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Lessons of Keynes's Economic Consequences in a Turbulent Century

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Just over a century old, John Maynard Keynes's The Economic Consequences of the Peace (1919) remains a seminal document of the twentieth century. At the time, the book was a prescient analysis of political events to come. In the decades that followed, this still controversial text became an essential ingredient in the unfolding of history. In this essay, we review the arc of experience since 1919 from the perspective of Keynes's influence and his changing understanding of economics, politics, and geopolitics. We identify how he, his ideas, and this text became key reference points during times of turbulence as actors sought to manage a range of shocks. Near the end of his life, Keynes would play a central role in planning the world economy's reconstruction after World War II. We argue that the "global order" that evolved since then, marked by increasingly polarized societies, leaves the community of nations ill prepared to provide key global public goods or to counter critical collective threats.

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Abstract

Just over a century old, John Maynard Keynes's *The Economic Consequences of the Peace* (1919) remains a seminal document of the twentieth century. At the time, the book was a prescient analysis of political events to come. In the decades that followed, this still controversial text became an essential ingredient in the unfolding of history. In this essay, we review the arc of experience since 1919 from the perspective of Keynes's influence and his changing understanding of economics, politics, and geopolitics. We identify how he, his ideas, and this text became key reference points during times of turbulence as actors sought to manage a range of shocks. Near the end of his life, Keynes would play a central role in planning the world economy's reconstruction after World War II. We argue that the "global order" that evolved since then, marked by increasingly polarized societies, leaves the community of nations ill prepared to provide key global public goods or to counter critical collective threats.

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*This essay is an overview chapter for a forthcoming conference volume edited by the authors, *Keynes's* Economic Consequences of the Peace *after 100 Years: Polemics and Policy* (Cambridge University Press, planned for 2022). The volume will collect papers prepared for the Economic Consequences of the Peace Centenary Conference held at King's College, Cambridge University, on September 9 and 10, 2019. The conference benefited from the generous support of the Sveriges Riksbank, the Banca d'Italia, the Bank of England, INET at Cambridge, the Marshall Library of Economics at Cambridge, King's College, Cambridge Public Policy SRI, and the Centre for Macroeconomics. We are also grateful to the Keynes Fund at Cambridge University for supporting publication of the conference proceedings. Special thanks go to Catherine Piner, who provided professional, effective, and selfless support to this project from inception to finish. Anna Hitchin and Marion Reusch of Cambridge INET and Clare Trowell of the Marshall Library provided essential help along the way. At various points in this overview, we link our discussion to the forthcoming book's chapters.

The community of nations is not well positioned to meet the existential challenges facing it. The first two decades of the twenty-first century generated economic and political dilemmas that in many ways resemble those the world faced in 1919. As then, disunity provides a weak basis for providing key global public goods and countering collective global threats. For all the subsequent controversy over its facts, analysis, and style – even its geopolitical repercussions –John Maynard Keynes's book, *The Economic Consequences of the Peace*, stands as a prescient warning. A piece of history-writing, and history-making, the book painted a picture of what happens when enlightened multilateralism gives way to national rivalry and inward-looking electoral calculation. These lessons need to be taken to heart today. The stakes for humanity are higher than ever before.

Keynes correctly predicted the drift of the following decades, even if he was "right for the wrong reasons," as the historian Charles Maier put it. In many ways, we live with the repercussions of 1919 to this day. In this chapter, we review the arc of experience since 1919 from the perspective of Keynes's influence and his changing understanding of economics, politics, and geopolitics during a tumultuous historical period. At decisive moments that punctuated this past century, international economic, financial, and political relations took on particular architectures embodied in specific international institutions and legal treaties. Accompanying these constructions of "global order" was the development of international laws, standards, and practices of governance that connected policymakers with advisers. Notable hinge points include the Paris peace conference of 1919, the Bretton Woods agreement of 1944, and the end of the Cold War and reunification of Germany three decades ago. There are other key evolutions along the way, notably the collapse of the Bretton Woods system and the re-emergence of China as a global force in the late 1970s, alongside the deregulation of financial markets, the emergence of neoliberalism, and the resulting shock waves. Through it all, Keynes, as an economist, political thinker, adviser, government actor, and general intellectual lodestar – as in 1919 – remained a potent factor.

Setting Keynes within this century-long context draws out the dangers of binary thinking in relation to the year 1919 and his influential text. Historians and economists often present momentous years such as 1919, 1929, 1945, or 1971 as pivot points when the world is made, or unmade. This approach sets up a false dichotomy that contrasts a crisis – or shock – with an imagined prior stability when economic relations and global politics were in a supposed state of equilibrium. Reflecting on the century since *The Economic Consequences of the Peace* draws out that the world did not abruptly swing from one side to the other – from stability and peace, to war and depression. Rather, in the past, as now, the world experienced periods, and sometimes decades, of turbulence. Sometimes that turbulence led to new forms of economic thinking, as well as to multilateral cooperation that sought to moderate the choppy waves for the good of states, market actors, and civil society (see, for example, Papadia and Välimäki 2018). But as the history of Keynes and his 1919 text also exemplifies, the lines between these moments of crisis and the emergence of new ideas, policies, and practices were far from direct.

Putting Keynes at the center of our analysis not only highlights questions about him and his role, but also points to broader questions about the turbulent world he knew and its

evolution since his death in the spring of 1946. How should we evaluate Keynes's varied contributions: as the expert, the government adviser, the public intellectual, the gadfly? How should we evaluate the ways his experience in 1919 shaped his subsequent professional trajectory? And what explains the persistent influence of his ideas and his personal example? That influence grew from his activities and his writings, notably including the *Economic Consequences*, but it reached far beyond his considerable policy contributions. The role of the expert in shaping policy is a question about Keynes himself, but also, by extension, concerns the roles of academics and advisors in relation to influence, politics, and responsibilities. These experts include those Keynes described as "defunct academic scribblers," but as importantly, scholars, scientists, journalists, and others who, already in Keynes's day, functioned as public intellectuals, actively seeking influence over government policies (and sometimes, financial support from vested interests). In the realm of macroeconomics, Keynes's ideas became dominant, as both inspiration and target, helping to define the political landscape of the past century. While its specific merits and shortcomings remain contested, *The Economic Consequences of the Peace* is undeniably a seminal document of the twentieth century. The worldview it set out and the intellectual process it catalyzed have been essential ingredients in the unfolding of history since 1919.

Global order on the eve of World War I

The global order up-ended by World War I was one of empires in which laissez-faire capitalism prevailed, but was increasingly questioned. Before 1914, new political forces – populism, nationalism, socialist, labor and communist parties – arose to challenge capitalist norms and practices in the major European metropoles of Britain, France, Germany, Austria-Hungary, Italy, Spain, and Russia. There were also rising tensions between these empires that played out globally. The declining fortunes of the Ottoman Empire and imperial Spain fanned rivalries over territory, for example. The crumbling of Ottoman authority became salient to the world in 1875 when the empire defaulted on its public debt to European creditors. By the late nineteenth century, Tunisia was a French colony, Egypt a British protectorate, and by the dawn of the twentieth century, Bulgaria and Romania gained independence. If this set the scene for new geopolitical arrangements in Eurasia and North Africa, the US victory in the 1898 Spanish-American naval war fought in the Caribbean and Pacific confirmed a new ordering was also underway in American and world relations.

Spain lost the last remnants of its overseas empire in a defeat that triggered fierce debate about the decline of Catholicism as a global force in ways that also tainted French, Italian, and Austro-Hungarian authority. Protestant values and Anglo-Saxon empires, by contrast, seemed ascendant. Following the Spanish-American war, the United States gained island possessions that were strategically important to its navy, in particular, with US interests now spanning the world. Controversial at home, globally these territorial acquisitions signaled a US interest in expansion that completed its move from a former colony to a leading naval imperial power, with economic and political ambitions to match.

Momentous changes in the global balance of power were readily evident also at the heart of Europe. If ethno-nationalist claims were challenging the coherence of the Ottoman and Austro-Hungarian empires, they fueled the ambitions of the recently unified German and

Italian states. German, and notably Prussian, supremacy was measured in economic terms, and often related to military capacity. Like the United States, Germany enjoyed rich natural endowments of hard and soft commodities such as coal, iron ore, and grains that stressed the link between territory, economic strength, and military power in ways that were profoundly consequential for international politics before and after 1914.

More specifically, the German empire challenged the norms and practices of laissez-faire, notably in relation to trade. The onset of a global depression in 1873 triggered a move to greater trade protection, with free trading Britain increasingly an outlier in western trade policy. The newly unified German state, in contrast, assumed a more central role. In 1902, Germany passed a tariff increase to take effect in 1906 as an opening bid for a series of trade negotiations. Many of its trade partners responded by introducing higher *tarifs de combat* as a basis for negotiations. By 1905, Germany had signed treaties with Russia, Italy, Belgium, Austria-Hungary, Serbia, and Switzerland. These were bilateral deals but contained concessions automatically extended to all third parties with most-favored nation status. Some regarded the German approach as a future model for world economic relations, others as dangerous gamesmanship that risked tariff wars, especially as not all *tarifs de combat* were canceled in subsequent trade treaties (see Dietzel 1903 and Bairoch 1989).

Britain and the United States, the two countries that were the decisive players in shaping the new economic order after 1918, played relatively modest roles in the European system of trade treaties before 1914. Britain had no protective tariffs, and thus, few bargaining chips. The United States had high tariffs, but the executive branch of its government had few powers to negotiate them down with trade treaties. But the two countries did not forget their experience of European protectionism. It shaped Wilson's decision to include free trade in his January 1918 Fourteen Points. These, in turn, formed the basis of the Armistice negotiated in November 1918 and of Anglo-American determination to force Germany, Austria, and Hungary to move to free trade in peace negotiations in 1919. As shown in the paper by Madeleine Dungy, these changes drew comment and interest from Keynes.

Before 1914, British, French and US power and authority in shaping global order, defined by the arrangement of relations between states, markets, and civil society, lay much more in their dominance of the international financial system. Particularly important was their role as international creditors, and in the fixed exchange mechanism, the gold standard, which they dominated. The gold standard network comprised a group of the world's most prosperous countries, with Britain at the center, which offered access to major markets of the world without the disruption of currency fluctuations. It facilitated international capital movements by reducing exchange rate risk. It was assumed the rules governing the gold standard meant it was difficult for governments and financiers to manipulate money for their own ends, and the system was associated with an increased standard of living in the countries that adopted it. Major belligerents in World War I switched from silver or bimetallic currencies to gold in the last quarter of the nineteenth century: Germany in 1872, France in 1878, the United States in 1879, and Japan and Russia in 1897 (Meissner 2005). These developments – like free trade – were associated with international cooperation and

harmony. Membership was contingent, however, and could be suspended in a crisis. And no crisis came bigger than World War I.

War and peacemaking

The war meant free trade, too, was readily abandoned, notably by Britain. The move was central to British military strategy. The British government orchestrated a blockade against the Central Powers. The Allied blockade was designed to prevent all goods, including food and agricultural supplies as well as more overt war materiel, from entering Germany, Austria-Hungary, Bulgaria, and Turkey. Britain also implemented a series of political, bureaucratic, military and naval maneuvers to convince neutral countries to cease trading with the Central powers. The operations of the blockade created a network of administrative bodies that underpinned Allied relations, and greatly increased the need for economic and statistical expertise.[1] The blockade unleashed other contradictory impulses as its operations both helped globalize the war, and break up global markets that had become increasingly integrated and specialized in the preceding century.[2] Nor did the blockade end with the war in November 1918. It remained in force until the conclusion of peace negotiations in Paris the following year, with catastrophic effects on commodity supplies, notably food desperately needed for the civilian populations across Central and Eastern Europe (M. E. Cox 2019).

At the same time, the war increased Western European dependency on US commodity markets, notably in relation to foodstuffs, and on US capital in ways that had a transformative effect on the global economy and international relations. Nor did this dependence end with the Armistice in November 1918. Under the direction of future Secretary of Commerce and Republican President Herbert Hoover, the United States took the lead in organizing aid, notably food and medical supplies, to war-shattered Europe (Riley 2017). By February 1922, allied debts to the United States amounted $10,512 million. France alone owed $3,555 million and Britain $4,427 million. Each, in turn, had loaned money to its imperial allies. The net effect did more than transform the United States from a debtor to a creditor nation; it was now the world's banker.

America's role in the world economy was transformed, a change matched, in the first instance at least, by President Woodrow Wilson's ambition in international relations. His plan for a new inter-governmental organization, the League of Nations, signaled a momentous break with the nineteenth-century notion that a "balance of power" would pacify the European continent and prevent its military domination by a single state or group of powers. After 1919, there was an attempt to establish procedural rules on which stable and legitimate cooperation would depend.

