

9 | Why Was Keynes Opposed to Reparations and a Carthaginian Peace?

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I Introduction

The Economic Consequences of the Peace was first published in 1919 and, since then, changed the economic discourse surrounding reparations and Carthaginian peace. The entire book is a thoughtful plea against the peace treaty signed in Versailles. It contains some 180 pages of data, calculations, and projections, reshuffling the data as a deck of cards in the hands of a virtuoso player. Keynes's conclusion is cut and dried: Reparations are bad.

The book begins in another sphere altogether. The first two chapters do not even mention reparations. Why? Recall the movies based on the books of Agatha Christie: The movie begins with one or two frames that appear unrelated to the rest of the story. It is these frames that hold the solution to the mystery: a seeming digression, that contains the explanation for what happens at the end. If you missed this first frame, you missed the entire plot of the movie. Likewise, if you seek to understand why Keynes claims that 'the purpose of [his] book is to show that Carthaginian peace is not practically right or possible' (p. 18), then focus on the first two chapters of his book.

What ideas do we find in the first two chapters, which are essential for understanding reparations and Carthaginian peace? Three main subjects are developed in these two chapters; subjects that are hinted at in the introduction and that are essential to understanding reparations and Carthaginian peace: (i) the 'International Political system', (ii) the notions of 'social identity' and 'national sovereignty', and

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(iii) the fact that ‘social identities’ differ for the various social classes, that is, the elite versus the working class.

About the international political system, Keynes made a clear dichotomy between periods of rivalries and periods of internationalization.¹ About national sovereignty and power, Keynes stressed that the notion of nation and nationalism enter the economic realm:²

Finally, the difference between social classes is crucial in Keynes writings. The first page of the introduction begins with this statement: ‘All classes alike thus build their plans, the rich to spend more and save less, the poor to spend more and work less’ (p. 2), and thereafter, ‘Thus the bluff is discovered; the laboring classes may be no longer willing to forgo so largely and the capitalists 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. 11).

These three elements – the international political system, national sovereignty, and the differences between the elite and the working class are the hints given by Keynes in the introduction and which enable understanding of his position on reparations.

This chapter’s purpose is to indicate how these three elements can explain Keynes’s assessment on Carthaginian peace. About the international political system, and the differences between social classes, I show that when there is a hegemonic state, it is optimal for all classes to ask for no reparations: the working class as well as the elite find free trade to be optimal, and there is no need for harsh reparations.

However, when countries are in a ‘balance-of-power’ period, then the elite and the working class have differing optimal policies. While, for the working class, it is optimal to claim for harsh reparations, the transnational elite find it optimal to reduce reparations.

¹ He wrote: ‘The projects and politics of militarism and imperialism, of racial and cultural rivalries, of monopolies, restrictions, and exclusion, which were to play the serpent to this paradise, were little more than the amusements of his daily newspaper, and appeared to exercise almost no influence at all on the ordinary course of social and economic life, the internationalization of which was nearly complete in practice’ (p. 6).

² ‘Nations are real things, of whom you love one and feel for the rest indifference – or hatred. The glory of the nation you love is a desirable end – but generally to be obtained at your neighbour’s expense. The politics of power are inevitable.... the balance of power in one’s own interests’ (p. 17).

Is Keynes on the side of the working class or of the elite? Keynes exhibits in his writing a ‘transnational elite’ assessment, and he chooses to reduce reparations since identity and nationalistic values are for him no more than ‘nonsense’ despite his having lived during a period of balance of power.³

The reasons for the difference between the view of the elites and the working class about reparations are their difference in social identity. The working class cares about national sovereignty, because it gives them a national identity, while the elite are part of the transnational elite, and do not need a national identity. So, Keynes, who is part of the intellectual transnational elite, chooses to reduce reparations since identity and nationalistic values are not important for him.

It is interesting to note that in France, Clemenceau takes the view of the working class, which cares about national sovereignty and therefore claims harsh reparations. Keynes believed in a top-down flow of ideas, while Clemenceau understood that the rage of the working class burst from the bottom-up. And indeed Keynes’s remarks about Clemenceau and the French are harsh:

He [Clemenceau] had one illusion – France, and one disillusion – mankind.... His principle for the peace can be expressed simply. In the first place, he was a foremost believer in the view of German psychology that the German understands and can understand nothing but intimidation (p. 16).... The future life of Europe was not their concern; its means of livelihood was not their anxiety. Their preoccupations related to frontiers, nationalities, to the balance of power, to imperial aggrandisements, to the future enfeeblement of a strong and dangerous enemy. (p. 27)

Therefore, Keynes’ views differ from those of Clemenceau and of the working class of France that cares about national sovereignty. Thus, the main differences between Keynes and Clemenceau are in their identification either with the elite, or to the working class. Keynes feels part of the elite, while Clemenceau is close to the working class and cares about reparations, which are linked to nationalism and national sovereignty.

But why do the workers care so much about national sovereignty? Because it gives them a national identity, while the elite are part of the transnational elite, and do not need a national identity. This is the topic of the next section.

³ See also Mantoux (1946), Katiforis (2004), and Binkley (1929).

II National Sovereignty and National Identity

One of the main shifts in the history of economic theory lay in the introduction of Behavioural Economics in mainstream theory, which opened the floodgates to many other innovative lines of thinking. In consequence, it not only became ‘kosher’ to speak of culture and psychology in the economic realm, it became ‘in’.⁴

Sociology also slowly penetrated the field of economic theory. In 2000, Akerloff and Kranton introduced ‘identity’ as an element affecting economic choices. In the field of social psychology, Tajfel developed the ‘theory of social identity’. He contended that individuals have an inherent tendency to categorize themselves into one or more ‘in-groups’, building a part of their identity based on membership in that group and enforcing boundaries with other groups.

The social identity theory posits the fact that a person’s self-concept and self-esteem derive not only from personal identity and accomplishments, but from the status and accomplishment of the groups to which s/he belongs (Tajfel and Turner, 1979). In their experiments, they have shown that humans have a need for ‘us/them’ distinctions. Thus, social identity theory suggests that people identify with groups in such a way as to *maximize positive distinctiveness*.

Tajfel and Turner (1979) have shown that social identity leads to discrimination. When being divided into two groups, and asked to split budgets between the two groups, individuals had the choice of giving \$100 to each member of both groups, or receiving \$50 for each person in their group, but only \$10 to the other group. Most individuals chose the second option. Making the other group worse off is more important than making your group better.⁵

In some of their experiments, group selection was chosen along random traits, and in some of the experiments, it was chosen randomly by tossing a coin. Yet, all the experiments have shown that human beings have a tendency to identify with a group.

These results were for a random selection of groups, so what happens when the group has some sort of common trait or culture, such as being white? Or being French?

⁴ In reference to Temin (1997): ‘Is it Kosher to talk about Culture?’

