COPING WITH COMPLEXITY.
KEYNES AND INTERNATIONAL ECONOMIC RELATIONS
IN THE AFTERMATH OF WWI

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Abstract

In the attempt to deepen the understanding of Keynes's thought as an international macroeconomist, we explore the hypothesis of consistency between his general methodological approach to the economic material and his way of reasoning about international economic relations as shaped by WWI. We argue that the methodology of *The Economic Consequences of the Peace* reflects Keynes's attempt to cope with the attributes of the complexity characterizing the European settlement for the post-war period, and particularly 1) organic interdependence among variables at play, 2) irreducible dilemmas and situations of conflict, as well as 3) the need for external, public assistance to overcome the impasse and promote a "shared responsibilities" approach to the imbalances. Striking similarities appearing with the method of Keynes's economic diplomacy in the Forties call for further research in this sense.

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1. Introduction

The 1997 Asian crisis, the failure of the Washington Consensus, and the surge of global imbalances are arguably the three main reasons lying behind the tendency to rediscover Keynes's work as an international economist. While previous analyses of the faults of the "non-system" which replaced the Bretton Woods regime seemed to confirm the "end of the Keynesian era" (Skidelsky, 1977), the early cracks of the integrationist agenda of the Nineties and the difficulties of coping with its legacy in terms of global imbalances have brought about a renewed interest in Keynes's thought. The rediscovery of both the "embedded liberalism" of Bretton Woods and Keynes's proposals for a better ordering of international economic relations after WWII understandably occurs at the end of a trial which sees Williamson's paradigm accused of providing *the* tool itself for the integrationist agenda (see Cedrini, 2008a). More surprising, perhaps, are suggestions of international monetary reform by Greenwald and Stiglitz (2006), among others, agreeing with Post-Keynesian economists' analyses (see Davidson, 2002) on the need to rescue the systemic character of Keynes's schemes for a "sounder political economy between all nations" (CW XXV, p.43).

The comparison between today's nonsystem and the successful experience of Bretton Woods, or even the pre-war gold standard and its "socially-constructed monetary agreement that included a simple set of rules around which core lenders and borrowers could build expectations of a stable future" (Unctad, 2004, p.92), may provide good reasons to give a second look at Keynes's thinking about globalization. But revisiting Keynes means approaching a well-defined vision of international economic relations, as shown by David Vines' (2003) review of Skidelsky's *Fighting for Britain* (2000); "a vision of global capitalism as an *inter*-national system" (Vines, 2003, p.357), deriving from "an extraordinarily clear understanding of how pieces of global economy interact, driven by the policies of autonomous nations, in an only partly coherent manner" (ibid, p.339). At the end of his essay, Vines invites to rethink the content of Keynes's "international macroeconomics", but above all his contributions on "focus and method" (ibid, p.358). Unlike modern microeconomic models of international interaction, Vines remarks, Keynes's vision was anti-utilitarian and fully aware of the impossibility of understanding international relations solely by means of rational action theory.

The most remarkable example offered to demonstrate, against Skidelsky, that Keynes must be rescued for, rather than from the economists is Vines's lecture of Keynes's 1945 memorandum *Overseas Financial Policy in Stage III* as a threefold model of international adjustment. The well-known mutually exclusive alternatives outlined by Keynes for Britain's transition to the new order – the *Starvation Corner* and its policies of austerity and isolationism, the *Temptation* to canalize Britain's Sterling debts into a single US loan, in exchange for the acceptance of the American conception of the international system, and *Justice*, i.e. a plan for sharing the war burden between Britain, the US and the Sterling Area – are shown to provide a much useful theoretical framework for the ongoing debate about the ways out from the 1997 East Asian crisis. Likewise, the three options may serve as a powerful theoretical guide to avoid getting lost in the extremely complicated picture of competing views about the insurgence of current global imbalances and organize them according to the unilateral, bilateral or multilateral character of the adjustment they propose (Carabelli and Cedrini, 2007).

That Keynes's model does not seem to lose validity despite the time elapsed may owe really much to the "focus and method" of his work. We explore the hypothesis of consistency between, on the one side, Keynes's conception and practice of economics, which qualifies him as a thinker of complexity (Marchionatti, 2002), and the "method", i.e. the way of reasoning in economics (Carabelli, 1988) underlying his approach to the complexity of international economic relations. The focus is on *The Economic Consequences of the Peace* and Keynes's economic diplomacy in the aftermath of WWI. We argue that both his criticisms of the Treaty of Versailles and the multilateral approach he envisaged for the settlement of international imbalances brought about or consolidated by the war were shaped by the use of a method reflecting the characteristics of the complex material he had to investigate on. A method, in other words, enabling Keynes to tackle organic interdependence among the variables of the European system without theoretically reducing its complexity.

Three major attributes of Keynes's notion of complexity (see Carabelli and De Vecchi, 2000) are here inquired into detail: i) organic interdependence, which underlies the whole analysis developed in Keynes's pamphlet; ii) "tragic" dilemmas and fallacies of composition between particular and general interests, and iii) the need for "public" or social – that is, beyond the reach of the individual – solutions to be provided from external sources of relief but conceived, at the same time, as mechanisms to promote "shared responsibilities" approaches to international imbalances. Methodological coherence between Keynes's reform plans in 1919 and those of the Forties may allow to explain the rationale of the most controversial episode of Keynes's diplomacy, i.e. his call for an American Gift to Britain in 1945, and induce to reappraise Skidelsky's (2000) "fighting for Britain" view of Keynes's work after 1937.

2. Complexity and organic interdependence

Keynes regarded his *Indian Currency and Finance* as the attempt to bring out the fact that

> the Indian system is an exceedingly *coherent* one. Every part of the Indian system fits into some other part. It is impossible to say everything at once, and an author must needs sacrifice from time to time the complexity and interdependence of fact in the interest of the clearness of his exposition. But the complexity and the coherence of the system require the constant attention of anyone who would criticize its parts. This is not a peculiarity of Indian finance. It is the characteristic of all monetary problems (CW I, pp.181-82).

