The Economic Consequences of the Peace

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By Sir Josiah Stamp


I HAVE a vivid recollection of walking up Whitehall in the early summer of 1919, when we were all tired of reading the tiny daily increments of news and views in the papers concerning the proceedings at Versailles, and getting confirmation of the rumor that the economists had been having a bad time in Paris trying to hold within the bounds of reason the politicians and eminent lawyers who were in the inner circles of settlement. Either the economists in that circle were too few to count, or else they were at fault in not bringing into the fray, if they could, the array of eminent supporters who were kicking their heels outside. Surely such a display of consolidated expertise would have impressed, where the single skirmisher would be bundled aside. No one can ever know whether additions to the prophets would have made prophecy more acceptable in that strange uprush of combatant concession to mass psychology on “paying for the war,” and “what Germany would have done if she had won.” Waiting while a slow witness at the Royal Commission on Income Tax thought of his answer, Professor Pigou gossiped to me that Maynard Keynes was giving up in Paris in sheer despair, and that he was producing a book which would startle the Powers in its self-vindication and its pictures of personality. Indeed, to this day, there are apocryphal stories of sentences in the manuscript that were even more biting than those that ultimately survived and which the earnest persuasion of friends alone prevailed on the author to remove from his manuscript. To this day there will be those who think that publication was not a “right” thing to do — not quite nice for a civil servant — while others think the end, if

Editor’s Note. This is the second of a series of several articles examining, in the light of experience and later knowledge, some of the problems with which the world was wrestling a few years ago and some of the outstanding books written at the time. The first article, “Things Not Foreseen at Paris,” by Arnold J. Toynbee, based on “A History of the Peace Conference at Paris,” edited by H. W. V. Temperley, was published in the April 1934 issue.
sufficiently serious, justifies the means; many who just "wait and see," and if the prophet turns out right, then what he did was right *ab initio* — a relativity of moral sense in terms of time, which means that if we are to wait to see which way the cat jumps, she must learn very long jumps.

"The Economic Consequences of the Peace" appeared early in December 1919. It at once raised a storm of comment from three main directions. Most vocal were those who criticized the author's departure from the "good form" of the Civil Service. Next came those who found in the famous Chapter III, with its descriptions of the chief *dramatis personae* of the Conference and of its working, one of the most arresting pieces of writing of modern times, which will probably be quoted in generations when reparations are forgotten. But the third were those who hated the prophecies, and dreaded the ills of their fulfilment. For fifteen years now these fulfilments have been unrolled with the majesty of doom.

Maynard Keynes was not a prophet, wholly aloof from his fellow economists, whose prowess as an exception proved the rule of their general ineptitude. He was fearless and expert in the subject, and best qualified to lead in expressing views held by many with varying degrees of clarity or wealth of evidence and, confirming as he did their latent ideas, he had immediately a solid following of his own kind.

Every economist who knew the meaning of international trade, knew that reparations could only be paid by gold or goods and services, and not in some mysterious "money;" knew that a "balance of trade" of this order was not easily conjured *out of* an industrial country into countries equally or similarly industrial. If this large principle was known, the rest of the story of the prophecy of woe was detail. But it was by the detail and the rate of its unrolling in point of time that the prophet would be judged. Many years would be needed to convince the unwilling nations that things so desirable and so just were not also economic.

Those who could not challenge his economics found fault with his politics. The *Spectator* said: "The world is not governed by economical forces alone, and we do not blame the statesmen at Paris for declining to be guided by Mr. Keynes, if he gave them such political advice as he sets forth in his book." The *Times* said it was "an extremely 'clever' book" — note the distinctive apostrophes — but that it was "the cry of an academic mind, ac-
customed to deal with the abstractions of that largely metaphysical exercise known as political economy in revolt against the facts and forces of actual political existence.” His most striking characteristic was “political inexperience. He believes it would have been wise and just to demand from Germany payment of £2,000,000,000 in final settlement of all claims.” Even by April 1920 its Literary Supplement reëchoed this: “Exhibits every kind of ability except the political kind, which is the science of discovery and the art of accomplishing the practicable in public affairs” — though the Daily News in December had declared that “he prophesied the result and the reality is crowding hard upon his prophecy.”