⁵ Moreover, it was shown that those who had been allowed to engage in intergroup discrimination had higher self-esteem than those who had not been given the opportunity to discriminate (Lemyre and Smith 1985; Oakes and Turner 1980).

Metzl (2019) discussed discrimination between whites and non-whites. He shows that individuals belonging to a given group can make decisions that are not ‘rationally’ productive for them, just to feel part of the group and to separate themselves from the other group. An example he gives is that young white individuals belonging to the working class who were sick and in need of Medicare chose ‘to be broke, but not to let the other group get it for free’.⁶ They are willing to make choices that harm themselves in order to maintain their class identity.

Another clear grouping is the nation itself. One speaks today about the identity of being American: While ‘Being an American is an element of the self-concept of most Americans’, it leads to discrimination and to in-group favouritism.

What are the ‘markers’ of social identity of a nation? Following Metzl (2019), the main elements defining working-class identity are the symbols of nationalism, which, alongside sovereignty, are always part of the identity of the working class. Thus national sovereignty and power influence the sense of well-being of the working class.

However, social identity is not a value assimilated across society in a one-size-fits-all manner. Within each nation-state, the various in-groups – especially the working class and the elite – do not share the same identity.

The literature on twentieth-century elites pinpoints the interconnection of all elites, and their transnational values.⁷ Weber (2008) showed that at the beginning of the twentieth century, the elites of Germany and England had connections between them, and shared the same values despite tensions between the countries, and acted to improve Anglo-German relations: ‘The British and German ruling elites tried to ease the tensions between the two empires’ (p. 49).⁸

⁶ Medicare might improve life for all groups, but as it would improve the well-being of the non-white group more, working-class ‘white’ Americans actively oppose it.

⁷ See Brezis and Temin (1999, 2008).

⁸ Indeed Weber brings Britain and Germany’s preeminent universities and playgrounds for political and social elites back to life to reconsider whether any truth is left in the old contrast between British liberalism and German illiberalism.

Ciampani and Tolomeo (2015) follow a similar reasoning about the elite: ‘In effect, the research avenue that focuses on the meetings of the European elites aims to account for the progressive ‘amalgam’ of the European elites’ national



Plate 1 John Maynard Keynes. A rare image of John Maynard Keynes at work from the King's College Archive, Cambridge University. Reproduced by kind permission of the King's College Archive.



Plate 2 John Maynard Keynes and Jan Christiaan Smuts. Smuts attended the Paris Peace Conference and played a “central but complex” role in the making of the *Economic Consequences*. Reproduced by permission of the National Portrait Gallery.

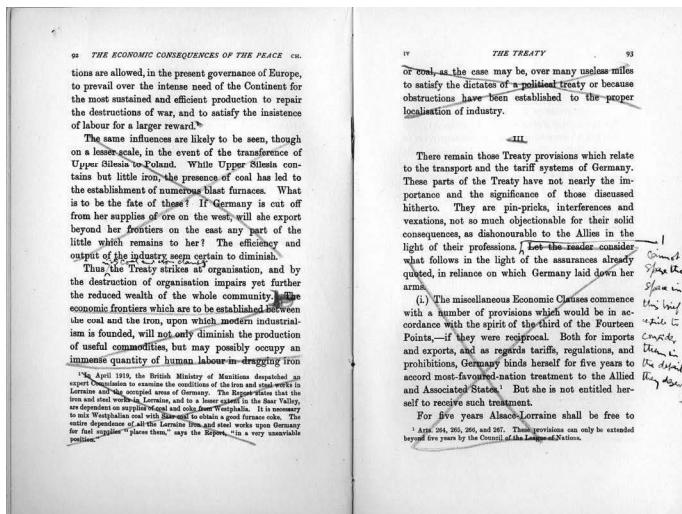


Plate 3 Original proofreading copy of the *Economic Consequences*, with Keynes's notes. Keynes reduced the length of the manuscript through extensive cuts as he revised. One key motivation was to make sure that the book could be produced at reduced cost and thus sold at an accessible price for the widest audience. Reproduced by kind permission of the Marshall Librarian.



Plate 4 Keynes's mother, Florence Ada Keynes. Maynard's friends affectionately referred to her as "the good mother Keynes," and although she was committed to so many important causes, her family always came first and she was immensely proud of her elder son. Reproduced by permission of the National Portrait Gallery.

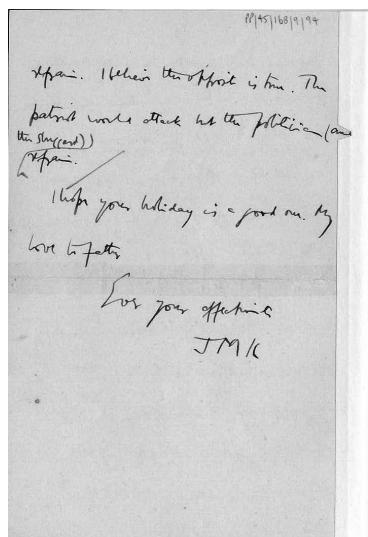
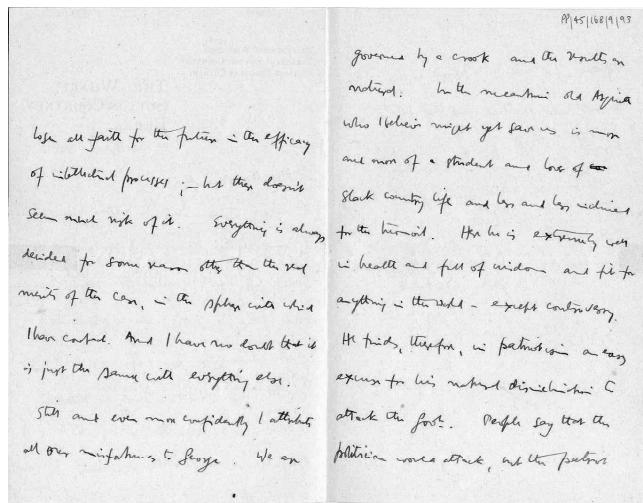


Plate 5 A letter by John Maynard Keynes to his mother Florence, written during the negotiations at Versailles in 1918. "Everything is always decided for some reason other than the real merits of the case [...] Still and even more confidently I attribute all our misfortunes to George. We are governed by a crook [...] In the meantime old Asquith who I believe might yet save us is more and more of a student and lover of slack country life and less and less inclined for the turmoil. Here he is extremely well in health and full of wisdom and fit for anything in the world - except controversy. He finds, therefore, in patriotism an easy excuse for his naked disinclination to attack the Gov[ernment]. People say that the politician would attack, but the patriot repair. I believe the opposite is true." Reproduced by kind permission of the King's College Archive.