The notion of "complexity and interdependence" recurs frequently in Keynes's writings. As known, in his exchange with Roy Harrod concerning the latter's "Scope and Method in Economics", Keynes defined economics as a "moral science", "a branch of logic, a way of thinking ... in terms of models joined to the art of choosing models which are relevant to the contemporary world" (CW XIV, p.297). It is in the "nature of economic thinking", he had observed in the *General Theory*, that to cope with the complexity of the economy without abstracting from variability, "after we have reached a provisional conclusion by isolating the complicating factors one by one, we then have to go back on ourselves and allow, as well as we can, for the probable interactions of the factors among themselves" (CW VII, p.297). Accordingly, Keynes's methodological criticism of the classical theory was grounded on the tacit introduction of the "atomic hypothesis" and consequent failure to deal with organic interdependence (Carabelli, 1991).

The literature concerning the continuity between Keynes's methodological approach to probability and the way of reasoning about the economic material underlying his mature economic writings stresses the centrality, in Keynes's thought, of organic interdependence among economic variables (see Dow and Hillard, 1995). Similarities are shown to exist between the focusing of *A Treatise on Probability* on problems of measurement and comparison of magnitudes, which derive from probability being regarded as an organic, complex and incommensurable magnitude, and attempts made by Keynes to cope with manifold, multidimensional economic magnitudes and the uncertainty which is associated with them (Carabelli, 1988). In *A Treatise on Money*, Keynes refers to core economic magnitudes, like purchasing power, which "are complex or manifold in the sense that they are capable of variations of degree in more than one mutually incommensurable direction at the same time" (CW V, p.88). Heterogeneity in dimension, he later observed in the *General Theory* – "To say that net output is greater, but the price level lower, than ten years ago or one year ago, is a proposition of similar character to the statement that Queen Victoria was a better queen but not a happier woman than Queen Elizabeth" (CW VII, p.40) – prevents the comparison between two complex magnitudes. As Keynes pointed out in his 1926 *Essay on Edgeworth*, complexity combines with organic interdependence so that

> the atomic hypothesis which had worked so splendidly in physics breaks down in psychics. We are faced at every turn with the problem of organic unity, of discreteness, of discontinuity – the whole is not equal to the sum of the parts, comparison of quantity fails us, small changes produce large effects, the assumptions of a uniform and homogeneous continuum are not satisfied (CW X, p.262).

Still unexplored is the relevance of this methodological positions for understanding how Keynes came to construct his international macroeconomics and diplomacy. Yet, *The Economic Consequences of the Peace* is undeniably dominated by "complexity and interdependence" and may be described as an essay against the atomic hypothesis in international relations. Keynes's criticism of the "Treaty's [*of Versailles*] wisdom and expediency" was based on that it

> ignores the economic solidarity of Europe, and by aiming at the distruction of the economic life of Germany it threatens the health and prosperity of the Allies themselves (CW XVII, p.58).

Rather, it should have been a duty of the settlement to defend the "economic unity of Europe" – the first of the "main thesis of my book" (ibid, p.88) – by preserving the economic (and territorial) integrity of Germany, the heart of the European "body" (CW II, p.2), on which the unity was grounded. The structure itself of the book reinforces the view of European organic interdependence as the main focus of Keynes's work: the triptych Peace Conference-Treaty of Versailles-reparations is the centre of a wider framework linking "Europe before the War" with "Europe after the Treaty".

> Europe is solid with herself. France, Germany, Italy, Austria and Holland, Russia and Roumania and Poland, throb together, and their structure and civilization are essentially one. They flourished together, they have rocked together in a war, which we, in spite of our enormous contributions and sacrifices (like though in a less degree than America), economically stood outside, and they may fall together. In this lies the destructive significance of the Peace of Paris (ibid).

Disregarding Wilson's "Fourteen points" and their insistence on Germany's integrity as a precondition for the recovery of Europe, the Treaty had seriously impaired Germany's chance of restoring prosperity and strengthened a tendency toward international disequilibrium. Before the war, Keynes observed,

> [r]ound Germany as a central support the rest of the European economic system grouped itself, and on the prosperity and enterprise of Germany the prosperity of the rest of the Continent mainly depended. The increasing pace of Germany gave her neighbors an outlet for their products, in exchange for which the enterprise of the German merchant supplied them with their chief requirements at a low price (ibid, pp.9-10).

"The statistics of the economic interdependence of Germany and her neighbors are overwhelming" (ibid, p.10), he argued. Best customer of countries like Russia, Italy and Austria-Hungary, second best customer of Great Britain (after India) and third best customer of France, Germany was "the largest source of supply to Russia, Norway, Sweden, Denmark, Holland, Switzerland, Italy, Austria-Hungary, Roumania, and Bulgaria; and the second largest source of supply to Great Britain" (ibid) after the US, and to France. But Germany was a provider of capital and, what is more, organization, contributing to the development of East European countries. By showing on how "sandy and false" (ibid, p.1) foundations on which the European "economic Eldorado" (ibid, p.6) was based, namely a certain "psychology of society" (ibid, p.11) and a peculiar win-win "relation of the Old World to the New" (ibid, p.13), "war had so shaken this system as to endanger the life of Europe altogether" (ibid, p.15): it was the task of the Conference to settle Europe on new bases, but this required a careful consideration of those factors which superseded "the existing order of [*the European*] society" (ibid, p.23). The "Carthaginian peace" Party was too little aware of "the deeper economic tendencies which are to govern the future" (ibid, p.22).

Keynes's book was to remind politicians – especially Clemenceau (see CW II, pp.20-21) – and the public opinion that the European system was an organic world. The introduction of the atomic hypothesis for the convenience of a clear-cut settlement of Europe, masking the Allies' desire to impose on Germany the unworkable clauses of a highly punitive Treaty and the whole burden of the costs of the war, was destined to transform inter-European relations into a social conflict of the "lose-lose" kind, as shown in Chapters IV and V. The final articles of the Treaty and exhorbitant requests for reparations could but lead Germany to ruin, and Europe with it:

> The German economic system as it existed before the war depended on three main factors: I. Overseas commerce as represented by her mercantile marine, her colonies, her foreign investments, her exports, and the overseas connections of her merchants; II. The exploitation of her coal and iron and the industries built upon them; III. Her transport and tariff system. Of these the first, while not the least important, was certainly the most vulnerable. The Treaty aims at the systematic destruction of all three, but principally of the first two (ibid, p.41).