One may distinguish political from economic wisdom by saying that the latter will and must ultimately prevail, but that it is too hard and unpalatable for a world that will not “come off” its wishes until relentlessly pulled by the force of events. It may be political “wisdom” to flatter the public mind with slightly weaker and weaker doses of what it likes and slightly stronger and stronger doses of what it will have to get used to. It is amazing what a lot of people think they “knew it all along.” If that be the sense of political wisdom, then Keynes’s book wholly lacked it. Some members of the Dawes Commission, and even of the Young Commission, knew that they had to go through such stages of partial disillusionment and such ultimate make-believe as would achieve the political object of the moment, and make possible the next stage of agreement, which alone made progress towards the ultimate solution. Complete economic candor such as Keynes’s would have made havoc, and no names were more condemned in “correct” circles in Paris in 1924 during the Dawes discussions than those of Keynes and Moulton. “Telling the truth to people who misunderstand you is equivalent to promoting falsehood,” said the “Dolly Dialogues.” Must the economist be dubbed “unpractical” because he propounds what alone is practicable, ultimately, and the politician called “practical” because he propounds what is completely unpracticable ultimately?

The Nation, Westminster Gazette, Sunday Chronicle, Athenaeum, Fortnightly Review, all recognized at once the authentic and masterly, and freely welcomed it. The general instructed chorus in America was with Keynes — a strange comment on after history, when as soon as the dilemma of international trade was to strike at their own contentions on international debts, the great
American public were to remain as obscurantist and invincibly blind as any nation could well be without any lesson from history at all. The economists — Taussig, Allyn Young, Dennis Robertson — all made early acknowledgment of their agreement with the central position.

The main burden of the first book was the prophecy that, when evaluated, the treaty claims for reparations would lie between £6,400,000,000 and £8,800,000,000 and that £2,000,000,000 would be the limit of Germany’s capacity in the long run. Keynes showed that the literal interpretation meant:

a. £1,000,000,000 down by May 1921.

b. £2,000,000,000 in bonds etc., so that in all £3,000,000,000 would be found by that date. Interest being 2½ percent till 1925, and 5 percent plus 1 percent for amortization thereafter, that meant £180,000,000 per annum.

c. As soon as possible another £2,000,000,000 in bonds was to be issued, bringing the annual payment up to £280,000,000.

d. Further bonds were to be issued for the balance of the totals due. On Keynes’s assumption of a total of £8,000,000,000 this would raise the annual charge to £430,000,000.

e. Interest was to be debited as from May 1921 on the outstanding debt. On the assumption that Germany could not pay more than £150,000,000 per annum till 1936, she would have to pay £650,000,000 per annum after 1936 to keep pace with interest alone, and any year in which she failed in this would increase the capital debt. To discharge the whole debt in 48 years from the Armistice would bring the annual charge up to £780,000,000.

This result was, of course, trounced by Keynes in the severest fashion as fabulously impossible, and the political effects of the attempt to extract it were plainly set out.

In the result, the Reparation Commission did the sum set by the treaty, and assessed the total due. The “claims” made by the Powers affected had amounted to £11,600,000,000 but the Reparation Commission’s total was £6,600,000,000 — very near to the lower limit set by Keynes.¹ This assessment did not refer to “ability to pay” but was a computation of legal liability; and the task of determining Germany’s annual contribution towards it began its painful and fatuous history. The total of £6,600,000,000 remained theoretically due until modified by the Young

¹ To quote his own words at a later date (“A Revision of the Treaty,” 1922): “Allied Finance Ministers had foreshadowed 300 milliard gold marks; at the time of the Decisions of Paris, responsible opinion expected 160-200 milliards, and the author of ‘The Economic Consequences of the Peace’ had suffered widespread calumny for fixing on the figure of 137 milliards (exclusive of sums due in repayment of war loans made to Belgium), as being the nearest estimate he could make. The public, and the Government also, were, therefore, taken by surprise when the Reparation Commission announced that they unanimously assessed the figure at 132 milliards.”
Plan in 1929. Keynes's main positive statement after detailed computation was that Germany might improve her trade balance so as to have £100,000,000 available for payment of reparations.

"Having regard to the political, social, and human factors, as well as the purely economic, I doubt if Germany could be made to pay this sum annually over a period of 30 years; but it would not be foolish to assert or to hope that she could. Such a figure, allowing 5 percent for interest and 1 percent for repayment of capital, represents a capital sum having a present value of about £1,700,000,000. I reach, therefore, the final conclusion that, including all methods of payment — immediately transferable wealth, ceded property, and an annual tribute — £2,000,000,000 is a safe maximum figure of Germany's capacity to pay. In all the actual circumstances, I do not believe that she can pay as much."

