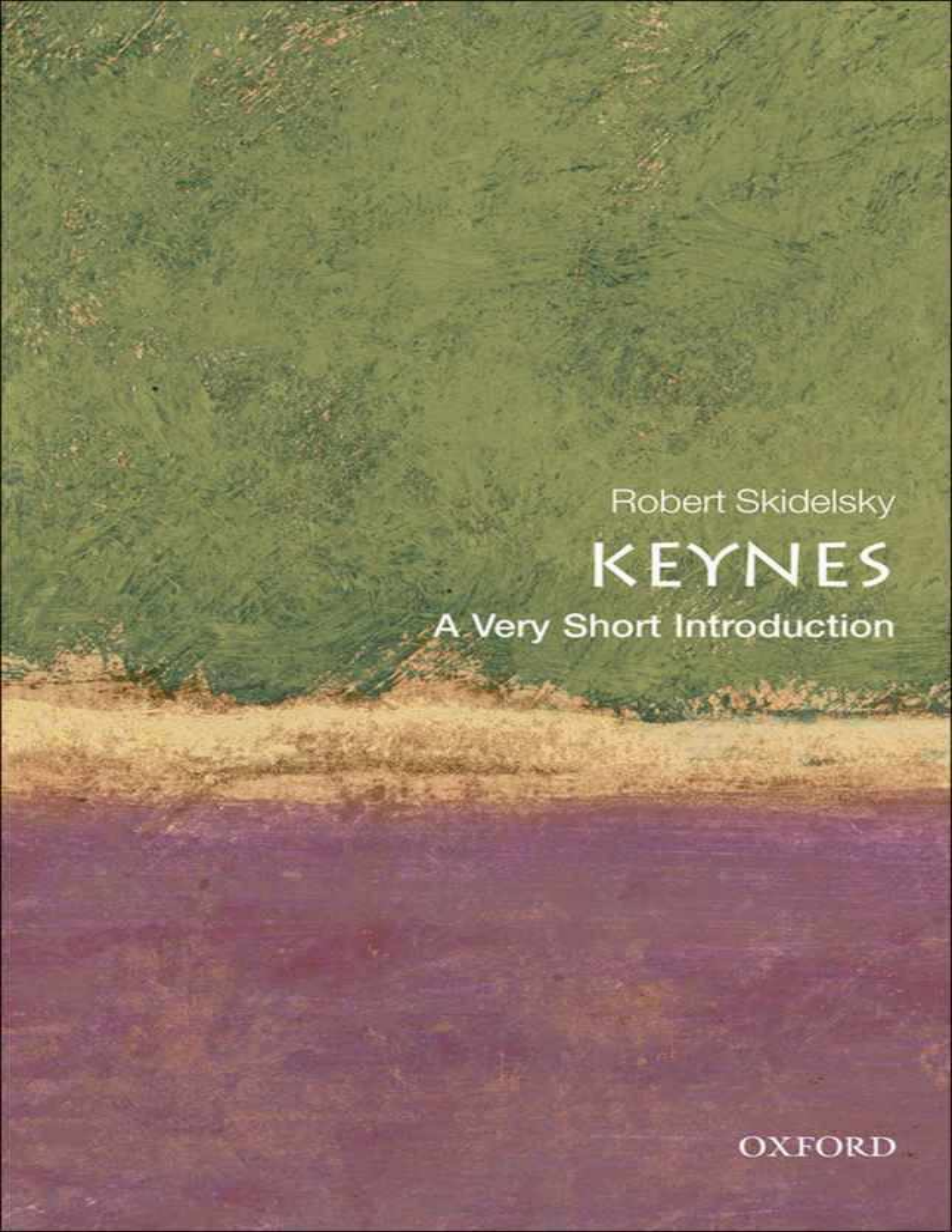

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KEYNES

A Very Short Introduction

OXFORD

Chapter 5
Economic statesmanship

Keynes was as creative in administration as he was in theory. For every economic problem which interested him he had ready a ‘Keynes Plan’, drafted at lightning speed. The common feature of these plans – which go back to his proposal for an Indian Central Bank in 1913, praised by Marshall as a ‘prodigy of constructive work’ – is that while always ahead of the intellectual orthodoxy of the moment they could be readily fitted to existing administrative arrangements. Keynes could thus present them as evolutionary developments of existing practice. The partial exception is his endorsement of a centrally directed public works programme in 1929, which would have required a revolution in government. But this was a Lloyd George, not a Keynes, plan; Keynes’s own preference was to channel increased investment through the public utility corporations. He also favoured indirect (financial) to direct (physical) control over the economy, in order to retain the advantages of decentralized decision-making. This brought him into conflict with socialist methods, if not with some aspects of the socialist ideal.