"We cannot both deprive Germany of her sources of wealth and also expect her to save on her pre-war standards for the purpose of paying a tribute", Keynes had commented (in Markwell, 2006, p.41) on 27 October 1916 while preparing the well-known memorandum he later signed with Ashley. Being aware, now, that by aiming at the destruction of Germany, the Allies were inviting their own destruction too (CW II, p.2), he tried to convince the world that "whatever the other merits or evils of the treaty, its real vice was its failure to treat Europe as an economic whole and to reconstruct it for the benefit of the common people. It was a treaty of strategy and national greediness – with the League of Nations thrown in to make it look pretty" (Martin, 1946).

3. The dilemmas and conflicts of an impending catastroph

Keynes's main concerns were for the Treaty's dispositions about German coal and iron. The former had been the key factor of industrial growth and, more specifically, of "organization" (CW II, p.9) in Central Europe and a symbol of the economic unity of the continent. The obligations to cede the Saar Basin to France and Upper Silesia to Poland and to compensate France for estimated losses incurred due to German war were accompanied by the requirement that part of the reparations – to France, Italy, Belgium and Luxemburg – should be paid in kind, i.e. in coal or coke. This was an unprecedented sanction for a defeated enemy, since

> Hitherto, a sum has been fixed, and the nation mulcted has been left free to devise and select for itself the means of payment. But in this case the payees can (for a certain period) not only demand a certain sum but specify the particular kind of property in which payment is to be effected. Thus the powers of the Reparation Commission [...] can be

> employed to destroy Germany's commercial and economic organization as well as to exact payment (ibid, p.49).

Germany was required to cede to the Allies 40,000,000 coal tons annually out of an estimated annual output reduced to 100,000,000 coal tons, so that only 60,000,000 would have been available for Germany's own use. It seemed obvious to Keynes that the country

> cannot export coal in the near future (and will even be dependent on her Treaty rights to purchase in Upper Silesia), if she is to continue as an industrial nation. Every million tons she is forced to export must be at the expense of closing down an industry (ibid, p.57).

The coal settlement was leading European policymakers into a "real dilemma" (ibid, p.58). Due to the "desperate" (ibid) European overall coal position, France and Italy would have done their best to secure their reparations in kind. Their case, Keynes conceded, was grounded on justice and possessed "unanswerable force from a certain point of view" (ibid), so that a conflict was bound to arise between different ethical claims which could scarcely be weighted one against the other – justice for the Allies, and the moral obligation of Wilson's Fourteen Points to a peace of magnanimity.

> The position will be truly represented as a question between German industry on the one side and French and Italian industry on the other. It may be admitted that the surrender of the coal will destroy German industry, but it may be equally true that its non-surrender will jeopardize French and Italian industry (ibid, pp.58-59).

"In such a case", he wondered, "must not the victors with their treaty rights prevail, especially when much of the damage has been ultimately due to the wicked acts of those who are now defeated?" (ibid, p.59). Nevertheless, Keynes remarked using concepts frequently recurring in modern theory of complexity, should the "unanswerable force" of French and Italian requests to Germany "prevail beyond what wisdom would recommend, the reactions on the social and economic life of Central Europe will be far too strong to be confined within their original limits" (ibid).

Much more alarming, the effects of the fallacy of composition between the conflicting, though legitimate, individual interests of the European countries would have likely resulted to the disadvantage of the whole continent. In case of surrender of German coal, Northern Europe and

Austria-Hungary, in particular, would have been deprived of their supplies, and the latter brought to ruin. Germany's neutral neighbours should have necessarily recurred to "international barter" (ibid), i.e. to exchange German coal against materials which Germany rightly regarded as essential to its development or even survival. This was "an extraordinary complication as compared with the former almost perfect simplicity of international trade" (ibid, p.60), Keynes wrote twenty years before his heretic statements about Schachtianism, but it "may produce the coal where other devices would fail" (ibid). Still, France and Italy could not have tolerated Germany resorting to international barter to buy vital imports against its coal unless treaty obligations were met first.

> In this there will be a great show of justice, and it will be difficult to weigh against such claims the possible facts that, while German miners will work for butter, there is no available means of compelling them to get coal, the sale of which will bring in nothing, and that if Germany has no coal to send to her neighbors she may fail to secure imports essential to her economic existence (ibid).

But then, with France and Italy allowed to secure their shares of German coal, and the rest of Europe contented with what is left,

> the industrial future of Europe is black and the prospects of revolution very good. It is a case where particular interests and particular claims, however well founded in sentiment or in justice, must yield to sovereign expediency (ibid).

The repeated use in Keynes's pamphlet of the term "dilemma", all the more so in a situation, in his own words, of "impending catastrophe" with "all the elements of ancient tragedy" (ibid, p.3), is not to be overlooked. The existence of a plurality of moral ends and values moving into opposite directions and yet all of them making claims upon the decision-makers, which engenders the possibility of an irreducible clash between them, is typical of ancient Greek tragedy and classical dramas. As shown by Carabelli (1998), Keynes's early writings are disseminated with references to Greek tragedy, which shaped his tragic view of ethics and aesthetics and stimulated his interest in moral and rational dilemmas. Dilemmas quite obviously concern Keynes's treatment of probability as the hypothesis upon which it is reasonable to act and a guide of life. But they enter the realm of economics as well, since they are based on those same incommensurability and non-comparability of moral or rational reasons for action which characterize situations of radical uncertainty (Carabelli and De Vecchi, 2000).

A moral conflict for the European body charged with the settlement of the continent (the Four and the Commission of Reparations), the coal settlement assumes the forms of a rational dilemma, arising from conflicting reasons for decision, for France and Italy, who are bound to recognize that

> If the European Civil War is to end with France and Italy abusing their momentary victorious power to destroy Germany and Austria-Hungary now prostrate, they invite their own destruction also, being so deeply and inextricably intertwined with their victims by hidden psychic and economic bonds (CW II, p.2).