Plate 6 John Maynard Keynes with Carl Melchior (left) and Dudley Ward (center) in Trèves (Trier), Germany, in 1919. Dr. Melchior, a prominent German banker, was part of a German delegation that met with French, British, and American financial officials in January 1919 to negotiate German payment for food imports in the light of potential reparations. Ward was a member of Keynes's Treasury staff and a former student at Cambridge. Reproduced by kind permission of the King's College Archive, Cambridge University.

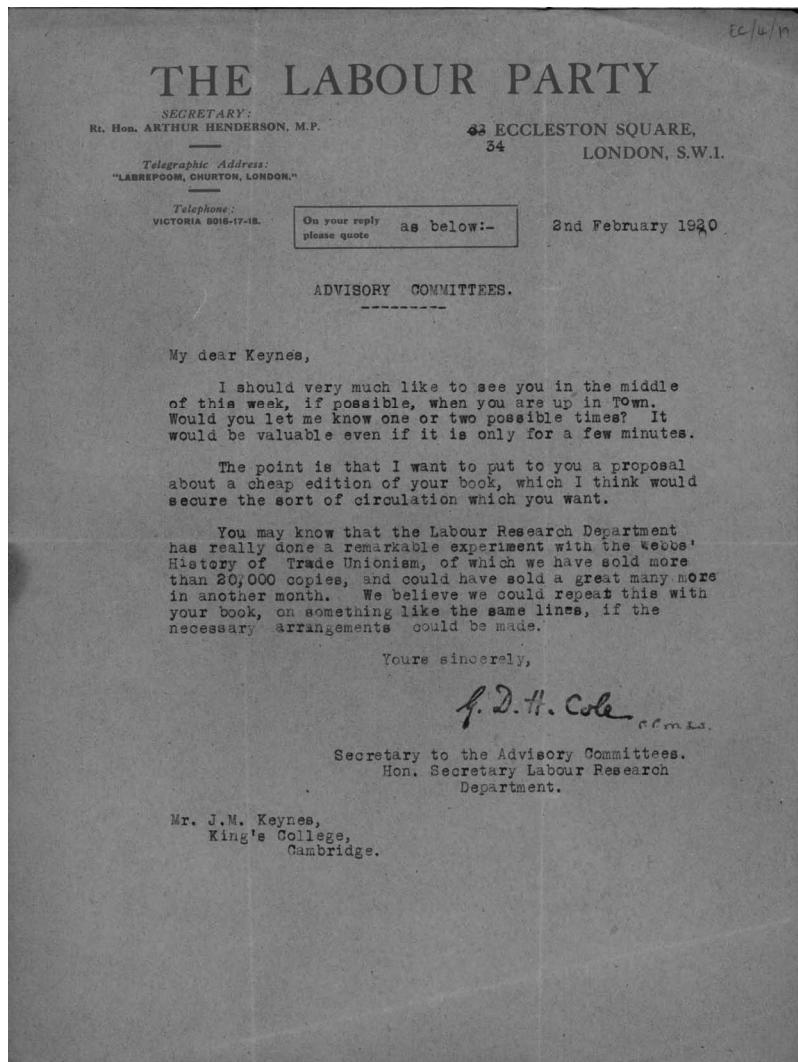


Plate 7 Letter to Keynes from G. D. H. Cole, proposing the publication of a cheaper Labour Research Department edition of Keynes's book. The very great success of *The Economic Consequences of the Peace* in the United Kingdom was in no small part due to a publishing deal Keynes had had with the Labour Research Department, who brought out and sold a cheap version of the book. Total sales of this edition nearly topped 10,000 copies. Reproduced by kind permission of the Labour Party.



Plate 8 Ali Fethi Okyar, translator of the *Economic Consequences* into Turkish and later Prime Minister of Turkey, in the company of Kemal Atatürk. Ali Fethi translated Keynes's book in 1920 while imprisoned by the British in Malta. The translation appeared in print in 1922. Courtesy of the Okyar family.

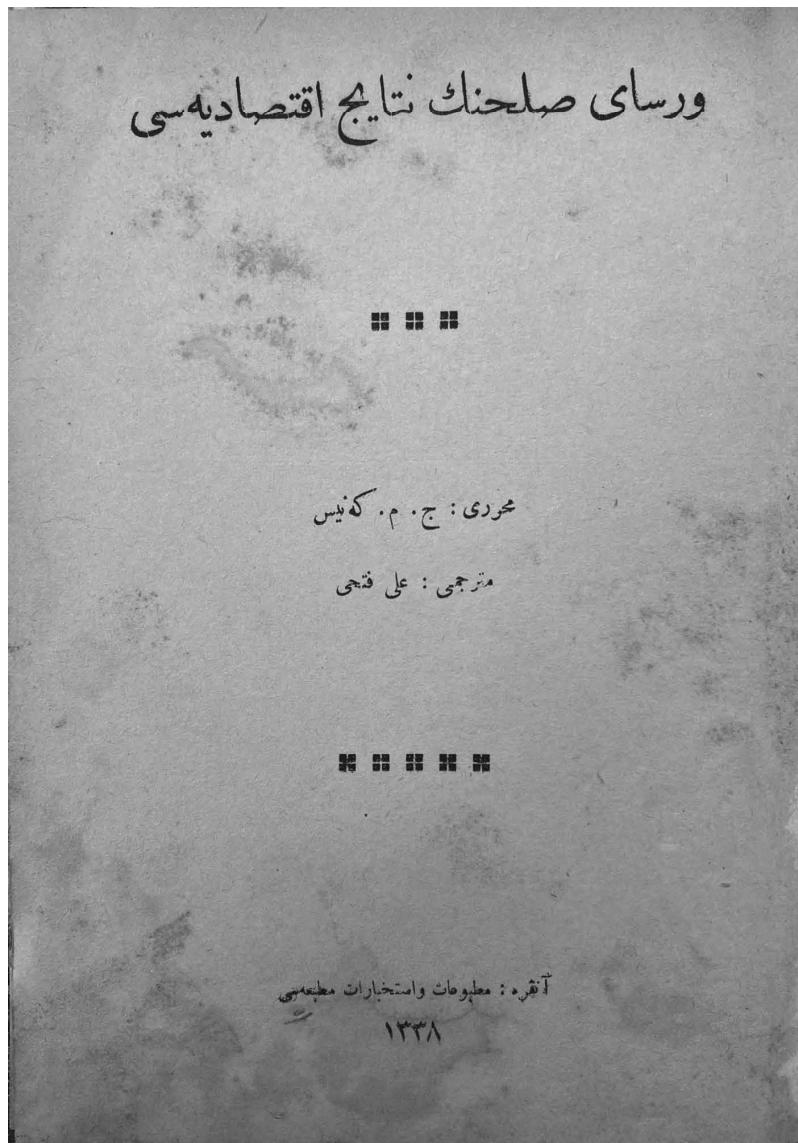


Plate 9 The 1922 Turkish edition of *The Economic Consequences of the Peace*. This image is reproduced from the personal copy of the translator, Ali Fethi Okyar. Courtesy of the Okyar family.