The outbreak of war with Germany on 3 September 1939 posed the kind of economic challenge he could not shirk; and he responded with two articles, ‘Paying for the War’, published in *The Times*, on 14 and 15 November, and recast and expanded into a booklet, *How to Pay for the War*, which appeared in February 1940, five months before his return to the Treasury. *How to Pay for the War* has been hailed as the first major application to policy of *The General Theory* model of the economy, and so it was. But it also reflected Keynes’s experience as a Treasury official in the First World War.

With full employment assured through the big increase in state orders, the problem Keynes faced in 1939 was to transfer resources to the war effort without undue inflation, disincentive tax levels, or the bureaucratic controls associated with comprehensive physical planning. In the First World War, increased government purchases had caused prices to rise; rising prices had reduced the real incomes of the working class; the 'windfall' profits of entrepreneurs were commandeered by the government in the form of taxes and loans. The results were industrial unrest in the later stages of the war; a high cost of government borrowing, which increased the post-war debt burden; and the ownership by the wealthy of the national debt.

The new Keynes Plan was designed to overcome these problems. Its centrepiece was a scheme for 'deferred earnings'. Excess private purchasing power would be mopped up by a heavily progressive surcharge on all incomes above an exempted minimum, made up of direct taxes and compulsory saving. The latter, credited to individual accounts in the Post Office Saving Bank, would be released in instalments after the war to counteract the expected post-war slump. As Professor Moggridge notes, 'the scheme had the advantage that it could operate through the existing arrangements for national insurance contributions'. Following criticisms of the original plan, Keynes proposed to 'provide for this deferred consumption without increasing the National Debt by a general capital levy after the war'; and to protect the poorest through family allowances – 5*s* or 25p a week per child – and an 'iron ration' of necessaries to be sold at low fixed prices. In estimating the size of the 'inflationary gap' – the amount by which civilian consumption would need to be reduced to enable output to be transferred to the war effort without prices rising – Keynes, in the absence of official national income statistics, offered estimates, based on the work of Colin Clark, of national output and taxable income, the division of total spending between the government and private sector, and income distribution, all in 1939 prices. It then became relatively easy to calculate how much 'private outlay' had to be reduced to accommodate any desired increase in 'government outlay' at these prices, as well as the sacrifice required from each section of the community.

Keynes's plan had no influence on the budget of July 1940; he was better placed to continue his campaign of persuasion within the Treasury.

Kingsley Wood's budget of April 1941 has been hailed as the first 'Keynesian' budget, not because it adopted the specific measures Keynes had proposed (though deferred pay survived in the form of a modest scheme for post-war tax credits), but because it was based, for the first time, on the national accounting framework developed, from Keynes's suggestions, by James Meade and others. Whether it marked general acceptance of the Keynesian Revolution is far more doubtful. The endorsement of the Keynes Plan by prominent anti-Keynesians like Hayek gives the clue to its popularity with economists and Treasury officials: it suggested a method of minimizing wartime inflation. As Jim Tomlinson has remarked: 'Keynesian arithmetic provided a theoretical rationale and quantification for policies which ran with rather than against the grain of the traditional Treasury stance on wartime finance.'

The debate sparked off by *How to Pay for the War* gave Keynes a chance to link his new economics to the political ideas of the Middle Way, ideas which he had espoused since the 1920s. 'Nature's way' (inflation) of first redistributing income from workers to entrepreneurs, and then taxing it, would no longer work, he said, because, in the new conditions of trade-union strength, rising prices would be matched by equivalent wage demands, which would either have to be conceded, defeating the object of reducing civilian consumption, or prohibited, bringing about industrial disruption. Stable prices were the quid pro quo for trade-union collaboration – a thought which goes back to his early days as a monetary reformer. The object of his plan was '*social:* to prevent the social evils of inflation now and later; to do this in a way which satisfies the popular sense of social justice; whilst maintaining adequate incentives to work and economy'. The significance of Keynes's proposals was thus twofold: they sought to circumvent the problem of 'cost push' inflation at full employment; and they claimed for the budget a role in social policy which went beyond macroeconomic stabilization.