At a more general level, Keynes concluded, nationalism and "private interest" (ibid, p.60) were to impose new "economic frontier[*s*]" – which nonetheless "sentiment and historic justice require" (ibid) – destined to diminish economic efficiency and organization to the detriment of the general needs of the continent. Due to the logic of interdependence which dominated European economic relations, competing "particular interests and particular claims" (ibid) were at the origins of a conflict between individual and social interest, which Keynes pictured in metaphorical language:

> men have devised ways to impoverish themselves and one another and prefer collective animosities to individual happiness (ibid, p.62).

In Keynes's thought, conflicts of this kind are brought about by individual initiatives which – as in the case of the paradox of savings of the *Treatise on Money* – "if taken by an individual [...] would benefit him, but do not benefit anybody if they become shared, that is if everybody adopts them" (Carabelli and De Vecchi, 2000, pp.231-232). Due to uncertainty and ignorance, individuals are induced to shape conventional rather than reasonable expectations, so that, as Keynes made clear in *The End of Laissez-Faire*, "it may even be to the interest of individuals to aggravate the disease" (CW IX, pp.290-91) to their own disadvantage. The same for Germany's creditors, who were confronted with the possibility of sacrificing their future individual happiness on the altar of collective animosities, however profitable –

economically and politically – it could appear to them in the short term. Rather, only apparently a paradox, to extract a larger volume of reparations the Allies should have

> "nurse[d]" the trade and industry of Germany for a period of five or ten years, supplying her with large loans, and with ample shipping, food, and raw materials during that period, building up markets for her, and deliberately applying all their resources and goodwill to making her the greatest industrial nation in Europe, if not in the world (CW II, p.128),

As known, reparations had not been established on the basis of Germany's capacity to pay. This was the criterion Keynes and Asquith adopted in their 1916 memorandum on the issue while discussing the extent of the analogy between WWI reparations and the indemnities paid by France to Germany after the former's defeat in the 1870 conflict. Due to starvation and war debts, currency depreciation and the loss of colonies, overseas investments, mercantile marine, territories, population, coal and iron, Germany's annual savings at the end of the conflict were strongly reduced with respect to their pre-war volume. Uncertainty reigned as regards the possibility – which only a sensible lowering of the standard of life could secure – to convert a surplus available for home investments into a surplus available for exports. Germany would have not attained, for a long time being, her pre-war capacity to pay an annual foreign tribute. And yet, against this evidence, a tacit assumption had been introduced to justify Europeans claims:

> most estimates of a great indemnity from Germany depend on the assumption that she is in a position to conduct in the future a vastly greater trade than ever she has had in the past (ibid, p.84).

The analysis of the pre-war trade balance suggested that Germany should rather adjust consumption and production to cover a likely post-war deficit: raw materials and food accounted for two thirds of total imports, whose shrinking would have led to further difficulties in stimulating the production of manufactures to be sold in foreign markets. Above all, rising exports were prevented by the Treaty clauses (in the case of coal), by the incapability to expand trade of goods produced in small aggregates (cotton and wool) and by the Allies' fears lest Germany could launch a competitive struggle on international markets against their own interests. To obtain repayment, Britain should have favoured

Germany competitiveness in exchange for fifteen per cent of the reparations only. Yet, Lloyd George knew that being the first and the most resolute to proclaim the need to punish Germany was an indispensable asset in the general election of 1918, and acted accordingly. Therefore, the Treaty's dispositions about reparations turned out to be a "compromise between the Prime Minister's pledge to the British electorate to claim the entire costs of the war and the pledge to the contrary which the Allies had given to Germany at the armistice" (ibid, pp.99-99). The hopes nurtured by Lloyd George had in fact

> set him at variance with the [*US*] President, and on the other hand with competing interests to those of France and Belgium. The clearer it became that but little could be expected from Germany, the more necessary it was to exercise patriotic greed and "sacred egotism" and snatch the bone from the juster claims and greater need of France or the well-founded expectations of Belgium (ibid, p.92).

Two different kinds of "false statement" (ibid, p.99), one relative to the enemy's capacity to pay and the other to justice for the Allies, prevented the possibility to determine an exact amount of reparations. "The fixing of either of these figures presented a dilemma" (ibid, pp.99-100), wrote Keynes:

> A figure for Germany's prospective capacity to pay, not too much in excess of the estimates of most candid and well-informed authorities, would have fallen hopelessly far short of popular expectations both in England and in France. On the other hand, a definitive figure for damage done which would not disastrously disappoint the expectations which had been raised in France and Belgium might have been incapable of substantiation under challenge, and open to damaging criticism on the part of the Germans, who were believed to have been prudent enough to accumulate considerable evidence as to the extent of their own misdoings (ibid, p.100).

Uncertainty about the amount of reparations to be imposed on Germany was thus functional to the short-term individual interests of the parts involved, but its burden of negative consequences on the future of Europe could not be underestimated. Unsurprisingly, chapter VI of *The Economic Consequences of the Peace* was

> one of pessimism. The Treaty includes no provisions for the economic rehabilitation of Europe,—nothing to make the defeated Central Empires into good neighbors, nothing to stabilize 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 (ibid).

Europe should remedy, in the immediate future, a reduction in internal productivity and a great limitation of its ability to import supplies from overseas. Lowered coal production was obviously a matter of serious concern, “[b]ut even when coal can be got and grain harvested, the breakdown of the European railway system prevents their carriage; and even when goods can be manufactured, the breakdown of the European currency system prevents their sale” (ibid, p.147). Keynes devoted considerable attention to “the breakdown of transport and exchange by means of which its products could be conveyed where they were most wanted” (ibid, p.146), and believed that the currency problem could irreparably break the links of the economic unity of the continent. Persistent generalized inflation during and after the war had brought a serious attack against “confidence in the equity of the existing distribution of wealth” (ibid, p.149) and disordered the relationships between debtors and creditors.

