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Charles S. Maier

Economic Consequences of the Peace...Social Consequences of the War

Keynes's *Economic Consequences of the Peace* -- brilliant, unfair, wrongheaded, destructive perhaps in its consequences...but right for the wrong reasons. After ninety years it remains perhaps the most successful published polemic of the twentieth century -- thrown off in white heat in the summer and fall of 1919 by an author whose major work seventeen years later, *The General Theory of Employment, Interest and Money*, would brilliantly overthrow one economic orthodoxy and, for a generation at least, prepare the way for another.

Ultimately Keynes was dealing with a topic that he did not acknowledge in his title: the economic consequences of the war, the disruption of the economic exchanges and commerce of that pre-1914 globalized world that he evokes with brilliance in chapter 1. The war had demonstrated that politics or at least the passions of nationalism trumped economic reasoning, and that is why politics, although Keynes may have lamented the fact, tended to come first at the peace conference. The commitment to resurrect a Polish nation-state with a Baltic coastal outlet meant the creation of a state that had to cost Germany traditional Prussian territories. Self-determination in the Baltic and the former Habsburg realms meant the creation of fragile and weaker nations. The inability to suppress the Bolsheviks and/or the unwillingness to appease them, meant a tremendous ambiguity about Russia's role in post-1918 Europe. But Keynes understood that the tragedy came not only in 1918 but 1914.

Skidelsky's brilliant biography makes clear how Keynes and his liberal British intelligentsia lived in a world of transnational culture that they hardly wanted disrupted, but gradually saw destroyed.¹ From one perspective the *Economic Consequences* is a *cri de coeur* against the destruction of that world. Keynes served his government during the war, but he never abandoned his cosmopolitanism and his hope for a compromise that might repair the continent. What he lamented in his tract was that the statesmen of 1919 could not finally overcome that rupture.

The part of the book that often seems to have captured most attention comprised the character sketches. With the exception of his mother -- so Skidelsky reports -- his readers loved these clever portraits. They carried on his friend Strachey's tradition in *Eminent Victorians*. To Keynes the traits he described explained why the settlement was so flawed: Lloyd George, too clever by half, calling for heavy German obligations, then repenting of his demagoguery; Wilson, caught up in Presbyterian rectitude and representative of a crass material culture whose politicians could not see beyond their local interest; and Clemenceau: single-minded cynic intent on subjugating Germany.

These merciless sketches (and ultimately Keynes self-censored the one on Lloyd George and removed it from his book) play a curious role in his tract. One has the sense that they were inserted to make a supposedly dull subject interesting to a culture that was most likely to tolerate political economy only when sugared by biography. They showed he could master “fine writing.” Had Keynes been less determined to be an appealing writer, he might have reflected that the traits he had sport in identifying were the ones that had brought their countries through desperate straits: providing the ruthlessness needed to keep Britain and France so single-mindedly through the terrible years of 1917-18, and allowing Wilson the moral fervor finally to enlist his countrymen in a far-away cause. Did Keynes really believe that the Treaty of Versailles was adversely affected by the fact, as he saw it, that Woodrow Wilson’s hands, “though capable and fairly strong, were wanting in sensitivity and finesse”? (p.25) Wilson “had no plan, no scheme, no constructive ideas whatever for clothing with the flesh of life the commandments which he had thundered from the White House.” (27) This was just rhetorical nonsense: defective though the results might have been, the League of Nations and the construction of nation-states in Eastern Europe followed Wilsonian precepts.