In another respect, though, they went against the grain of left-wing thinking. For most socialists the war offered an opportunity for physical, rather than financial, planning. State allocation of manpower and supplies in accordance with 'national needs' would replace the 'chaos' of the market. Also, rationing of foodstuffs and clothing had a much more straightforward egalitarian appeal than ‘forced saving’. The difference in principle was that Keynes’s plan left the disposition of post-tax incomes to individual choice, while rationing required that individuals spent their money on things, and in the amounts, laid down by the state. ‘I am seizing an opportunity’, Keynes wrote to *The Times* on 18 April 1940 ‘to introduce a principle of policy which may come to be thought of as marking the line of division between the totalitarian and the free economy’. Similarly, the release of deferred pay, ‘by allowing individuals to choose for themselves what they want, will save us from having to devise large-scale government plans of expenditure [after the war] which may not correspond so closely to personal need’. Keynes was once more staking a middle way between the ‘*invalidism* of the Left which has eaten up the wisdom and inner strength of many good causes’ and the ‘sclerotic’ reaction of the Right to any tampering with the existing system. In practice, Keynes lost the argument to the central planners, and regulation of aggregate spending took second place to manpower planning, physical allocation of inputs, and rationing of consumer goods.

Keynes was far less involved with the famous ‘Keynesian’ White Paper on Employment Policy, published on 26 May 1944 (Cmd. 6527). Its first sentence – which Keynes thought ‘is more valuable than the rest’ – committed the government to the ‘maintenance of a high and stable level of employment after the war’. But the text of the White Paper was a compromise between the Keynesians of the Economic Section of the Cabinet and the traditional sceptics of the Treasury, who felt that concessions had to be made to political pressures. Much of its analysis of the prospective unemployment problem was un-Keynesian, reflecting the view of Hubert Henderson that the problems of the British economy were on the supply rather than the demand side. Little thought was given about how to satisfy two of the conditions laid down in the White Paper for sustainable ‘high employment’: moderation in wage policy (the responsibility of employers and organized labour) and adequate labour mobility.

The international economy was the subject of the next Keynes Plan. The inherited gold standard/free-trade system had seemingly been damaged beyond repair by the First World War, the Great Depression, and the nationalist economics of the interwar years. The question was: could British full employment best be secured by a continuation of the Imperial Preference/Sterling Area arrangements built up in the 1930s, or did the war offer the chance of a 'single act of creation', impossible in peacetime, to restore a liberal system free of the deflationary bias which had wrecked the old one? This question engaged most of Keynes's attention and dwindling energy between 1941 and 1944. Its answer lay in the United States, because American policy would determine the shape of the post-war order.

Keynes's involvement with the United States provides an important context for understanding his economics. Those who take their Keynes solely from the 'closed economy' model of *The General Theory* forget that the problem which exercised him for most of his professional life arose from the effects of the unbalanced creditor position of the United States on the British economy. Most of his economic plans were concerned with ways of overcoming or offsetting this imbalance. They culminate in the establishment of the Bretton Woods system in 1944, and the negotiation of the American loan in 1945, as a result of which Britain tacitly accepted a junior role in an American-managed international economic order. But there was nothing inevitable about this culmination, and for much of his life Keynes actively explored alternatives.

In the 1920s, as we have seen, Keynes wanted to decouple the British (and, more generally, the European) financial system from that of the United States. But even in his *Tract* period he was not a currency floater. He wanted a 'managed' exchange-rate system - something consistent with stability of exchange rates for long periods. More often he hankered for a fixed exchange-rate system, with discretion and devices to give it flexibility. In both the early 1920s and the 1930s, when currencies floated against each other, he had proposed returning to a modified gold standard based at various times on wide bands, crawling pegs, automatic creditor adjustment, or supplementary reserve assets. He was convinced that any fixed exchange-rate system would break down if it was used as an instrument of deflation. Such a system worked best when supported by policies to maintain full employment over time. Stable exchange rates would, in turn, help keep the world growing in step and act as anti-inflationary discipline.