A figure of this order had been computed much more roughly by other British and American economists as reasonably possible — but all non-economists gave much higher figures by the process of "thinking of a number," thinking of their own needs, or confusing "capital wealth" with transferable wealth. Keynes allowed for changes in his estimate if German labor was transported to devastated areas, if her industries were specially nursed for some years (without reparations) by loans; if gold changed in value; and if there were revolutionary changes in nature's yield to man's labor. He declared that a capacity of even £5,000,000,000 was "not within the limits of reasonable possibility. It is for those who believe that Germany can make an annual payment amounting to hundreds of millions sterling to say in what specific commodities they intend the payment to be made and in what markets the goods are to be sold."

In the complicated series of proposals continually modified from 1920 to 1924 for extracting as much as possible from Germany towards the assessed liability, they began with £100,000,000 plus 26 percent of German exports, and finished with an issue of A and B bonds amounting to £2,500,000,000, with ghostly C bonds to be made effective some day for the balance. In the Dawes Plan in 1924 provision was made for a standard annuity of £125,000,000 with a possible supplement computed on an index of prosperity. Obviously the annuity was just enough to meet the A and B bonds' interest, without any contribution of repayment. The theory of the total £6,600,000,000, to be discharged some day, still remained uncancelled, and the only theoretical
possibility of its discharge lay in the substantial growth of the supplement through increasing German prosperity. There was no technical reduction of the total for there was no limit of time to the Dawes annuities save the ultimate discharge of the total. But in the Young Report, in 1929, a time limit and an exact schedule of definitive payments gave a “present value” totalling about £200,000,000, which cancelled the old £6,600,000,000 and came within Keynes’s limits (ignoring sums already paid). Even this, however, had much less reference to Germany’s own capacity to pay than to the creditors’ minimum requirements for their own outpayments and expenses.

Thus in ten years the world came to the conclusion that Keynes had not been far out. But shortly it was to outdo him when it recognized that even this settlement was impossible. It is fair to argue that but for the excessive pressure on, and exhaustion of, Germany in the early stages, but for the impoverishment due to the Ruhr incidents and inflation, and but for growing nationalism elsewhere making exports difficult to increase, £100,000,000 per annum would have been a feasible sum, and I believe that Keynes was right on the conditions of 1919. But even without these hindrances, the great world slump of 1929–1933 would have put an effective end to this estimate.

Keynes himself described later the main contentions of “The Economic Consequences of the Peace:”

1. The claims against Germany which the Allies were contemplating were impossible of payment.
2. The attempt to enforce these claims might ruin everyone.
3. The money cost of the damage in France and Belgium had been exaggerated.
4. The inclusion of pensions and allowances was a breach of faith.
5. The legitimate claim against Germany was within her capacity to pay.

The first was demonstrated in a few months; the second in four years; the fourth was non-economic. The fifth was only feasible if the second never came into play, and if every circumstance of assistance were favorable. Keynes never realized the extent of the political impasse that would arise. The third contention, the extent of the damage, was reexamined by him in the “Revision of the Treaty.” The French claims during the first two years rose from 65 milliard francs to 134 milliards. The actual claim submitted was 127 milliard francs. The puzzle of giving this a gold franc value was tackled, and it became 57.7 milliard gold marks
May milliards. Keynes called this “fantastic.” His detailed estimates came to not more than one-third of this total. The Reparation Commission’s findings broadly confirmed the more conservative estimate — 30 milliards for direct damage to property.

When Keynes wrote his sequel, or continuation, “A Revision of the Treaty,” the definitive scheme of reparations, published in May 1921, had been in force for six months. He said at once, “It will not endure.” But it was the fait accompli of the hour and he had to subject it to the same patient examination. The elaborate machinery of A bonds and B bonds (a total of £2,500,000,000), with provisional C bonds, was set up. “It is probable that, sooner or later, the C bonds at any rate will be not only postponed, but cancelled.” The whole scheme of quarterly payments (£100,000,000 a year and 26 percent of the value of exports), although an abatement of the Treaty, was “like all its predecessors, a temporary measure, bound to need amendment.” When Keynes first gave 2 milliards of gold marks per annum, M. Klotz was forecasting 18 milliards in the French Chamber — a considerable drop from Lord Cunliffe’s general election figure a year earlier, 28.8 milliards.