Power politics remained inherent to the work of the League, although economists and historians too often ignore a step that contemporaries in 1919 found radical: in founding the League, the Paris peacemakers multilateralized the practice of international relations at a

[1] The classic studies of the blockade's operation are Bell (1937) and Marder (1965). Lambert (2012) has recently re-energized scholarly debate regarding the importance of economic warfare and the blockade to the course and outcome of war. For an incisive and extended critique of Lambert's argument, see Coogan (2015).
[2] In these circumstances, globalization did not disappear, but it was transformed to meet the imperatives of the global war economy (see Tooze and Fertik 2014).

stroke. It proved difficult to negotiate multilateral arrangements, such as the 1936 Tripartite stabilization pact, within the League, partly because the United States failed to join the League (though it regularly sent experts to its conferences and meetings).[3] At the same time, the legal norms and practices developed by the League were foundational for new institutions of global governance founded in 1945. By 1989, the move from bilateral treaties to a multilateral world order seemed a given, but the unfolding history of the twenty-first century suggests that one can take neither multilateralism, nor the institutional bodies that support it, for granted (Ruggie 1993).

Although Keynes did not engage directly with the League project, he was involved in a number of related initiatives. Notably, at one point he hoped to pin the credit-raising initiatives tracked in the chapter by Harold James and Andrew Koger to the League's coat tails.[4] In *The Economic Consequences of the Peace*, Keynes stressed the systemic breakdown at the heart of Europe that peacemakers missed because of their fixation with the politics of ethno-nationalism and territorial carve-ups.[5] As he would put it later, "The Wilsonian dogma, which exalts the divisions of race and nationality above the bonds of trade and culture, and guarantees frontiers but not happiness, is deeply embedded in the conception of the League of Nations as at present constituted" (Keynes 1922, p. 14). The principle of self-determination inspired many, but disappointed more, when it became clear it would apply to only to white, western populations and in often contradictory ways. If it reunited ethnic Poles who had fought on different sides of the war in a new Polish republic, it also banned union between ethnic Germans of the former Austria-Hungary and the new Weimar Republic. Victorious nationalists, such as Thomas Masaryk, the highly respected Slovak president of the new Czechoslovak republic, may have portrayed the new states in Eastern Europe as a victory against the "Caesarism" of Europe's former empires. Yet, Czechoslovakia was not alone among the new states in harboring its own imperial ambitions (Lemmen 2021, pp. 343-362).

Keynes's cynical view of Wilsonian idealism was understandable. While dismantling the empires of the losers, the global order instituted in Paris reasserted the imperial rights of the victors. In 1919, the British Empire reached its greatest territorial extent. Britain, under the mandatory regime of the League of Nations, took charge of territories such as Palestine, Transjordan, and Iraq (Pedersen 2015; AHR Reflections 2019). At the same time, British Dominions became sovereign members of the League with Australia and New Zealand also gaining mandatory authority in the Pacific (Duffy 2019). The United States, too, toyed with the idea of mandatory authority.

Keynes was famously more animated, however, on the financial settlement and its implications. The chapters by Peter Clarke and Michael Cox touch on the long-running and well-known controversy over Germany's ability to pay the magnitude of indemnity that

[3] On the Tripartite Agreement, see the chapter by Max Harris.

[4] Keynes to Florence Keynes, April 17, 1919, and Austen Chamberlain to Lloyd George, April 17, 1919, in Johnson and Moggridge (1978, pp. 428-436).

[5] See the chapter by Elise Brezis on the role of new balance of power relationships in steering domestic political consensus, especially workers' attitudes, on the pursuit of national sovereignty.

seemed probable after the peace conference.[6] More broadly, Keynes feared that reparations, legitimated by the Allies' insistence on a legal war guilt clause, would combine with other demands flowing from the Treaty to embitter international relations going forward, especially within Europe. The Treaty would also promote economic fragmentation. In Keynes's words, it would "impair yet further, when it might have restored, the delicate, complicated organisation, already shaken and broken by war, through which alone the European peoples can employ themselves and live" (1919, pp. 1-2).

But there were also the sins of omission. In a passage foreshadowing similar challenges that would arise a quarter century later in 1945, Keynes wrote:

> The Treaty includes no provisions for the economic rehabilitation of Europe,—nothing to make the defeated Central Empires into good neighbours, nothing to stabilise the new States of Europe, nothing to reclaim Russia; nor does it promote in any way a compact of economic solidarity amongst the Allies themselves; no arrangement was reached at Paris for restoring the disordered finances of France and Italy, or to adjust the systems of the Old World and the New….. It is an extraordinary fact that the fundamental economic problem of a Europe starving and disintegrating before their eyes, was the one question in which it was impossible to arouse the interest of [Clemenceau, Lloyd George, Wilson, and Orlando]. (Keynes 1919, p. 211).

For Keynes (1919, p. 274n), "Hoover was the only man who emerged from the ordeal of Paris with an enhanced reputation … his eyes steadily fixed on the true and essential facts of the European situation." This was because he sought to address the economic and social challenges posed by the war-like conditions of the peace. Wilson, in contrast, was puritanical and out of touch. Between 1918 and 1923, revolution, civil war, and episodes of ethnic cleansing killed another four million people across Central and Eastern Europe, a figure higher than the combined figure of war casualties of Britain, France, and the United States (Gerwarth and Horne 2012).

Keynes's Influence in private and public

Keynes was a young man when he took up his role as an adviser to the U.K. Treasury. His efforts to shape the Treaty terms in the face of countervailing political realities proved fruitless. Michael Cox's chapter outlines how Keynes authored two detailed memoranda on the indemnity issue in 1918 and further memoranda in Paris, finally proposing what he called a "grand scheme" to ease the logjam of reparations and inter-Allied debt, while providing Germany (and other defeated powers) some financial support for domestic reconstruction. His proposal was not taken up and his warnings against the Versailles Treaty were not heeded. Ultimately, reparations went largely unpaid, and the treaty terms and *sequelae* served as a potent prod to nationalistic resentment within Germany. Having failed

[6] Simon Hinrichsen's chapter elucidates the debate through a novel comparative analysis of fifteen episodes of enforced war reparations between 1800 and today. Keynes had a broad view of possible harmful economic effects of reparations on Germany, including what economists now call the debt overhang effect (Keynes 1919, p. 217).

to move official opinion within the UK government, Keynes decided to go public with his views. The decision provoked a mixed reaction at the time, and heated historical debate ever since. Maier (2009) judges that Keynes's book was "brilliant, unfair, wrongheaded, destructive perhaps in its consequences … but right for the wrong reasons." Kindleberger's (1973, p. 39) view is more even-handed:

> Keynes's brilliant polemic . . . may have been distorting in many respects; self-confirming in its contention that if the Germans heard a reasonable argument to the effect that they could not pay, they would not; and devastatingly encouraging to American isolationists in its attacks on President Wilson as an incompetent invalid; but it was surely right in thinking it useful to cancel war debts, set a small figure for reparations … and clear the issue off the international agenda.

One might add that Keynes was most unfair in his treatment of Clemenceau, who far from being a reactionary, had more claim to the mantle of radicalism than Wilson, Lloyd George, or Keynes himself. It was the government of Republican France that pushed for a peace that was not merely more punitive, but also provided a more robust international security order.

With its widespread notoriety, Keynes's book threw a shadow over the League of Nations. It also encouraged isolationists in the United States, who blocked that key country's participation and who remained influential in the subsequent two decades. Some even claim the book created a degree of international sympathy for Germany's revanchist claims in the 1930s (Peter 2015). The Canadian economist and past president of the American Economic Association, Jacob Viner, expressed this view in 1947, drawing out how the "war guilt" clause became tied to the public's memory of the French invasion of the Ruhr, the hyperinflation, and the suffering these episodes inflicted on ordinary Germans. The result was a psychological complex that shaped policy for the worse (Viner 1947):

> [T]he guilt complex toward Germany and toward the Treaty of Versailles, which Keynes helped to establish in England and America; the grossly unfair caricature of the personality, the character, and the intellect of Woodrow Wilson, which is the most widely remembered part of his book on the Peace; his exaggerated account of the greed and intransigence of the French and of their obsession with a security bogy -- these … contributed their weight to easing the path to world hegemony for a resurgent and reparations-free Nazi Germany.

The issues Keynes raised in his book, his decision to publish his privately expressed official advice, and his provocative language remain controversial. Arguably Keynes was politically naïve if he expected that going public with his arguments would win the day when his attempts to influence policy from within the councils of government had not. Perhaps he believed too much in people power. After all, expectations of self-determination were also cruelly dashed. Perhaps Keynes had overlooked – a trap many other economists would fall into in subsequent years – that if positive ideas on economic policy are to move from

concept into practice, they must dovetail with the political and social imperatives of the times.[7]

There was another side to the balance sheet. *The Economic Consequences of the Peace* gave Keynes instant worldwide fame. It launched his career as a "public intellectual" in economics and as a perennial government adviser. He was not alone in trying to influence policy through lectures, popular writings, and the press. In the United States, Irving Fisher, like Keynes a proponent of managed money, wrote in non-specialist outlets on topics beyond economics, including public health, eugenics, and the League of Nations (which he supported; see Dimand 2013). The chapter by Benny Carlson and Lars Jonung highlights the energetic involvement of Swedish university professors in public economic discourse. These public-facing scholars included Gustav Cassel, whose systemic critique of the gold standard was prescient, and Knut Wicksell, a key Keynesian interlocutor who argued that his chief obligation was the education of the Swedish people. In Britain, William Beveridge, Henry Clay, G. D. H. Cole, Walter Layton (editor of the *Economist*), and A. C. Pigou were among many other economists who sought to take economic science to a wider audience in order to influence views beyond academia.

Keynes took these activities to a higher level. Backhouse and Bateman (2013, p. 70) recount that in writing the *Economic Consequences*, Keynes was so confident his book would find a ready market, he underwrote the publishing costs himself. Macmillan thereby acted as his agent, giving him control of the book's price and its print run. He published all his subsequent books the same way, helping to make journalism his principal income source. As Michael Cox notes in his chapter, Keynes even contracted with the trades-union affiliated Labour Research Department to bring out a very successful low-priced edition of the *Economic Consequences*.[8]

An early example of Keynes's entrepreneurship – and the immense convening power that came because of his intellectual firepower, connections, and fame – was his editorship of a series of twelve *Manchester Guardian* reconstruction supplements that appeared between April 1922 and January 1923. These assembled contributions by Keynes himself (forming the basis for his classic *Tract on Monetary Reform*) and an international cast of distinguished contributors including Hjalmar Schacht, Walter Lippmann, John H. Williams, Luigi Einaudi, Lord Asquith, Ramsay MacDonald, Cassel, Pigou, and Fisher (Skidelsky 1994, p. 103;

[7] As MacMillan (2018) observes: "Keynes would have preferred that the economist ran things, writing in 1922: "He is a better and wiser governor than the general or the diplomatist or the oratorical lawyer. Perhaps, but what he was suggesting was not politically feasible in 1919, in the aftermath of one of the worst wars Europe had ever experienced. Looking back from the vantage point of a century later we know how badly Europe and the world were going to fare, but we have to remember that the peacemakers did not have free rein." Keynes himself acknowledged the political constraints of 1919 in the early 1920s (Tooze 2014, p. 295). He went on in Keynes (1922) both to clarify and defend his earlier analysis, while proposing a new scheme to end the debt overhang entangling America and Europe, which he did not think private sector initiatives could solve.

[8] In the blog series that the Marshall Library at Cambridge University devoted to the centennial of the *Economic Consequences*, Catherine Piner analyzes Keynes' correspondence around the publication date, highlighting the "unanticipated enormity of the response" to the book. See http://marshlib.blogspot.com/2019/05/the-economic-consequences-of-peace-by.html.

Backhouse and Bateman 2013).[9] Keynes established a pathway to a "business model" for the social scientist as public intellectual.[10]

Since World War II, business models similar to that of Keynes have powered public advocacy by economists of diverse view ranging from Milton Friedman on the Right to Paul Krugman on the Left, sometimes with consequential results.[11]

A world restored?

Wilson's Fourteen Points proclaimed, "There shall be free trade between the countries who accept the peace." Subsequently, Part I, Article 23(e) of the Treaty of Versailles enjoined members of the League of Nations to "make provision to secure and maintain freedom of communications and of transit and equitable treatment for the commerce of all Members of the League." Wilson's proclamation and the Paris treaties established free trade as a supporting pillar of the coming global economic order. In 1919, Keynes explicitly embraced the goal of free trade, because he feared that "nationalism and private interest" would join forces to turn political into economic frontiers (Keynes 1920, p. 91). Indeed, he proposed a European Free Trade Union under the auspices of the League.