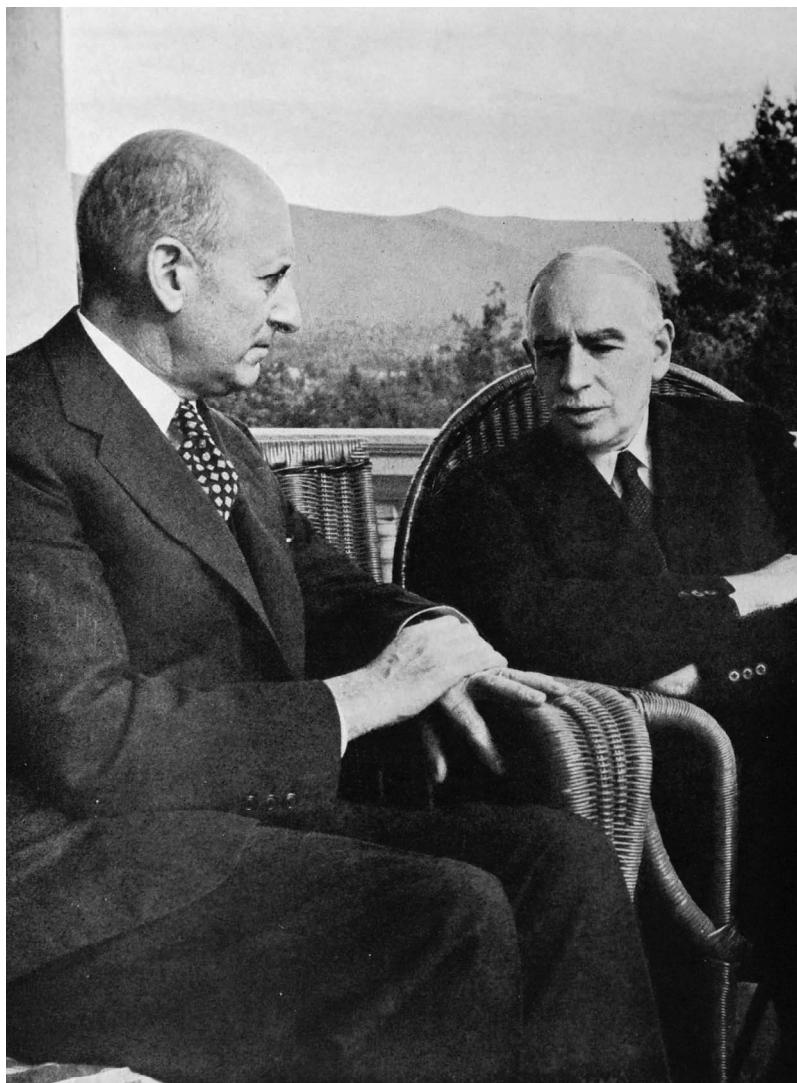


Plate 10 Keynes with US Secretary of the Treasury Henry Morgenthau. Keynes led the UK delegation to the 1944 Bretton Woods Conference that designed the International Monetary Fund and World Bank. Reproduced by permission of Alamy.



Plate 11 Keynes in 1918. Under enormous strain owing to his wartime duties at the Treasury, Keynes relaxed in the countryside on weekends with Bloomsbury friends or at the home of the former prime minister, Herbert Asquith. Reproduced by kind permission of the King's College Archive.

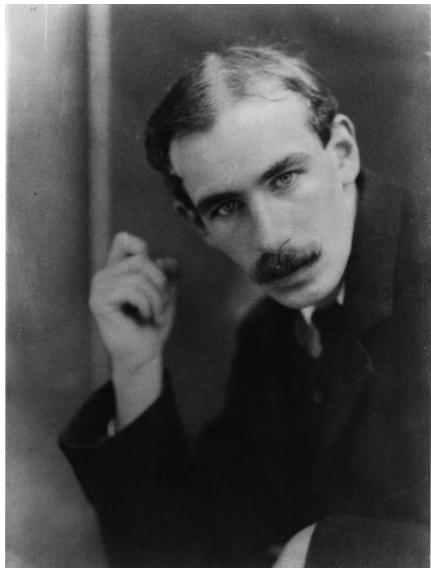


Plate 12 Keynes circa 1911. This portrait was taken after Keynes had returned to King's from the India Office. Reproduced by kind permission of the King's College Archive. A high resolution image was obtained from Charleston.

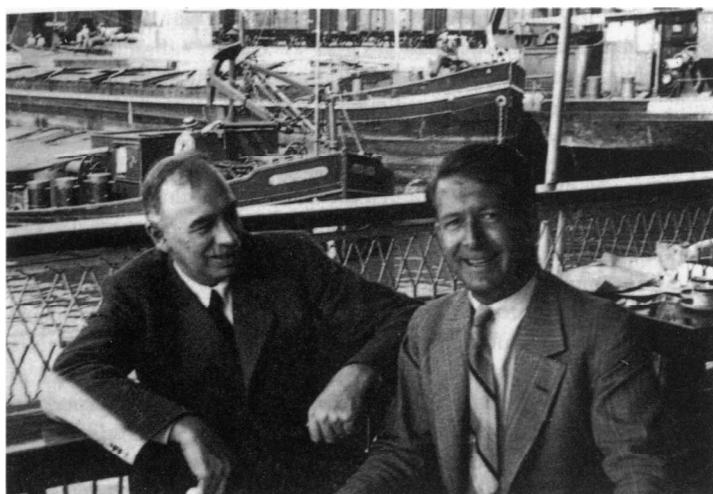


Plate 13 John Maynard Keynes and Bertil Ohlin in Antwerp, 1935. Keynes's 1929 exchange with Ohlin over the "German transfer problem," published in the *Economic Journal*, raised fundamental questions for future research in international macroeconomics. Reproduced by kind permission of Tomas Ohlin, son of Bertil.



Plate 14 Participants at the September 2019 *Economic Consequences* centenary conference, King's College, Cambridge. Courtesy of Julian Peters.



Plate 15 Lord Skidelsky during the conference, leaning on the black government despatch box found at Keynes's brother Geoffrey's home, Lammas House, Brinkley, Suffolk. The box carries the cypher of King George V and was presumably issued to Maynard while he was working at the Treasury from 1915. One of his friends tells the story that he used to come to their support, when attending tribunals in connection with conscription, carrying an official black box with the royal cypher on it, in order to intimidate the panel. Presumably this is the same box! Courtesy of Julian Peters.

Weber showed that militarist nationalism and European transnationalism were not mutually exclusive concepts: militarist nationalism appealed to the working class and transnationalism to the elites. He stressed that the elite of various countries feel related by their culture, and feel themselves to be part of the same group – the transnational elite of Europe. They emphasize humanistic, universal values and do not relate to values such as militarism, power, and nationalism.

