW, IV, pp.139-40

responsibility, as he saw it, for rehabilitating Europe after the first world war. After the experience of the restored gold standard between 1925 and 1931, Keynes's view became Treasury orthodoxy.

3. The Economic Consequences of Mr. Churchill (1925) This was the first clear statement of Keynes's view that the price of debtor adjustment was mass unemployment. Keynes's insistence in the Tract that price stability, rather than exchange stability, should be the aim of (what would now be called) macroeconomic policy rested on the assumption of sticky money wages. 'Deflation does not reduce wages 'automatically'. It reduces them by causing unemployment'.²¹ By 1928 this had become Keynes's standard explanation for the 'abnormal' British unemployment of the 1920s: 'We have deflated prices by raising the exchange value of sterling and by controlling the volume of credit, but we have not deflated costs..The fundamental blunder of the Treasury and Bank of England has been due, from the beginning, to their belief that if they looked after the deflation of prices the deflation of costs would look after itself'.²² The idea that a country's wage system was an exogenously given variable, dominates his thinking from this point onwards.

4. A Treatise on Money (1930) was the first clear statement of Keynes's doctrine of the need for interest rate autonomy. The central object of national monetary policy, as here defined, was not to maintain stable prices, but to maintain a rate of interest consistent with full employment at a price level governed, in the long run, by the behaviour of 'efficiency wages'. Interest rate autonomy, Keynes argued, was incompatible with the gold standard and its corollary of a 'laissez-faire attitude to foreign lending'. Hence he doubted whether 'it is wise to have a currency system with a much wider ambit than our banking system, our tariff system, and our wage system'.²³ This was a pretty extreme statement of monetary nationalism, yet Keynes toyed with the

²¹, JMK, CW,IX, p.219

²².JMK, CW,XIX, p.762

²³, JMK, CW,VI, p.299

idea of a reformed gold standard which would combine the advantages of fixed exchange rates with monetary autonomy. The essential condition was to ensure that countries never had to deflate because of a shortage of gold. As a 'minimum' step towards co-ordinated management of the gold standard, Keynes proposed that all central banks be allowed to hold at least half of their legal reserve requirements in foreign currencies. But the 'ideal arrangement would surely be to set up a supernational bank to which the central banks of the world would stand in much the same relation as their own member banks stand to them'. The bank would have power to create a fiduciary reserve asset (supernational bank money or SBM) which would count equally with gold as legal reserves of the member banks. It would be able to lend SBM to the central banks of countries in temporary balance of payments difficulties in proportion to their deposits of gold and securities. It would vary the total quantity of SBM (by bank rate and open-market policy) so as to stabilise its value in terms of a tabular standard of the major traded commodities and to stabilise the world business cycle.²⁴ This was the first of Keynes's plans to secure a compulsory redistribution of reserves from surplus to deficit countries and to provide automatic overdrafts (at a price) for countries in temporary difficulties.

The plan for this ideal standard was sketched out before the gold standard system itself broke up in September 1931. In foreign editions of the Treatise, written in late 1931 and early 1932, Keynes reverted to the ideas of the Tract, envisaging two blocs, one adhering to a gold standard, and the other to a sterling-based currency union. This latter would embrace the British Empire, Japan, South America, Central Europe and Scandinavia, with a common currency unit (sterling), the value of which would be kept stable within 5 per cent of a composite commodity made up the principal articles of international trade, in a fixed, but not invariable, relationship to gold. The United States, still on the gold standard, would be outside this union. 'If, on the other hand, all the leading countries were to show themselves disposed...to abandon a rigid gold standard and to join in an international

24. Ibid. pp. 354-61

scheme of management, drawn up scientifically and without reference to obsolete prejudices, that would be..another matter, and I would warmly welcome and explore the possibilities which it would offer'.²⁵