As for Clemenceau, who kept his hands gloved throughout (Keynes remains fascinated by hands!) he could not be accused of naiveté or lack of comprehension. Keynes is more on the mark. For Clemenceau the natural state of Franco-German relations had to be implicit if not explicit war, and thus the task was to reduce German power, including economic power. “By loss of territory and other measures her population was to be curtailed: but chiefly the economic system, upon which she depended for her new strength, the vast fabric built upon iron, coal, and transport must be destroyed.” (p.22) Keynes’s argument is that this attitude had to lead inexorably to the “Carthaginian Peace.” And here is where the book gains force, namely in Keynes’s argument that the Carthaginian peace “is not practically right or possible...The clock cannot be set back. You cannot restore Central Europe to 1870 without setting up such strains in the European structure and letting loose such human and spiritual forces as, pushing beyond frontiers and races, will overwhelm not only you and your ‘guarantees’, but your institutions, and the existing order of your society.” (p.23)

This was a serious argument. Keynes devotes the heart of his book to showing how the Allies were working toward this perilous end. His tract first discussed all the diminutions of German territory and population, the removal of coal resources, and the handicaps laid on a merchant marine – all designed, he suggested, to render Germany an economic cripple. Keynes then proceeds to show second is to show how the reparations settlement was not only unjust but unworkable. Here is where historiography of the 1970s found it easiest to criticize. As Keynes himself recognized, British domestic politics in the fall of 1918 was a prime factor in leading to heavy reparations claims. He at least is unsparing of his own countrymen, rashly promising to squeeze the German citrus “until the pips squeaked.” By the time Lloyd George sought to reverse course in the Paris negotiations, it was too later. It was easier to bamboozle Wilson than de-bamboozle him. (p.34)

When Keynes wrote, the final reparations bill had not yet been determined, but Keynes calculated that the damages that might be charged to Germany would total perhaps £3,000 million (=milliard or thousand million) for physical damages and another 5 £5,000 million for pensions and allowances, or up to £8 thousand million pounds. In fact the reparation bill was to total about £6.6 billion sterling (or close to 3 billion dollars or 132 billion gold marks – the unit of account based on the Mark’s prewar value). The provisions for extracting that sum involved having Germany amortize a series of bonds, that would be issued in different series sequentially, but, so Keynes estimated with the result that it would require 48 years of payments continually rising to over £3 billion pounds or close to 60 billion gold marks per year. Keynes was “as certain as anything can be” that Germany could not pay this sum (pp. 100-105). Two billion pounds (£2,000 million =40-50 billion gold marks) represented the upper limit of German capacity to pay (pp. 126-127).

Keynes’s book caused an outcry among Tory and hard-line opinion in Britain; it obviously was welcomed in Germany. Recent historiography has divided. For many *The Economic Consequences of the Peace* quickly became obvious wisdom. Keynes had said the Germans couldn’t pay, and by and large they didn’t once having made an initial payment of a billion gold marks and a contested sum in kind by 1921. Keynes predicted a possible inflation, which followed. Still, the generation of historians returning to the reparation issue about thirty years ago was much more critical. Stephen Schuker, forcefully demonstrated that the Germans evaded making payments they might have made. The opening of French documents allowed a more sympathetic understanding of the French position.² The question became the one that the French had insisted on: not what payments were feasible, but what compensation was just. This author felt more critically about Keynes in the 1970s and 1980s than since. Subsequent historical work has tended to redress the balance and to look less at injustice than short-sightedness. As Keynes understood, forcible extraction of resources from an enemy country was very difficult or required a much greater degree of control (such as the Germans had over the French from 1940 to 1944, or the Soviets had over the East Germans after 1945).

Of course the heart of the book was the economic argument: The reparations conflict inflamed nationalist opinion in Germany, led the country into a desperate crisis by 1923, and then abated. The supposedly draconian terms levied in 1921 were postponed in 1924. In fact, the continuing series of different bonds spaced out over time diminished the present value of the burden (as Keynes would recognize in 1921) although it appeared primarily to prolong it. The United States banking system played the role from 1924 until 1929 that Keynes had wanted official U.S. policy to play in 1919: that is to recognize the linkage between German payments to the former allies and their payments to the United States. But when the system of capitalist credits broke down (in fact once it came under strain from 1927 even before the Crash), reparations were to be wound down