Therefore, we obtain a dual social identity.⁹ On the one hand, the working class of each country cares about national sovereignty and power. On the other, the elite in each country want a globalized economy with interdependence between countries. The transnational elite identity values internationalism, humanism, and universalism.

And to which group did Keynes belong? Did his feelings pull towards the working class? or towards the elite? As he mentioned in *Essays in Persuasion*, commenting about Marxism (1931):

How can I adopt a creed which, preferring the mud to the fish, exalts the boorish proletariat above the bourgeois and the intelligentsia who, with whatever faults, are the quality in life and surely carry the seeds of all human advancement? Even if we need a religion, how can we find it in the turbid rubbish of the Red bookshops? It is hard for an educated, decent, intelligent son of Western Europe to find his ideals here, unless he has first suffered some strange and horrid process of conversion which has changed all his values. (p. 298)

This dual social identity leads to a dual view on trade policy and reparations. On the one hand, the working class of each country care about national sovereignty and power. On the other, the elite in each country want a globalized economy with interdependence between countries. In the next section, we analyse the relationship between reparations and national sovereignty in the perspective of the international political system. We analyse why in periods of hegemony, the elites as well as the working class have common views on trade policy and reparations, while in periods of balance of power, their views differ. We start with a historical perspective on these relationships.

groups, their coming together both to initiate the processes to form new generations of élites, and to broaden (or restrict) the means of access to decision-making⁷ (pp. 10–11).

⁹ See also Brezis and Hellier (2018).

III Reparations and the International Political System

The historical record of the past 350 years shows cycles in which there are periods of ‘hegemony’, in which one nation-state has leadership, while there are periods of ‘balance of power’ in which there is no dominant state, and many nations have similar power.

We should, of course, first ask if in 1919, at the time of the Treaty of Versailles, is the international system in a hegemonic or a ‘balance of power’ period?

The data are presented in Figures 9.1–9.3. From 1850 to 1910, the Western world lives in a system of *Pax Britannica* – the UK is the leader of the world. The UK has leapfrogged the Dutch, and is the hegemonic power. However, after 1910, the UK is not anymore a leader country (see Figure 9.1).

After 1945, we are in a period of *Pax Americana*, the United States is the leader of the world, and the United States has leapfrogged the UK. From 1945 until 2008, the United States is the hegemonic power of the world (see Figure 9.2).¹⁰

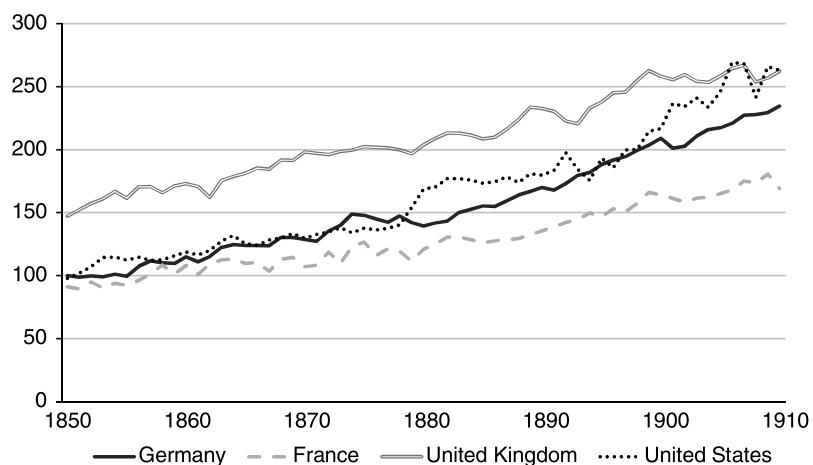


Figure 9.1 Hegemony of Britain: 1850–1910 – GDP per capita

Notes: The GDP per capita index is set at 100 for 1850. The UK is in yellow, Germany is in blue, France in red, and the United States is the green line.
Source: Maddison.

¹⁰ Brezis, Krugman, and Tsiddon (1993) present a model explaining endogenously the changes in hegemony, and about the data on the balance of payments; see Brezis (1995).

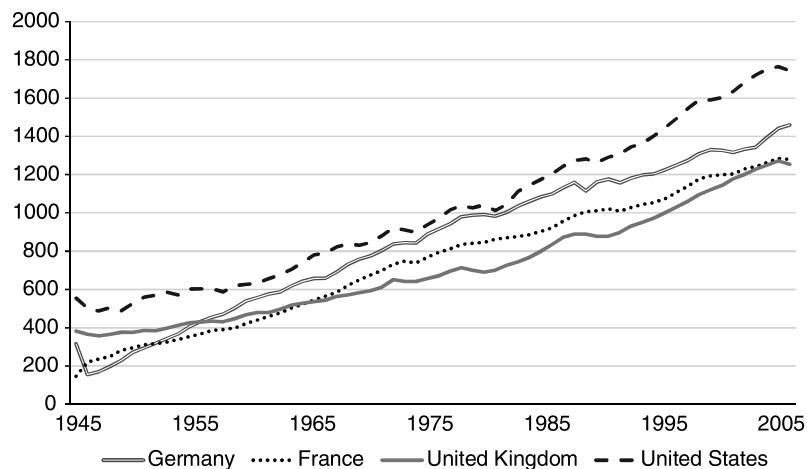


Figure 9.2 Hegemony of the United States: 1945–2008

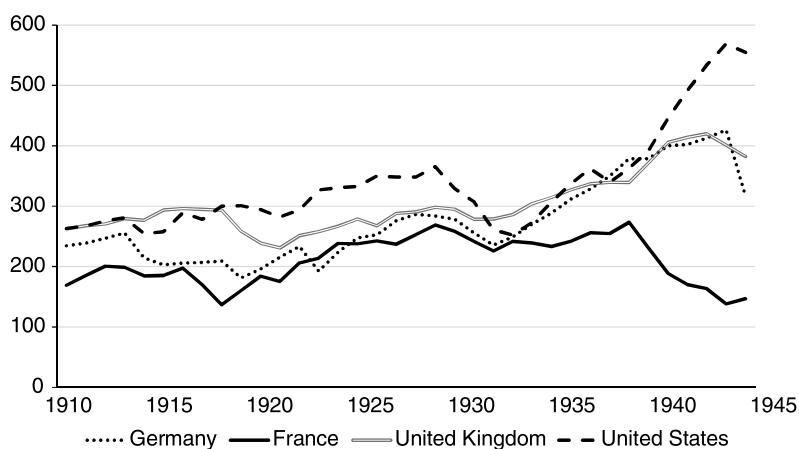


Figure 9.3 Balance of Power: 1910–1945

But, during the period 1910–1919, the data display that GDP per capita among the main powers are similar (although Germany has higher GDP than France from 1900 and on). This is a typical ‘balance of power’ period. There are no leader countries, and this situation will stay so until 1945, the end of World War II (see Figure 9.3). thus, the international system shows cycles in power leadership.