The negotiators at Versailles also assumed implicitly that the world order starting in 1919, like the prewar order, would be reconstructed on the monetary basis of an international gold standard (Eichengreen 2019, p. 7)—although as Keynes pointed out, no explicit plan for the complementary goals of stabilising currencies and public finances was worked out at the peace conference. Only a few years later in his *Tract on Monetary Reform*, Keynes characterized gold as a "barbarous relic" (Keynes 1923, p. 172). Later, he fiercely opposed sterling's 1925 return to gold at the pre-war parity. Nonetheless, as of 1919, in line with prevailing opinion at the time, Keynes did not yet reject the implicit assumption of an eventual return to gold. (The Cunliffe Committee had recommended this route for Britain in 1918.)[12] Keynes would not be prepared to urge a definitive rift between sterling and gold

[9] The *Guardian* newspaper offers the flavor of these at https://www.theguardian.com/business/from-the-archive-blog/2020/mar/04/reconstruction-in-europe-keynes-guardian-guide-1922.

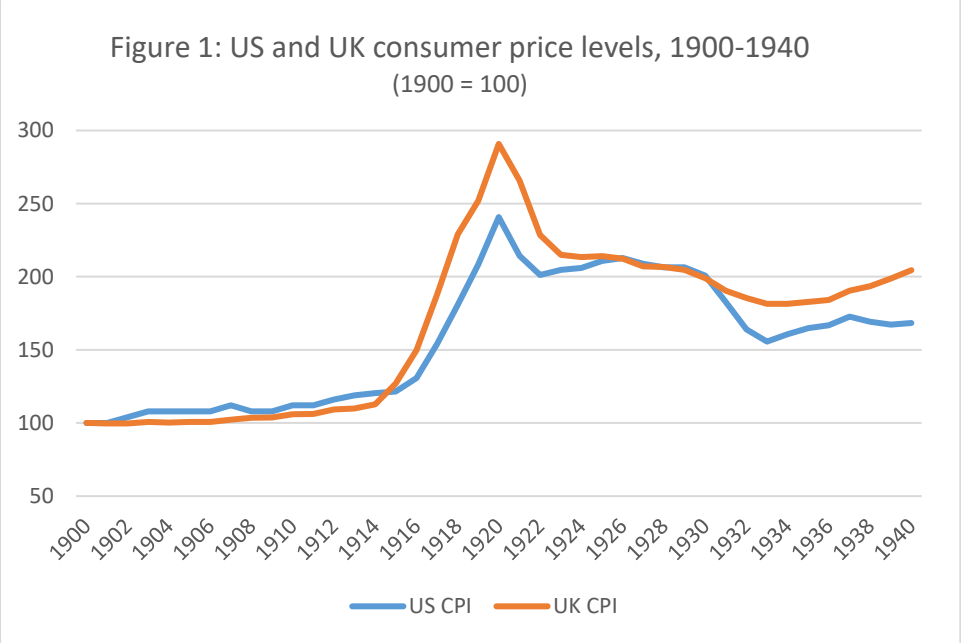
[10] Keynes's influence as a public intellectual may well have been unusually far reaching, though hard to demonstrate. The chapter by Jonathan Boff argues the *Economic Consequences* helped shape the collective memory of the Great War in Britain and elsewhere. The chapter by Eyüp Özveren presents a fascinating account of how the book shaped the minds of key political figures in Turkey, helping to determine the country's treaty re-negotiations and subsequent foreign policy. Even in France where anti-German sentiment remained especially intense throughout the interwar period, a non-negligible segment of public opinion sympathized with Keynes's arguments in the *Economic Consequences,* as Guilherme Sampaio recounts in his chapter.

[11] Fourcade (2009, pp. 178-181) notes that in Britain, alignment between economic writers and the press has long been especially strong, and she discusses some hypotheses about the reasons for this relationship.

[12] Late in 1920, he told a Cambridge lecture audience, "There is a great deal to be said against gold, but nearly all the more significant and scientific arrangements depend on confidence in governments. The advantage of the gold standard is the convention behind it that it is … disgraceful to tamper with gold" (Skidelsky 1992, p. 45). Later in the same lecture series, however, Keynes recommended that sterling's return to gold occur at a depreciated parity, not the prewar parity.

until just before the UK government's withdrawal from gold convertibility in September 1931 (Irwin 2014, p. 217).[13]

The attempt to reboot the post-World War I global economy along pre-1914 lines was only partially successful.[14] The system was an unsustainable, turbulent, and short-lived construction (James 2001). An initial postwar rebuilding boom led to sharp price rises (notably in America and Britain), analogous to those that accompanied economic reopening in 2021 following the COVID-19 lockdowns. But boom turned to bust and consumer prices fell sharply in 1921, notwithstanding a global boom in commodity prices. The latter lasted until the middle of the 1920s, when world agricultural prices dropped as farmlands



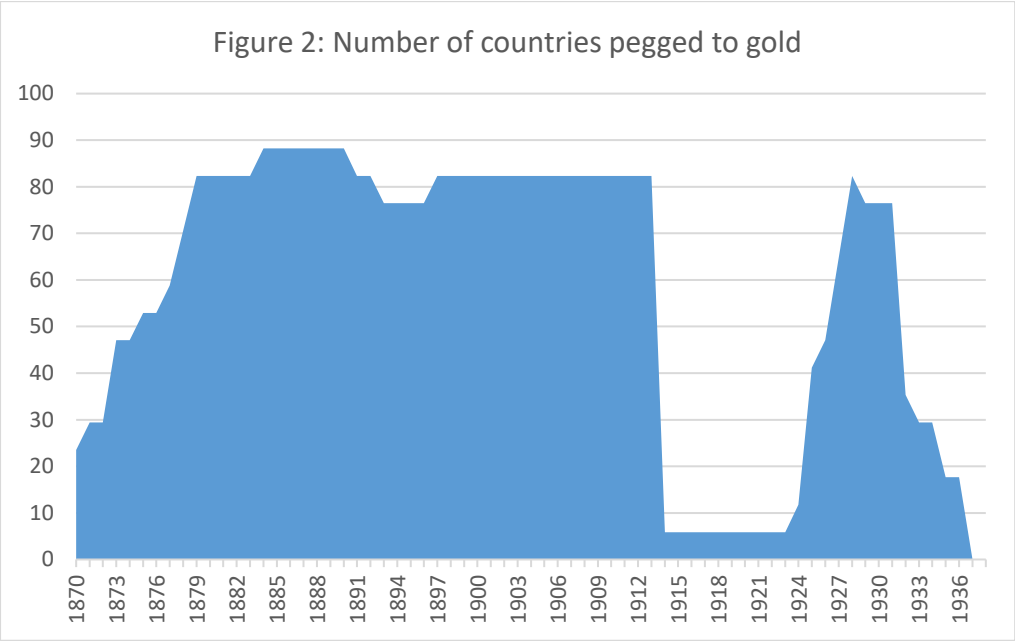
Source: US data: https://www.minneapolisfed.org/about-us/monetary-policy/inflation-calculator/consumer-price-index-1800-;
UK data: Constructed from annual inflation data reported at https://fred.stlouisfed.org/series/CPIIUKA

in Europe returned to production. Figure 1 shows the trajectory of US and UK consumer price levels (eloquently encapsulating key features of Anglo-American interwar macroeconomic history). The price-level collapse left the United Kingdom with a persistent legacy of double-digit unemployment, helping to convince Keynes that deflation was even more dangerous than the inflation he had warned against in the *Economic Consequences*.[15]

The United States restored gold convertibility in June 1919. Thereafter, numerous European countries returned to gold either at the 1913 parities – for example Sweden (1922),

[13] See also Temin (1989, p. 15). The chapter by Olivier Accominotti, David Chambers, and James Ashley Morrison builds an illuminating bridge between Keynes's analysis of postwar monetary issues and his activity as a foreign-exchange investor between August 1919 and February 1920.
[14] The chapter by Michael Bordo and Catherine Schenk provides a complementary chronicle of the international monetary system since 1919, focusing on systemic aspects of international policy cooperation.
[15] The chapter by Jagjit Chadha, Jason Lennard, Solomos Solomou, and Ryland Thomas brings a novel high-frequency dataset to bear on the question of whether high tariffs and devaluation in the 1930s helped counteract UK deflation by raising import prices.

Australia, the United Kingdom, the Netherlands (all in 1925), and Canada (1926) – or at depreciated parities – famously France (1926), but also Belgium (1926) and Italy (1927). Germany returned after a monetary reform in November 1923, whereas Japan waited until December 1930 to return at the prewar parity, shortly before the gold standard's collapse. In his missions to Latin America and other countries such as Poland, Princeton professor Edwin Kemmerer lobbied effectively for monetary reforms and the gold exchange standard during the 1920s. Figure 2 shows the historical course of gold standard adherence, notably the rush to return in the 1920s. The Versailles aspiration of free trade fared less well. The League of Nations attempted to effect multilateral trade negotiations, but trade deals remained bilateral, and numerous countries either declined to roll back or freeze existing tariffs. New quotas and tariffs were widely levied, culminating in the U.S. Smoot-Hawley Tariff Act in 1930 (Kindleberger 1973, pp. 77-78).

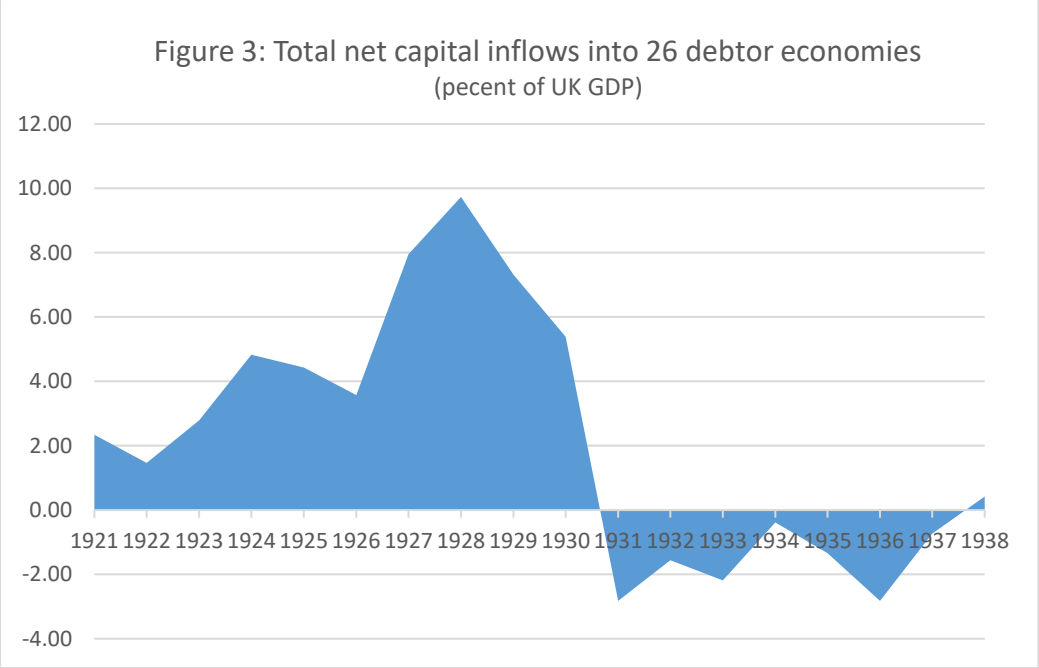


Source: Jordà, Schularick, and Taylor (2017). URL: https://www.macrohistory.net/database/.

The 1920s also saw a resurgence of what modern economists would call the "global financial cycle" as capital flows revived and asset prices soared, supported in part by an accommodative Federal Reserve policy stance. In 1924, the Dawes Plan saw French forces leave the Ruhr region, and it set a schedule for German reparation payments. The scheme floated collateralized bonds in world markets to help Germany pay. Kindleberger (1973, p. 38) argues that, "More than anything else, [the Dawes loan] was the spark that ignited foreign lending from New York, first to Germany, and shortly thereafter to Latin America and much of the rest of Europe." Figure 3 shows net foreign capital flows into the sample of 26 debtor countries for which Reinhart, Reinhart, and Trebesch (2016) have assembled data. Only the pattern of commodity prices after mid-decade failed to conform to the typical pattern of a global financial cycle – an ominous signal when primary producing countries were borrowing heavily. Much of this foreign lending ended in tears, as did the global growth boom of 1925-1929. After 1931, the international gold standard quickly unravelled under the pressure of global depression, currency crises, and bank failures. Centrally

implicated were systemic flaws in the international payments system, best explained at the time by Cassel, although the issue was only partially addressed in the later architecture of the Bretton Woods system.[16]

Reparations were not a direct cause of collapse, but through their political as much as economic effects, they acted as a constant irritant and destabilizer. As Kindleberger (1973, p. 39), puts it, "together with war debts they complicated and corrupted the international economy at every stage of the 1920s ….". Germany's balance of payments was severely lopsided, setting it up for a savage sudden stop in 1930 and making it vulnerable to bank runs in 1931.



