

KEYNES AND THE FIRST WORLD WAR

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War has been the only means of really improving employment that is respectable.

—John Maynard Keynes, *Keynes's Lectures*

Peace and not war is the father of all things... Peace builds, war destroys.

—Ludwig von Mises, *Socialism*

1. Introduction

IN JANUARY 1919, after the unprecedented bloodshed of the First World War had finally ceased, leaders of the allied governments congregated at the Paris Peace Conference to restore world peace. The dwindling ranks of classical liberals warned the allied governments that a just and durable peace must be based on the free market economy and genuine national self-determination. The allies embraced the rhetoric of classical liberalism, but they ignored the substance. The allied governments used the peace treaties to permanently enshrine British and French imperial war gains. They created new nation-states by government coercion, and established the League of Nations to enforce the new status quo under the guise of collective security.

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CITATION INFORMATION FOR THIS ARTICLE:

Edward W. Fuller and Robert C. Whitten. 2017. "Keynes and the First World War." *Libertarian Papers*. 9 (1): 1-37. ONLINE AT: libertarianpapers.org. THIS ARTICLE IS subject to a Creative Commons Attribution 3.0 License (creativecommons.org/licenses).

The results were tragic. The Great War and the allies' peace-making produced Nazism in Germany, fascism in Italy, militarism in Japan, extremism in the Middle East, and communism in Russia, China, and Vietnam. In short, the war and subsequent imperialistic peace treaties created a century of statism and war.

Like so many of the twentieth century's great heroes and villains, John Maynard Keynes (1883-1946) emerged out of the chaos of the First World War. *The General Theory of Employment, Interest, and Money* (1936) made Keynes the most influential economist of the twentieth century. But he first achieved international fame for his bitter attack on the Versailles Peace Treaty in *The Economic Consequences of the Peace* (1919). This celebrated book ranks as one of the most influential works of the twentieth century, and it laid the foundation for Keynes's enormous influence. Even the harshest critics of Keynes's interventionist economic theories have greeted his attack on the Treaty of Versailles with sympathy. For example, Murray N. Rothbard, a free market economist and Keynes critic, wrote that *The Economic Consequences of the Peace* is a "fine work" (1961, 214).

Most economists and historians uncritically accept the standard interpretation of *The Economic Consequences of the Peace*. According to the traditional view, Keynes heroically resigned from the British delegation at the Paris Peace Conference of 1919 to write his book in protest of the harsh reparations clauses of the Treaty of Versailles. This standard interpretation is provided in Liberty Fund's *Concise Encyclopedia of Economics*: "Keynes wrote it to object to the punitive reparations payments imposed on Germany by the Allied countries after World War I" (Henderson 2008). This traditional interpretation is seriously incomplete and misleading. The central thesis of this paper is that Britain's war-debt problem, not German reparations, led Keynes to resign from the British delegation and write *The Economic Consequences of the Peace*.

2. Britain's War-Debt Problem

To understand *The Economic Consequences of the Peace*, it is necessary to understand Britain's financial situation at the end of the First World War. Britain had a significant debt problem when the conflict ended. During the war, Britain provided its European allies with significant financial assistance. France, Russia, Italy, Serbia, and Belgium could not pay for their own war spending. On March 15, 1916, Keynes wrote, "By the middle of 1916 we [Britain] shall be responsible for the whole of the external expenditure of Italy, for the whole of the external expenditure of Russia (outside France and part of Japan), and for two-thirds of external finance of France, as well as a

half share of [the] entire expenses of Belgium and Serbia” (1916a, 3). Before 1914, Britain had normally granted its allies war subsidies, but the scale of the Great War made the traditional practice of war subsidies impossible to continue. Instead, Britain supported France, Russia, Italy, Serbia, and Belgium by making large war loans. At the end of the war, these nations were heavily indebted to Britain.

Despite its financial strength, however, Britain could not support the entire allied war effort by itself. Consequently, the allied war machine became totally dependent on the United States for financing. While the United States was willing to make loans to Britain, it was reluctant to provide sufficient loans to the riskier European allies. As a result, Britain borrowed from the United States to make loans to its less creditworthy allies: “Almost the whole of England’s indebtedness to the United States was incurred, not on her own account, but to enable her to assist the rest of her Allies” (Keynes 1919a, 175). Britain used its superior credit rating to borrow on behalf of its riskier partners: “They [the United States] have lent mainly to the countries whose credit is relatively good, namely, ourselves and France, leaving us to re-lend to the poorer debtors” (Keynes 1919b, 424). Britain accumulated significant debts to the United States by acting as a middleman between the United States and riskier European countries.

Table 1
Inter-Allied Indebtedness

Loans to	By United States	By United Kingdom	By France	Total
	Million Dollars	Million Dollars	Million Dollars	Million Dollars
United Kingdom	4,210	4,210
France	2,750	2,540	...	5,290
Italy	1,625	2,335	175	4,135
Russia	190	2,840	800	3,830
Belgium	400	490	450	1,340
Serbia and Jugo-Slavia	100	100	100	300
Other Allies	175	395	250	820
Total	9,450	8,700	1,775	19,925

Source: Keynes 1920, 271

Keynes estimated the net war-debt position of each ally in *The Economic Consequences of the Peace* (1919a, 172; 1920a, 271). Table 1 shows that, “the war ended with everyone owing everyone else immense sums of money... [T]he

Allies owe a large sum to Great Britain; and Great Britain owes a large sum to the United States” (Keynes 1919a, 177-78).¹

Table 1 indicates that the United States was the largest creditor during the war. Britain was also a net creditor, but the quality of debt held by the two countries was asymmetrical. Britain held much low-quality debt from the European allies, while the United States held much higher-quality debt from Britain. Britain was obligated to repay the United States, although it was far less certain whether Britain would be repaid by France, Russia, Italy, Belgium, and Serbia. Britain was in a position in which it would be forced to repay debts to the United States without being repaid by the European allies.

During the war, Keynes was aware that the system of inter-allied war loans was shifting the balance of financial power from Britain to the United States. Britain had been the great financial power of the world before the war, but by the end of 1916, the United States had gained financial dominance. He wrote on October 10 of that year, “The American executive and the American public will be in a position to dictate to this country” (1916b, 198). In December 1917, he observed that Britain had “forfeited the claim we had staked out in the New World and in exchange this country will be mortgaged to America” (1917, 265). On April 30, 1918, he reported that Britain was in “a position of complete financial helplessness and dependence in which the call loan is a noose around our necks” (1918a, 287). As Keynes saw it, the war debt would give the United States control over Britain and Europe in the postwar world. In November 1918 he predicted that Britain’s war debt “will cripple our foreign development in other parts of the world, and will lay us open to future pressure by the United States of a most objectionable description” (1918b, 418). Throughout the war, Keynes recognized that Britain’s escalating debt problem would haunt it afterward.