again. They still inflamed Germany and mobilized Nationalists and Nazis together. But agricultural recession, choking markets were the prime cause: reparations would be wound up by 1932. Keynes was right: far better to have avoided that tremendous exacerbation of revanchist sentiment in Germany! Far wiser for America to have moved to limit the French-British *surenchère* of claims in the early months of the conference! Americans would in effect substitute Marshall Plan payments for German reparations after 1945, but, not being able to envisage the consequences, were not ready to take on that burden after 1919. Still, by the time the U.S. had negotiated settlements with each of its debtor nations in the 1920s, it had excused roughly half of the present value of what it was nominally owed.

Keynes said some wise things, but did he write a wise book? His demonstration was bound to encourage German resistance to the reparations and hardly likely to encourage the French to accept revision. Keynes's analysis impressed because of the supposedly scientific weight behind the numbers. Germany was sacrificing 15 percent of its territory and its productive base. Before the war it had barely balanced its international accounts. How on this reduced national territory could it ever create the export surplus needed to send payments abroad?

But this is a curious argumentation. The Bonn Republic from 1949 until 1989 achieved its formidable economic achievement on a far smaller size than the interwar German Republic. More fundamentally, Keynes virtually dismissed the possibility of economic growth. He understood the argument that Germany was "capable of very great productivity," by which he meant economic growth, and he recognized "that in 1870 no man could have predicted Germany's capacity in 1910." (pp. 128-29) Nonetheless, he dismissed the potential for growth as having virtually no bearing on the problem. First, he argued, that wartime industrial wear and tear, unfertilized fields, the diminution of livestock, the burden of pensions, would preclude recovering the prewar growth rates, as estimated by Karl Hellferich (pp. 129-30). Second he raised the issue of what would soon become known as the transfer problem: even assuming growth might resume, how could the new capacity be made into a surplus available for export (p.131)? Some sleight of hand emerged in this argument. Keynes maintained that the possibilities of growth should not justify the wilder notions that ultimately she might pay £10 billion pounds – but the issue was whether she might eventually pay the sum of about £7 billion, not even more exaggerated claims. And was German economic growth rendered irrelevant by the transfer problem? There would be a huge debate on this issue by the late 1920s, but it would eventually be demonstrated that budget surpluses could become current account surpluses.

What is striking is that Keynes presupposes a Malthusian framework that prewar growth belied, indeed one that he himself abandoned when he wrote the essay "Economic Possibilities for our Grandchildren," in 1930 with its vision of a future plenty. Keynes, however, was not really a growth economist; his analysis presupposed economic

plateaus: plateaus of plenty perhaps, but plateaus nonetheless. His major work, *The General Theory* of 1936, would focus on restoring an earlier prosperity, not ensuring continuous economic growth. This theoretical challenge was left to his younger enthusiastic Anglo-American readers in the late 1930s and 1940s.

Perhaps because he wished to emphasize the difficulty of extracting reparations, Keynes depicted the prewar world economy as a taut and precarious web of relations, which was facing Malthusian limits. “I have selected for emphasis the three or four greatest factors of instability,” he writes of 1914: “the instability of an excessive population dependent for its livelihood on a complicated and artificial organization, the psychology instability of the labouring and capitalist classes, and the instability of Europe’s claim, coupled with the completeness of her dependence, on the food supplies of the New World.” (p.15) What a skewed picture this is! Rather than emphasize what material prosperity had been achieved, or how European manufacturing gave her unparalleled command over the agrarian products of the world (which he had conjured up nine pages earlier), he stressed Malthusian fragility – a continuing pressure on resource limits. There was a neurasthenic hyperdevelopment to the golden age of 1914. Moreover, the two resources that were most constraining were wheat or food and coal. The scarcity of food ensures the vulnerability to America; the limits on coal ensure the unworkability of the immediate German payments. Keynes assigns a resource determinism to the extraction of coal throughout his argumentation. Keynes could have provided other numbers but he was beset by an overriding vision of breakdown and collapse. I am not claiming he was wrong: the great depression might be said to have shown how well founded was his image of fragility. But the growth in Europe of 1925-29, brief though it was, and certainly that after 1945, should lead us to question whether there was not more resilience than he chose to depict.