In almost complete correlation with the cycles in leadership, the historical record of the past 350 years shows cycles in trade policy. These

two cycles are correlated: Hegemony is related to periods of free trade, while protectionism occurs in periods of balance of power.

To give some examples, the most notable change in policy is the Navigation Act of 1651, which is widely held to have represented the end of effective Dutch commercial hegemony in Europe and to have marked the beginning of the British challenge.

By the end of the second decade of the nineteenth century, Britain had set about dismantling its own protectionist apparatus and had initiated an era of free trade which lasted as long as the *Pax Britannica* endured.¹¹

And as a last example, in the twentieth century, the rise of American power in the pre–World War II years was associated with a succession of protectionist measures, whereas the establishment of American hegemony after the war led to the pursuit of free trade.¹²

Why is there a relationship between trade policy and the international system? The relationships between protectionist commercial policy, nationalism, and balance of power have been explored in the works of a number of political scientists. One of the most widely accepted paradigms linking the structure of the international political system with protectionism is the theory of ‘hegemonic stability’.¹³

Kindleberger (1973), following in the footsteps of Frohlich, Oppenheimer, and Young (1971), argues that international security is a collective good. Since free trade can arise only in a climate of international security, it is only when a national power is dominant enough to enforce security that a regime of free trade will arise. Given the inevitable tendency of weaker states to free-ride on the provision of the collective good by a hegemonic power, the absence of a hegemonic state leads to the erosion of free trade and to the growth of protectionism. Gilpin (1975) writes that ‘a liberal international economy cannot come into existence and be maintained unless it has behind it the most powerful state(s) in the system. ... A liberal economic system is not

¹¹ Gilpin (1975) writes that ‘Britain’s interest lay in universal free trade and the removal of all barriers to the exchange of goods’ (p. 84).

¹² About the end of the American hegemony and ‘neomercantilism’ at the end of the twentieth century, see Calleo and Rowland (1973), Cline (1980), and Malmgren (1970).

¹³ A precursor is Hirschman (1945); see also Kindleberger (1975), Whitman (1975), Krasner (1976), Keohane and Nye (1977), MacEwan (1978), Keohane (1980), Wallerstein (1980), and Gilpin (1977, 1981).

self-sustaining, but is maintained only through the actions – initiatives, bargaining, and sanctions of the dominant power(s).¹⁴

Another paradigm linking these cycles is the theory of ‘imperialism of free trade’.¹⁵ It purports to explain the development of the world trading system in the presence of a hegemonic power. This theory argues that ‘the hegemonic power is expected to extend its control – and the open international trading order – over local economies by informal or indirect means whenever possible, since this constitutes the cheapest way to create and maintain its predominant position in the world’. The link between the international political system and economic policy was also emphasized by Skidelsky (2010, 1976).

In conclusion, the literature relating trade policy to the international political system is vast. But the theories of ‘imperialism of free trade’, ‘hegemonic stability’, or ‘collective good’ are too broadly stated. There is a need to pinpoint the essential elements which are the thread between trade policy and the international system. Some political scientists stress that during a period of balance of power, maintaining power necessitate to increase foreign reserves.

Already in 1776, Adam Smith has laid out the reasons for increasing foreign reserves during periods of balance of power:

The real wealth or poverty of the country ... would depend altogether upon the abundance or scarcity of those consumable goods. But ... they are obliged to carry on foreign wars, and to maintain fleets and armies in distant countries. This, cannot be done, but by sending abroad money to pay them with; and a nation cannot send much money abroad, unless it has a good deal at home. Every such nation, therefore, must endeavour in time of peace to accumulate gold and silver, that when occasion requires, it may have wherewithal to carry on foreign wars.¹⁶

Wallerstein (1980) also emphasized the importance of foreign reserves: ‘control of an adequate bullion stock was ... a crucial variable in the struggle between core powers’.¹⁷ Much earlier, Colbert also claimed: ‘trade is the source of public finance and public finance is the vital nerve of war’. With more foreign reserves available in the economy, the nation-state could increase its success at war, and even in ‘balance of power’ system refrain from war. Moreover,

¹⁴ Gilpin (1975), p. 85. See also Coleman (1969), and Brezis (2003).

¹⁵ See Gallagher and Robinson (1953), MacDonagh (1962), Moore (1964), Mathew (1968), and Platt (1968, 1973).

¹⁶ Smith (1937), p. 399. ¹⁷ Wallerstein (1980), p. 277.

Kinder and Hilgemann (1964) note that ‘the duration of campaigns depended on finances’.¹⁸

In this vein, this chapter asserts that the main reason for asking for reparations is the desire to increase foreign reserves in periods of balance of power, in order to increase ‘national sovereignty’ and thus national power. Requesting reparations is one of these means in the hands of a nation to maintain its national sovereignty, especially when the other country is slightly more developed. In periods of hegemony, then, reparations are not necessary, as countries can free-ride on the power of the hegemonic nation-state.

This is the idea developed in the following framework. We focus on periods of balance of power, as it was the case in 1919, when Keynes published *The Economic Consequences of the Peace* exploring the effects of reparations. We show that the optimal policy for the elite is different than for the working class, due to the fact that their social identities differ. In order to analyse the effects of reparations, we incorporate in the model these following elements: social identity theory, the concept of national sovereignty for the working class, and the concept of humanism for the transnational elite.

IV The Framework

4.1 Introduction

The Economic Consequences of the Peace was published in 1919, a period of balance of power. In consequence, we will only analyse the case of balance of power, wherein no single actor on the international scene possesses hegemonic status.

We focus on the case of France and Germany for describing the model. In Table 9.1, it is shown that the GDP of Germany is higher than that of France.

This very simple framework will permit to explain why during a period of balance of power, as it was the case in 1919, the working class (and Clemenceau) will choose harsh reparations, while the elite (and Keynes) will not. And the main reason I emphasize in this chapter is that it is due to social identity. The social identity of the working class is national identity and national sovereignty. The social identity of the elite is humanism, and internationalism, and they

¹⁸ Kinder and Hilgemann (1964), p. 253.

Table 9.1 Data on leader countries – 1850–1950

Year	Germany	France	United Kingdom	United States
GDP per capita in 2011 US\$				
1860	3,312	3,113	4,988	3,425
1870	3,715	3,086	5,716	3,736
1880	4,023	3,488	5,879	4,866
1890	4,904	3,909	6,711	5,184
1900	6,029	4,731	7,446	6,252
1910	6,763	4,878	7,567	7,586
1920	5,647	5,309	6,881	8,485
1930	8,027	7,455	8,504	9,490
1940	10,914	6,650	10,716	11,307
1950	7,840	8,531	10,846	15,241
Population, in thousands				
1850	33,746	36,350	27,181	23,580
1860	36,049	37,300	28,888	31,839
1870	39,231	38,440	31,400	40,241
1880	43,500	39,045	34,623	50,458
1890	47,607	40,014	37,485	63,302
1900	54,388	40,598	41,155	76,391
1910	62,884	41,224	44,916	92,767
1920	60,894	39,000	46,821	106,881
1930	65,084	41,610	45,866	123,668
1940	69,835	41,000	48,226	132,637
1950	68,375	42,518	50,127	152,271

Source: Maddison.

want a globalized economy with interdependence between countries. Therefore, we obtain a dual social identity.