3. Keynes at the British Treasury

Keynes saw the war as an opportunity to advance his career. While many British men were enlisting in the army, Keynes wanted to fulfill his lifelong dream of working in the British Treasury. He got his chance when the Austrian ultimatum to Serbia on July 23, 1914, triggered a severe financial

¹ Keynes’s figures are used here to elucidate his mindset before and after the conference. On war debt, see Balderston (1989, 227), Broadberry and Harrison (2005, 219), Ferguson (1999, 328), Gomes (2010, 5), Hession (1984, 132), Keynes (1919b, 420), Lloyd George (1923, 97, 120), MacMillan (2002, 183), Self (2006, 15), and Silverman (1982, 119, 145).

crisis in London. On July 31 he was invited to the British Treasury to give unofficial advice, but did not receive the invitation until August 2. Too impatient to wait for the next train, he rushed to the Treasury in the sidecar of his brother-in-law's motorcycle. Although he helped convince the Chancellor of the Exchequer not to suspend gold payments, the Treasury did not adopt his plan and he was not offered a wartime job.

Keynes was desperate for a job connected with the war. To renew the Treasury's attention, he wrote articles about the financial crisis in such public forums as the *Morning Post*, *The Economist*, the *Quarterly Journal of Economics*, and the *Economic Journal*. While some were irritated by his articles, he nevertheless got the Treasury's attention. On January 6, 1915, he was offered a job: "I have been offered a position in the Treasury alongside of Paish for the period of the war... The governor of the Bank of England [Montagu Norman] has been reading my works and asked me to come and visit him at the bank" (1915, 42). Keynes had yearned for a job in that institution for many years, and he invited seventeen of his Bloomsbury friends to the Café Royal to celebrate the realization of this goal. He started work on January 17, 1915.

His first position at the Treasury was assistant to George Paish, the economic advisor to the Chancellor of the Exchequer. Initially, Keynes was appointed to a committee on food prices, but became involved in war finance almost immediately. After two weeks in the Treasury, he attended the allies' first financial conference:

The conference which Keynes attended in Paris from 2 to 5 February was the first inter-Ally conference. It inaugurated the whole complex of inter-Ally war credits... From the decisions taken at the conference stemmed the whole post-war debt problem ... This was the system which Keynes helped to build up over the next two years, and over which he came to preside... Keynes played a prominent part in the negotiation of these arrangements... He was quick to make his mark at the Treasury. (Skidelsky 1983, 298-9)

After this conference, Keynes rapidly gained more responsibility for financing the war. He was transferred to the Treasury's First Finance Division in May 1915. On February 27, 1916, he wrote, "I am now almost entirely occupied with our financial relations with our Allies" (quoted in Moggridge 1992, 264). A month later, he reported, "It is my business to deal with our financial relations to the allies day by day" (1916a, 187). On September 1, 1916, he became first assistant to Malcolm Ramsey, Assistant Secretary to the Treasury in charge of inter-allied finance. In January 1917, he was made chief of the A Division, a new Treasury division created for Keynes to manage and oversee all of Britain's inter-allied lending and

borrowing. At the end of the war, he was the third-highest ranking official in the British Treasury, and only John Bradbury and Robert Chalmers were his superiors. In short, Keynes was Britain's leading authority on inter-allied debt during the war.

Keynes oversaw all of Britain's war lending and borrowing. In December 1923, he boasted, "I was in the Treasury throughout the war and all the money we lent or borrowed passed through my hands" (1923a, 3). In July 1929, Keynes admitted that he was responsible for "drafting the agreements for the loans raised by the British Treasury from the U.S. during the war" (1929a, 165). On December 12, 1932, he confirmed, "I happen to have been during the war the Treasury official most directly concerned with the borrowing and the spending of the money" (1932a, 383-84).² Roy Harrod, his official biographer, writes, "He occupied the key position at what was without challenge the centre of the inter-allied economic effort, he thought out the policy, and in effect bore the *ultimate responsibility* for the decisions" (1951, 206, emphasis added). Keynes was the chief architect of Britain's war-debt problem, and he was aware that the system of war loans he developed and applied would create significant problems for postwar Britain.³ But to his mind, this system of war debt was the only way to save the British Empire from defeat. Keynes deserves much responsibility for creating Europe's war-debt problem and shifting the balance of financial power from Britain to the United States. The Paris Peace Conference of 1919 marked the beginning of his failed lifelong struggle to win back Britain's economic and financial hegemony from the United States.

² On December 10, 1920, Keynes gave a speech to the Society of Civil Servants on the importance of Treasury control. About wartime expenditure, he declared, "What took place greatly depended upon individual Civil Servants and individual ministers... The whole thing was of the nature of an improvisation" (1920d, 85). In the summer of 1917, the Governor of the Bank of England, Lord Walter Cunliffe, tried to have Keynes dismissed from the Treasury for high-handed conduct (Davenport-Hines 2015, 85; Moggridge 1992, 273).

³ In a "stream of letters to Maynard Keynes during 1915 and 1916 ... [Alfred] Marshall also warned Keynes of the dangers of over reliance on the American capital markets for raising war loans" (Groenewegen 1995, 644). On July 21, 1917, President Wilson recognized that Britain was "financially in our hands" and "when the war is over we can force them to our way of thinking" (quoted in Ferguson 1999, 327, 329).

4. Keynes at the Paris Peace Conference

Keynes arrived at the Paris Peace Conference on January 10, 1919, as the British Treasury's chief representative. It is important to understand his mindset when he arrived in Paris. First, Keynes was a nationalist, and all of his actions at the peace conference were aimed at protecting and improving the British Empire's position in the postwar world (Mundell 2002, 259n17; Steil 2013, 149). According to Joseph Schumpeter,

It cannot be emphasized too strongly that Keynes's advice was in the first instance always English advice, born of English problems even where addressed to other nations... [H]e was fervently patriotic—of a patriotism which was indeed quite untinged by vulgarity but was so genuine as to be subconscious and therefore all the more powerful to impart a bias to his thought and to exclude full understanding of foreign (also American) viewpoints, conditions, interests, and especially creeds. (1946, 505)

To fully understand his diplomatic work during both World Wars, it must be realized that Keynes was intensely anti-American. Britain's war debt made the United States Keynes's main adversary in Paris, and his anti-American attitude had a substantial influence on all of his activities at the peace conference: "What has not been sufficiently appreciated is the extent to which Keynes was anti-American... This feeling affected his attitude to reparations... [H]e wanted to keep America out of Europe" (Skidelsky 1992, 20).⁴ Keynes believed the United States would be the British Empire's main rival in the postwar world, and that Britain's war debt gave the United States control over both Britain and Europe. He was convinced he had to reduce Britain's debt burden to the United States in order to re-establish the empire's dominance and neutralize American influence in Europe.

Second, Keynes had deeply mixed emotions about his role in the war. He was an imperialist throughout his life, and he desperately wanted to help Britain preserve her empire. He wrote, for example, that,

⁴ Keynes "tended to see the United States as a philistine and mechanized hellhole" (Davenport-Hines 2015, 90). Elizabeth and Harry Johnson write, "He was impatient and intolerant of slower human beings, and this is the way he generally regarded Americans... He had the Englishman's habit of regarding ordinary Americans as uncultured and naïve—and crass, to boot, in wanting to be paid back their war debt" (Johnson and Johnson 1978, 13-14). He had an adversarial attitude towards almost everyone at the conference, including the French and his own colleagues and superiors (MacMillan 2002, 181, 182, 188). Ed Conway observes, "Maynard may well have proven himself during the Great War to be a rather terrible diplomat" (2014, 111).