Source: Reinhart, Reinhart, and Trebesch (2016).

Out of the debates launched by Keynes's *Economic Consequences of the Peace*, key parts of modern international macroeconomics were born. The celebrated 1929 exchange in the *Economic Journal* between Keynes (the journal's editor) and the Swedish economist Bertil Ohlin grew directly out of the book and opened a controversy that remains central for open-economy theory and policy.[17]

Keynes claimed that Germany's need to transfer reparations payments abroad would require it to have a larger trade surplus. However, to market additional exports abroad, Germany would need to lower their prices, creating a loss in her terms of trade that would add to the real economic pain of reparations. Ohlin denied the necessity of this outcome. The transfer would reduce German income but would augment recipients' incomes equally.

[16] See Irwin (2014), who notes Keynes's endorsement of Cassel's gold standard critique.
[17] The chapter by Carlson and Jonung also discusses the Keynes-Ohlin dialogue, as does Mundell (2002). Some French economists, notably Jacques Rueff, also weighed in to criticize Keynes on the issue (see Sampaio's chapter). Rueff attacked Keynes's economics repeatedly over the following decades.

If those countries raised their overall spending as much as Germans cut theirs, and at the margin spent the same proportion on German goods as Germans did, there need be no change in relative prices in equilibrium.

The "transfer problem" at issue in the Keynes-Ohlin debate remains a central focus of research and policy debate. It is a question about the basic nature of countries' external adjustment processes, and by implication, about the need for exchange rate movements to preserve full employment as domestic and foreign demand fluctuate. In his chapter, David Vines argues that as of 1929, not yet having the intellectual apparatus of his *General Theory* at hand, Keynes was unable to frame a rigorous counter-argument to Ohlin. The argument would have been that German and foreign expenditure patterns might be skewed at the margin toward their own products, and that Germany would cut its spending more than transfer recipients raised theirs if its residents had higher marginal propensities to consume out of income.

Although Ohlin was the more accomplished theorist as of 1929, subsequent analysis and experience suggest that Keynes's intuition was correct as a practical matter. Paul Samuelson (1946, p. 195) concluded that "If it can be said that [Keynes] was right in his reparations-transfer controversy with Ohlin, it is in part for the wrong reasons – reasons which in terms of his later system are seen to be classical as compared to the arguments of Ohlin." Similarly, Krugman (1991, p. 19) judged, "[W]hile Keynes may have been wrong in theory, he was right in practice." The British economist John Williamson (1991, p. 243) dismissed the outcome Ohlin suggested as an "immaculate transfer." As always, Keynes was concerned, not with what *may* happen, but with what *will* happen.[18] Keynes's realistic judgment would later underlie the structure of the Bretton Woods international monetary system, as Vines details in his chapter.

Interwar multilateralism

Central to Keynes's argument in 1919 was the underlying insight that a sustainable peace would be impossible without going beyond gold and free trade to create the preconditions for shared prosperity, social security, and social cohesion. Jan Christiaan Smuts, an author of the League of Nations covenant who grew to be close to Keynes at the peace conference, painted a bleak view of Europe after the war: "We witness the collapse of the whole political and economic fabric of Central and Eastern Europe. Unemployment, starvation, anarchy, war, disease, despair stalk the land" (Clavin 2020, p. 2). Addressing a broad range of potential social ills motivated much of the League's interwar work on a range of economic and social issues. The same sense of social crisis permeated Keynes's polemic. As Maier (2009) puts it: ""The greatest damage the war had inflicted was not on French and Belgian

[18] The turn of phrase is adapted from Deardorff (1987). While Krugman (1991) strongly endorsed Keynes's conclusion, Krugman (1989) showed theoretically how the export prices of a fast-growing economy need *not* fall if its growth takes the form of completely new products (a case of higher supply as opposed to lower domestic demand). In the same framework, however, Corsetti, Martin, and Pesenti (2013) show that while entry of new products may reduce the need for a fall in the market price of exports, entry adds a different form of secondary burden to the transfer: it harms consumption and employment. Welfare therefore deteriorates substantially, even though changes in the terms of trade and relative labor costs are contained, suggesting that Keynes was, after all, correct in practice.

territories, but on the hitherto docile acceptance of class inequality. Could the Europeans and the Americans (who were being asked to cancel their financial claims as well) not understand a venerable civilization was at stake? We must read [Keynes's] text finally not as just a statistical argument about realistic peace-making but as a warning about the social and cultural order." Here is where Keynes's critique proved prophetic.

Keynes's mother Florence and his sister Margaret played important roles in steering his thinking toward a more capacious conceptualization of security. Both were very active in the Women's International League for Peace and Freedom (WILPF) and its landmark campaign, led by Eglantyne Jebb and Dorothy Buxton, to "Save the Children" that created the non-governmental organization with the same name. (Margaret was a close friend of Jebb's). Both before and after Keynes was in Paris, his mother wrote to him repeatedly regarding what she described as "famine conditions" in Central Europe. Her views undoubtedly helped to shape her son's decision to resign from the peace delegation, as well as his take on the failings of the peace.[19]

Save the Children, the NGO founded in 1919, is one example of the type of global movement that began to spring up in the late nineteenth century to foster international cooperation on a range of issues including health, culture, peace, and communications (including the landmark Universal Postal Union) – see Ikenberry (2020, chapter 3). Despite the crippling absence of official US political engagement (though hundreds of Americans would participate in its work as experts), the League of Nations pursued initiatives in many of these areas.[20] While superficial perceptions of the period label the League as a "failure," it played a key role as a locus for international diplomacy and the dissemination of information. Moreover, the precedents it established created a "muscle memory" – physically embodied in its cadre of international civil servants – that would be reactivated across a range of more robust post-World War II institutions. Crucially, these did have full US political support.

One key arena of interwar multilateralism was global public health. Recent experience with COVID-19 has revived popular consciousness of the last great global pandemic, the 1918-1919 influenza plague. Though eclipsed in much historical writing by the dramatic political events of those years, the H1N1 virus (avian influenza) killed tens of millions worldwide and likely more than 3 million in Europe. Many of those at the Paris peace conference contracted the "Paris Cold," including Clemenceau, Lloyd George, Wilson, and Keynes himself, Keynes falling quite ill with a possible secondary bacterial infection as well (Carter 2020, p. 64). 'Flu was not the only epidemic disease that pre-occupied the peacemakers. At the time, contemporaries were as – if not more – preoccupied by the risks of typhus and

[19] Private papers of John Maynard Keynes, Kings College Cambridge (hereafter, JMK), JMK PP/45/168/9/159, Florence Keynes to John Maynard Keynes, March 6, 1919. Only his response is published. See Johnson and Moggridge (1978, p. 428). The WILPF grew out of the International Committee of Women for Permanent Peace, headed by Jane Addams, which denounced the terms of the Versailles Treaty in 1919 prior to changing the organization's name and moving its headquarters to Geneva for proximity to the planned League of Nations. Over the interwar years, the WILPF cooperated in a number of League of Nations social and humanitarian initiatives, including in the areas of refugees, disarmament, and multilateral cooperation over aviation. Two WILPF leaders won Nobel prizes for Peace, Addams (1931) and Emily Greene Balch (1946). Balch was the first woman economist ever to win a Nobel prize (Dimand 2011).

[20] In 1924, the League adopted the Declaration of the Rights of the Child, drafted by Jebb.

tuberculosis (TB). In 1920, TB caused one in every four deaths in Vienna. Poor nutrition and living conditions were behind death rates so high they rivaled those of the fourteenth-century Black Death (Rosenfeld 1931). The disintegration of European empires highlights three causes of morbidity that are evident in the COVID-19 pandemic too: population density and poverty, along with mobility. Revolution, civil war and nation-building drove mass population displacement at the same time as Central European armies did not so much demobilize as disintegrate. The legacy of disease may have helped destabilize interwar politics.[21]

Building on earlier international health conventions (see Cooper 1989 and Fidler 2001), the League created its Health Committee in 1923, the precursor to the World Health Organization, and in 1924 sponsored what is now called the World Organization for Animal Health. Moreover, the interwar period saw the conclusion of ten international treaties relating to human infectious diseases, covering specialized issues ranging from dengue fever to venereal disease among sailors. In general, the continuing war-like conditions in Europe after 1918 obliged the League to undertake a range of other activities that moved beyond health, covering refugees, transportation, and communication.

Economic and financial questions came to be a major arena for League activity, even though – perhaps surprisingly – the United States and the Allies did not plan for it to have competencies in this sphere. Albeit indirectly, Keynes did help to make the case. With League help, Austria stabilized its currency and returned to gold. In the process, the League transformed its Provisional Economic and Financial Committee, which would take on the status of a permanent "specialist organization" of the League (Clavin 2013, p. 16). The Economic and Financial Organization (EFO) went on to play myriad roles, employing some of the most storied theoretical, empirical, and policy economists of the twentieth century. These functions ranged from surveillance of member countries to the systematic collection, publication, and analysis of global economic data. In 1928, the EFO helped organize the Gold Delegation that assessed the performance of the global gold standard (Clavin and Wessels 2004), and it provided support for the first-ever global economic conferences in the 1920s and 1930s. These included the fateful London Conference of 1933, which famously failed to stabilize exchange rates after the US devaluation. The organization also sponsored Ragnar Nurkse's (1944) classic study of interwar currency experience, setting out the EFO view of recent international macroeconomic history. Its intent was to influence the framing of the new Bretton Woods institutions – and it did. Today, the activities of the International Monetary Fund and World Bank mirror many of the EFO's functions.

Rebuilding after World War II: Lessons learned

The plan for a United Nations organization, this time with US participation, was announced at Dumbarton Oaks in Washington D.C. in October 1944. Two of the United Nations' key economic agencies, the International Monetary Fund and the World Bank, had been agreed earlier that year in Bretton Woods, following a protracted bilateral negotiation between Keynes, leading for the UK Treasury, and Harry Dexter White, leading the US Treasury team. Despite the rapidly changing power-political character of these states' relations, and their

[21] See Blickle (2020) on the predictive power of influenza mortality for subsequent German voting patterns.

place in the world, the patterns of diplomacy were remarkably similar to 1919. These Anglo-American initiatives became part of a broader postwar settlement that would promote the rebuilding of war-shattered countries, including western Germany and Japan, and a revival of global trade.

Unlike 1918, however, 1945 was not a unipolar moment. Whereas in 1918, the Russians had been knocked out of the war, leaving the coalition of the British Empire, France, and the United States to dictate terms, in 1945 the victory was even more complete, and within the United Nations coalition, the Western powers were pitted against the Soviet Union. In the aftermath, each side pursued its own vision of economic and political development, domestically and on the global stage.

Eichengreen (2007) describes the first twenty-five years after World War II as a "golden age" for the West European economies, underpinned in part by a "neocorporatist bargain" in which wage restraint by workers augmented profits that in turn were devoted to investment. The arrangement recalls Keynes's (1919) account of pre-World War growth. He put it down to the "psychology of society" which had channeled high profits into capital accumulation and growth largely because labor was powerless rather than self-restrained. Japan staged its own economic miracle, based on far-reaching industrial policy and government-sponsored credit expansion. Aggregate demand due to the Korean War gave an early fillip to growth everywhere, but especially in Japan with its key position as a regional supplier.

In contrast to 1919, this time multilateral institution building flourished, backed in both the US and Soviet spheres of influence by hard-power security agreements. Achievements included rounds of multilateral trade liberalization under the General Agreement on Tariffs and Trade (GATT): GATT negotiations reached their high-water mark in 1994 with the establishment of the World Trade Organization, an institution envisaged by Keynes during World War II but rejected by the United States in 1950. The GATT helped global trade to revive in the quarter century after the war under the stabilized exchange rates mandated in the IMF Articles of Agreement, and supported by the latter's provisions for the restoration of national currencies' convertibility for current account transactions.

The United Nations organization, the inter-governmental heir to the League, also resurrected League-created bodies. UNESCO, for example, succeeded the League's International Committee on Intellectual Cooperation in 1945 and the World Health Organization (WHO) of 1948 built on its Health Committee (as noted earlier). The UN also created new agencies, beyond the IMF and World Bank linked to Keynes, such as the International Atomic Energy Agency (1957). The crowning achievement of post-World War II international health efforts was the eradication of smallpox globally in 1979, the result of more than two decades of effort requiring close collaboration by Cold War adversaries working through the WHO (Cooper 1989; Carroll 2016). The case of global public health well illustrates, however, that as the number of specialist global institutions proliferated alongside a growing number of NGOS, the challenges of coordination and cooperation among them grew. Such frictions often went unaddressed because, as in 1944-1945, social and health questions appeared to be second-order priorities compared with hard security and financial stability.