Then, as already hinted in the previous section, we show that the ‘markers’ of national sovereignty and power are related to foreign reserves, while the ‘markers’ of internationalism are just increasing investments. Let us start by modelling social identity.

4.2 Social Identity of the Working Class

This model is assuming a duality of social identity: There are two social classes, and each class has its own identity, which has an impact on the individual’s utility. We start with the working class.

One of the main elements defining the working class is its attachment to symbols of nationalism, as ‘national sovereignty’ and power. (We use these two notions as equivalent.) How national sovereignty and power affects the utility of the working class? We could, of course, introduce national sovereignty directly into the utility function. In this chapter, I try a more ‘subtle’ line of modelling.

Following the research presented above, I assume that the working class does not have utility from the size of national sovereignty per se; it is the comparison with the other country which affects utility. If power is less than a required amount in competition with another country, then the utility is affected.

We focus on the case of France and Germany for describing the model. France is country 1, and Germany is country 2. Thus, the country with higher output is country 2. Moreover, France could ask for reparations, since it was a winner at war.

Each country is represented by an individual of the working class, and which faces the following payoffs:

$$V_1 = \begin{cases} c_1 & PW_1 \geq PW_2 \\ c_1 - K & PW_1 < PW_2 \end{cases} \quad (1)$$

Equation (1) presents the utility of a worker in France (country 1). For country 2, it is the same equation, with the suffixes inverted. We define c_i as the output allocated to consumption. Equation (1) emphasizes that the utility/payoff of a citizen is equal to its utility from consumption (assuming that $U(C) = C$).

The workers care about consumption, but the workers care also about national sovereignty and power (this is their social identity). In other words, the French working class feel ‘insulted’ by an equivalent quantity of size K when the power of Germany is greater than the one of France, as it was shown above in the works of Tajfel and Metzl that people feel insulted when the other group gets some more than their own group.

What is the definition of power, PW ? In Appendix 1, I show that the power of a nation can take the following form:

$$PW_i = \text{Min}(c_i, R_i + y_i - c_i) \quad (2)$$

where R_i represents the reparations paid by a foreign country (only a country having won a war can ask for reparations), and y_i is output (see the exact definitions in the appendix).

4.3 Objectives and Payoffs for the Transnational Elite

The transnational elite put the emphasis on humanism, that is consumption and economic growth of the world. Moreover, recall that the elite are the individuals who are investing (as underlined by Keynes in the introduction). So the utility function of the elite in country 1 is:

$$V_{E,1} = U(C_E, I) \quad (3)$$

where C_E is the consumption of the elite, and I are investments, since the savings of the elite finance the investment of the nation. In their utility, there is no national sovereignty and power.

4.4 Equilibrium

In equilibrium, the workers choose c and R as to maximize (1). The elite maximize equation (3). Remember that we assume $y_2 \geq y_1$ (Germany has higher output than France). We get the following proposition.

Proposition 1

When countries are in a balance-of-power regime, with output quite similar, then in the unique equilibrium, the working class (and the politicians listening to the working class) will choose to increase their national power by hoarding foreign reserves until they attain maximum power. In case, one country can ask for reparations, then, the optimal size of reparations is:

$$R_1^* = -R_2^* = (y_2 - y_1) / 2 \quad (4)$$

and

$$c_1^* = c_2^* = (y_1 + y_2) / 4 \quad (5)$$

The proof is presented in Appendix 2.

Proposition 2

In a balance-of-power system, the transnational elite choose not to hoard foreign reserves and not to ask for reparations.

In their utility, there is no national sovereignty so that hoarding foreign reserves are not important, and therefore reparations are not necessary. And since we have:¹⁹

$$S = I + NX \quad (6)$$

Then, they are better off, when hoarding foreign reserves and reparations are zero.

To conclude, in case of balance of power, and when one takes into consideration the aspirations of the working class, then it is optimal to ask for harsh reparations. This was the point of view of Clemenceau, in the name of the ‘people of France’. The optimal size of reparations is given by equation (4). It is interesting to note that the optimal amount of consumption and reparations is such that all countries have equal consumption.

The transnational elite put the emphasis on humanism, that is, consumption and economic growth of the world. Moreover, recall that the elite are the individuals who are investing. Hoarding foreign reserves is not optimal, and therefore the amount of optimal reparations is zero.

V Conclusion

There is no better conclusion of Keynes’s *Economic Consequences of the Peace* than to quote Skidelsky:

Keynes was also a product of the old Europe, of which Britain was an integral part. He was brought up by a German governess, married a Russian ballerina, and was at home in France and Italy. He looked forward to an era of small political and cultural units combined into ‘larger, and more or less closely knit economic units (2010, 191–192).... Keynes was staking the claim of the economist to be Prince. All other forms of rule were bankrupt. The economist’s vision of welfare, conjoined to a new standard of technical excellence, were the last barriers to chaos, madness and retrogression. (1983, p. 384).

¹⁹ Government expenditures are included in the maximization of the working class.

This chapter seeks to explain the disagreements between Keynes and Clemenceau. I have shown that the differences in national identities of the working class and the elite explain their opposing views on reparations. For the working class, national sovereignty is essential, despite ‘the apparent inability of the intelligentsia to understand and appreciate power-problems’. This difference in identity can explain why the optimal policy for the working class differs from that of the elite.

This chapter has stressed that in the context of a hegemonic country, both classes, the working class and the elite, opt for no reparations. But, in a ‘balance of power’ situation, wherein no single actor on the international scene possesses hegemonic status, the working class will choose harsh reparations, while the elite will not.

What, then, does this chapter teach us? There are two main conclusions: The first is that if we ask why 1945 is so different from 1918; and why the peace treaties after 1945 differ from those of the 1919 Treaty of Versailles, the answer is obvious.

Because in 1945, there was a hegemonic state – the United States – while in 1919, the world was in a balance-of-power period. As this chapter has shown, this fact changes the entire perspective of countries on reparations and free trade. Under a hegemonic system, there is no ‘Clemenceau’ to ask for harsh reparations ‘in the name of the people’, in order to enhance national identity. In periods of hegemony, there is room for coordination, for the UN, for the GATT, for the Marshall plan; there is no room for harsh reparations.

Being part of the intellectual transnational elite, Keynes understood this already in 1919. He fought for a treaty of reconciliation. But Clemenceau could not accept this. On behalf of the French working class, Clemenceau cared about national sovereignty and national identity, for which the French were willing to pay the price. They did not know that the price will be so high.