It is only during the present reign that we have begun to realize the responsibilities of the Empire and to see our duties to subject races. We have begun to see that Great Britain may have a high destiny and a great future before her. We have before taken up “the white man’s burden” and we must endeavor to wield the power of Empire with more lasting effect and to greater good than the mighty empires that have risen and fallen through the course of history. (1899, 4)

Moreover, he viewed Germany as a serious threat to British imperialism:

We, who are imperialist... think that British rule brings with it an increase of justice, liberty, and prosperity; and we administer our Empire not with a view to our pecuniary aggrandizement... Germany’s aims are not such... [S]he looks rather to definite material gains... [W]e distrust her diplomacy, we distrust her international honesty, we resent her calumnious attitude towards us. She envies our possessions; she would observe no scruple if there was any prospect of depriving us of them. She considers us her natural antagonist. She fears the preponderance of the Anglo Saxon race. (1903a, 24)⁵

Keynes was a fervent imperialist, but at the same time he was a key member of the Bloomsbury group. This clique of eccentric writers and artists passionately opposed the war. Following his Bloomsbury friends, he applied for exemption from conscription as a conscientious objector in February 1916. His friends did not approve of his work in the Treasury, and they demanded that he resign. While he loved his work organizing war loans, his friends accused him of being a hypocrite. To them it was “impossible to reconcile his avowed sympathy for conscientious objectors with the job of demonstrating how to kill Germans as cheaply as possible” (Holroyd 1995,

⁵ As Carlo Cristiano notes, “Keynes was an imperialist” (2014, 30). In 1903, he spoke for a motion “in favour of the support given by the present Government to the Principles of Imperialism” (Harrod 1951, 94). He opposed Home Rule for Ireland, and on May 12, 1903, he proposed a motion that “Home Rule for Ireland is beyond the sphere of practical politics” (Keynes 1903b). He administered the empire as a clerk at the India office from 1906 to 1908. In his first book, *Indian Currency and Finance* (1913), he defended British rule over India and advocated imperialistic control of India’s monetary system. During the Second World War, he fought in vain to preserve imperial preference (Conway 2014, 116-20, 178; Steil 2013, 14, 114-18; Skidelsky 2000, 126-31). His belief in “the white man’s burden” is reflected in his support of population control, eugenics, and neo-Malthusianism (Hernandez and Magness 2017; O’Donnell 1992, 779-80; Raico 2008, 172).

343).⁶ He had spent the war financing the slaughter of 10 million combatants, and saw the peace conference as an opportunity to sanitize his conscience and repair his reputation within the Bloomsbury group (Skidelsky 1983, 353).

Keynes's primary goal at the Paris Peace Conference, however, was to solve Britain's war-debt problem. He viewed the war debt as "an acute problem" and "a menace to financial stability everywhere" (1918c, 435; 1919b, 421). Keynes's main recommendation was to cancel war debt. He first recommended this course of action in 1916, which means he was already contemplating it as he organized war loans from the United States (Dostaler 2007, 143). In November 1918, he wrote a proposal for cancelling inter-allied debts called "The Treatment of Inter-Ally Debt Arising out of the War" (1918b). By November 29, 1918, he was of the opinion that,

At the opening of the Peace Conference, this country should propose to the United States that all debts incurred between the Governments of the Associated countries prior to January 1st, 1919, should be cancelled... Failing such a settlement the war will end with a net-work of heavy tributes payable from one Ally to another. A certain amount of indemnity will be recoverable from the enemy, but this is likely to be of a less amount than the indemnities which the Allies will be paying to one another. This is an improper conclusion to such a war as the present one. Hitherto the balance between the old world and the new has been to some extent redressed by the fact that the old world owned an interest in the undeveloped resources of the new; but henceforth the new world will not only own the principal undeveloped resources of the world but will also draw tribute from the greater part of Europe. Apart from other considerations the financial contribution of the United States to the war has not been sufficient to justify such a state of affairs, which would be one very injurious to the future of Europe. Indeed, failing a readjustment, the financial sacrifice of the United States will have been disproportionately small, and Germany will be the only Power free from the financial grip of the U.S. (1918b, 16)

In March 1919, at the conference, he reaffirmed, "A proposal for an entire cancellation of inter-ally indebtedness is put forward as being likely to

⁶ Keynes supported the right of the State to deprive citizens of their liberty by conscription. Still, he hypocritically refused to surrender his own liberty: "I claim complete exemption because I have a conscientious objection to surrendering my liberty of judgement on so vital a question as undertaking military service" (quoted in Moggridge 1992, 257). He promised his lover Lytton Strachey that he would resign from the Treasury if conscription was introduced, and infuriated his Bloomsbury friends when he broke his promise (Strachey 1915, 259-60; Strachey 1916, 267).

promote the well-being of this country and of the world” (1919b, 421). As Table 1 shows, the United States and Britain were net creditors. Keynes suggested that Britain cancel its European allies’ debt, but only if the United States would cancel Britain’s debt. Britain had less to lose than the United States by such action. Russia had already defaulted, and Italy was unable to start repayment. Also, the British did not believe France was trying very hard to repay its debt (Keynes 1918b, 20). Thus, Keynes thought Britain would be the net beneficiary of cancellation: “The general liquidation of the financial position and the clearing up of all sorts of difficult and embarrassing problems which the proposed clean cut would ensure would make up from a financial standpoint for the sacrifice of paper claims which would be called for” (1918b, 21). In Keynes’s imperialistic view, cancelling war debt was the ideal outcome for Britain and, by extension, the entire world.

Keynes’s recommendation to cancel the debt was popular with the European allies, but the Americans rejected his proposal (Lloyd George 1923, 97-98, 100, 102). Thomas W. Lamont, President Woodrow Wilson’s chief financial advisor, reported, “The question [of cancelling inter-allied debts] in one form or another constantly arose. It was always ‘stepped on’ by the American delegates” (Lamont 1921, 289). Cancelling the debt would shift the financial burden of the war onto the United States. Austen Chamberlain, the Chancellor of the Exchequer, wrote to Keynes, “No doubt it would be a very good thing if the United States would propose or support a universal cancellation of debt, but my information from Paris is that they show no inclination to do anything of the kind... To propose the mere cancellation of debt looks as if we were trying to shift the whole burden on to America” (Chamberlain 1919, 437). Like the British, the Americans did not want to bear the huge cost of the European war or allow any losses to fall on US banks. Keynes’s unrealistic plan to cancel the debt was doomed to repeated rejection because it ignored American interests.⁷ It became a source of compounding conflict between the allies until the Second World War.

⁷ Until 1933, Keynes consistently advocated cancelling the debt (Keynes 1920e, 152; 1921a, 277; 1923b, 188; 1928, 299; 1929a, 165; 1931, 363; 1932b, 367). He recognized that “without [lavish US financial] assistance the Allies could never have won the war,” but admitted that he “never really considered them as normal bonds” (1919a, 173; 1929a, 165). Ethically, Keynes was an immoralist, and even stated: “I remain and always will remain an immoralist” (1938, 447). In other words, Keynes did not believe in universal ethical rules (O’Donnell 1989, 109-12; 1999, 165). Some libertarians favor repudiation of government debt (Rothbard 1962, 1028; 1992). But even in private exchange, “Keynes believed that there could be no absolute sacredness of contract” (Skidelsky 2009, 150; Keynes 1932a, 384). See Keynes (1925) for a brief statement of his view on the war debt.