5. The Means to Prosperity (1933) Here Keynes propounded a reflationary variant of the Treatise of Money 's 'ideal' scheme, aimed explicitly at raising, and thereafter stabilising, the world price level. An international authority would create additional international reserves by issuing gold certificates to the amount of \$5bn., which all countries would accept as a means of international payment. Each country would receive a quota equal to its gold reserves in 1928, up to a maximum of \$450m. These caches of gold certificates would enable their recipients to return to a modified gold standard, with wider bands (Keynes suggested 5 per cent) and at adjustable parities; they would renounce exchange restrictions, reduce tariffs, eliminate quotas and embargoes on foreign lending, and write down their debts. In the long run, there should be 'an elasticity in the quantity of additional reserves outstanding, so that they would operate not as a net addition to the world's monetary supply, but as a balancing factor to be released when prices were abnormally low as at present, and to be withdrawn again if prices were rising too much'.²⁶ Limiting national quotas to \$450m. would secure a redistribution of total reserves, since Britain and four other countries would receive the same share of additional gold certificates as the USA and France on the basis of much smaller gold stocks. The distribution of additional reserves, Keynes wrote, should 'not be of an eleemosynary [ie., discretionary] character, but should be available, not only to the exceptionally needy, but to all participating countries in accordance with a general formula'.²⁷ That redistribution from creditor to debtor should be compulsory, not discretionary, was the cardinal principle of his Clearing Union plan of 1941. He did not feel the need to

25. JMK,CW,V,pp.xxi-xxii

26. JMK,CW, IX, pp.355-64

27. Ibid. p.358

emphasise the fact that the formula was set in such a way that Britain just qualified for the maximum of additional reserves.

6. National Self-Sufficiency (1933) The general theme of this article is that the economic advantage of the international division of labour had been greatly reduced, since 'most modern mass production processes can be performed in most countries and climates with almost equal efficiency'. But Keynes adduced, as an additional reason for 'national self-sufficiency', the desire of nations to be free to experiment with different political and social systems. 'We each have our own fancy. Not believing we are saved already, we each would like to have a try at working out our own salvation. We do not wish, therefore, to be at the mercy of world forces working out some uniform equilibrium according to the ideal principles of laissez-faire capitalism. We wish to be our own masters, and to be as free as we can make ourselves from the interferences of the outside world'.²⁸ Keynes's insistence, embodied in Article IV, Section 5(f) of the Articles of Agreement of the IMF, that 'domestic social or political policies' which create 'fundamental disequilibrium' should be immune from Fund criticism, harks back to this line of thought.

7. The General Theory (1936) The model is that of a 'closed economy' and does not deal with international complications. There is one (congested) passage though which gives an indirect explanation, in terms of Keynes's new theory, of why an international system based on gold delivered tolerable results in the 19th century:

..the growth of population and of invention, the opening-up of new lands, the state of confidence and the frequency of war over the average (say) of each decade seem to have been sufficient, taken in conjunction with the propensity to consume, to establish a schedule of the marginal efficiency of capital which allowed a reasonably satisfactory level of employment to be compatible with a rate of interest high enough to be psychologically acceptable to wealth-owners.²⁹

²⁸. JMK, CW, XXI, pp.239-40

²⁹. JMK, CW, VII, p.307

This, as we can see, is a version of the favourable conjuncture argument. The spontaneous forces making for expansion in the 19th century (when?) were sufficiently strong to offset the gold's standard's flawed adjustment mechanism. Keynes stated this proposition more precisely in the first draft of his Clearing Union plan. Here he argued that there were only two periods when the use of commodity money in international trade worked -the silver inflation period of the 16th century and the gold standard of the late 19th century when 'the system of international investment pivoting on London transferred the onus of adjustment from the debtor to the creditor position'. This system of unlimited capital mobility only worked because the flow of money corresponded to the development of new resources, unlike in the interwar years, where speculative flows dominated investment flows. 'To suppose that there is a smooth adjustment which preserves equilibrium if only we trust to methods of laissez-faire is a doctrinaire delusion which disregards the lessons of historical experience without having behind it the support of sound theory'.³⁰