Indeed, in 2020, the COVID-19 pandemic revealed that international cooperation on public health remained much too limited to meet current challenges, despite advances in institutional infrastructure and remarkable scientific progress. Keynes – or perhaps more likely his mother and sister – would argue that future global pandemic diseases remain a fundamental threat to peace and security within, as well as between, societies. As in 1919, a highly contagious virus killed millions across the world, with more set to die if the international community continued to respond in a disjointed fashion to a truly global threat.

It is tempting to credit Keynes's warnings of 1919 for the comparative success of post-World War II arrangements. But it is hard to draw straight lines from *The Economic Consequences of the Peace* to the post-1945 settlement. A multitude of other factors was in play, notwithstanding Keynes's important personal contributions in the financial sphere.

In 1945, Allied sentiment and policy toward the defeated Germany was if anything (and understandably) more hostile after the second great war than after the first. In academic circles, Étienne Mantoux's *The Carthaginian Peace, or the Economic Consequences of Mr. Keynes* was a well-received economic and political critique that warned of the perils of treating Germany too leniently after World War II. (The book appeared posthumously at the start of 1946, its author having died in action only days before the end of the war.) More generally, as of the first half of the 1940s, the prevailing opinion of the Versailles Treaty was not that it had been too harsh, but that it had failed to neuter Germany decisively enough to prevent its industrial resurgence and a new, more deadly, conflict.

Initial proposals to deindustrialize Germany after the war reflected this mind-set. In late 1943, the Allies agreed in principle that Germany and its allies should pay some form of reparations.[22] Famously, Treasury Secretary Henry Morgenthau Jr.'s 1944 memo, *Suggested Post-Surrender Program for Germany*, included, among other provisions, partitioning a diminished Germany, turning the Ruhr into an international zone, and stripping German territory of its industries (by removing plant and equipment and destroying mines). President Roosevelt distanced himself from the plan only after opposition from his own State and War departments, as well as from the British government, which feared the wider repercussions for Europe's recovery. FDR was also warned that knowledge of the plan had strengthened German resistance in the field.

But the plan's general spirit survived. Immediately after the German surrender in May 1945, President Truman authorized a policy that prohibited US occupation forces from taking any steps to restore or maintain the German economy. Slightly more than two months later, at the Potsdam Conference, Truman, Churchill, and Stalin agreed to divide Germany into occupation zones. They agreed to strip it of resource-rich territories, including industrial Upper Silesia, impose reparations (by seizing industrial equipment and other assets), dismantle industry potentially capable of producing military goods, and take measures that would ensure Germans' standard of living would be no greater than the European average.

[22] US officials consulted Keynes on the issue, "[y]et the man who had pronounced so famously in 1919 was now very reluctant to be drawn on the lessons of history ...." (Clavin 2013, p. 320).

The problem of German ethnic minorities across Eastern Europe, which had destabilized the peace after 1919, was resolved after 1945 by the ruthless transfer of between 12 and 14 million Germans above all from the territories of Poland and Czechoslovakia. It was the largest forced transfer of population in European history. At least 500,000 died in the process. Unlike after World War I, there was little sympathy for German suffering on the Allied side and no protest from Keynes.

As far as reparations were concerned, a total of $20 billion was set, to be paid in kind. Priority was given to Poland and the Soviet Union. Early in 1946, the Allies' first Level of Industry Plan set out a concrete plan to cap German industrial capacity at half the 1938 level through the destruction of 1,500 manufacturing establishments. Meanwhile, France occupied the coal-rich Saar although the Americans and Britons thwarted French attempts to control the Ruhr's coal and steel industry by establishing the International Authority for the Ruhr. French goals were in line with the Monnet Plan of 1946, which sought to transform France into Europe's leader in heavy industry on the back of the two contested German regions.[23] It was circumstances rather than any lessons of history read from *The Economic Consequences of the Peace* that prompted a change of strategy on the part of the Americans, British, and (more reluctantly) the French.

By the end of 1947, the US led a change in the punitive approach toward German industrial rehabilitation owing to three principal factors. First, with the German economy disabled, the costs to Allied (and especially US) taxpayers of the German occupation were high, mounting, and ultimately difficult to sustain. The territories of what would now comprise "Germany" needed to become self-supporting. Second, it was becoming evident that the engine of German capital goods exports would be necessary for a broad-based European recovery. Third, the emerging Cold War split placed a premium on Western European recovery and cohesion and hardened the unwillingness of the Western powers to see Soviet demands for reparations satisfied from "their" zones of Germany.

After World War I, partition of Germany had never seriously been considered. Clemenceau considered the aggressive mutation of German nationalism in the nineteenth century – in no small part due to the violence of Napoleonic imperialism – as tragic, but he took unification to be irreversible. After World War II, there were no such qualms. By 1948, as an effect of Western-Soviet conflict, the partition of Germany was an accomplished fact.

The three western occupation zones were amalgamated over 1947-1948 and a new currency, the Deutsche Mark, was introduced. In April 1948, the US-sponsored Marshall Plan commenced operations – another reflection of the imperative to support European economic recovery as a bulwark against Communism. The Marshall Plan was less about the monetary resources the US provided to Europe than about US efforts to leverage Marshall aid in the interest of European economic integration and cooperation. These were viewed as necessary conditions for western economic and political security in the light of the Soviet

[23] Monnet attended the Paris peace conference and in 1919 became deputy secretary-general of the League, a post he occupied until 1922. He played a key role much later in inspiring the Schuman Plan for the European Coal and Steel Community, which superseded the early postwar arrangements for the Ruhr, removed output ceilings in key German industrial sectors, and set Europe on the path to the current European Union. However, the emergence of the Schuman Plan owed much to American pressure (Berger and Ritschl 1995, pp. 216-219).

threat (Berger and Ritschl 1995; Eichengreen 2010). The western economic interventions triggered the Soviet blockade of Berlin in June 1948 – and a sharp escalation of East-West tensions.

These economic initiatives echoed arguments Keynes had made in 1919, but not because western policymakers consciously channelled the *Economic Consequences*. It was because Keynes's vision of the requirements for Europe's return to prosperity had been fundamentally correct after the First World War and remained so after the Second.[24] How could Europe after World War I return to prosperity on the back of a disabled German economy, when, prior to the war, Germany was "a central support [of] the rest of the European economic system," enjoying an "overwhelming" economic interdependence with her neighbors?[25] The goal should be to "make possible the renewal of hope and enterprise within her territory" and "permit the continuance of Germany's industrial life" (Keynes 1919, pp. 248-249). In the later 1940s, the aim of policymakers became to remake the economy of Western Europe, not according to the fragmented interwar model, but as a rump of the pre-1914 allocation of activity, implying that a revived western Germany would need to play a driving role.

Perhaps ironically, the *volte-face* on US policy toward Germany owed much more to Herbert Hoover than to Keynes – the same Hoover of whom Keynes had written glowingly after Versailles, but who presided over the US slide into depression a decade later. Recognizing Hoover's success in organizing aid to Europe after the previous war, President Truman invited him to tour Europe again in 1947, and specifically to make recommendations on the humanitarian and economic crisis in Germany and Austria. The third of his three reports, dated March 18, 1947, contained this warning:

> There is only one path to recovery in Europe. That is production. The whole economy of Europe is intertwined with [the] German economy through the exchange of raw materials and manufactured goods. The productivity of Europe cannot be restored without the restoration of Germany as a contributor to that productivity.[26]

Hoover had made similar arguments after World War I, and Keynes quotes him extensively and with approval in chapter VI of the *Economic Consequences.* This time, Hoover's vision, backed by the United States' preponderant power, won the day.

In one indirect and incidental way, Keynes's contribution to the postwar monetary system may have accelerated US understanding of the need to fortify all of Western Europe against

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[24] George F. Kennan, an architect of the Marshall Plan at the US State Department, wrote in later life that the major influence on his initial thinking about the shape of post-World War II Europe was not Keynes but Bainville (1920), which was written as a counterpoint to the *Economic Consequences* (Kennan 1998).
[25] Keynes (1919, p. 14).
[26] The *New York Times* published a complete report text, available at https://timesmachine.nytimes.com/timesmachine/1947/03/24/issue.html. Hoover also noted that "[E]ntirely aside from any humanitarian and political aspects, policies which will restore productivity in Germany and exports with which to buy their food and relieve [the monetary] drain upon us are of primary importance." In his report, Hoover identified the "major mistake of Versailles" as the failure to demilitarize Germany effectively and permanently. Yet, he believed demilitarization could be accomplished consistently with German economic prosperity.

Soviet designs. Early in 1946, while serving as deputy head of the US mission in Moscow, George Kennan received a request from the US Treasury to explain the USSR's refusal to join the Bretton Woods institutions (despite having been party to the negotiations creating them). This refusal surprised some in Washington, who naively expected the Soviets to embrace the Keynes-White vision of multilateral economic governance despite the facts unfolding on the ground in Europe, the Middle East, and Asia. Shortly thereafter, Kennan on February 22, 1946 composed and sent to the State Department his influential "long telegram" on the inevitability of Soviet hostility to the West (Kennan 1967, p. 293).[27] Soviet rejection of Keynes's handiwork thereby marked a key moment in the opening of the Cold War.

The last act in the drama of German foreign indebtedness was the London Debt Agreement (LDA) of 1953 (Tooze 2011). An Anglo-French pact to pressure the US into cancelling its war debts had the effect of enabling Germany to wriggle out of its World War I reparations bill, but Germany still had obligations connected with the Dawes and Young loans (which grew out of those reparations). It also owed monies because of private cross-border loans made to German businesses and government bodies during the interwar period, as well as assistance extended to Germany after World War II (including a portion of the Marshall aid). The LDA terms were relatively lenient, with the United States forgiving $2 billion in German debt and Germany paying at best half of what it owed (Guinnane 2015). As with the earlier reconstruction initiatives, the motivations for this generosity were to bind Germany into the western democratic alliance and to resist Communism through prosperity. Galofré-Vilà et al. (2019) argue that the LDA powerfully catalyzed German growth through multiple channels.

Keynes and the achievement of Bretton Woods

Keynes's *The General Theory of Employment Interest and Money* (1936) was a work of closed-economy theorizing, as Vines's chapter reminds us. The book sought to explain how a largely autarkic economy operating as an insular unit could pull itself out of depression. By the early 1930s, Keynes had come to believe that the political stability of democratic capitalism depended on each government's ability to satisfy its citizens' legitimate demands for economic security. The primacy of this national objective meant jettisoning laissez-faire principles, including unimpeded international trade and capital movements, when necessary.[28] However, Keynes did not favor autarky *per se* and did not view his prescriptions for domestic stabilization as being inconsistent with a degree of international economic integration. Instead, he recognized that countries could reap benefits from international interdependence and need not fall into policy conflicts as a result, provided they also had macroeconomic tools sufficient to ensure domestic economic stability. As *The General Theory* (p. 382) put it:

[27] The components of the former USSR eventually joined the IMF over 1992-1993. In his authoritative biography of Kennan, Gaddis (2011, p. 216), denies that the Treasury request was the catalyst for the telegram (despite what Kennan recounts in his own memoirs). Regardless of these details, the Soviet attitude toward Bretton Woods was one of several indications of coming tensions. If one reads the long telegram today (as reproduced in Kennan 1967), the continuity of the subversive methods Kennan describes with current tactics of "asymmetric warfare" is striking.

[28] On Keynes's views, see Obstfeld (2021).

> [I]f nations can learn to provide themselves with full employment by their domestic policy … there need be no important forces calculated to set the interest of one country against that of its neighbours. There would still be room for the international division of labour and for international lending in appropriate conditions.

In June 1940, Keynes returned to the UK Treasury as an adviser – this time, not as a brilliant but relatively unknown 31-year-old, but as the world's most renowned economist. By then he had an influential following among economists in the United States (Carter 2020), including at the US Treasury. (Indeed, it was the Depression and World War II that cemented the influence of economists at treasuries in both America and Britain, in part owing to Keynes's ideas about government's role in the economy; see Ikenberry 1992.) As early as 1941, he began to consider postwar international economic arrangements. Key elements of his approach were to provide international liquidity and to channel countries' nationalistic pursuit of prosperity away from the international conflicts that beggar-thy-neighbor policies caused. Allied negotiations over the postwar monetary system, most importantly the bilateral negotiations between the United States and United Kingdom, began in 1942 and culminated in the July 1944 Bretton Woods agreement.