A confirm that the pre-war order was definitely over could be traced in the effects of uncertainty about European currencies’ values on domestic and foreign trade. The much required price regulation inevitably impeded the working of the normal adjustment mechanism between domestic and foreign prices, so that essential goods should be imported or provided by the government, “which, in re-selling the goods below cost price, plunges thereby a little further into insolvency” (ibid, p.152). Uncertainty about the mark’s future value makes the purchase with foreign credit of raw materials or manufactured a “hazardous enterprise” (ibid, p.153), while the gap between domestic and external prices and reduced individual credit abroad were dramatically impairing Germany’s chance of raising its import trade to the level required by reconstruction. France and Italy were equally unprepared for the return to normal economic conditions: the former should find means of covering the excess of imports over exports, hitherto financed through Britain’s assistance, while the latter was faced with the collapse of Austria, historically a relevant market for its exports, and the effects of raising world prices on its dependence on imported raw materials.

The budgetary positions of the two countries, as well as of the other belligerants, was desperate; Russia, Hungary and Austria "were the signal to us of how in the final catastrophe the malady of the body passes over into malady of the mind" (ibid, p.158). Keynes knew that economic interdependence, causing the European system to react more than proportionally to variations in the initial conditions, could but render the overall picture even darker. He described Europe after the Treaty as threatened by a "catastroph" (ibid, p.145) and compared it with those "catastrophs of past history which have thrown back human progress for centuries" (ibid, p.146), emerged as "the reactions following on the sudden termination, whether in the course of Nature or by the act of man, of temporarily favourable conditions which have permitted the growth of population beyond what could be provided for when the favourable conditions were at an end" (ibid).

4. The way out of the impasse

While searching for remedies, Keynes maintained that complexity was truly the crux of the problem, i.e. the element associating with and somewhat favouring the *impasse*, as seen, but also, not unexpectedly, the only way out of it:

> in so complex a phenomenon the prognostics do not all point one way; and we may make the error of expecting consequences to follow too swiftly and too inevitably from what perhaps are not *all* the relevant causes (ibid, p.160).

A revision of the Treaty and of the "wild and fantastic chimera" (CW XVI, p.336) of asking Germany to cover through reparations the whole sum of the Allied war (£24-25 million), was absolutely needed. Reparations should be limited to Germany's capacity to pay, namely £2 million, a quarter of which to be paid through merchant ships and submarine cables, war material, State properties in ceded territories and claims against the latter and Germany's Allies in respect of public debt; the remaining should be corresponded, with Germany free to choose the form of repayment, through thirty interest-free annual instalments beginning in 1923. A substantial relaxation of the coal clauses would have contributed to revive the country's hope for quick economic recovery. With the help of a Free Trade Union counteracting nationalism and the loss of organization and efficiency, European countries should have assisted Germany to regain prosperity, not least to the advantage of Southern and Eastern European countries.

> 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? (CW II, p.170)

"Such changes", however, "would not be enough by themselves" (ibid): the atomistic hypothesis recalled at the beginning of this analysis should be rejected for a second time being.

> In proposing a modification of the Reparation terms, I have considered them so far only in relation to Germany. But fairness requires that so great a reduction in the amount should be accompanied by a readjustment of its apportionment between the Allies themselves (ibid).

The key variable of Inter-Allied debts had been hitherto only tacitly introduced in the analysis to explain why Germany's creditors should insist on collective animosities against the general welfare, including their own. Due to Inter-Ally indebtedness – amounting at £5,000 million; "The United States is a lender only. The United Kingdom has lent about twice as much as she has borrowed. France has borrowed about three times as much as she has lent. The other Allies have been borrowers only" (ibid, p.172) –, France and the other claimants caught in the dilemma could not recede from asking *impossible* indemnities. Hence Keynes's proposal for an all-round cancellation of those debts. The idea was in the air, writes E. Johnson (CW XVI, p.418); but the plan was nonetheless typical of Keynes the insider, the Treasury man, "dominated by the irresistible urgency to realize grand schemes, by the instinct to hazard a solution which could suddenly light a dark sky like a brainwave" (Ferrari Bravo, 2002, p.9; our translation).

The proposal dates back to November 1918; it proved to be of the most longeve of Keynes's policy suggestions (see Markwell, 2006). Keynes asked his government – and initially against it, since Bonar Law had judged the plan as "too altruistic" (CW XVI, p.419) – to renounce its share of reparations in cash to the advantage of France, Belgium and Serbia. This way Britain would have fortified its position while calling for a revision of the Treaty and trying to stimulate American largesse (Elcock, 1975). Once the reparation problem settled as such, in fact, it would have been possible to make "an appeal to the generosity of the United States" (CW II, p.93), and an onerous one, since the US would have been the only country to lose real debts rather than "paper debts" like those corresponding to credits advanced to Russia during the war or to the impossible part of German reparations. The US would have surrendered £2,000 million approximately; Britain would have renounced to £900 million, while France would have gained £700 million and Italy £800 million, but Britain's loss and France's gain are inflated by Russian's paper debts.

Europe was entitled to ask for such concessions, Keynes maintained, since the financial sacrifices of the US had been comparatively lower with respect to those of the European states. Above all, the US "could better afford to make the sacrifice than Britain and the Allies" (Dimsdale, 1975, p.157). After condemning, in *The Economic Consequences of the Peace*, the US representatives at the Conference, "greatly at fault" for "having no constructive proposals whatever to offer to a suffering and distracted Europe" (CW II, p.94), Keynes compared the US and Britain's sacrifices during the war. He strategically omitted references to the deliberate "until the depletion of Britain's reserves" policy adopted by the American administration before assisting Britain and the role of "conduit pipe" (CW XVI, p.279) for US credits the Americans had imposed to London, and soonly recognized that the calculus of sacrifices could not "provide any compelling argument for Americans", but only show that in asking for debt forgiveness, "an Englishman is not seeking to avoid due sacrifice on his country's part" (CW II, p.175).

