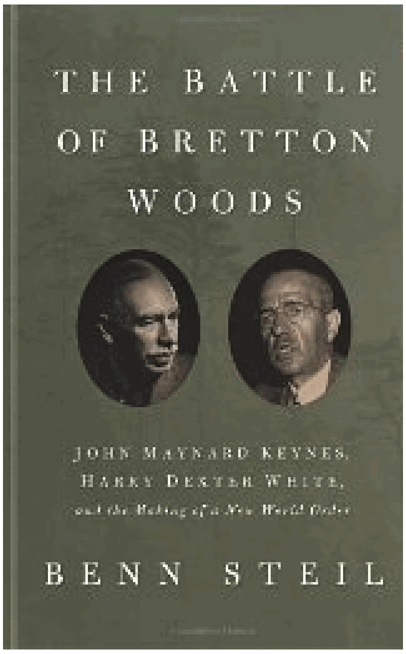
Retirement Income
JOURNAL

When the Empire Didn’t Strike Back

By Martin Hutchinson *Thu, Mar 14, 2013*

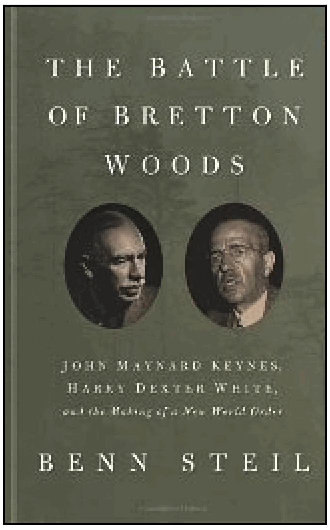
Conservative reviewer Hutchinson praises Benn Steil's new book on the 1944 Bretton Woods negotiations, which documents how Britain lost its economic crown jewels at the historic conference in New Hampshire.



Benn Steil’s excellent new study *The Battle of Bretton Woods* (Princeton, 2013) focuses on the 1944 global monetary conference as a struggle between its two principal protagonists, the U.S. Treasury’s Harry Dexter White, and Britain’s celebrity economist, Maynard Lord Keynes.

Even Steil, an American who has considerable sympathy with Keynes, is quite clear that he lost, playing a bad hand poorly. To this British-born columnist with less sympathy for Keynes’ bizarre economic beliefs, his Bretton Woods performance was not merely a defeat, it was a historic disaster.

Britain went into the Bretton Woods negotiations with an unfounded belief in the goodwill of Franklin Roosevelt’s administration. Churchill had, a few years earlier, described the U.S. Lend-Lease arrangements as “the most unsordid act in the whole of recorded history.”



In reality the Lend-Lease arrangements of 1940-41 were designed to leave Britain as close to insolvency as possible while she wore out her economy and people in a life-and-death struggle that had little relevance to particular British interests.

Keynes himself had been notably uninvolved in the British economic successes of the 1930s, but had been brought back into influence only at the outbreak of war, when Chamberlain’s pacific free-market approach to Britain’s needs seemed discredited.

He was philosophically opposed to the centerpiece of British 1930s policy, the Imperial Preference agreements of 1932, which had finally ended the unilateral trade disarmament of 1846-1932 and imposed a modest 10% tariff on imports to the Empire and Dominions to combat the tariffs of 50% and more imposed by Britain's trading partners, notably the United States under the 1930 Smoot-Hawley tariff.

Keynes was also philosophically opposed to private-sector bankers, refusing to negotiate a possible post-war loan with Wall Street, which would have greatly increased his bargaining power at Bretton Woods. He apparently failed to perceive that Britain's interests coincided in many respects with Wall Street's, since both groups wanted to avoid a post-war financial system dominated by the public sector bureaucrats of Washington.

Finally, Keynes was opposed to the pre-World War I Gold Standard, and also to a floating exchange rate system, typically wanting a system in which exchange rates would be determined by a superior group of public sector mandarins. He also favored a new currency, "bancor," which the mandarins could create through the IMF, which would prevent a repeat of the deflation of the 1930s.

On the American side, White (who we now know was an active Soviet agent) and his boss Treasury Secretary Henry Morgenthau were convinced that much of the U.S. misery in the 1930s had been due to British and French "competitive devaluation," so they were determined to establish a system of fixed exchange rates.