The alternative to cancelling debt was to shift the financial burden to the former enemy powers (which Keynes referred to as “ex-enemy states”), especially Germany. In practice, this meant imposing reparations on Germany to extract money to repay the debt. The allies could claim that the reparations were for reconstruction, and the imposition was encouraged by embittered voters in allied nations as just punishment. For their part, the Americans refused to cancel the debt, but would allow the European allies to impose reparations on enemy states. When Germany signed the Armistice, it agreed that “compensation will be made by Germany for the damage done to the civilian population of the Allies and to their property by the aggression of Germany by land, sea, and from the air” (Burnett 1940, 411). Given American constraints, reparations were viewed by the allies as the only viable solution to the European debt problem. Some reparations were inevitable, but the war-debt problem made the allies view reparations as an existential issue: “The subject of War-debts made any concession on Reparations exceedingly difficult” (Lloyd George 1923, 104). The debt problem that Keynes oversaw supercharged the allies’ drive for reparations.

The allies needed a legal basis for German reparations, so the infamous war-guilt clause, Article 231 of the Treaty of Versailles, was invoked: “The Allied and Associated Governments affirm and Germany accepts the responsibility of Germany and her Allies for causing all the loss and damage to which the Allied and Associated Governments and their nationals have been subjected as a consequence of the war imposed upon them by the aggression of Germany and her Allies” (Keynes 1919a, 95). Keynes helped draft Article 231: “Central to the arrangements over reparations was article 231 of the treaty, the ‘war guilt clause’ drafted by Keynes and John Foster Dulles” (Cairncross 2004). Keynes reaffirmed his belief that Germany was responsible for the war on the first page of *The Economic Consequences of the Peace*, and in September 1920, he wrote, “Persons in power in Germany deliberately provoked the war” (1920b, 52). He never criticized the infamous war-guilt clause during his fourteen-year crusade against the Treaty of Versailles. Instead, he wrote that Article 231 “is a well and carefully drafted article” (1919a, 95). In fact, he assured his audience that it was harmless: “All this is only a matter of words, of virtuosity in draftsmanship, which does no one any harm, and which probably seemed much more important at the time than it ever will again between now and judgment day” (1919a, 96). With Keynes’s virtuosity in draftsmanship, Article 231 became the great symbol of

the injustice of the Treaty of Versailles, and it poisoned European politics throughout the 1920s and 1930s.⁸

The allies had to decide whether reparations should be a single upfront payment or whether they should be made over a period of years. The joint “Memorandum of the Effect of an Indemnity” shows that Keynes was already planning for reparations by late 1915 (Keynes 1916d). Before the peace conference, he determined that the best reparations strategy was a large upfront payment *combined* with annual payments made over several decades. In Keynes’s view, the optimal strategy for Britain was “to obtain all the property which can be transferred immediately or over a period of three years, levying this contribution as ruthlessly and completely, so as *to ruin entirely for many years to come Germany’s overseas development and her international credit*; but having done this... to ask only a small tribute over a term of years (1918c, 382, emphasis added). Importantly, he wanted to impose a large upfront payment in order to destroy Germany’s ability to compete with Britain in foreign trade. He wanted to then stack a long-term reparations liability on top of this payment. Along with William J. Ashley, he was the first expert to recommend extracting reparations from Germany by annual installment over several decades. British Prime Minister David Lloyd George later reported, “Professor Ashley and Mr. Keynes are thus the joint authors of the long-term indemnity which was incorporated in the Treaty” (1938, 446). Keynes was an early architect of this policy, which he advocated at the Paris Peace Conference and in *The Economic Consequences of the Peace*.

Keynes wanted to punish Germany by imposing a large upfront reparations payment. But he argued that the annual reparations payments should then be modest. He believed large annual payments “can only be carried out to the detriment of our own export trade” (1918c, 383). Underlying Keynes’s recommendation was his mercantilist theory of the transfer problem. For Keynes, the amount of reparations paid by Germany

⁸ On Keynes and Article 231, see Binkley (1948, 60), Burnett (1940, 847, 964), Dostaler (2007, 156n43), Lentin (1984, 74, 151), Keynes (1919c, 1919d, 1919e), Mantoux (1919, 168n5), McCormick (1919, 535), Moggridge (1992, 308, 346), and United States (1919a, 44, 63; 1919b, 413). Skidelsky (2000, 27) incorrectly reports that Philip Kerr drafted the war-guilt clause. In fact, Kerr did not draft Article 231, only the language in the pre-Armistice agreement later inserted into Article 232. See Bunselmeyer (1975, 82), Burnett (1940, 393, 408, 411), Butler (1960, 72-73), and Lentin (1986). Ralph Raico writes, “It was unprecedented in the history of peace negotiations that those who had lost a war should have to admit their guilt for starting it,” and “There is no evidence whatsoever that Germany in 1914 deliberately unleashed a European war” (1999, 203, 214).

was limited by its trade surplus: “The only way in which Germany may pay her [reparations] obligation abroad is by obtaining a favorable balance of trade (that is, an excess of exports over imports)” (1929a, 162). In Keynes’s mercantilist theory, Germany could only pay reparations by exporting goods abroad. Thus, he thought imposing annual reparations on Germany would increase its exports. Since Germany was Britain’s main competitor in foreign trade, any reparations policy that stimulated German exports would injure Britain. Keynes favored smaller annual reparations payments because he held the mercantilist view that large annual payments must increase German exports and reduce British exports:⁹

Two eventualities have to be sharply distinguished; the first, in which the usual course of trade is not gravely disturbed by the payment... the second, in which the amount involved is so large that it cannot be paid without a drastic disturbance of the course of trade and a far-reaching stimulation of the exports of the paying country... An indemnity so high that it can only be paid by means of a great expansion of Germany’s export trade must necessarily interfere with the export trade of other countries... The fact is well known, and is also confirmed by the analysis made above of Germany’s exports, that her export trade before the war shows a strong tendency to compete with British trade. Broadly speaking, her great staple industries are the same as ours... These export industries cannot enjoy a great expansion without injuring ours... An indemnity high enough to absorb the whole of Germany’s normal surplus, for investment abroad and for building up foreign

⁹ Keynes’s mercantilism was already on display in January 1916, and he repeated such ideas throughout the 1920s (Keynes 1916d; 1918d, 32; 1921b; 1922, 102, 105-14; 1924, 262). In 1929, Keynes (1929b) formalized and defended his view on the transfer problem against Bertil Ohlin (1929) and Jacques Rueff (1929). Ludwig von Mises criticized Keynes’s mercantilism as follows: “There is no such thing as a problem of transfer” (Mises 1938, 128). As Mises explains, “An excess of exports is not a prerequisite for the payment of reparations... [Britain’s] imports exceeded their exports because they collected the reparations. From the viewpoint of mercantilist fallacies this effect seemed alarming” (Mises 1944a, 241). Mundell (2002, 245) notes that, “Keynes let himself fall victim to such an absurd position,” and Harry G. Johnson (1975, 30) argues that his position was “technically incompetent.” In the *General Theory*, “Keynes finds considerable merit in the mercantilist theory of the favorable balance of trade” (Dillard 1948, 280-81). On the transfer problem see Gomes (2010, 228-38), Haberler (1985), Machlup (1964), Maier (1975, 250-53; 1979, 65), Mantoux (1946, 117-32), Mises (1943a, 150; 1944a, 241; 1944b, 74), Moggridge (1992, 476-78), Ropke (1930), Schuker (1988, 46), Schumpeter (1946, 501n10), Skidelsky (1992, 309-12), and Trachtenberg (1980, 72-84).