Academics dealing with Keynes the international negotiator have quite naturally insisted on his plea for American generosity as a fundamental element of his plans to construct a better international intercourse. Ferrari Bravo sees the attempt to "imbue the new hegemonic centre, the US, with the behaviour and ethics which pertain to the world creditor power" (1990, p.407, our translation) as the constant of Keynes's diplomacy. According to Markwell, "Keynes joined others in appealing – [...] in *The Economic Consequences* – for US leadership in the international action they prescribed" (2006, p.91); and he did so because he "clearly believed that interdependence required management, and that a 'leader' was a great asset (if not an essential one) in doing this" (Markwell, 1995, p.209). However, the interpretation here proposed of Keynes's pamphlet as an essay in complexity might throw further light on the rationale of this appeal, which rests rests on interventions by actors lying outside the borders of the European conflict. This is obvious, in the case of America; more surprising as concerns Britain. True, Lloyd George had enlarged the risk of bringing the continent to ruin, and Britain was facing the economic problems of a difficult transition. But these, Keynes observed, were

> of a different kind altogether from those impending on Europe. [...] The most serious problems for England have been brought to a head by the war, but are in their origins more fundamental (CW II, pp.160-61).

Even her share of Inter-Allied Debts was of a different nature, with respect to those of the Allies, since US credits to her had been advanced "to save civilisation" (CW XVIII, p.300) rather than Britain only and directly, so that while the Allies' debts should be cancelled on the basis of the "foreign trade argument", the argument for eliminating Britain's debts to America was their "not chiefly economic" origin (CW XVII, p.277). In general, and more importantly,

> England still stands outside Europe. Europe's voiceless tremors do not reach her. Europe is apart and England is not of her flesh and body (CW II, p.2).

Though the appeal to American generosity could be "fairly" made "in view of US far less financial sacrifices", the ultimate reason for it lay in that it was "inevitable" (ibid, p.92). However, inevitability has here an additional meaning: if a solution to European problems must come from America, this is because European countries' claims cannot be reconciled with one another nor with the declared aim of a peace of magnanimity. Nor, above all, with Germany's interests in reconstruction and stability – which coincided, in Keynes's view of Europe as an organic world with Germany at its heart, with those of the whole continent. The dilemma of fixing a definite amount of reparations is a clear, and equally tragic, illustration of such an irreducible conflict. Within this framework – and after recalling that in *A Revision of the Treaty*, Keynes called for Britain's unilateral action towards debt forgiveness should the US persist in their isolationism – the comparison of US and Britain's sacrifices appears more as the tool for sharing the burden of external assistance to Europe according to the role held by each of the two countries during the war, than the "compelling argument" (ibid, p.175) which cannot be drawn from it.

But the attention here posed to the method of Keynes's analysis leads to conclude, more in general, that debts forgiveness was conceived as *the* precondition to solve the problems generated by the war. The plan was "absolutely essential to the future prosperity of the world" (ibid, p.171); "an indispensable preliminary to the peoples of the allied countries facing with other than a maddened and esasperated heart the inevitable truth about the prospects of an indemnity from the enemy" (CW XVI, p.422). Due to their bad financial situation and prospects, Keynes insisted, France and Italy were not even disposed to discuss the reparations issue – "You might persuade [*the French*] that some current estimates as to the amount to be got out of Germany were quite fantastic. Yet at the end they would always come back to where they had started: 'But Germany must pay; for, otherwise, what is to happen to France?'" (CW II, p.94n) – "unless one could at the same time point out to them some alternative mode of escape from their troubles" (ibid, p.94). After explaining the dilemma, Keynes generically called for a distribution of coal to be effected with an “even-handed impartiality in accordance with need” (ibid, p.60), but soonly afterwards argued that the problem, which was of a more general nature, required Britain and the US to enter “deeply [...] into the economic and financial situation as a whole” (ibid, pp.92-93). This task was rather accomplished in Chapter 7 of *The Economic Consequences of the Peace*, where Keynes revised and re-edited as an outsider the proposals he had suggested as an insider.

In his 1926 pamphlet against laissez-faire, Keynes holds that the cure for the fallacy of composition between particular and general interests which is typical of worlds characterized by complexity and interdependence lies “outside the operations of individuals” (CW IX, p.291); it has a social character and is provided by public institutions acting with a view to favouring common rather than particular interests. In 1919, Keynes was not so much asking Britain and the US a modicum of individual altruism, as to act with the spirit which is typical of, and demanded from, public institutions concerned with long-term perspectives and capable to “exercise public action grounded upon deliberate and reasonable [...] judgement” (Carabelli and De Vecchi, 2000, p.234). The most evident illustration of this scheme of thought, in Keynes’s work as an international economist, is to be found in the proposal for an international cure for the world slump of 1931. On that occasion, he echoed his “The End of Laissez-Faire” arguments to explain how countries may act against their own interest if caught in a situation of extreme uncertainty:

> Reasoning by a false analogy from what is prudent for an individual who finds himself in danger of living beyond his means, he is usually, when his nerves are frayed, a supporter, though to his own ultimate disadvantage, of national contraction (CW IX, p.232).

Acting, as often, with “a degree of folly which we should not excuse in an individual” (CW XVII, p.276), during the slump countries had given life to a “competitive struggle for liquidity” (CW XXI, p.42), i.e.

> an extreme example of the *disharmony* of general and particular interest. Each nation, in an effort to improve its relative position, takes measures injurious to the absolute prosperity of its neighbours; and since its example is not confined to itself, it suffers

> more from similar action by its neighbours than it gain by such action itself (ibid, p.52).

In *The General Theory*, Keynes argued that the general solution to the struggle for liquidity lies in the "simultaneous pursuit [...] by all countries together" (CW VII, p.349), of policies of full employment, which require national autonomy as regards interest rate and investment policies. The Great Depression and the unqualified return to a gold standard showing lack of respect for the general interest in global stability, however, imposed the supra-national cure of a renewed British leadership. As a public institution, possessing the "experience or the public spirit" (CW IX, p.236) to occupy that position, London "should regain its liberty of action and its power of international initiative" (CW XXI, p.57), which she alone, according to Keynes, could use to the "general advantage", helping others to expand by expanding her own purchasing power. "*We* must set the example" (ibid, p.62), he contended.