As Kingsley Martin records, Keynes's immediate response to the disintegration of the gold standard in 1931 was characteristic: 'At one stroke Britain has resumed the financial hegemony of the world,' he announced, 'chuckling like a boy who has just exploded a firework under some one he doesn't like.' The spontaneous emergence of a sterling bloc suggested to him a 'reputable sterling system for the Empire… managed by the Bank of England and pivoted on London'. He applauded the Bank of England's nationalistic policy of sterilizing gold inflows to keep the pound undervalued against the dollar and franc, which remained on the gold standard – just as he had praised the same policy pursued by the Federal Reserve Board in the 1920s.

This euphoria did not last. Roosevelt's devaluation of the dollar in terms of gold on 19 April 1933 eliminated Britain's short-lived competitive advantage. Keynes now suggested that Britain and the United States might link their currencies together in a modified gold standard so long as they pursued reflationary policies in tandem. Nevertheless, on 4 July 1933 he proclaimed, 'President Roosevelt is Magnificently Right,' when Roosevelt scuppered the London World Economic Conference by denouncing all plans to stabilize currencies as 'the fetishes of so-called international bankers'. Keynes echoed: 'Let finance be primarily national.'

The way to make sense of these twists and turns is to remember that Keynes was offering advice he thought suited Britain best. The pound and dollar, he thought, might be safely linked provided certain conditions were met. He summed up his position in a letter to a German correspondent on 13 October 1936:

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

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

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

Keynes's attitude to the United States softened in the 1930s. He visited it twice, in 1931 and 1934. On the second, and much more important visit, he went to study the New Deal, saw Roosevelt, and explained his new theory of effective demand in Washington and New York. Keynes was greatly impressed. 'Here, not in Moscow is the economic laboratory of the world,' he wrote to Felix Frankfurter on 30 May 1934. 'The young men who are running it are splendid. I am astonished at the competence, intelligence and wisdom. One meets a classical economist here and there who ought to have been thrown out of [the] window – but they mostly have been.' The commitment of the Administration, and of the younger section of the economics profession, to a policy of economic expansion was to be crucial in winning Keynes over to the idea that an American-led world economic system might not be as damaging to Britain's interests as he had feared.

There is a certain paradox, here, for Hitler's New Deal was much more coherent than Roosevelt's and much more successful in getting rid of unemployment. But except for a guarded reference to the advantages of totalitarianism in planning output as a whole, in the German preface to his *General Theory*, Keynes made no public comment on the Nazi economic system, either laudatory or critical. However, he freely condemned Nazism as a barbaric political system, and took to calling Germany and Italy 'brigand powers'. The main reason for Keynes's lack of approbation of Nazi economics was his detestation of the regime. But a subsidiary factor was that, unlike in the United States, there was no body of professional economists, in Germany or anywhere else in Europe outside Sweden, with whom he could seriously engage. The contribution of the Stockholm school apart, the technical discussion following the publication of Keynes's *General Theory of Employment, Interest and Money* in 1936 was an Anglo-American affair. This is a neglected source of Keynes's simultaneous pull to

America, and repulsion from Europe, which followed the breakdown of the supposedly self-regulating international economy in the 1930s.

On the other hand, although Hitler's Germany was in no sense a fit partner for Britain, Keynes at no time urged a preventive war to stop Germany. He approved of the Munich settlement, though not of Hitler's methods in extracting it, thought that whether Hitler seized Danzig or not did not matter in the least, and would have been content to let him take over the Ukraine if he could. As Professor Carr has shown, there were complicated reasons for all these attitudes, but avoidance of another Western European war, and giving Germany its outlet in the east, as part of the rebalancing of Europe he had advocated in 1919 and 1921, were the most important. The United States barely featured in his plans to contain the 'brigand powers'.

The United States was not at first involved in the European and Asian wars, and *all* the belligerents' plans for a post-war economic order left out the United States. Initially, these were based on the reasoning of the 1930s, when Britain, Germany, and Japan had tried to form economic blocs which discriminated against the United States, since none of them felt they could live with America's unbalanced competitive power. The United States, by contrast, had become increasingly internationalist, with Roosevelt's secretary of state, Cordell Hull, vociferous in support of free trade. Once involved in the war, its major war aim was to dismantle the neo-mercantilist blocs established by the other belligerents. (These hopes extended, more vaguely, to the even more autarkic system established by the USSR.) The defeat of Germany and Japan would automatically eliminate their systems; but the United States could also exert powerful pressure on its dependent ally, Britain.