business and connections must certainly be advantageous to this country and correspondingly injurious to the enemy. (Keynes 1918c, 379-81)

Keynes did not resist large annual reparations payments out of humanitarian concern for Germany. Instead, he resisted them because he thought smaller payments would be best for the British Empire.¹⁰ Although his call for modest payments appears at first lenient, his mercantilist recommendation was deliberately crafted to keep Germany in a state of relative poverty for decades after the war.

Germany's capacity to pay was a key issue in the reparations debate. Before the war ended, Keynes determined that Germany's maximum capacity to pay was \$16.35 billion (1918c, 378). This \$16.35 billion consisted of immediately transferable property of \$4 billion, property transferred over three years of \$1.75 billion, property in ceded territories of \$1.1 billion, and payments over thirty years of \$9.5 billion. He estimated that the total cost of the war was \$125 billion (1918c, 358). Based on these estimates, he determined that Germany did not have the capacity to pay the entire cost of the war: "A claim for the general cost of the war, in addition to reparation, could not be met even in part" (1918c, 382).

After estimating how much Germany could pay, Keynes tried to determine how much it should pay. While he never believed in the sanctity of contract, he still argued that the Armistice agreement was an inviolable contract that did not allow the allies to recover the full cost of the war. He thought the terms of the Armistice restricted Germany's reparations liability to \$20 billion (1918c, 357). Still, he believed that \$20 billion would injure Britain: "The limit of what we can safely exact, having regard for our own selfish interests only, may therefore be as low as £2,000 million [\$10 billion]" (1918c, 381). Again, behind this recommendation was the mercantilist theory that reparations must stimulate German exports at Britain's expense. His

¹⁰ Keynes also contributed to impairing Germany's ability to compete with British exporters by persuading the Germans to surrender their merchant marine as part of reparations in exchange for food. In late 1915, he suggested that, "The material property most obviously suitable for the purpose [of indemnity] is the ships of the enemy navies and the ships of the enemy mercantile marine" (Keynes 1916d, 323). Following Keynes, the Board of Trade advised that "ships... form by far the most important item in any material interest which Great Britain has in the proceeds of reparation" (United Kingdom 1918, 13). In March 1919, Keynes leveraged food supplies for starving Germans to pry ships away from Germany. See Davenport-Hines (2015, 100), Dostaler (2007, 142), Hession (1984, 140), Moggridge (1992, 301), and Skidelsky (1983, 358).

overwhelming concern for reducing Britain's war debt mixed with his mercantilist ideas led him to perform a balancing act. On the one hand, he wanted a level of reparations sufficiently high for Britain to repay its war debt. On the other hand, he wanted to keep the annual payments low enough to prevent a large expansion of German exports. He concluded that it would be in Britain's best interest to force Germany to pay \$10 billion in reparations. On May 29, the unwitting Germans revealed that his estimates were too low by offering to fix the reparations bill at \$25 billion. Keynes's mercantilist approach to economic analysis led him to underestimate Germany's capacity to pay.¹¹

For political reasons, the delegates at the peace conference could not agree on the amount of reparations. Many Europeans were bitter and wanted Germany to be punished. Lloyd George and French Prime Minister Georges Clemenceau knew Germany could not pay the entire cost of the war, but they wanted to appear firm in order to appease British and French public opinion. The Americans tried to fix the amount of reparations, but British resistance made it impossible to agree on a figure. Keynes found a politically acceptable solution. His memorandum, "Reparation and Indemnity," dated March 11, 1919, shows it was his idea to leave the amount of reparations undetermined in the treaty:

Germany is liable up to the full extent of the injury she has caused to the Allied and Associated Nations. The aggregate material injury so caused is not capable of exact computation, but it is certain that it much exceeds Germany's capacity to pay by means which it is in the interest of the Allied and Associated Governments to enforce... The Allied and Associated Governments demand accordingly that Germany render payment for the injury which she has caused up to the full limit of her capacity. At the present time it is not possible to predict what degree of economic and material recovery is possible and permissible for the German nation within the generation now to come. It is therefore impossible at the present time to compute in terms of a definite money figure the ultimate extent of Germany's capacity to make good... A Commission shall be set up including

¹¹ In the opinion of Ludwig von Mises, "It is a gross misrepresentation of the facts to assert that these payments made Germany poor and condemned the Germans to starvation" (1944a, 239). Some scholars who argue that the reparation demands were not overly harsh include Davenport-Hines (2015, 115, 118), Glaser (1998, 398), Gomes (2010, 36, 232), Ferguson (1999, 412, 414), Keylor (1998, 505), MacMillan (2002, 181), Mantoux (1946, 111-17, 163), Marks (1969, 364-65; 1976, 18, 143; 1978, 254-55; 1998, 367), Moggridge (1992, 345), Schuker (1980, 125; 1988, 14-19), Sharp (2008, 107), Tardieu (1921, 318, 328), Taylor (1961, 70), and Trachtenberg (1980, 66-68, 85).

representatives of European neutral nations to fix year by year the sum payable annually by Germany for a period of thirty years. In fixing such sum the Commissioners shall have regard to the capacity of Germany to pay from time to time without injurious consequences to the Allied and Associated Nations. (1919f)

In the mercantilist theory, leaving Germany's reparations liability undetermined would harm its export industries by impairing its international credit (Harrod 1951, 243). Thus, Keynes's suggestion to leave the liability unfixed was consistent with his desire to ruin Germany's export industries. The German people, however, resented the decision not to fix the amount of reparations. They felt they were being forced to sign a blank check, and were thereby condemned to indefinite slave labor. In *The Economic Consequences of the Peace*, Keynes hypocritically attacked the decision not to fix the amount of reparations (Keynes 1919a, 85, 99). His suggestion, and the ultimate decision not to fix the amount of reparations, had a profound influence on European politics in the following two decades.