In 1919, Keynes adopted a similar attitude with regards to Inter-Allied debts and their economic consequences on the already exhausted finance of European countries. Their cancellation "would be an act of farseeing statesmanship for the United Kingdom and the United States, the two Powers chiefly concerned, to adopt it" (CW II, p.93). Though Keynes had been continuously referring to American "generosity", he proudly claimed, in Burkeian terms, that the "force in this mode of thought" (ibid, p.179) lay in that "expediency and generosity agree together, and the policy which will best promote immediate friendship between nations will not conflict with the permanent interests of the benefactor" (ibid). The seemingly less important premise for US generosity, to be stimulated "provided Europe is making an honorable attempt in other directions, not to continue war, economic or otherwise, but to achieve the economic reconstitution of the whole Continent" (ibid, p.173), is on the contrary absolutely crucial.

> The question of inter-allied indebtedness is closely bound up with the intense popular feeling amongst the European allies on the question of indemnities – a feeling which is based not on any reasonable calculation of what Germany can, in fact, pay, but on a well-founded appreciation of the intolerable financial situation in which these countries will find themselves unless she pays (ibid, p.176).

On reviewing how the Four came to sign the Treaty, Keynes had remarked that Britain's hopes of securing out of Germany the general costs of the war – induced by the gloomy prospect of the American debt – could but pose British "sacred egotism" (ibid, p.92) and juster claims of France and Belgium one against the other:

> the financial problems which were about to exercise Europe could not be solved by greed. The possibility of *their* cure lay in magnanimity. Europe, if she is to survive her troubles, will need so much magnanimity from America, that she must herself practice it. It is useless for the Allies, hot from stripping Germany and one another, to turn for help to the United States to put the States of Europe, including Germany, on to their feet again (ibid).

Though somewhat contrary to common sense, but in line with a solution making "expediency and generosity agree together", the European countries' commitment to reconstruct Europe rather than continue war under other forms was a necessary counterpart of US assistance; in a way, it was *both* a result of and a necessary condition for it. Keynes's aim was to show that greed rather than magnanimity would have turned quite paradoxically European countries' attempts to liquidate debts against the interests of the US itself. In his memorandum "The Treatment of Inter-Ally Debt Arising Out of the War" of March 1919 (later included in *A Revision of the Treaty*), Keynes maintained that "If the loans are to be met, a serious obstacle will exist to future trade relations between the Allies" (CW XVI, p.424): Britain should necessarily attempt to stimulate exports to the US and imports from the Allies, bitterly opposing trade flows in the opposite direction. That between post-war world and the pre-1914 order with its well-established partnership linking the Old World with the New was in fact a false analogy: Europe could not rely, in the future, on US loans with a self-liquidating character, so that Keynes could argue that "[t]he unwillingness of American investors to buy European bonds is founded in common sense" (CW XVII, p.274). But this implies that

> If [...] the United States were to exact payment of the Allied debts, the position would be intolerable. If she persevered to the bitter end, scrapped her export industries, and diverted to other uses the capital now employed in them, and if the former European associates decided to meet their obligations at whatever cost to themselves, it is not impossible that the final result might be to America's material interest. But the project is

> utterly chimerical. It will not happen. Nothing is more certain than that America will pursue such a policy to the bitter end; she will abandon it as soon as she experiences its first consequences. Nor, if she did, would the Allies pay the money (ibid).

In *A Revision of the Treaty*, Keynes concluded that "[t]he decisive argument, however, for the United States, as for Great Britain, is [...] the unlikelihood of permanence in the exaction of the debts [...] because of the great difficulty of the problem which the United States has before her in any case in balancing her commercial account with the Old World" (CW III, p.110). In effect, the US position was "exactly parallel to that of German reparation" (CW XVII, p.276). Keynes correctly saw that "America will not see through the repayment of Allied debt any more than the Allies will see through the collection of their present reparations demands" (ibid, p.277) and insisted on the continuity between problems in future creditors-debtors relationships emerging from Inter-Allied debts on the one side and German reparations on the other. There lay, however, the possibility to treat them as parts of a unique question and solve them as such:

> The settlement of the inter-Allied debts is intimately bound up with the reparation settlement. The cancellation of the former would be a ground and an excuse for a sensible conclusion of the latter. On the other hand, France and Italy cannot be expected to forgo their own paper claims, unless they get quit at the same time of their own paper liabilities. It is nearly impossible, in my opinion, to settle the one question without the other (ibid).

By playing the role of a public-spirited institution, the US would have thus promoted its own interests while "setting the example". In *The Economic Consequences of the Peace*, Keynes exposed a second proposal, requiring cancellation of Inter-Allied debts as its precondition: winners, losers and even neutral countries expected to participate in the "grand scheme for the rehabilitation of Europe" (CW XVI, p.428). Britain and the US should have provided interest-bearing credit (£200 million) allowing Germany to issue bonds to a present value of £1,000 (75% to be used for reparations, 25% available for purchases of food and raw materials). Interest payments were to be guaranteed by the Allies, some neutral countries and Germany itself. The loan would have been given priority over any reparation claim, Inter-Allied debt and war loans; accordingly, borrowing countries receiving reparations should use them to repay the loan. "[T]he problem of restoring Europe is almost certainly too great for private enterprise alone" (ibid, p.434), wrote Keynes to the Big Three in April 1919 to justify the scheme.