The first post-war plan was produced by Germany. Dr Walther Funk, Hitler's Economics Minister, proclaimed a European 'New Order' in Paris on 25 July 1940. This called for a European economic bloc with fixed exchange rates and a central clearing union in Berlin. Relations with the United States would be on a barter basis. The purpose of the plan was to restore within Europe what Funk called 'an intelligent division of labour', while shielding Europe as a whole from the deflationary consequences of an international gold standard.

Keynes at the British Treasury saw much virtue in the Funk proposals. He wrote to Harold Nicolson on 20 November 1940: 'If Funk's plan is taken at its face value, it is excellent and just what we ourselves ought to be doing. If it is to be attacked, the way to do it would be to cast doubt and suspicion on its *bona fides.'* Even more striking was Keynes's formal response to the German plan on 1 December:

> It is not our purpose to reverse the roles proposed by Germany for herself and for her neighbours… Germany must be expected and allowed to assume the measure of economic leadership which flows naturally from her own qualifications and her geographical position. Germany is the worst master the world has yet known. But, on terms of equality, she can be an efficient colleague.

On 25 April 1941, Keynes envisaged a sterling system including some European countries, free to discriminate against American goods if the United States 'persisted in maintaining an unbalanced creditor position'.

He received a rude jolt when he visited Washington from 7 May to 29 July 1941. As in 1915, Britain depended on purchases in neutral United States for which it could not pay. In December 1940, Roosevelt had announced 'Lend-Lease' – a scheme to provide Britain with supplies, not in exchange for borrowed money, as in the First World War, but for an undisclosed post-war 'consideration'. Keynes came as the emissary of a 'great & independent nation', inclined 'to ask as of right what they are only prepared to give us as a favour'. On 28 July, the day before he left, he was handed a State Department draft of the Lend-Lease agreement which, in Article VII, spelt out the 'consideration': a pledge by Britain to avoid 'discrimination against the importation' of American goods – in essence, a demand that Britain trade Imperial Preference for Lend-Lease. Keynes himself may have precipitated the American *démarche* by telling the State Department, on 25 June, that Britain might be forced to resort to discriminatory trade policies to balance her exports and imports after the war. When he saw Article VII, he exploded. His denunciations of 'Mr. Hull's lunatic proposals' went round Washington. All this seemed a rerun of the sour atmosphere of the First World War. But Keynes was now older, and wiser. Besides, in 1941 Britain had no realistic option but to meet American wishes, as, unlike in 1916, there was no hope of a negotiated peace. So Keynes retired to his country house, Tilton, in August to draft a new Keynes Plan. This was his famous proposal for a 'Clearing Union', which now included the United States, initialled on 8 September 1941.

The essential feature of the plan was that creditor countries would not be allowed to 'hoard' their surpluses, or charge punitive rates of interest for lending them out; rather they would be automatically available as cheap overdraft facilities to debtors through the mechanism of an international clearing bank whose depositors were the central banks of the union. However, he was still prepared to fall back on the alternative of a British-led currency bloc, maintained by 'Schachtian devices' if the United States refused to play. (Dr Schacht, Hitler's economics minister in the 1930s, had developed a successful system of bilateral trade agreements to balance Germany's external accounts.) A second draft, which Keynes initialled on 18 November 1941, added the 'highly substantive proposal' that membership of the Currency Union might be grouped by 'political and geographic units' such as the sterling area. These suggestions retain their interest as a possible model for a gradual return to a global fixed exchange-rate system today.