Although the total amount was not fixed, however, the allies began negotiating how the payments would be divided. France and Belgium had suffered the most damage, but Britain spent the most on the war. Keynes therefore wanted his nation to receive the highest possible percentage of the reparations payments. The French started the apportionment negotiations by suggesting a French-British distribution of 72:18 (Sharp 2008, 93). The British were alarmed, so Keynes threw himself into the battle for a larger distribution for Britain:

Keynes became involved in another attempt to secure Britain a reasonable level of receipts, an agreement to apportion any of the sums received. [British delegate] Sumner proposed a distribution between France and Britain in the ratio of 50:30. The French replied with 56:25. [American delegate] Lamont suggested a compromise to Keynes of 56:28. This compromise did not find favor with the French, who were unhappy with the 2:1 ratio of relative damage implied. Keynes suggested that the British accept 56:25 if the three percentage point difference went to the other Allies. Lloyd George declined the concession. (Moggridge 1992, 307)

Keynes believed it would hurt Britain if France received a very high percentage of large annual payments: "It will be very disadvantageous to this country [Britain] artificially to stimulate German exports in order that the proceeds of these exports may be paid over (e.g.) to France" (1918c, 380). In *The Economic Consequences of the Peace*, he argued that France should only receive 38 percent of the reparation payments (1919a, 84). At the Spa Conference in July 1920, France conceded to the British and agreed to a 52:22 ratio. This

and other French concessions on reparations undermine Keynes's portrayal of France as the vindictive villain in the diplomatic battle over reparations.¹²

As explained above, Keynes's primary goal at the Paris Peace Conference was to solve Britain's debt problem, and that meant shifting the burden onto others. For Keynes, the ideal option was to shift the cost of the war onto the United States by cancelling the debt, but he viewed transferring Britain's financial burden to Germany as a second-best solution. The British thought that "it would be a good thing if Germany could take over our debt and the French debt to the United States" (United Kingdom 1919, 4). However, the Americans would not allow the European allies to shift their debts to enemy states. The Americans were concerned about default risk, and they realized their enemies were more likely to default than the allies. According to Wilson's Press Secretary, Ray S. Baker, "the United States Treasury had flatly refused to consider any readjustment of the European debts" (Baker 1922, 374). In short, the Americans would not let previously-hostile states simply take over the European allies' war debts.

Given his goals and American constraints, Keynes produced his "Scheme for the Rehabilitation of European Credit and for Financing Relief and Reconstruction" (Keynes 1919g). This proposal, which Keynes nicknamed "The Grand Scheme for the Rehabilitation of Europe," is the most important one he wrote at the Paris Peace Conference. The Grand Scheme involved the enemy powers issuing \$6.725 billion of reparations bonds.¹³ Of this amount, \$5 billion "shall be paid over to the allied and associated governments on account of sums due for reparation" (Keynes 1919g, 430). According to Keynes's apportionment suggestions, Britain would receive reparations bonds of \$1.25 billion, France of \$2.8 billion, and the other allies \$950 million (1919h, 450). The remaining \$1.725 billion would be used by the former enemy states as collateral for loans by the Federal Reserve System. Under Keynes's scheme, reparations bonds were "acceptable as first-class collateral for loans at the central banks of all the issuing or

¹² It was the British, not the French, who were the hardliners on reparations: "The old idea of a vindictive French reparation policy, and more generally the idea of a vengeful France intent on destroying the German Reich, no longer seems tenable" (Trachtenberg 1979, 56). See Lentin (2001, 40), MacMillan (2002, 192), Sharp (2008, 95-96), Skidelsky (1983, 395), and Trachtenberg (1979, 26; 1980, 18, 63; 1982, 499).

¹³ The present value of the total bond issue was \$7.225 billion. The enemy powers would issue reparations bonds with a present value of \$6.725 billion, and the new states of Eastern Europe would issue bonds with a present value of \$500 million. The bonds issued by the new states of Eastern Europe are not considered here.

guaranteeing states” (1919g, 431).¹⁴ With \$1.725 billion from the Federal Reserve, enemy states would use \$1.345 billion to buy food, while the remaining \$380 million would repay the European neutrals.

How did Keynes’s Grand Scheme solve Britain’s debt problem? Reparations bonds could be used “in payment of all indebtedness between any of the allied and associated governments” (Keynes 1919g, 431). Simply put, they could be used to repay war debts. To demonstrate, the other allies would receive reparations bonds of \$950 million. To reduce their debts, the allies would send reparations bonds of \$530 million to France and \$420 million to Britain. After the discharge by the other allies, France would own reparations bonds of \$3.33 billion. At the end of the war, France owed Britain \$2.54 billion, so France would send Britain reparations bonds of \$2.54 billion. France would be left with bonds of \$790 million to discharge debts to the United States, to borrow from the Federal Reserve for reconstruction, or both.

Under Keynes’s Grand Scheme, Britain would receive \$1.25 billion of reparations bonds from its enemies. After the \$420 million discharge by the other allies and the \$2.54 billion discharge by France, Britain would own bonds of \$4.21 billion. At the end of the war, Britain owed the United States \$4.21 billion, so Britain sends the United States bonds in that amount. Thus, Britain’s war debt to the United States would be completely paid off, and, at the end of the process, all of the reparations bonds would end up in the United States.¹⁵ In summary, Keynes’s Grand Scheme “would in effect have wiped out the bulk of inter-allied indebtedness by liquidating it with the bonds delivered for reparations” (Lloyd George 1923, 105).

While the Grand Scheme was favorable to the European allies, it was unrealistic because it ignored American interests. Keynes’s scheme was a roundabout, disguised way to transfer a large portion of the European allies’ war debt to Germany. The scheme involved the United States effectively

¹⁴ As noted by Harrod (1951, 246), the European Allies could have used all the reparations bonds as collateral for loans from the Federal Reserve. Given Keynes’s goal of solving the war-debt problem, however, he argued that a large portion of the reparations bonds should have been used to discharge inter-Ally debt.

¹⁵ The hypothetical pattern of debt discharge described above is the ideal pattern for Keynes, but many other patterns are possible: “There are many points in it which will require very careful discussions between our experts, and it is doubtless capable of much modification and improvement without detriment to the main ideas which underlie it” (Keynes 1919g, 435). Regardless of the pattern of discharge, all of the reparations bonds would end up in the United States because it was the largest creditor.

swapping lower-risk allied bonds for higher-risk reparations bonds. The US government and American investors would end up with all the reparations bonds and all the default risk.¹⁶

Here was a “joker”—so far as America was concerned—for, passed from hand to hand, these bonds would wipe out a large share of the inter-allied debts, leaving the ultimate creditors (mainly the United States) creditors directly of Germany. While this would accomplish after a fashion the project the British had constantly in mind—of getting rid of this huge burden of international debts as a hindrance to the resumption of normal conditions of international trade—it would leave America “holding the bag.” (Baker 1922, 289-90)

Furthermore, under Keynes’s scheme, the reparations bonds would not start paying interest until January 1925, so bondholders in the United States would receive no interest for five years. Keynes knew Europe’s default risk was high: “If I had influence at the United States Treasury, I would not lend a penny to a single one of the present Governments of Europe” (Keynes 1919a, 181). He also knew that the Americans were unwilling to rearrange debt obligations. There are two possibilities: either Keynes did not understand that his scheme would effectively shift allied war debt to Germany, or he hoped the Americans were too unsophisticated to notice.