8. The last prewar piece of evidence comes from a letter Keynes wrote to a German correspondent, W. Luck, on 13 October 1936. This came just after the Tripartite Monetary Agreement and conveys Keynes's (and the Treasury's) sense of the limits of what was possible and desirable at that moment:

1. In general I remain in favour of independent national systems with fluctuating exchange rates.
2. Unless, however, a long period is considered, there need be no reason why the exchange rate should in practice be constantly fluctuating.
3. Since there are certain advantages in stability...I am entirely in favour of practical measures towards de facto stability so long as there are no fundamental grounds for a different policy.
4. I would ever go so far...as to give some additional assurance as to the magnitude of the fluctuations which would be normally

³⁰. JMK, CW, XXV, pp.21-2,30-1

allowed...Provided there was no actual pledge, I think that in most ordinary circumstances a margin of 10 per cent should prove sufficient.

5. I would emphasise that the practicability of stability would depend (i) upon measures to control capital movements, and (ii) the existence of a tendency for broad wage movements to be similar in the different countries concerned.³¹

IV. KEYNES AND SCHACHT

There is one missing piece in the jigsaw: Hjalmar Schacht. In the 1930s, Keynes took no interest in Schacht's system of bilateral clearing agreements, which were designed to free the Nazi government's rearmament programme from the balance of payments constraint. It therefore comes as something of a shock to find the early pages of volume XXV of the Collected Writings, dealing with the origins of the Clearing Union plan, full of appreciative references to the 'Schachtian system'. A little historical background is needed to explain Keynes's appreciation.

When British and German leaders first thought of economic life after the war it was in terms of the economic and political systems they had built up in the 1930s, consolidated during the war and augmented by victory. They thought, that is, in terms of largely self-sufficient blocs (national or imperial) which traded with third countries on a restricted, reciprocal, basis.

In the 1930s, Britain's sterling area, which was larger than the Empire proper, was not seen as a 'closed' system by Keynes or anyone else. Britain was the largest market for all sterling area countries. Without the need for exchange controls or formal embargoes on capital export, it was able to use its buying power to build up sterling balances in London which, by the outbreak of war, came to £500m. -down from their peak in early 1938. Britain was able to balance its accounts with the United States, and thus maintain exchange rate stability between the £ and the \$ from

³¹. JMK, CW, XI, p.501

1933 to 1938, by running up debt to sterling area countries. After 1938, London was no longer such a safe haven. The withdrawal of short-term funds caused the sterling-dollar exchange to drop to \$4.02, where it was fixed soon after the war started. After a slow start, and with considerable prodding from Keynes, the British authorities blocked off all escape routes of foreign exchange from London. Sterling balances were made inconvertible into hard currencies. Bilateral clearing agreements were negotiated with non-sterling neutrals in Europe and Latin America. By the summer of 1940, Britain had adopted the Schachtian system to fight the war. The closed area was open only at one point, but a crucial one: Britain was forced to pay out gold for its growing import bill with the United States. It did so for the first eighteen months of the war.

In the summer of 1940 Hitler was master of Western and Central Europe. As far as he was concerned, the war started in September 1939 was over, Britain's refusal to recognise this fact no more than an awkward detail. As part of his 'peace offensive', he authorised his Economics Minister, Walter Funk, to think out loud about the shape of the postwar economic system. In a rare effort to make Germany's conquests more palatable to its victims, satellites, and European neutrals, Funk announced a 'New Order' at a press conference in Berlin on 25 July 1940. It had two elements. Germany and Italy would use their combined productive power to reconstruct Europe after the war. Beyond this, Germany would set up a payments union managed by a central clearing office in Berlin. Within the Union there would be fixed exchange rates and free trade, with any trade imbalances being offset by the clearing office. Trade with outside countries would be regulated by barter agreements. European imports from the United States would exactly balance European exports to the United States. In any case, gold would no longer function as a means of payment, either within the Union or with other countries: America's gold stock would become redundant.³² The plan was the work of able