The Reparation Commission, eighteen months after, reached 8.28 milliards, and two months later the London Settlement was 4.6 milliards. The British and French Ministers had come down from 10.8 milliards to this figure in two years. Keynes held on to 2 milliards. He showed that imports would have to amount to an unprecedented figure, double their best level, without any rise in imports, to achieve the required annuity. Against this, Germany’s need was for more and more imports. A scale of payments was arranged for the early period, but the instalment of August 31, 1921, was only paid out of accumulated foreign balances and temporary advances. November 1921 was covered by the delivery of coal and material. Keynes thought January and February 1922 might be covered by deliveries and advances, but that April 1922 would present more difficulty.

The Conference of London wiped out the impossible liability under which Germany lay of paying a balance of £600,000,000 (gold) due under the Treaty on May 1, 1921.

Keynes said that in the “second ultimatum” of London the Allies were no longer in fanatical mood. He hoped, therefore, that Germany would accept the notification of the Allies and do
ECONOMIC CONSEQUENCES OF THE PEACE

her best to obey it, “trusting that the whole world is not unreasonable and unjust, that Time is a healer and an illuminator, and that we had still to wait a little before Europe and the United States could accomplish in wisdom and mercy the economic settlement of the war.”

After examining the budget problem against the declining mark (only just beginning its tremendous career of inflation), and the burden on the total income, he concluded that the London Settlement gave a breathing space to the end of 1921, but could be “no more permanent than its predecessors.” He foresaw with great accuracy that a real attempt to pay in goods would arouse protectionist sentiment and cries of “Germany’s attempt to ruin trade with nefarious competition.”

Keynes diagnosed the reasons for the fall in the value of the mark, and declared that a serious attempt to meet reparations demands would cause a big currency inflation, and a redistribution of wealth amounting to a social catastrophe. He spoke also of a financial catastrophe, and even of a rate of exchange exceeding 1,000 marks to the pound, reducing the real burden of the public debt to very moderate dimensions. But even he failed to realize how much further than all this the situation would develop, and the tragic scale of the disaster.

The question of coal loomed large in the original ideas of reparations. Coal was a form of payment Germany could easily make, but it had important effects on her own internal economic welfare. The Treaty provided for a delivery of about 40,000,000 tons per annum, with many complicated details which lent themselves to much debate. Keynes said flatly that this was impossible, and gave good economic reasons for the conclusion.

The complicated totals were soon forced under revision. Up to the middle of 1921 practically the whole of Germany’s reparations were paid in coal, and yet in the first quarter the Reparation Commission reduced the demand to 1,660,000 tons per month, and then to 1,500,000 (when actual delivery proved to be 770,000 tons per month). From August 1920, 2 million tons per month were expected, but against a return payment (or loan) for miners’ food! Germany got cash at about 40 shillings per ton for those deliveries. As a matter of fact, even the restricted deliveries seriously incommmoded the recipients.

It is perhaps too meticulous at this date to go into stale controversies about the minutiae of Keynes’s coal estimates; but he
revised the figures himself and substantiated the greater part even of the details. Of course, his main position was incontrovertible.

In August 1921 he published the prediction that some time between February and August 1922, Germany would succumb to an inevitable default. He repeated this in December 1921. "This is the maximum extent of our breathing space." In December 1921 the German Government notified the Reparation Commission that having failed to secure a foreign loan, they could not find, apart from deliveries in kind, more than 150 or 200 million gold marks towards the February 1922 instalment. Conferences in January 1922 had to prescribe a moratorium. In August, after Germany had asked for a moratorium of two and a half years, cash payments were suspended by agreement and bills at six months were accepted. Then follows a long story of revisions up to the time the French occupied the Ruhr and the disintegration of Germany's economic life was complete until the rescue of the Dawes Plan.

There may be those who will urge that all this was "dead easy" — those who, having seen "how it's done" imagine that a wizard has no skill — those who deceive themselves by reading their present or recently-won insight back into their past attitude. Others will urge that Keynes has not always been so happy in his opportunity, and that attempts at prophecy in other directions do not justify the economist as seer or even as diagnostician. He speaks for himself in "Essays in Persuasion." I am content to judge "The Economic Consequences of the Peace" and its sequel by the fact that it was written against the full tide of popular political and even instructed opinion, was regarded as "reckless," academic, or unwarrantable at the time, but has since justified its author, not only in its broad conclusions, not only in the greater part of its detail, but also in the action and the occasion of its writing.