Keynes submitted his Grand Scheme on April 18, 1919, and it was rejected on May 4. He was horrified. He wrote to his lover, Duncan Grant, “One most bitter disappointment was the collapse of my Grand Scheme... [T]he American Treasury (of whom no more was asked than ours) turned it firmly down as a most immoral proposal” (quoted in Moggridge 1992, 312). There was a rapid shift in Keynes’s attitude towards the treaty after his rejection. On May 4, he ambivalently reported, “We come out exceedingly well... The financial clauses are, I think, innocent” (1919i, 452-53). Just a short ten days later, he railed, “The Peace is outrageous and impossible and can bring nothing but misfortune behind it... Well, I suppose I’ve been an accomplice in all this wickedness and folly” (1919j, 458). Keynes submitted

¹⁶ The British were aware that under Keynes’s scheme, a default by Germany “would have the same effect as a cancellation... of so much of the war-debts” (Lloyd George 1923, 106). The Americans were correct to believe that Europe’s default risk was high: “The final figure was set in London in 1921 at 132 billion gold marks (about £6.6 billion or \$33 billion)... Germany regularly defaulted on its payments—for the last time and for good in 1932... In the final reckoning, Germany may have paid about 22 billion gold marks (£1.1 billion, \$4.5 billion)” (MacMillan 2002, 480). Britain finally defaulted on its war debt after 1933. On the history of reparations, see Dostaler (2007, 151-53), Gomes (2010), Mantoux (1946, 133-59), Marks (1969; 1976, 44-143), and Sharp (2008, 105-8).

his resignation from the British delegation on May 19, but on June 2, he submitted his “Memorandum on Alternative Reparation Proposals” (Keynes 1919k). This proposal was his last try, and it made Germany responsible for totally restoring France and Belgium. He estimated that the total claim against Germany was \$31.5 billion. This was the harshest proposal he drafted at the peace conference, and his figure was not significantly different from the final figure of \$33 billion set in 1921. Yet it was also rejected, and he left Paris on June 7.

The traditional view is that Keynes gallantly resigned from the British delegation in Paris because he thought the treaty was too harsh on Germany. According to this conventional wisdom, he had a “humanitarian concern for the underdog” and “his passionate disagreement with what he considered to be harsh clauses of the Versailles Peace Treaty led to his resignation” (Hession 1984, 141; Patinkin 1982, xx). However, Keynes’s overwhelming concern was Britain, not Germany. Also, the fact that he had already agreed to leave the Treasury before the start of the peace conference makes his resignation seem less significant (Dostaler 2007, 140). Fundamentally, his intimate involvement in planning for reparations is totally incompatible with the view that he resigned in protest over harsh reparations. Instead, the explanation given by Thomas W. Lamont, Keynes’s American counterpart at the conference, is more consistent with Keynes’s actions: “Keynes got sore because they wouldn’t take his advice, his nerve broke, and he quit” (Lamont 1919). All of this advice was aimed at resolving the war-debt problem. In short, Keynes resigned because American opposition made it impossible for him to resolve the dilemma he helped to create.

5. *The Economic Consequences of the Peace*

The Economic Consequences of the Peace is an analysis of the European economy after the First World War. Keynes’s defenders tend to argue that “the book was written as an explanation of the reparations problem” (Davidson 2007, 10). However, Keynes himself did not describe it as a book about reparations. Rather, he described it as “a book on the economic condition of Europe” (1919m, 4). The central thesis of *The Economic Consequences of the Peace* is that the war destroyed the economic order of Europe. His main criticism of the peace is that “the Treaty includes no provisions for the economic rehabilitation of Europe” (1919a, 143). Before and after the peace conference, he viewed war debt as the chief problem:

The war will have ended with a network of heavy tribute payable from one Ally to another. The total amount of this tribute is even likely to exceed the amount obtainable from the enemy; and *the war will have ended with the intolerable result of the Allies paying indemnities to one*

another instead of receiving them from the enemy... If we have to be satisfied without full compensation from Germany, how bitter will be the protests against paying it to the United States. We, it will be said, have to be content with a claim against the bankrupt estates of Germany, France, Italy, and Russia, whereas the United States has secured a first mortgage upon us. (1919a, 175-76, emphasis added)

Keynes thought the European economy would not recover until the debt problem was solved: “We shall never be able to move again, unless we can free our limbs from these paper shackles” (1919a, 178). In his view, the war debt and reparations problems were inextricably entwined, though the reparations problem was simply one part of the much larger debt problem. The allies thought they needed reparations to repay their debts, so “the question of inter-Allied indebtedness is closely bound up with the intense popular feelings amongst the European allies on the question of indemnities” (Keynes 1919a, 176). On the connection between war debt and reparations, Keynes later wrote, “If, in addition, the United States exacts payment of the Allied debts, the position will be intolerable... The position is exactly parallel to that of German reparation” (1922, 113). Keynes’s main concern was war debt, not German reparations. He was only concerned with reparations insofar as the payments affected Britain’s war debt and exports.

From Germany’s perspective, Keynes’s proposal in *The Economic Consequences of the Peace* was harsher than the one in his Grand Scheme. Characteristically, he recommended completely cancelling all inter-allied war debts as “absolutely essential to the future prosperity of the world” (Keynes 1919a, 171). To his mind, the debt problem had priority over other issues: “Settlement of inter-Ally indebtedness is, therefore, an *indispensable preliminary* to... the prospects of an indemnity from the enemy” (1919a, 176-77, emphasis added). He observes,

If all the above Inter-Ally indebtedness were mutually forgiven, the net result on paper (i.e. assuming all the loans to be good) would be a surrender by the United States of about \$10,000,000,000 and by the United Kingdom of about \$4,500,000,000. France would gain about \$3,500,000,000 and Italy about \$4,000,000,000. But these figures overstate the loss of the United Kingdom and understate the gain to France... [T]he relief in anxiety which such a liquidation of the position would carry with it would be very great. It is from the United States, therefore, that the proposal asks generosity. (Keynes 1919a, 172-73; 1920a, 272)

Cancelling the debt would naturally solve Britain’s war-debt problem. Regardless, Keynes still advocated imposing reparations on Germany. Thus, the reparations he demanded in *The Economic Consequences of the Peace* were not

intended to repay war debt. They were intended to eliminate Germany as an economic rival to Britain. Keynes proposed that,

- (1) The amount of payment to be made by Germany in respect of Reparation and the costs of the Armies of Occupation might be fixed at \$10,000,000,000
- (2) The surrender of merchant ships... war material... State property... public debt, and Germany's claims against her former Allies, should be reckoned as worth the lump sum of \$2,500,000,000
- (3) The balance of \$7,500,000,000 should not carry interest pending its repayment, and should be paid by Germany in thirty annual installments of \$250,000,000, beginning in 1923. (Keynes 1919a, 166; 1920a, 261-62)¹⁷

A large upfront reparations payment was intended to destroy Germany's ability to compete with Britain in foreign commerce. By Keynes's logic, the size of the annual reparations payment was advantageous to Britain because it limited Germany's exports and hence its economic development. In accordance with Britain's foreign policy since the late sixteenth century, his plan was intended to prevent the rise of a strong power on the European continent. On top of war debt cancellation and \$10 billion of German reparations, "the United States, must provide foreign purchasing credits for all the belligerent countries of continental Europe, allied and ex-enemy alike... Much might be done perhaps with a fund of \$1,000,000,000... for the purchase of food and materials" (1919a, 182; 1920a, 269). Like all of his proposals at the conference, Keynes's plan in *The Economic Consequences of the Peace* was highly favorable to Britain but unrealistic because it ignored American interests.