³². Dormael, pp.5-7; see also Harold James, 'Post-War German Currency Plans' in Christoph Buchheim, Michael Hutter, Harold James (hrgs) Zerrissene Zwischenkriegszeit: Wirtschaftshistorische Beiträge, 1994, pp.205-218

technocrats in the Reichsbank and Economics Ministry, who in turn might have been influenced by Britain's wartime Sterling Area arrangements. Hitler, of course, never took the Funk Plan seriously - a warning to historians that political leaders are rarely interested in the schemes of their experts.

The 'New Order' dossier finally arrived on Keynes's desk on 19 November 1940, with a note from Harold Nicolson at the Ministry of Information asking for his comments on a suggested broadcast designed to discredit it. Keynes immediately wrote back that the proposed broadcast was hopeless: it was no use trying to outflank Funk by offering Europe the blessings of the gold standard. In fact the Funk plan was 'excellent and just what we ourselves ought to be thinking of doing. If it is to be attacked, the way to do it would be to cast doubt and suspicion on its bona fides'.³³ Following a request from the Foreign Office, Keynes drafted some notes on Britain's economic peace aims for use by the Foreign Secretary, Lord Halifax. In these he concentrated on the fraudulence of Funk's reconstruction proposals.³⁴ Keynes's draft did the rounds of Whitehall, ending up on Churchill's desk on 30 January 1941. Suitably watered down it became the Foreign Office draft.

Much more important than this propagandist exercise was Keynes's acceptance of the fundamental postulates of Funk's permanent system:

I have assumed [he wrote in a covering note] that we shall continue our existing exchange controls after the war, and that we do not propose to return to laissez-faire currency arrangements on pre-war lines by which goods were freely bought and sold internationally in terms of gold or its equivalent. Since we ourselves have very little gold left and will owe great quantities of sterling to overseas creditors, this seems only commonsense...The virtue of free trade depends on international trade being carried on by means of what is, in effect, barter. After the last war laissez-faire in foreign exchange led to chaos. Tariffs offer no escape from this. But in Germany Schacht and Funk were led by force of necessity to evolve something better. In practice

³³. JMK, CW, XXV, p.2

³⁴. Ibid. pp.12-16

they have used their new system to the detriment of their neighbours. But the underlying idea is sound and good. In the last six months the Treasury and the Bank of England have been building up for this country an exchange system which has borrowed from the German experience all that was good in it. If we are to meet our obligations and avoid chaos in international trade after the war, we shall have to retain this system. But this same system will serve to protect the impoverished European countries and is an essential safeguard against a repetition of what happened last time. ³⁵

In a letter he wrote to Ashton-Gwatkin of the Foreign Office on 25 April 1941, Keynes expanded on these initial observations, as follows:

(i) Capital exports would be restricted to the case where the capital exporting country had a favourable trade balance with the capital importing country. 'Whatever one might wish, something of the sort seems to be inevitable, since we shall no longer have a cushion of gold or other liquid assets, by means of which the immediate effects of unbalanced capital movements can be handled'.

(ii) Large elements of multilateral clearing would exist within the Sterling Area, but payments agreements would be required to handle relations between the area and the outside world. 'Unquestionably [this] would involve a discrimination against the United States if she persisted in maintaining an unbalanced creditor position. Again, whether we like it or not, this will be forced on us. We shall have no means after the war out of which we can pay for purchases in the United States except the equivalent of what they buy from us'.

(iii) The exchange rate between sterling and the dollar should be fixed by agreement, but the rate at which it was fixed would no longer be so important. 'For, with a proper system of payments agreements which would prevent an unbalanced situation from developing, there would be no longer much object in depreciating the exchange. The method of depreciation is a bad method which one is driven to adopt failing something better. The currency system I have in view would be that something better. If USA inflates more than we do, we might even appreciate sterling'.