The second conclusion of this chapter is that the small framework presented in the previous section helps us understand the present. Indeed, the hegemony of the United States extended from 1945 until 2008. Since then, we are back in a balance of power between the United States and China. From 2008 and on, the world has entered a new balance-of-power system. Therefore, the working class in many countries oppose free trade.

I hope this chapter shed new light on Keynes’ view on reparations and Carthaginian peace. Let me conclude this overview on Keynes with a practical quote:

It is our duty to prolong peace, hour by hour, day by day, for as long as we can. We do not know what the future will bring, except that it will be quite different from anything we could predict. I have said in another context that it is a disadvantage of the ‘long run’ that in the long run we are all dead. But I could have said equally well that it is a great advantage of the ‘short run’ that in the short run we are still alive. Life and history are made up of short runs. (Keynes, *New Statesman*, July 1937)

Appendix 1

The debates over the definition and measurement of national sovereignty and power are endless. Despite the lack of consensus on precise definitions, most scholars of the ‘realist’ school agree that economic as well as military factors are crucial. We thus begin with the premise that the national sovereignty, that is power of a nation depends both on its economic and on its military power. Mathematically, we express this assumption as:

$$NS_i = PW_i = F(EPW_i, MPW_i) \quad (A1)$$

where NS_i, PW_i, EPW_i, MPW_i are national sovereignty, total, economic and military power respectively. Without loss of generality, we take a Leontief form of relationship between both powers:²⁰

$$NS_i = PW_i = \text{Min}(EPW_i, MPW_i) \quad (A2)$$

All suggested measures of economic power are intrinsically ad hoc. The proxy we adopt for economic power is total consumption – private and public. A priori, a more natural choice might be output. This choice has the inconvenience that in the case where a country decides to allocate its output to exports and leave very little for consumption, this country would be said to have economic power. Consumption is therefore a more appropriate proxy in the context of our model. Thus:

$$EPW_i = C_i + G_i = c_i \quad (A3)$$

Where C_i is consumption of citizen, G_i government expenditures, and c_i is then the output allocated to consumption.

²⁰ I choose this discontinuous functional form for convenience, and in order to ensure transparency of the results, but any functional form in the class of the CES function yields the same results.

Military power, MPW_i is a function of the stock of military equipment and infrastructure of war owned by the country (planes, missiles, artillery, warships...), but also of the possibility of immediately purchasing ammunition and financing the soldiers. The stock of military equipment, as well as the stock of foreign reserves hoarded in the past, M_i is given exogenously at the start of the period and there is no depreciation of materials during periods of peace. The possibility of being ready for war is then a function of the stock of foreign reserves.

Therefore the increase in foreign reserves, denoted by O_i is a factor influencing the military power of a country. (Note that the accumulation of foreign reserves in the past is included in M_i .)

We therefore have the specification

$$MPW_i = O_i + M_i \quad (A4)$$

Therefore the power of a nation, PW is:

$$NS_i = PW_i = \text{Min}(c_i, O_i + M_i) \quad (A5)$$

From the national income identity, we have that:²¹

$$Y_i = C_i + G_i + NX_i \quad (A6)$$

The flow of foreign reserves and the trade balance are linked by the simple expression:

$$O_i = R_i + NX_i \quad (A7)$$

where O_i is the increase in foreign reserves, NX_i is the current account surplus, and R_i represents the reparations paid by a foreign country (only a country having won a war can ask for reparations).

In consequence we have:

$$NS_i = PW_i = \text{Min}(c_i, R_i + y_i - c_i) \quad (2)$$

where $y_i = Y_i + M_i$.

²¹ Recall that investments are equal to the savings of the elite, a small group of size 0 not included in this part.

Appendix 2

In order to prove Proposition 1, we first show two lemmas. Note that we assume that K is such that $K \gg y_1 / 2$.

Lemma 1

Given reparation of size R , consumption which lead to maximum power is:

$$c_i^* = (y_i + R_i) / 2 \quad (\text{A8})$$

Proof

Equate the two elements of equation (2). See also Figure 9.4.

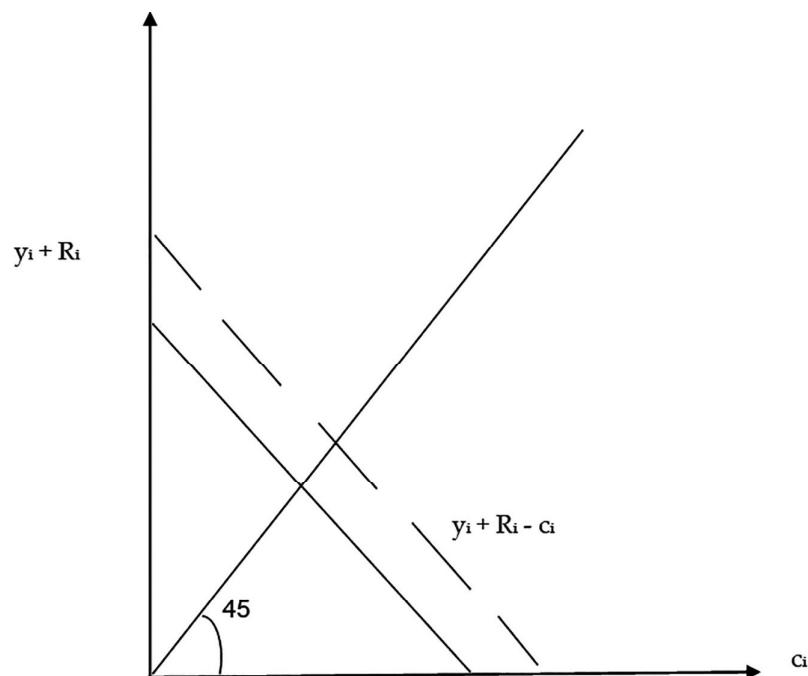


Figure 9.4 Equilibrium

Lemma 2

Given that $K \gg y_1 / 2$ then the optimal amount of reparations is:

$$R_1^* = -R_2^* = (y_2 - y_1) / 2 \quad (4)$$

And therefore we get:

$$c_1^* = c_2^* = (y_1 + y_2) / 4 \quad (5)$$

$$NX_1^* = (3y_1 - y_2) / 4 - M_1 \quad O_1^* = (y_1 + y_2) / 4 - M_1 \quad (A9)$$

$$NX_2^* = (3y_2 - y_1) / 4 - M_2 \quad O_2^* = (y_1 + y_2) / 4 - M_2 \quad (A10)$$

Proof

The equilibrium is a perfect Nash equilibrium of a one period decision game. In the case of balance of power, then the Nash equilibrium necessitates that $PW_2 = PW_1$.

In consequence, given equation (A8), we get the equations (4) and (5) and especially that $c_1^* = c_2^* = (y_1 + y_2) / 4$. QED

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