In addition to all his reparations planning before and during the peace conference, Keynes's reparations proposal in *The Economic Consequences of the Peace* proves he was not a genuine opponent of reparations. He wrote, "The accepted standards of international justice entitled us to impose, at Germany's expense, any terms which might be calculated to make good some part of the destruction done" (1920b, 52). Superficially, his modest figures

¹⁷ The present value of Keynes's proposal was \$5.988 billion if the installments are discounted at 5 percent. On April 24, 1921, the Germans undermined Keynes's analysis by offering to fix the present value of their liability at \$12.5 billion: "Germany expresses her readiness to acknowledge for reparation purposes a total liability of 50 billions gold marks (present value). Germany is also prepared to pay the equivalent of this sum in annuities adapted to her economic capacity totaling 200 billions gold marks [\$50 billion]" (United States 1921, 46).

make him appear to be a merciful reparations planner. In reality, his plan was designed to simultaneously improve Britain's debt problem and prevent any expansion of German exports. His goal was to prevent German trade from expanding and, consequently, to keep Germany relatively poor for decades after the war. Even Lytton Strachey advised that the reparations proposal in *The Economic Consequences of the Peace* was "far too harsh" (Strachey 1919, 65).

6. Conclusion

According to conventional wisdom, Keynes heroically resigned from the British delegation at the Paris Peace Conference in protest against the punitive reparations payments imposed on Germany. In this view, he "became increasingly disillusioned with the demands for reparations being placed on Germany, which he saw as unethical and unrealistic, and he eventually resigned in protest" (Backhouse and Bateman 2011, 52). The standard interpretation is seriously misleading and incomplete. Keynes's overarching concern during and after the Conference was Britain, not Germany. His main goal in Paris was to solve Britain's war-debt problem, and he resigned from the British delegation because his proposals were repeatedly rejected by the Americans. It must be emphasized, however, that Keynes was the person most responsible for creating Europe's war-debt problem in the first place. At the Conference, the allies came to view reparations as the only politically viable way to pay off war debts. Thus, the problem partly orchestrated by Keynes intensified the allies' lust for reparations. In this sense, Keynes was the father of the tragic reparations debacle after the First World War.

Regarding Germany, Keynes's actions at the Paris Peace Conference are totally incompatible with the view that he opposed reparations. He helped draft Article 231; he recommended a large upfront reparations payment followed by long-term payments; he estimated how much Germany could pay and how much Germany should pay; he suggested that Germany sign a blank check; he tried to maximize Britain's percentage of the reparations payments; and he wrote "A Grand Scheme for the Rehabilitation of Europe" and other more onerous reparations proposals. Keynes devised the ideas that "formed in substance the proposals with regard to Reparations which were embodied in the Treaty of Versailles" (Lloyd George 1938, 456). In contrast to the standard view that Keynes was a humanitarian opponent of punitive reparations, he wanted to use reparations to impair Germany's trade and development after the war. His mercantilist plan was intended to keep Germany in a state of relative impoverishment. He only resisted very large *annual* reparations payments as a solution to his war-debt problem because he accepted the mercantilist fallacy that large payments would stimulate German

exports at Britain's expense. His overwhelming desire to eliminate Britain's war debt mixed with his mercantilist ideas led him to write *The Economic Consequences of the Peace*.

Keynes's lifelong fight for British imperialism was counterproductive and self-defeating. While each of his wartime efforts was aimed at preserving British imperialism, the system of allied war loans he developed and applied destroyed the financial foundation of the empire. The war-debt problem masterminded by Keynes contributed to the trade and currency wars of the interwar period that played an important but neglected role in causing the Second World War. Furthermore, he advised the British government to suspend repaying war debt, which it did after 1933 (Keynes 1932a, 1932c, 1933). One result was the Johnson Act of 1934 prohibiting loans from the United States to any government in default. The Johnson Act meant Britain would become totally dependent on the lend-lease program used by the US government to dismantle the British Empire (Rothbard 1976, 479-80; Steil 2013, 99-124). By creating the war-debt problem and then advising the government to default, Keynes destroyed the financial basis of Britain's imperial power and handed the American government the lend-lease weapon it used to tear it apart. Although he fought vigorously throughout his life for the British Empire, Keynes actually deserves much credit for its demise.

Keynes's critique of the Treaty of Versailles in *The Economic Consequences of the Peace* is highly problematic. The allies' imperialistic nation-building must play a central role in any substantive criticism of the treaty (Rothbard 1990, 230-32; Denson 2001, 461-84). The British and French used the treaties to carve up the world and create new nation-states by government coercion. But Keynes argued that the problems with the Treaty of Versailles were entirely economic, not territorial (Keynes 1919a, 92, 146). Hence, Keynes's entire case against the treaty was rooted in a tissue of mercantilist fallacies. He was an imperialist, and he never opposed the imperialistic territorial clauses (Skidelsky 1983, 371). He declared, "The setting up of a great many of these states was, in my opinion, justified" (1920c, 51). Moreover, Keynes never realized that a just and lasting peace must be based on the free market economy and private property rights. As Ludwig von Mises (1944a, 320) said, "There is but one system that makes for durable peace: a free market economy."¹⁸ Keynes spent his entire career recommending and justifying interventionist policies that create economic conflict and war. Along with *The*

¹⁸ On durable peace, see Mises (1919, 71; 1922, 268; 1927, 112-15; 1940, 97, 147; 1941; 1943a; 1943b; 1944a, 317-20; 1949, 682, 817-828). On national self-determination, see Mises (1919, 25-31; 1927, 78-80; 1944a, 102-6) and Rothbard (1990, 230-34; 1994).

General Theory, *The Economic Consequences of the Peace* can lay a claim to be regarded as Keynes's most problematic book. Keynes himself regretted it, and so should historians and economists today:

Sometime in 1936, after the March 29 "election" in Germany which consolidated Hitler's power, Elizabeth Wiskemann, a German-born, Cambridge-educated historian, met [Keynes] at a social gathering in London. Suddenly, she reported later, she found herself saying, "I do wish you had not written that book [meaning *The Economic Consequences of the Peace*, which the Germans never ceased to quote], and then longed for the ground to swallow me up. But he said simply and gently, 'So do I.'" (Hession 1984, 306-7)¹⁹

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¹⁹ Libertarians tend to blame the Second World War on economic and military interventionism (Rothbard 1984, 20). By contrast, advocates of the appeasement argument blame the war on English, French, and American noninterventionism in the 1930s. Ludwig von Mises ultimately blames all modern wars on interventionism, but also criticizes appeasement in the 1930s (Mises 1943a, 154; 1943b, 159; 1944a, 13-14, 231, 237). Advocates of the appeasement argument must assign Keynes much responsibility for the war. Roger Opie writes, "It could be argued, I suppose, that Keynes was the cause of the Second World War... There can be no doubt that Keynes's two books, *The Economic Consequences of the Peace* and *A Revision of the Treaty* were the most important factors in creating that intellectual, moral and political climate" (1974, 76). On Keynes and appeasement, see Chernow (1990, 208), Ferguson (1999, 407), Harcourt (2012, 20-1), Lentin (1984, 141; 2012), Mantoux (1946, 17), Martin (1970, 240), and Rolph (1973, 245).

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