³⁵. Ibid. pp.8-9

(iv) The postwar sterling area could be extended to countries like Holland and Belgium. But even within the closed area it would still be necessary to guard against an 'unbalanced position' of a member country. 'There would have to be some arrangement by which an unbalanced position up to an agreed figure would have to be cared for by credit arrangements. But, if the maximum were reached, then the unbalanced debtor would have to restrict its purchases until it was in balance again'.

(v) The essence of the system was 'trading goods against goods'. If Argentina bought maize from Britain, it would have to spend its sterling in Britain or in the Sterling Area. Britain's role as the world's largest importer would give it a huge bargaining power to negotiate payments agreements with outside countries.

(vi) 'The difficulty is to know quite how far it is safe to go in the direction of a complete freedom of transactions within the sterling area'. If Britain found itself with an adverse balance of payments as a result of countries like Argentina using their export earnings to Britain to buy too many goods from other sterling area countries then 'we should have to insist that the Argentine seller of maize must spend his sterling in the United Kingdom'.

(vii) 'The necessity for some such plan as the above arises essentially from the unbalanced creditor position of the United States. It is a necessary condition of a return to free exchanges that the United States should find some permanent remedy for this unbalanced position. Sooner or later one can only suppose that she will have to do so. But it would be very optimistic to believe that she will find the solution in the immediate post-war period, even if she tries to mitigate her task by making large presents for the reconstruction of Europe'.³⁶

Keynes's letter to Ashton-Gwatkin was a first, very uncertain, bash at his own Clearing Union plan, which he drafted that autumn. It is essentially what his Clearing Union might have looked like without the United States in it. The crucial point was the priority given to commercial planning. If trade between the Sterling Area and the United States was to be on a barter (bilateral clearing) basis, monetary issues like the sterling-dollar exchange rate and creditor versus debtor adjustment became

³⁶. Ibid. pp.16-19

secondary. It was the inclusion of the USA in the Clearing Union which would make them primary.

It would be a mistake to believe that Keynes was advocating a 'Schachtian' world for Europe after the war, only one managed by Britain, not Germany. This is to ignore the context in which these ideas were put forward. Until America entered the war at the end of 1941, Keynes could not assume that America would play any part in constructing a new international economic order, one which would provide a 'permanent remedy' for its 'unbalanced position'. The Atlantic Charter was some months ahead; Russia was not yet involved in hostilities. If Britain 'won the war' in these circumstances, it would be left responsible for the 'economic reorganisation of Europe'; or more realistically, it would be left a deux with a presumably post-Nazi Germany. An economic settlement would therefore of necessity have to build on the 'Schachtian' arrangements of the 1930s, as developed during the war itself; hence, too, the importance Keynes attached to the continuing 'economic leadership [of Germany] in central Europe'.³⁷

At the same time, Keynes never thought of Schachtian devices merely as a pis aller. Even an 'ideal system' which included the United States, would not be a return to the gold standard, free trade, and unlimited capital mobility. Equally striking was his refusal to contemplate floating currencies which, on some standard assumptions, would have provided a complete answer to the problem of short-run payments imbalances. In his reading of interwar history, currency manipulation and tariffs alike were weapons in the 'blind struggle' of countries to escape from the shackles of the gold standard, with a tendency to produce war.³⁸ The Schachtian system (in its 'good' sense) avoided this by ensuring that 'goods exchanged for goods' not gold. The doctrine that exchange controls were superior to currency depreciation

³⁷. Ibid. p.9

³⁸. JMK, The General Theory of Employment, Interest and Money, CW, VII, pp.348-9, Hubert Henderson agreed: 'Of the various expedients which different Governments employed in the 1930s, none produced more unfortunate results than deliberate exchange depreciation. It was the least helpful to countries which tried it, and the most harmful to other countries', q. Dormael, p. 129

became a permanent part of Keynes's thinking. It also became Treasury and Bank of England orthodoxy. It owed less to Keynes than to general reflection on interwar currency experience, though Keynes may have sharpened these reflections.