The Bretton Woods compromise between the United States and the United Kingdom envisioned a world economy with fixed exchange rates and two inclusive international organizations, the IMF and the World Bank, to meet the challenges of short-term balance of payments disruptions and long-term financing of economic reconstruction and growth. Critically, a country could change its IMF exchange parity (with IMF notification) in circumstances of long-term "fundamental disequilibrium" – such as that which bedeviled Britain on gold after 1925. In such cases, an overvalued currency, if not devalued, would condemn the economy to a long period of unemployment and deflation. In Keynes's mind, having the option to change an exchange rate in cases of fundamental disequilibrium would enable national currencies to adjust consistently with requirements of domestic macro stability. This would be much preferable to having price, output, and employment adjust to the requirements of an immutable exchange rate. Through a compromise made possible by the IMF's capacities, its rules squarely addressed the dilemma between exchange rate stability and price level stability Keynes had identified in his *Tract*. IMF lending, if necessary, would help countries maintain stable exchange rates in the face of *temporary* balance-of-payments disturbances (thereby promoting a less volatile international trade environment). However, in the face of hopefully less frequent *permanent* balance-of-payments disturbances – those requiring long-term adjustment of the domestic price level through deflation in order to maintain full employment – the pegged exchange rate would instead be adjustable to avoid protracted recessions.

Critical to the viability of this compromise was the absence of speculative capital movements. If private investors were free to move funds across borders and even suspected that an exchange rate might be devalued, they would perceive a "one-way bet" and would shift their investments in such a high volume that central banks, even with the aid of IMF resources, might be overwhelmed. Keynes's and Nurkse's critiques of such destabilizing "hot money" flows during the interwar period were central to the Bretton Woods system's design. Thus, while the IMF Articles of Agreement aimed to restore currency convertibility for current account transactions quickly, and thereby to promote international trade, they

did not intend to promote convertibility for *financial account* transactions, even as an implicit goal. By excluding free private capital mobility, the IMF rules aimed to operate a regime of deliberate infrequent exchange rate changes, thereby gaining most of the assumed benefits of fixed exchange rates for trade, while guarding against protracted disequilibria in labor markets. Restrictions on international finance would match the widespread restrictions on domestic finance that prevailed following the post-1929 financial instability and wartime controls.

As it turned out, the final shape of the Bretton Woods agreement adhered more closely to the US blueprint than to Keynes's, and more closely reflected American economic interests than those of Britain. Nonetheless, the agreement addressed, if imperfectly, several of Keynes's key objectives, and he lent it his strong public support. Keynes personally made the case for the agreement in the House of Lords while gravely ill. Approval of the IMF and World Bank by both the Congress and Parliament marked a strong contrast with Keynes's fruitless attempts to influence the financial outcome of the Versailles treaty in 1919, and his public attacks on it after afterward. As James and Koger point out in their chapter, Keynes's relative inexperience of diplomacy in 1919 may have been counterproductive; his much greater capacity as of 1945 may have been decisive

What had changed? For one thing, Keynes's own role was different. Unlike in 1919, in 1945 Keynes was completely committed to the war against Germany, and its Axis associates, that he had helped the Allies to win. In addition, unlike in 1919, he had a much greater degree of personal responsibility for the actual negotiations and outcomes, so the option of resigning and writing a flaming denunciation of a difficult compromise settlement was less attractive. The changing context between 1919 and 1945 went well beyond Keynes as an individual. British radical liberal opinion more generally was at odds with World War I. And the place of experts such as Keynes in the structure of the state was still quite marginal. The emergence of "big government" and modern expertise in the interwar period changed all of that both in terms of professional participation in policymaking and the degree of political engagement to which the experts as functionaries were now committed.

But Keynes as an individual also made a critical difference by creating an intellectual apparatus that justified government economic initiative on a large scale. This apparatus related to the state's approach to both macroeconomic stabilization and economic development. His life's work – as an economist, policy practitioner, and public intellectual – demonstrated that international economic relations must support rather than thwart the public pursuit of inclusive domestic prosperity. Keynesianism offered a solution to the mid-century dilemma of western capitalism: how to balance the market against the need for governmental domestic policy space to support and protect democracy. In Keynes's vision, international institutions were essential to addressing this core challenge.[29]

[29] Viner's (1947) verdict was that, "[I]n the third phase of his career, from Munich to his death, [Keynes] rose to the highest levels of maturity, balance of judgment, and responsible and world-oriented statesmanship. If there is a successful outcome of the present effort of the great Western democracies to find a common platform from which to promote a postwar world in which peace, freedom, and plenty can all prevail, to Keynes will be due a significant fraction of the credit."

The unstable dynamics of Bretton Woods

As originally conceived, the Bretton Woods system – with its controls over international finance and its provisions for exchange rate adjustment -- embodied a philosophy of the relation between market and state quite different from the classical liberalism that ruled before World War I. As Ruggie (1982, p.393) put it, famously characterizing the underlying philosophy as "embedded liberalism,"

> [U]nlike the economic nationalism of the thirties, it would be multilateral in character; unlike the liberalism of the gold standard and free trade, its multilateralism would be predicated upon domestic interventionism.

On its own terms, the Bretton Woods system, buttressed by the Marshall Plan and associated institution building in Europe, successfully promoted postwar reconstruction, international trade, and the achievement of full employment and growth. But the very success of the system generated internal contradictions that led to centrifugal economic and political strains Even as the scars of war healed over in the quarter century following 1945, several major destabilizing trends emerged as results of the Bretton Woods system's economic success.

First, the international mobility of financial capital rose as international trade expanded and the "international division of labour" Keynes had referred to in the *General Theory* became more efficient, through specialization along lines of comparative advantage as well as through increasing returns to scale and economies of multinational production. These developments raised the demand for global financial services, but they also provided ample opportunities for hidden or disguised capital movements. The result was greater turbulence in foreign exchange markets as cross-border funds moved with increasing violence in anticipation of exchange rate adjustments.

Second, the growing export success of Western Europe and Japan raised the competitive bar for US industries. The latter had been overwhelmingly dominant in the early years after the war. Thereafter, rising levels of US imports from lower-wage countries put pressure on US wages, while the manufacturing share of US employment leveled off in the 1960s, and then began a rapid descent at the decade's end. In contrast, manufacturing employment was still growing in Germany and Japan (Obstfeld 1985, p. 380). US organized labor supported the Kennedy Round of GATT negotiations that Congress authorized in 1962, but subsequently switched to opposing trade liberalization, a sign of pessimism that export promotion could benefit US workers enough to offset the impact of higher imports.[30]

Third, and in line with these developments, the US balance of payments position weakened as the postwar period of global "dollar shortage" ended. The United States, uniquely within the Bretton Woods system, had no need to use foreign exchange reserves to defend dollar

[30] Alden (2017, p. 80). The Trade Expansion Act of 1962, which authorized the Kennedy Round, also set up Trade Adjustment Assistance programs that are widely judged to have been ineffective in countering trade-induced disruptions of US labor markets.

exchange rates because the dollar served as a numeraire within the system: other countries bought and sold dollars to keep their currencies in line at the official par values. However, the US had promised keep foreign governments' dollar reserves convertible into gold at an exchange rate of $35 per ounce – making gold the bedrock of the system, despite Keynes's warnings. As foreign dollar reserves grew, the US ability to fulfil this pledge given the limits of its gold stocks came into question.[31] By the end of the 1960s, the US relied upon the forbearance of its trade partners and allies, who had accumulated reserve holdings of paper dollars far in excess of the value of US gold. But these countries were becoming increasingly skeptical of US political and economic leadership in light of US economic policies, US policies in Vietnam, and the response the latter provoked on their own streets. US inflation rose markedly. In a world pegged to the dollar, the inflation spilled abroad.

Following the establishment of the European Economic Community in 1957, cooperation among its members increasingly intensified. In 1970, the Werner Report recommended the establishment of a single European currency. These developments were in line with the hopes Keynes expressed in the *Economic Consequences* for a free trade zone radiating from continental Europe, but they also nurtured a new economic and political power center independent of the United States. The report clearly signaled that Europe's willingness to sustain the Bretton Woods currency system was fraying.

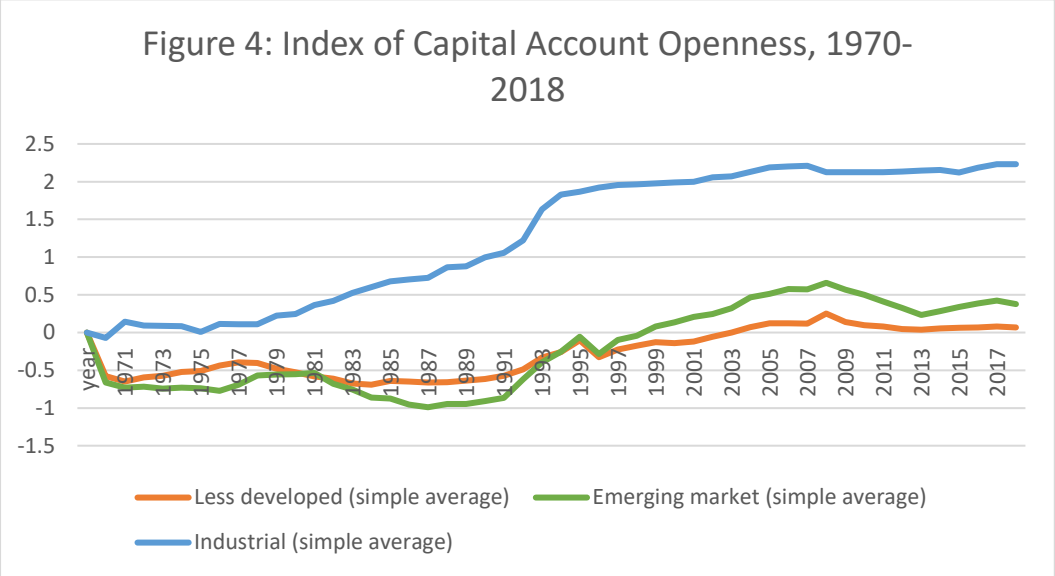
These tensions came to a head under US President Richard Nixon's administration. Anticipating attitudes that President Trump would take much further five decades later, in 1969 the president put forward his "Nixon Doctrine" in 1969, denoting that nations of non-Communist Asia, including Vietnam, Taiwan, and Korea, should increasingly bear the burden of their own defense. The doctrine rationalized increased US arms sales to Iran, Saudi Arabia, and Israel, with welcome collateral benefits for the US balance of payments. In August 1971, with unemployment and inflation both having risen substantially, Nixon imposed an import surcharge on US trade partners, forcing them to revalue their currencies against the US dollar, while also mandating wage and price controls and discontinuing the US government's commitment to redeem official dollars in terms of gold.

The "Nixon shock" highlights that by the later 1960s, a clear trade-off had emerged, in which Americans would increasingly evaluate the US global leadership role in terms of its economic costs at home. This trade-off was also an element of the US position in 1919, as Keynes pointed out: the implications for American policy of Wilson's Fourteen Points, including the commitment to a new League of Nations, had neither been thought through nor tested with Congress and the US electorate. After the Wall Street crash, US internationalism was deeply tainted, with isolationists ascendant. While America embraced its leadership of a hegemonic multilateralist system in the first quarter-century after World War II, Nixon's actions in 1971 were a sharp turn toward nationalism – launched without consulting allies (Garten 2021). The motivating trends in the US global economic position would only accelerate in future decades, partly because of another of Nixon's foreign policy moves, and arguably his signal foreign policy achievement, US opening to China.

[31] The Belgian economist Robert Triffin, then a professor at Yale, raised this problem at the start of the 1960s shortly after Europe attained current account convertibility for its currencies under IMF rules.

This history is well known, but a less-noticed development of 1971 was economist Robert Mundell's publication of a meandering pamphlet, remembered today mostly for setting out an intellectual basis for what would later be called supply-side economics (Mundell 1971). Mundell's concern was to set out a mix of monetary and fiscal policies that could resolve the United States' simultaneous internal and external balance problems – a topic that, in a general sense, had preoccupied Keynes over the years and was fundamental to the IMF's *raison d'être*. Stripped of the political valence that some assign to it, Mundell's core point was important and economists of all stripes acknowledge it. Fiscal policies are diverse and can operate, not only in terms of Keynesian aggregate demand effects, but also in terms of how they change the economy's underlying productive potential.

The complete and permanent collapse of the Bretton Woods fixed exchange rates early in 1973, under the pressure of massive speculation, provided countries with welcome room for monetary policy maneuver. But it did not (and could not) alter the long-term direction of real structural transformation in the world economy.