American requirements were spelt out explicitly once the United States entered the war in December 1941. The United States insisted that, in return for aid, Britain should pledge itself, after the war, to abandon trade discrimination. This pledge was incorporated into Article VII of the Lend-Lease Agreement signed on 23 February 1942, five days after the fall of Singapore to the Japanese. Keynes now realized that the economic bloc alternative was a non-starter. America would not finance the British war effort to allow Britain to emerge as head of a 'Schachtian' system which discriminated against American exports. Keynes had to apply himself to the intellectual problem of how to fit the British demand for freedom to pursue full employment policies into an American free-trade framework. He was forced to accept that the post-war world would be shaped by American power, as modified by American idealism and British brains. He would also have been less than Keynes, and less of an economist and liberal, had he not been seized by the possibility of using a unique historical moment to recreate an improved version of the liberal economic order which had collapsed in the First World War. Keynes also understood a moral and geopolitical fact. Assuming the defeat of Germany, the choice after the war would be between what he called ‘the American and Russian bias’ – that is, between world capitalism and autarkic socialism, with not much in between. ‘Is there not much to be said’, he wrote, ‘for having a good try with the American bias first?’

Independently, the Americans had also been thinking about the post-war economic order. Harry Dexter White, a US Treasury official, produced a plan in March 1942. This was for a modified gold standard, to which was attached a modest adjustment facility in the shape of a Stabilization Fund on which subscribing members could draw up to the amount of subscriptions in their own currencies; a scheme which, by strictly limiting American liability, upheld, in effect, the orthodox doctrine of debtor adjustment. White’s total adjustment facility (originally $5bn later $8bn) was much smaller than the total overdraft facility ($26bn) envisaged in the Keynes Plan; and strict conditions were attached to the drawing of quotas. Neither Keynes nor White saw each other’s plans till the summer of 1942. Both were adopted as bargaining positions by their respective governments.

The Bretton Woods Agreement, signed on 22 July 1944, after two difficult negotiating sessions in Washington, reflected American rather than British views. British and American conflicts on such matters as exchange-rate management, access to reserves, tariff policy, and responsibility for adjustment reflected national interests, as filtered through the experiences of the interwar years and expectations of the future. Britain’s negotiating achievements were limited to obtaining safeguards, postponements, and derogations within the framework of the American plan. The chief British success was to secure a ‘scarce currency’ clause which allowed debtor countries to discriminate against creditor countries under specified conditions.

According to James Meade and Lionel Robbins, members of the British negotiating teams who kept diaries, Keynes’s performances at the two Washington conferences of September-October 1943 and July-August 1944 were mixtures of extraordinary eloquence, verbal as well as intellectual, and extraordinary rudeness to and about the Americans. After one negotiating session, Harry Dexter White told Robbins, 'Your Baron Keynes sure pees perfume.' Robbins wrote, after another, how 'The Americans sat entranced as the God-like visitor sang and the golden light played around'. On the other hand, Meade reported Carl Bernstein of the US Treasury 'smarting from Keynes's ill-manners'. (Keynes had said of one of his drafts: 'This is intolerable. It is yet another Talmud.') Keynes's bad manners as a negotiator no doubt reflected exhaustion and failing health, but also his frustration at Britain's impotence. This mingled sense of idealism and consciousness that America ultimately called the tune was true of all the British negotiators. 'In the world of the future we shall have to live more by our wits,' noted Lionel Robbins. The trouble was that wits, too, had to be muted, in deference to the American fear of being made suckers 'especially by the diabolically clever Lord Keynes'.

In the House of Lords on 23 May 1944, Keynes commended the agreed Anglo-American plan in terms both of idealism and necessity. 'What alternative is open to us …?' Unlike in the First World War, he now took pride in the fact that 'in thus waging the war without counting the ultimate cost we – and we alone of the United Nations – have burdened ourselves with a weight of deferred indebtedness to other countries beneath which we shall stagger'. Specifically, without the new framework afforded by the Anglo-American agreement,

> London must necessarily lose its international position, and the arrangements… of the sterling area would fall to pieces. To suppose that a system of bilateral and barter agreements, with no one who owns sterling knowing just what he can do with it… is the best way of encouraging the Dominions to centre their financial systems on London, seems to me pretty near frenzy.

The 'technique of little Englandism' was incompatible with England's imperial heritage. 'With our own resources so greatly impaired and encumbered, it is only if sterling is firmly placed in an international setting that the necessary confidence in it can be sustained.' To place American power and money, on terms, behind Britain's 'impaired and encumbered' system of earning its living was thus the ultimate object of the 'special relationship' which the war had made necessary.