Due to the American refusal, the plan never saw the light. Two British reviews of the plan may help to explain its weaknesses. Disagreement by the banker Robert H. Brand with Keynes's proposal was due to his qualified preference for cancellation of Inter-Allied debts. The grand scheme was a second-best, due both to its failure to cope with French and Italian debts and the risks inherent to the joint liability established by the plan (ibid, p.437). Chamberlain, the Chancellor of the Exchequer, held the opposite position: it was time to "put forward a constructive policy. To propose the mere cancellation of debt looks as if we were trying to shift the whole burden on to America: to take part in a large scheme like the one proposed by Keynes is to show readiness to help shoulder the common burden" (ibid). According to the interpretation here proposed, both Brand's and Chamberlain's advices were based on right grounds. As to the former, it is to be remembered that while in *The Economic Consequences of the Peace* the proposal for an international loan lies in continuity with, and logically follows its precondition, i.e. the plan to eliminate Inter-Allied indebtedness, Keynes came to advance his suggestion for the "grand scheme" as a second-best alternative to the latter, which proved to be a non-starter. Brand's remark was thus in line with the review Keynes made of his own plans in *The Economic Consequences of the Peace*. But Chamberlain was right to define Keynes's "grand scheme" as a "shared responsibilities" plan – requiring the whole spectrum of countries involved to participate in the reconstruction – designed to put Europe on to its feet again.

However, if for Keynes debt cancellation and international loan were but two linked means of solving a manifold, though unique problem, the US never came to conceive Inter-Allied debts and reparations as intertwined pieces of the same puzzle. As the editors of the American review "New Republic" made clear in their reply to an article by Keynes they published in 1928 under the title "A London View of War Debts", Keynes's proposals were believed to follow from undeserved incursions into the realm of morals rather than finance. The "American View of War Debts" was that if "both reparations and debt settlement must be scaled down and as a practical matter together", "this must be justified by economic circumstances, rather than by the dubious moral attitudes with which Mr Keynes and his associates [...] were veiling the controversy" (CW XVIII, p.296). The American refusal to comply with Keynes's plans – the Amsterdam conference of Winter 1919, or the attempt to promote the "grand scheme" by other (non-governmental) means, is but the last of a long series of "appeals unanswered" (Markwell, 2006, p.90) – was mainly grounded on the inflationist bias of the proposals, on fear that the British and European governments were trying to favour self-interest at US expenses, and contrariness to further inter-governmental loans: the renaissance of Europe should come from private activities and interventions on the part of *European* governments.

Already in May 1919, however, Keynes was aware of the "dilemma" (CW XVI, p.439) in which the US was caught. By assisting Germany, the Americans would have enabled European countries to extract a larger volume of reparations.

> They point out, with some justice, that our reparation proposals will take away from Germany her working capital, and that we are in effect asking them to restore the working capital to Germany which we have thus unnecessarily taken away (ibid).

The American reasoning was correct, Keynes observed, but only to a certain point: Germany had no immediately available capital left, nor liquid capital was to (and could) be taken from her for reparations. More importantly,

> even if we were to leave it to her the problem of her immediate future would not be solved. At the moment therefore the Americans are vainly trying to solve the problem of assisting Germany without assisting us, and they have not yet been able to alight on any method of doing this (CW XVI, pp.439-40).

Such a method was simply unavailable: the European conflict could not be settled unless the ignition key provided by US assistance to the continent, including Germany's creditors, allowed a spiral movement of "magnanimity" to spread along, and progressively expand, the chain of countries disposed to take part in Keynes's "shared responsibilities" plan. Lacking the starting engine of this figure of complexity – only a “gift element” and the gamble on mutual trust which goes along with it can create the preconditions of an agreement between actors otherwise destined to remain prisoners of an irresoluble dilemma; only a gift, a principle of “something for nothing” (Gouldner, 1973), as opposed to the “something for something” of the norm of reciprocity, may provide both the “mechanism for stopping vicious cycles of social interaction” and the “ignition key” that activates reciprocity so that “the ongoing cycle of mutual exchange” can start up again (ibid) – the “grand scheme” could not materialize or work properly, as the unhopeful words Keynes spent to comment the launch of the Dawes Plan made clear. There might be much truth in the review of *The Economic Consequences of the Peace* Dennis Robertson (1920) published in “The Economic Journal”. If a bias could be detected in the book, he wrote in response to critics accusing Keynes of pro-Germanism, it was “a bias of hope against despair – of taking, where the future is at best uncertain, the risks of generosity rather than the risk of meanness” (ibid, p.84). But Washington had already refused to take the risk of generosity “by reason of their strong desire to clear out of European responsibility (without however realising what this will mean to Europe)” (CW XVI, p.440).

5. Open Conclusions

We have here explored the hypothesis of consistency between Keynes’s method as a way of reasoning in economics adapted to the complex nature of the material under consideration, and his approach to international economic relations in the aftermath of WWI. To repeate this exercise for other episodes of Keynes’s diplomacy, additional space and research are obviously required. However, we assume that the understanding of the method Keynes used to cope with the complexity of the economic material may provide useful insights to rethink his “international macroeconomics” (Vines, 2003). Scholars who are well acquainted with the developments which led to the Bretton Woods order, to the settlement of war debts and the shaping of financial policies for the transition to the new system can scarcely fail to remark, in our opinion, the striking similarities existing between, on the one side, Keynes's diagnosis of the first post-war impasse and the character of the solutions he recommended to overcome it, and, on the other side, the vision of international economic relations he offered in the reform schemes of the Fourties to revive global multilateralism in a context of huge international imbalances. The mind easily goes, in particular, to Keynes's 1945 memorandum *Overseas Financial Policy in Stage III*, which was to be the basis of the negotiations for the American Loan to Britain.

Following the approach here outlined, further research on the topic should call into question Skidelsky's (2000) account of Keynes's "fighting for Britain" to revisit the economist's diplomacy as a way of providing solution to an international impasse only apparently centred on Britain and in truth clouding, due to the importance of the Sterling Area for future world trade patterns (see De Cecco, 1979), the prospects of global multilateralism. The stress on economic interdependence characterizing the whole bulk of considerations which led Keynes to design his plan for Bretton Woods may be shown to shape both his analyses of the dilemmas facing Britain (and, more in general, deficit countries) while entering the post-war world and his plea to London's future partners for sharing the burden of Britain's adjustment. The heretic proposal for an American Gift might then appear as Keynes's call for an act of statesmanship on the part of a public-spirited leadership willing to allow its generosity to induce the Sterling countries to participate in a multilateral movement toward a more equilibrated order. Should these tests give positive results, today's policymakers would be right to revisit Keynes's international macroeconomics for the purpose of discovering new devices to deal with contemporary problems.

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