V. ARTICLE VII

Between May and July 1941 Keynes was in Washington, negotiating details of Lend-Lease. They do not concern us, except insofar as they reveal America's commitment to 'creditor voluntarism'. Keynes had arrived with an ingenious plan, designed to preserve for Britain a modicum of financial independence. Britain would limit its requirements under Lend-Lease to the bare minimum needed for survival, provided the United States took over responsibility for three months' of pre-Lend Lease orders, by repaying downpayments, and meeting the balance owing, out of Lend-Lease appropriations.³⁹ This would replenish Britain's war chest, which could be used for buying non-American goods, and would not cost the USA a penny. Morgenthau flatly refused. He insisted on a smaller war chest, and a larger control over British procurements. Eddie Playfair, the British Treasury official attached to the Washington Embassy, summed up the problem: Morgenthau would have responded better to a begging letter. But 'Maynard..is inclined to ask as of right what they are only prepared to give as a favour'.⁴⁰

Keynes had another shock when Acheson handed him, on 28 July, a draft of the Lend-Lease Agreement, Article VII of which pledged Britain, in 'consideration' for Lend-Lease to end all discrimination against American goods, and to formulate measures for the achievement of this aim. Article VII ruled out a continuation both of the wartime Schachtian sterling system and the prewar Ottawa Preference system. Keynes's explosive reaction had been amply documented. But Britain was trapped, unless it was prepared to scale down its war effort sufficiently to risk imminent defeat or a forced peace with Germany. The Clearing

³⁹. JMK,CW,XXIII, pp.74-7

⁴⁰. E.Playfair to S.G.Waley, 16 May 1941, T.175/121

Union Plan was Keynes's attempt to set out the conditions which would enable Britain to meet American requirements.

VI. THE UPSHOT

Keynes wrote the first draft of his Clearing Union scheme in September 1941, drawing both on his prewar plans for an 'ideal standard' and on Britain's de facto wartime system. He was persuaded by James Meade to temper his advocacy of controlled trade. On 14 December 1941, Morgenthau instructed his Director of Monetary Research, Harry Dexter White, to draw up a plan for an Inter-Allied Stabilization Fund. Submitted three months later, White's plan provided for a Reconstruction Bank and a Stabilization Fund. The latter was modelled on the Exchange Equalisation Funds operated by both Britain and the United States in the 1930s. But instead of each country operating its own stabilization account as under the Tripartite Agreement, there would be a pooled fund. The two plans, endlessly redrafted, were exchanged in August 1942, and simultaneously published on 7 April 1943. In October 1943 a 'Joint Statement by Experts of the United States and Associated Nations' accepted the White framework. After further modifications the 'Joint Statement' was published in April 1944. This was the prelude to the Bretton Wood Conference itself, with the Final Act signed by the representatives of forty-four nations on 22 July, to universal acclamation, followed, over the next few months, by general ratification.

Keynes's Clearing Union was intended as a comprehensive alternative to Britain's discriminatory trading system of the 1930s. The main condition Keynes set for a return to 'a liberal economic system' was the 'creation of international credit' by a World Bank in which all central bank members of the Union would keep accounts for settling international balances. Every member country account would start off with a stock of reserves appropriate to its importance in world trade-equivalent to the 'caches of gold certificates', now called 'bancor', which Keynes had advocated in 1933. Just as a country's domestic banking system