Finally, I think, there is another reason behind his Malthusian assumptions. What worried Keynes in 1919 was the future of capitalism. And of course not only Keynes! But Keynes was concerned because he feared that the war revealed on what a thin moral foundation capitalism rested and indeed on what a thin moral foundation he, along with Bloomsbury as a whole, believed it merited. *The Economic Consequences of the Peace* assumes not merely a world of rival national economies. It suggests that all the European nations had an interest in not overburdening a bourgeois order built on great inequality. European “society was so framed as to throw a great part of the increased income of the class least likely to consume it....Herein lay, in fact, the main justification of the capitalist system.” (p.11) Only by saving the surplus the propertied received rendered bourgeois accumulation tolerable and allowed for prosperity. But this system rested on “a double bluff.” The laboring classes were cajoled or coerced into working so hard for relatively little; the propertied classes were convinced of the virtue of saving. “And so the cake increased; but to what end was not clearly contemplated.” (p.12) The war, moreover, might consume the cake – and even if it did not, “The war has disclosed the possibility of consumption to all and the vanity of abstinence to many. Thus the bluff is

discovered; the labouring classes may be no longer willing to forgo so largely, and the capitalist classes, no longer confident of the future, may seek to enjoy more fully their liberties of consumption so long as they last, and thus precipitate the hour of their confiscation” (p.13)

Lenin and his enthusiasts lurked in the corridors of history. The world war, which Keynes termed a European civil war (p.2) had already given the Bolsheviks control of one huge country. He had no illusions that their revolution represented any sort of progress. The greatest damage the war had inflicted was not on French and Belgian territories, but on the hitherto docile acceptance of class inequality. Could the Europeans and the Americans (who were being asked to cancel their financial claims as well) not understand a venerable civilization was at stake? We must read this text finally not as just a statistical argument about realistic peacemaking but as a warning about the social and cultural order. We can understand in retrospect that capitalism was more robust than his temporarily Malthusian assumptions allowed – it had at least almost a century left to thrive.

¹ Robert Skidelsky, *John Maynard Keynes*, vol. I: *Hopes Betrayed 1883-1920* (London: Macmillan, 1983). Page references to *The Economic Consequences of the Peace* are to *The Collected Writings of John Maynard Keynes*, vol. II (Cambridge: Cambridge University Press, the Macmillan paperback printing of 1984). They will be inserted in brackets directly after the citations.

² See among others Stephen A. Schuker, *The End of French Predominance in Europe: The Financial Crisis of 1924 and the adoption of the Dawes Plan* (Chapel Hill: University of North Carolina Press, 1976); also Schuker, *American "Reparations" to Germany, 1919-33*, (Princeton: Princeton University Economic Department); also Marc Trachtenberg, *Reparation in World Politics: France and European Economic Diplomacy, 1916-1923* (New York: Columbia University Press, 1980). For emphases on the difficulty of making reparation payments, see Peter Krüger, "Das Reparationsproblem der Weimarer Republik in fragwürdiger Sicht: kritische Überlegungen zur neuesten Forschung," *Vierteljahrshefte für Zeitgeschichte*, 29 (1981); Bruce Kent, *The Spoils of War: The Politics, Economics and Diplomacy of Reparation 1918-1922* (Oxford: Oxford University Press, 1989) Zara Steiner attempts a rapid summary in *The Lights that Failed: European International History 1919-1933* (Oxford: Oxford University Press, 2005), pp. 193-201. Other contributions by Barry Eichengreen, the late Gerald Feldman, Carl Ludwig Holtfrerich and Charles S. Maier, Sally Marks, have marked this ongoing debate.