Source: Chinn and Ito (2006) de jure index updated to July 13, 2020, URL: http://web.pdx.edu/~ito/Chinn-Ito_website.htm. The index ranges from −1.92 (most closed) to 2.33 (most open). The figure shows simple unweighted averages over countries. China enters the index in 1984. Russia and other former Soviet states enter in 1996.

Global finance, the market, and the state after Bretton Woods

Floating exchange rates were a sharp departure from the original Bretton Woods vision, but the dismantling of its "embedded liberalism" was due primarily to another factor: the progressive removal of restrictions on financial activity, particularly international financial activity. Figure 4 displays the evolution of a well-known measure of *de jure* openness to international capital mobility, taken from Chinn and Ito (2006). From the mid-1970s, the industrial countries' financial openness rose markedly, accelerating in the early 1990s and reaching a peak approximating maximal openness by the start of the millennium. Lower and middle-income countries begin to open their financial accounts around 1990. To date their opening falls far short of what the richer economies have chosen.

Freed of the need to defend fixed dollar exchange rates using their monetary tools, countries could in principle deploy monetary policy in pursuit of domestic price and employment objectives. Their ability to do so resolved Keynes's policy dilemma, even for countries that were highly financially interdependent with the rest of the world. But this does not explain why countries would *choose* to open their financial markets to global forces (Obstfeld and Taylor 2017). The process of financial liberalization was complex and gradual, involving the interplay of domestic and cross-border relaxation. It reflected a confluence of government objectives, changing global economic conditions, financial innovation, and the lobbying power of domestic financial interests (Helleiner 1994). In turn, the latter became richer and therefore gained political influence with each successive victory, in a snowballing process. By the 2000s, advanced economies had become extensively financialized in an environment of weak financial oversight (Krippner 2011), with momentous negative consequences. Compared with the vison of Keynes and other participants at Bretton Woods, this outcome represented a marked shift in the primacy of state power in the arrangement of states, markets, and civil society.

One irony of this process is its background in initiatives pursued by America and Britain, the same partners who in 1944 chose to make embedded liberalism the foundation of Bretton Woods. Hoping to regain some of the past financial glory of London, the UK government (already from the 1950s) promoted the London Eurodollar market as an offshore playground for global finance, finally starting in 1979 to pull down any boundaries between the City and the domestic financial system. In the early 1970s, the United States favored financial liberalization both to cement its own standing as a financial center and in the belief that relaxing outflow controls would further weaken the dollar, benefiting US exports. By the latter 1980s, the European Community, pursuing internal financial integration (and with the support of Britain, now a member), hopped on board the train.[32]

Ideology played a role in these developments, as well as in broader changes in economic policy. Again, the Anglo-American axis dominated the changing orientation of economic policymaking.[33,34] Neoliberal economists associated with the University of Chicago school (including George Shultz at Treasury and external advisers such as Milton Friedman) played

[32] Accounts of the political dynamics driving financial liberalization include, along with Helleiner (1994), Abdelal (2009) and Obstfeld (2021).

[33] See Fourcade (2009) on the recent Anglo-American dominance of professional economics. It is worth noting that strong elements in neoliberal thinking originated in continental European centers, notably Vienna, Geneva, and Freiburg (Slobodian 2018). Many of the continental scholars, including economists like Hayek, Mises, Haberler, Bonn, and Schumpeter, worked closely with Britons and Americans in the EFO of the League of Nations, connections that helped them flee Europe for the United States after the rise of Nazism (Clavin 2013). This history reinforced their connections to and influence on the Anglo-American scene. Of course, Swedish economists also played an outsized role both in theoretical and policy discussions before World War II (see the chapter by Carlson and Jonung). It is not just the debate between Keynes and Ohlin (who also worked at the League) that shows their influence. Also relevant are Cassel's critique of the gold standard, the Heckscher-Ohlin trade theory (which illuminates the redistributive effects of trade globalization), and Wicksell's work on monetary economics and inflation (which remains fundamental to modern central bank operations). The Freiburg school birthed ordoliberalism, which retains influence in Germany and helped to shape the design of the euro and the policy approaches of euro area policymakers.

[34] In his chapter, Clarke highlights that even in 1919, Wilson and Lloyd George approached the Paris negotiations with a shared "liberal moralism."

important roles in the Nixon Administration. But as in 1919, the policy outcomes – such as price administration and tariffs – tended to reflect political imperatives rather than economic theories. Nevertheless, in academia, economic models based on the rational expectations and the efficient markets hypothesis dominated the professional literature and generated arguments against discretionary macroeconomic policy and financial regulation. By the time Ronald Reagan was elected US president in 1980 – after the economic shocks and inflation of the 1970s – these ideas had set the stage for a frontal effort to scale back the reach of government policy. The conservative agenda also sought to transfer resources to wealthier groups within American society based on the unproven claim of self-styled supply-side economists that this would jump-start economic growth, which in turn would "trickle down" to lower-income households.

The public discussion of changing economic paradigms was, if anything, more visible in Britain, where the press played an important role in promoting Friedman's doctrine of monetarism as a counterpoint to Keynesianism. In an important article in the *Daily Telegraph* in 1974, Friedrich von Hayek, a founder of neoliberalism in the 1930s who had just shared that year's Nobel memorial prize in economics, airily declared: "What we are experiencing are simply economic consequences, of Lord Keynes."[35] High inflation coupled with high unemployment, he said, were the product of two decades in which policies accommodated inflationary pressures while governments falsely assured voters that Keynesian tools could and should maintain high employment.[36] A pivotal point came in September 1976, when Labour Prime Minister James Callaghan, speaking at his party's annual conference, echoed Hayek, warning: "The cozy world we were told would go on forever, where full employment would be guaranteed by a stroke of the Chancellor's pen, cutting taxes, deficit spending – that world is gone." On the same day that Keynesian countercyclical policies were being questioned in Blackpool, Callaghan's government announced that it was applying for financial support from Keynes's creation, the IMF.[37] Less than three years later, running on pledges to control inflation, rein in labor unions, and address voters' concerns over immigration, Margaret Thatcher entered 10 Downing Street

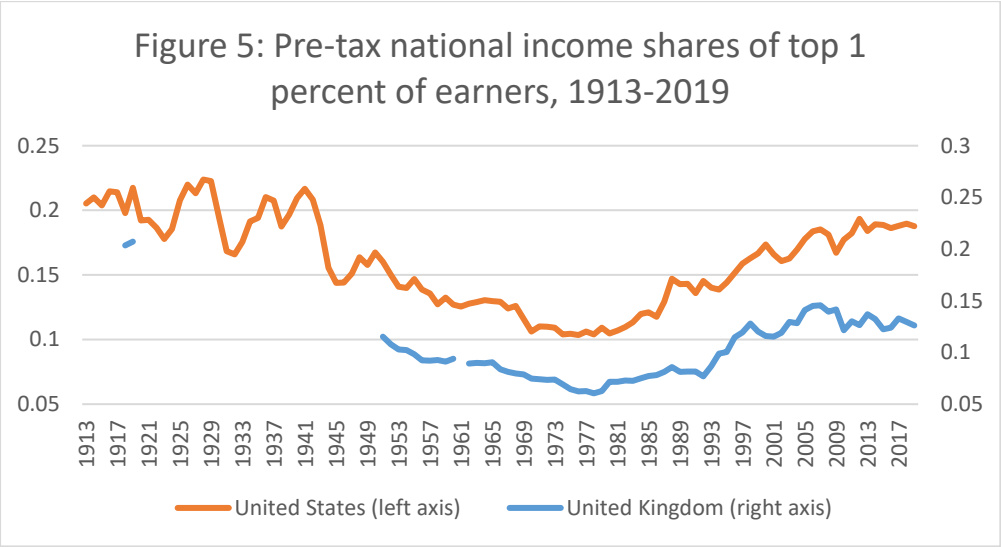
[35] Some early neoliberals, alarmed by the broader Keynesian project, had eagerly seized on flaws in the *Economic Consequences* as an ad hominem adjunct to their broader critique of Keynes's economics. For example, Rappard's (1946) blistering endorsement of Mantoux (1946) argues that Keynes was as much eloquent moralist as economist and adds the aside, "It is not in his *Economic Consequences* alone that the pen of Keynes has often persuaded where his brain has failed to convince." Rappard was not a disinterested reviewer. In 1927, he and the historian Paul Mantoux, Étienne Mantoux's father and Clemenceau's interpreter at the 1919 peace conference, joined forces to found the Graduate Institute of International Studies in Geneva. He was an ardent proponent of *laissez-faire*, including fully free trade, and delivered the opening address at the first meeting of the Mont Pèlerin society. Hayek organized the latter to build support for private free enterprise, and many distinguished economists participated—though not Viner, who thought people might view the group as "political" (Clavin 2013, p. 351). Some would argue that the neoliberal denial of a moral dimension in economics has intensely political implications, and in ways that have proved problematic for democratic societies (Brown 2019).

[36] The article is adapted for a US audience as Hayek (1974). For a modern retrospective on the inflation of the 1970s and its consequences, see Bordo and Orphanides (2013).

[37] For interesting background on this episode, see Sandbrook (2012, pp. 477-481). Journalist Peter Jay, the prime minister's son-in-law and an ardent proponent of monetarism at the *Times*, wrote the key portion of the speech repudiating deficit spending. Milton Friedman quoted it approvingly in his own Nobel acceptance speech in December 1976.

and administered monetarist medicine to the UK economy. Throughout these turbulent times, Keynes, now dead for three decades, remained a touchstone.[38]

Under the neoliberal approach promoted by both Thatcher and Reagan, the pendulum swung to an opposite extreme from the vision Keynes had accepted of government's proper role in the economy, based on its need to maintain a certain social contract. Later events would show that the pendulum had swung too far. In some ways, as the term "neoliberalism" suggested, this shift of the late 1970s was a purposeful return closer to pre-World War I economic liberalism. As Thatcher famously remarked in 1987, "[W]ho is society? There is no such thing! There are individual men and women and there are families and no government can do anything except through people and people look to themselves first."



Source: World Inequality Database. URL: https://wid.world/data/, accessed September 22, 2021.

Figure 5 shows one of several possible measures of income inequality for the United States and United Kingdom, the pre-tax income share of the top 1 percent in the national income distribution. For both countries, this measure of inequality reaches its low point around the mid-1970s, having fallen from levels around 20 percent around 1919. A striking reversal begins, however, around 1980, with the US measure approaching levels that prevailed before World War I and in the interwar period. The sharp rise in inequality starts with the specific polices Reagan and Thatcher adopted with respect to taxation, regulation, and

[38] Harry G. Johnson, professor at the LSE and Chicago (where he was a colleague of Friedman and Mundell) offered a candid and perceptive analysis of the growing academic influence of monetarism, even before its broader acceptance as a basis for economic policy. In Johnson (1971, p. 13), he reached the prescient judgment that "[monetarism's] success is likely to be transitory, precisely because it has relied on the same mechanisms of intellectual conquest as the [Keynesian] revolution itself, but has been forced by the nature of the case to choose a less important political issue – inflation – to stand on than the unemployment that provided the Keynesian revolution with its political talking point …." (One spectacularly wrong judgment of Johnson's was to dismiss imperfect competition in economic theorizing. Although dormant when he wrote, imperfect competition now underlies wide swaths of economics, including growth theory, the analysis of income inequality, the theory of international trade – and the New Keynesian approach to macroeconomics.)

workers' rights. But these and subsequent structural policy changes also presented an environment in which the rich were much better positioned to profit from trends in globalization, technological change, and financialization.

Around the same time Thatcher and Reagan came to power, a far-reaching economic regime change was taking place elsewhere: in China. Following Deng Xiaoping's December 1978 speech to the Chinese Communist Party (CCP) central committee, China embarked on a multi-decade program of pro-market reforms, starting with agricultural reforms, encouragement of private entrepreneurship, and some openness to foreign direct investment. Nixon's Sino diplomacy culminated in the formal establishment of diplomatic relations with the United States on January 1, 1979. In the years that followed, China's standard of living improved markedly. Its economy became more sophisticated, export levels surged, and it grew more economically interdependent with higher income countries. China's growth, along with that of the many developing countries whose economic reforms started about a decade later, would have important impacts on the nature and distribution of production abroad, as well on international and intranational distributions of income.

The Cold War's end and aftermath

Indeed, the years around 1990 were a key hinge point, and not just because numerous emerging markets, including China and India, embarked on economic reforms and trade opening. On November 9, 1989, perhaps the most potent symbol of the Cold War and the longstanding division of Germany, the Berlin Wall, fell to popular protest. Over the next two years the Soviet grip on Eastern Europe melted away, with the Soviet Union itself breaking up and repudiating the political monopoly of the Communist Party in 1991. Europe fortunately was spared violent repression on the model of the CCP's Tiananmen actions, which ensured that there would be no comparable political opening in China.