creates deposits by means of overdraft facilities, so the World Bank would provide member states with automatic overdraft facilities of a defined percentage of their initial bancor reserve or 'quota'. Accounts in debit would be cleared, or settled, by automatic transfers (up to the agreed percentage) from accounts in credit. Countries, that is, would no longer be allowed to pile up surpluses on their balance of payments by 'hoarding' gold. (Interest was also to be charged on credit and debit balances above a quarter of the member states' quotas, and there were to be agreed provisions for revaluation and devaluation of currencies and other corrective measures.) Because the country members' quotas were set at half (later 75 per cent) of the prewar value of their foreign trade - a formula which favoured the British - the total resources of the Clearing Union would be very large - about \$40bn. The principle of automatic creditor adjustment was to be applied to a large range of activities. The Clearing Union was to be an all-encompassing institution, an embryo world government run on formulaic principles. It was meant to finance not just short-term imbalances, but relief, reconstruction, investment, buffer stocks, even a world police force. Members would bind themselves to pursue liberal trade policies. The credit mechanism built into the Clearing Union was a straightforward application of Keynes's liquidity-preference theory of the rate of interest. The basic political thinking behind it was a desire to multilateralise hegemonic functions which Britain had performed before the first world war, but which it did not trust or want the United States to perform.

The White Plan for an International Monetary Fund comes out of a very different intellectual atmosphere. Fixed exchange rates were to be virtually immutable; members' quotas represented subscribed capital not credit; the total of quotas, worked out according to a different formula, was designed to limit the American liability to \$2bn; the Fund's short-term lending facility was seen as supplementary to the normal settling of international balances through transfers of gold and foreign exchange, and was not intended to be automatic. Keynes saw it as a combination of

the Tripartite Agreement and US Stabilization Fund principles.⁴¹ The wider functions envisaged for the Clearing Union were dropped or hived off to separate institutions: an International Bank for Reconstruction and Development (which formed part of the Bretton Woods Agreement) and an International Trade Organisation (which foundered).

The Bretton Woods Agreement reflected the American position. During the negotiations, the Americans made some concessions to the British view: the resources of the Fund were somewhat increased; minor adjustment of exchange rates in situations of 'fundamental disequilibrium' was allowed; domestic policies resulting in 'fundamental disequilibrium' were immune from criticism; the 'scarce currency clause' allowed members to introduce exchange controls against the 'scarce' currency; and an indefinite 'post-war transitional period' was agreed before the System became operational. However, no attempt was made to define 'fundamental disequilibrium', nor who should decide when it existed; neither the right to devalue nor access to quotas was to be unconditional. On the central issue of creditor versus debtor adjustment, the British made little progress. As White put it: 'We have been perfectly adamant on that point. We have taken the position of absolutely no...(to the British demands)'.⁴²

Thus the Agreement did not alter the fundamental realities of prewar monetary relations. Keynes and the British had not succeeded in binding the United States to the principle of involuntary creditor adjustment. The Agreement upheld, in modified form, the principle of compulsory debtor adjustment; the modification consisting in extending the escape clauses which had existed under the gold standard, and subjecting their exercise to agreed rules. Once Britain had failed to win Keynes's main point, belief that the System would help it overcome the 'dollar gap', either in the short-term or long-term, rapidly faded. The Bank of England was adamant that that Britain should retain exchange controls and the Sterling Area; the Imperialists, led by

41. JMK, 'The Berle Memorandum', 18 February 1943, T.160/1281/F 188885/1

42. q. Dormael, p. 171

Beaverbrook, insisted on maintaining the Ottawa Preference System. British support for the Fund idea cooled noticeably in the six months leading up to the Bretton Woods conference: all the pressure came from the United States to conclude an agreement, while the British dragged their feet as opposition developed in the Cabinet.⁴³ In the United States, the New York bankers were unreconciled to what they saw as the transfer of control over American foreign lending from the private sector to the Washington administration. They supported the so-called 'key currency' proposal, put forward by Professor John H. Williams, Harvard economist and vice-president of the Federal Reserve Bank of New York, which aimed to stabilise the exchange rate between the two major reserve currencies, the dollar and sterling, by means of a large bilateral grant or loan to Britain. Williams saw this as the key to a general return to a gold-exchange standard. With the retirement of Morgenthau, the discrediting of White, and the general fading of the New Deal after Roosevelt's death in 1945, the 'key currency' approach, rather than the multilateralism of Bretton Woods, came to dominate US monetary policy. In particular, it provided 'a substantial part of the intellectual underpinning' of the Anglo-American Loan agreement of 1946 and the Marshall Plan of 1947.⁴⁴