The defeat of Keynes's Clearing Union plan had highlighted the problem of financing Britain's prospective current account deficit after the war. Keynes eventually estimated this at between $6bn and $7bn over a three-year 'transitional' period. On 17 August 1945, three days after the Japanese surrender, the United States abruptly cancelled Lend-Lease. From now on Britain would have to pay for all supplies, including those already ordered. The Clearing Union proposal had been explicitly designed to make balance of payments assistance from America after the war unnecessary. 'Overdrafts' from the clearing bank would have been automatically available to plug Britain's post-war 'dollar gap'. Britain's quota from the IMF was far too small for this, and, in any event, only a country with a convertible currency could exercise its 'drawing rights'. Sterling devaluation was ruled out, partly because Britain's import surplus was too large, partly because 'repudiation' of Britain's sterling debts (totalling $14bn) would have killed off the sterling area. Isolationists of Right and Left favoured strict trade controls, but, Keynes asked Beaverbrook on 27 April 1945:

> Do you really favour a barter system of trade which would mean, in practice, something very near a state monopoly of imports and exports à la Russe? Do you welcome an indefinite continuance of strict controls and (probably) severer rationing? Do you look forward to our stepping down, for the time being, to the position of a second-class power…?

So American help was all that was left.

Keynes hoped that assistance from the United States would take the form of a grant, or at least an interest-free loan. Hugh Dalton, Labour's chancellor of the exchequer, recorded that 'Keynes in his talks with Ministers just before leaving for Washington, was almost starry-eyed. He was very confident that… he could get six billion dollars as a free gift… Nor did he… say much to us about the "strings".' The banker Robert Brand said: 'When I listen to Lord Keynes talking, I seem to hear those coins jingling in my pocket.' Soon after Keynes arrived in Washington on 5 September as joint head of the British delegation, he realized the mood had changed. Over incredibly sticky negotiations which lasted three months the six billion dollar ‘free gift’ was whittled down to a loan of $3.75bn at 2% interest, with the ‘string’ that sterling be made convertible a year after the agreement was ratified. This forfeited Britain’s transitional protection under the Bretton Woods Agreement. Having been over-optimistic at the start, Keynes drove a bewildered and angry Labour government, step by step, to accept progressively less favourable terms. His health and temper collapsed. In the end, he was replaced as joint head of the British delegation by Sir Edward Bridges, who agreed the final settlement.

Keynes’s eloquent defence of his handiwork in the House of Lords on 18 December, twelve days after the loan agreement was signed, put the negotiations in the context of events as they had unfolded since the First World War. There was first the argument from necessity. The alternative to the loan agreement, he said, ‘is to build up a separate economic bloc which excludes Canada and consists of countries to which we already owe more than we can pay, on the basis of their agreeing to lend us money they have not got and buy only from us and one another goods we are unable to supply’. Secondly, there was the appeal of a shared, reconstituted liberalism:

> The separate economic blocs and all the friction and loss of friendship they must bring with them are expedients to which one may be driven in a hostile world… But it is surely crazy to prefer that. Above all, this determination to make trade truly international and to avoid the establishment of economic blocs which limit and restrict commercial intercourse outside them, is plainly an essential condition of the world’s best hope, an Anglo-American understanding… Some of us, in the tasks of war and more lately in those of peace, have learnt by experience that our two countries can work together. Yet it would be only too easy for us to walk apart. I beg those who look askance at these plans to ponder deeply and responsibly where it is they think they want to go.

The familiar context of Keynesian economics is the Great Depression of the 1930s – the collapse of the world economy. But a more persistent context was the unbalanced creditor position of the United States. For the first ten years after the First World War, the United States boomed, while Britain slumped. Keynes saw British unemployment as a problem of sterling's overvaluation against the dollar. From this point of view, his *General Theory* is an addendum to, rather than the culmination of, his line of thought - the theory of a deep world slump when no amount of monetary manipulation can restore full employment.

Following the collapse of the gold standard in 1931, the world economy broke up into trading blocs based on 'key' currencies. It was as manager of an imperial payments system known as the Sterling Area that Britain went to war with Germany in 1939.

It took the Second World War to put paid to Keynes's hope of a British-controlled payments system as the monetary framework for the British economy. Much shared idealism and responsibility went into the making of the Bretton Woods system. Nevertheless it was the end of British monetary independence. The sterling system could not survive unless it was bolstered by the dollar. Keynes's lifetime spans the passage from control to dependence.