White (who was unpleasant and intellectually misguided, but not corrupt) also believed that the Soviet economic system was the wave of the future, to which we were all converging – perhaps not as lunatic a belief in the middle of World War II as it seems today – and so was determined to help that convergence along as far as he could.

He therefore wanted Imperial Preference dismantled, a fixed gold/dollar exchange rate system that gave the U.S. dollar primacy as the only reserve currency, and a World Bank/IMF that could lend money but not create it. He opposed Keynes' "bancor," since that would weaken the position of the dollar and effectively act as a hidden subsidy from the U.S. (the only fully solvent economy) to everyone else.

A negotiator with Britain's true economic interests at heart would not have allowed chimerical new schemes of international finance to dominate the conference, but would have focused on Britain's three crucial interests:

- The preservation of Imperial Preference
- The largest possible post-war loan
- Permission for an immediate sterling devaluation similar to the 30% fall which became inevitable in 1949

Imperial Preference had proved its value in the 1930s, in allowing a modest reciprocal arrangement against the still gigantic American tariffs, so that British manufacturers had a chance in Empire, Dominion and later Commonwealth markets of competing against U.S. products that had built huge efficiencies of scale behind their high tariff wall.

Britain would have had its own free-trade area that was well designed to balance its raw-material-poor manufacturing and service economy. Joining the European Economic Community would have been superfluous and indeed obviously economically counterproductive.

When Keynes came to focus on Britain's postwar loan, in 1945, he concentrated fanatically on the interest rate, demanding an interest-free loan instead of the 50 years at 2% that was on offer. In consequence he obtained a loan of only $3.5 billion instead of the $5 billion Britain needed—with conditionality of restoring full convertibility of sterling in July 1947, an impossibly early date.

A better negotiator would have opened negotiations with Wall Street, securing a $5 billion commitment, which appeared to be available, and then negotiated with the U.S. Treasury only for a top-up, sufficient to carry Britain through to 1950 or so, when private markets would be functioning properly again.

Finally, since both sides were determined to abandon a true gold standard (because of its automaticity and deflationary nature), Keynes should have pressed for floating exchange rates (which Britain almost introduced in 1952 by the "Robot" scheme, but alas wimped out of). At a minimum a good negotiator would have insisted on a 1949-style devaluation immediately.

As for the World Bank and IMF, a good negotiator would have avoided setting up these useless bodies altogether. Without (until 1968 with Special Drawing Rights) the ability to create Keynes' bancor, they did nothing useful to solve Britain's dollar shortage problem in the post-war years.

Moreover, once they got going they provided and have continued to provide subsidized competition to London merchant banks, which in the pre-1914 Gold Standard world had made a very good business out of providing advice and arranging loans for the world's emerging markets.

With sterling freely convertible at a floating exchange rate after, say, 1950 there was no reason why the merchant banks could not have resumed this business, driving out their domestically-oriented and undercapitalized U.S. cousins who had gained a position in the business in the 1920s.

The merchant banks would have had a much larger fee income, and would thereby have been saved from the depredations of the 1986 "Big Bang" while emerging markets would have received advice that helped rather than hindered their development—and far fewer opportunities for the local elites to siphon off loan monies.

The drawbacks of Keynes' approach were recognized by clear thinkers at the time. Leo Amery, Secretary of State for India, wrote in a Cabinet memo: "We must be free to take whatever measures we think necessary to the safeguard of our own production, to develop Imperial Preference, to use our bargaining power with foreign countries, and to strengthen that wonderful monetary instrument the sterling system. We must enter into no international commitments which in any way limit that freedom."

White and Morgenthau became notorious in 1944-45 by their "Morgenthau Plan" which would have stripped Germany of industry, thereby leaving Soviet tanks a clear run to the Channel ports. They didn't get to implement that one—but by the Bretton Woods Agreement, with the aid of the vain and foolish Keynes, they did just about as much damage to the British economy, damage that lasted until exchange controls were lifted in the early days of Margaret Thatcher.

Martin Hutchinson is the author of "Great Conservatives" (Academica Press, 2005). This article appeared unabridged at prudentbear.com.