In April 1990 the European Council (the grouping of the European Community's heads of state or government) approved rapid unification of the two Germanies, a decision supported by French President Mitterand after German Chancellor Kohl promised strongly to support ambitious European economic unification. That promise led to the Maastricht Treaty of 1992, which set out the roadmap toward a common currency, the euro, and transformed the European Community into the European Union.[39] Keynes would have understood Mitterand's strategy well: in the *Economic Consequences,* he stressed the need to embed Germany in a broad trade partnership of equals in order to avoid fears of the country "realising the former German dream of Mittel-Europa" (Keynes 1919, p. 250). In July 1990, Germany and the USSR agreed on Germany's reunification within the existing borders of the East and West (including a unified Berlin) and on the formal end of the country's 45-year occupation by the four World War II allies.[40] Eastern Europe and eventually the former Soviet Union began a process of

[39] Sarotte (2011, pp. 145-148).

[40] In an ironic echo of reparations, Germany had to pay the Soviets to get them to leave – DM 3 billion in the form of an interest-free loan and DM 12 billion as a grant, ostensibly to build housing in the USSR for returning

transition to market allocation, economic integration, and in many cases, democratic governance.

By the early 1990s, these developments led many to conclude that the capitalist system had triumphed; some asserted the world had reached the end of *economic* history. But the *form* of capitalism that prevailed in advanced economies, even in Europe to a degree, was far from the embedded liberalism Keynes had espoused. It was a global capitalism dominated by the political legacy of Reagan and Thatcher, which pushed even leaders of nominally left-wing parties to "triangulate" toward the right during the 1990s. Not only did this form of capitalism harbor inherent financial instabilities, as shown by the increasing frequency and severity of economic crises: turbulence was an innate feature. In retrospect, it also became clear how ill equipped this form of capitalism was to meet the labor-market challenges of skill-biased technical change and a surge of developing-country exports. Both of those forces played out as the entry of newly freed and reformed economies into global trade effectively doubled the world's supply of low-skilled labor. In the United States, the populist electoral appeals of Patrick Buchanan and H. Ross Perot were leading indicators of developments that propelled Donald Trump to the White House twenty-five years later.

Nineteen eighty-nine, like 1919 seven decades earlier, appeared to offer the opportunity for systematic transformation in Europe. The events of that year created a single Germany as well as several nations, nascent at the Paris Peace Conference but absorbed by Stalin into a Soviet eastern bloc after 1945. An especially consequential recasting took the form of extending the NATO Alliance and the EU eastward. As Sarotte (2011, p. 201) insightfully observes of American and European policymakers, "Rather than bringing an end to the history that had culminated in the Cold War, they had perpetuated key parts of it instead." The ramifications included later east-to-west migration pressures within Europe, the rapid absorption of young and (as it turned out) fragile democracies into an EU that required unanimity for key decisions, and a toxic Russian suspicion of the expanded western alliance now extended to its very borders.[41]

Despite high hopes in 1989, subsequent history would show that the dissolution of the Soviet empire, like that of the Habsburg and Ottoman empires earlier, could revive "the ancient conflicts now inherent in the tangled structure of Europe …." (Keynes 1922, p. 13). Moreover, even the merger of the two parts of Germany has not resulted in full economic convergence. Its political and economic legacy has made the former East Germany an epicenter of right-wing extremism. Subsequent decades would show that economic history did *not* end in the years 1989-1991, and that there would be no clean break from the drawn-out sequel to World War I and the Peace of Versailles. Turbulence, driven in part by new challenges, continued.

Soviet troops (Sarotte 2011, pp. 192-193). This sum was important, especially in view of the impending cost of absorbing East Germany.

[41] The ever-perceptive George Kennan predicted NATO expansion would be "the most fateful error of American policy in the entire post-Cold War era" (Kennan 1997).

Keynes and the world a century after 1919

Little over a century since Keynes wrote *The Economic Consequences of the Peace*, the world confronts existential problems raised by a century of rapid global growth. Because those problems are solvable only by national governments working in concert, the moment is perilous indeed. The multilateral institutions that a hegemonic United States sponsored after World War II remain important, but they have so far proven unequal to the immense challenges at hand. Meanwhile, politics in many places are increasingly polarizing, driven by a toxic informational ecosystem.

As in 1919, the world remains in the grip of a contagious virus, this time SARS-CoV-2 rather than H1N1, which has killed millions and will kill many more, in large part due to the failure of governments to cooperate. The immediate stresses of economic re-opening after COVID-19 are somewhat like those of realigning a wartime economy. The current pandemic raises a larger issue, though: How can the community of nations strengthen cross-border modes of public health cooperation to forestall or manage future pathogenic outbreaks? Increasing human encroachment on nature makes future pandemics and their associated economic shocks inevitable.

Even more dangerous than pandemic disease is the closely related crisis of anthropogenic climate change. Its aspects range from extreme weather events to polar melting to ocean acidification to collapsing biodiversity. Humankind is testing the planetary boundaries within which it evolved, with likely disastrous results (Rockström et al. 2009). Yet there is no agreed approach on how to change course.

The settlement of 1919 did not result in a sustainable solution to the problems left by the war. Consistent with Keynes's fears, the world slid into depression, political instability, and a new global war, despite the attempt at Versailles to re-establish international relations based on a visionary multilateral construct, the League of Nations. A resemblance between today's conditions and those of 1919 therefore bodes ill for unified global action to address humanity's most pressing challenges.

In one echo of 1919, the preponderance of US power and influence that existed in 1945 has been superseded by a world in which the United States and China will increasingly vie for global primacy in ways that unsettle established relations regionally – as in Europe and the Pacific – and globally. Moreover, the inward "America First" shift of the Trump administration garnered considerable domestic political support, and will be reversed partially, slowly, and perhaps only temporarily by President Biden. These changes underscore the world's multipolar configuration. They recall the interwar position of the United States, coexisting with European empires and an ambitious Japan, but neither being a global hegemon nor aspiring to a hegemonic role.

As in 1919, nationalism continues to rise, mobilized to support authoritarianism in Eastern Europe, Russia, India, Brazil, Turkey, and elsewhere. It underpinned Brexit in the United Kingdom and has continued to motivate the Johnson government's norm bending, both domestically and with respect to its withdrawal treaty with the EU. In the United States, a domestic nationalist movement has outlived the Trump presidency and only grown more

visible since, driven by new sources of grievance and increasingly anti-democratic inclinations.

Consistent with this geopolitical configuration, multilateralism remains under stress. Many of the global multilateral institutions, however useful their potential roles may be, now lie in the cross hairs of conflicts among major states. The United States has stopped threatening to withdraw from institutions it helped create, as during the Trump years. For now. But despite the need for cooperation to address global health and climate, as well as areas like trade, multilateral institutions and initiatives remain peripheral to the larger countries' main policy concerns.

Finally, the operations of the capitalist system are being vigorously questioned, as they were after 1918. Then, socialist ideas were still gaining traction and Russia was engaged in the first experiment of socialist rule. In Europe – it not in its overseas empires – a widespread extension of the franchise was underway. The labor movement was gaining political power, a trend harder for business interests to resist after wartime sacrifices. This history begs a critical, open question before the world today: Can capitalism be reshaped in an orderly way through established political processes within nations, without damaging the necessary cooperation *between* nations?

The roots of the current malaise are complex. In essence, they all relate to the turbulence generated by economic, technological, demographic, and cultural interdependence in a globalized environment that lacks adequate social guardrails. As Ikenberry (2020, p. 6) puts it, the liberal internationalist system that superseded embedded liberalism and that reached its full extent after the Cold War, "effectively overran its political foundations and undermined its social purposes."

Punctuating recent decades are key events that accelerated the emerging political impasse. Perhaps the most important was the Global Financial Crisis of 2008-2009, a direct outgrowth of the deregulation and globalization of finance. Apart from causing widespread economic misery, the crisis undermined further people's faith in government and in the economy's fairness, at the same time increasing skepticism of financial and economic expertise (Tooze 2018). The euro zone crisis which followed immediately, and advanced economies' drawn out recovery, led to further voter disaffection. Prior economic thinking was also challenged, particularly neoliberal notions that markets (including financial markets) function best without intervention, and that households and firms have sophisticated expectations of the future. In the crises of 2008-2012, Keynesian economic assumptions and policy prescriptions proved their relevance, as they did again during the later COVID-19 crisis.

The 9/11 attack on the United States in 2001 and the events that followed were, likewise, key elements on the road to the current polarization. The attack and its aftermath raised people's sense of vulnerability to global forces. At the same time, it undermined their faith in governments' ability to protect them. As Richard Haass has put it, "[W]e can now see that 9/11 was a harbinger of what was to come: less the globalization of terrorism than the terrors of globalization" (Haass 2021). The Iraq war, launched under an unfounded pretext, sapped faith in political leaders in much the same way as the Vietnam War had a generation earlier. The same was true of the failed two-decades-long efforts to create stable functional

democracies in Afghanistan and Iraq. The effects have been particularly corrosive in the United States and United Kingdom, where the Bush-Blair partnership to promote the Iraq war represents yet another instance of the "special relationship" gone awry. Throughout the West, the 9/11 attack and its *sequelae* have shaped attitudes toward Muslim citizens and immigrants in politically destabilizing directions.

Missed opportunities have had devastating effects. In 2003, the international community contained the virus now known as SARS-CoV-1, but not without public WHO criticism of China's initial secretiveness about the outbreak's early stages. That criticism and China's reaction ultimately helped countries to stop the disease with only 8,098 infections and 774 deaths worldwide. In 2005, aware of the near miss, the WHO's World Health Assembly voted unanimously to strengthen its International Health Regulations, but these enhancements clearly proved inadequate in 2020. Additionally, after 2003 there was no publicly-funded push to develop a SARS-CoV-1 vaccine, which might have allowed an even faster vaccine response to SARS-CoV-2.

Were Keynes here today, he would certainly recommend a reformed capitalism, believing reform and redistribution would go some way to heal our political climate. In 1926, he wrote in the prematurely titled *The End of Laissez-Faire* (Keynes 1926, pp. 52-53):

> I think that Capitalism, wisely managed, can probably be made more efficient for attaining economic ends than any alternative system yet in sight, but that in itself it is in many ways extremely objectionable. Our problem is to work out a social organisation which shall be as efficient as possible without offending our notions of a satisfactory way of life.

Keynes issued this relatively mild verdict in ignorance of the future ravages of the Great Depression, World War II, and the Cold War. Had he seen them, and observed the accelerating democratic recession in progress today even in America and Britain, he might well agree with Judt (2010) that without again reconceiving government's role in the economy, "The choice will no longer be between the state and the market, but between two sorts of state."[42]

Keynes would no doubt challenge policymakers to think big on climate. As he said in a 1942 BBC address:

> Anything we can actually do we can afford. Once done, it is there. Nothing can take it from us. We are immeasurably richer than our predecessors.

Noting how much wealthier we are now than in 1942, he would be astounded to see governments disregard the economic prospects of citizens' children and grandchildren by hesitating to take vigorous action to save the planet. He would denounce the tragedy of the commons inherent in each country's unwillingness to act with sufficient purpose, and would seek to solve it through a public investment compact involving all major greenhouse gas

[42] The term "democratic recession" is from Diamond (2015); the recession is threatening to become a depression.

emitters. But Keynes would also recognize that the burden of climate policy would fall disproportionately on lower income groups, thereby creating a political backlash with attendant political risks for everyone. He would urge governments to offset these losses by some combination of taxes on the rich and borrowing, borrowing justified by the benefits of "green" investments for future generations.

Finally, Keynes would have been shocked at the discrepancy between the rapid speed of COVID-19 vaccine development and the uneven pace of vaccine distribution throughout the global population. Keynes himself may have come close to death in 1919 during the last global pandemic, when influenza vaccines were still years away. He would have challenged rich countries to invest the relatively small amounts of money needed to produce and distribute vaccines for the entire world. He would surely argue, as vigorously as he railed against the self-interestedness of reparations, that globally coordinated vaccine production and comprehensive distribution would benefit vaccine donors as much as recipients. He would no doubt urge every effort to build stronger international surveillance mechanisms against future emergent threats – a function that neither the private sector nor one government can perform on its own, but which benefits all.

A final passage from the *Economic Consequences* makes this point more generally, and expresses the hopefulness that motivated Keynes's consequential efforts throughout his life (Keynes 1919, p. 251):

> Even though the result disappoint us, must we not base our actions on better expectations, and believe that the prosperity and happiness of one country promotes that of others, that the solidarity of man is not a fiction, and that nations can still afford to treat other nations as fellow creatures?

This may be the key lesson for our time of *The Economic Consequences of the Peace*.

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