Keynes continued to support his own handiwork, but even his enthusiasm cooled once the interpreters got to work. No sooner was the Agreement signed than Keynes and White had a major row over the conditions under which a country would have the right to impose exchange controls. By September 1944 Keynes himself was expressing doubts about whether Britain should ratify the Agreement.⁴⁵ In December he favoured the suggestion of 'responsible' American opposition that 'the Fund should be postponed until we can see our way more clearly'.⁴⁶ In April 1945 he was 'particularly interested' in Edward Bernstein's suggestion that 'the transition period might never in fact be formally brought

⁴³. See *ibid.* chs 11,12

⁴⁴. Harold James, International Monetary Cooperation, p. 66

⁴⁵. Dormael, p.228; JMK, CW,XXVI, p.134

⁴⁶. JMK,CW,XXVI, p.147

to an end'. This, he thought, might be the 'best way' of resolving the problem which had arisen.⁴⁷ Whether Britain would have ratified the Agreement at all had acceptance not been made a condition of the American Loan of 1946 remains an open question.

VII. CONCLUSION

The British started by championing the principle of a symmetry of compulsion; they were reduced to arguing for the principle of a symmetry of discretion. Having started the process with an ambitious plan for a world economic government, Keynes spent his waning energies fighting for a postponement of the coming into operation of the System, escape clauses designed to preserve British monetary independence, and eleemosynary American help on a bilateral basis. As for the United States, its insistence on the discretionary principle greatly limited the resources it was willing to make available to Fund and Bank, and sharpened its interest in imposing conditions for borrowing which would limit its exposure still further. It set about reconstructing a liberal economic system, on a dollar basis, outside the Bretton Woods framework

It would be wrong to conclude that nothing had changed. The 1950s and 1960s were not like the 1920s and 1930s. Exchange rates were gradually stabilised, and currency convertibility slowly reestablished. This promoted trade liberalisation, which in turn fuelled economic growth. But this favourable evolution had little to do with the Bretton Woods Agreement. The crucial shift which separated the postwar from the prewar years was the ending of America's political isolation. This came three years after the Agreement - with Marshall Aid, OEEC, NATO, and parallel initiatives in East Asia. Had it not been rescued by the Cold War, the Bretton Woods Agreement might have remained a historical curiosity - like the Funk Plan and other long-forgotten schemes for monetary union. In face of the perceived Communist threat, the United States took responsibility for underwriting the security

⁴⁷. Dormael, p. 237

of much of the non-Communist world. This released American money on a scale never imagined by the architects of the Bretton Woods system; and lubricated the liberalisation of trade and payments which Bretton Woods itself could never have achieved. But the cost of a largely discretionary system was a hubris which ultimately destroyed it.

Despite this, the Bretton Woods institutions - the International Monetary Fund and the World Bank - survived the objects they were set up to serve. The IMF's central function, support of fixed nominal exchange rates, was rendered superfluous by the collapse of the fixed exchange rate system between 1971 and 1973. The World Bank's function has been marginalised by the resumption of private capital flows. Although Milton Friedman has called for the abolition of the IMF, its short-term future seems relatively secure as crisis manager, guru to marketising economies, and lender of last resort. These remnants of the Grand Design may still have a part to play in the monetary arrangements of the next century.

Robert Skidelsky 25/3/98, modified 22 April - 4 May 1998

On 9 September JMK sent the first draft of his Clearing Union memorandum to Richard Kahn, his 'traditional first class critic'. His problem had been to reconcile the British-led Clearing Union, developed in the war out of the the Sterling Area system, with the American demand for non-discrimination. His solution was to extend the Clearing Union to include the United States.