

# *Keynes, Economics and War: A Liberal Dose of Realism*

by

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## **Abstract**

This paper examines Keynes's thoughts on the economic causes of war. Though an issue upon which the classical economists and their popularisers wrote much, the links between economics and war has become, beyond an unthinking acceptance of the pacific qualities of free trade, an issue largely ignored by economists. Keynes's thinking on the subject, however, was sustained, nuanced and, in its final manifestation, heavily influenced by the implications of his own revolutionary ideas in macroeconomics. By the end of his life Keynes had eschewed the simple liberalism of his youth, combining much that would later emerge within the 'realist school' of international relations with practical plans for a better world.

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## **Section I: Introduction**

The life of John Maynard Keynes was a life dominated by war. Whether it was pointing out the follies of war, devising ways to avoid war, to finance war, to manage post-war reconstruction or determine reparations – war imposed greatly on a mind naturally inclined to more pacific pursuits. His professional life book-ended by the two global wars, Keynes's personal life was no less afflicted. He saw many of his friends – the gilded youth of the Edwardian era – killed in war. He lived long enough to see some of the children of the survivors killed in later wars. Finally, war was effectively to kill Keynes too.<sup>1</sup>

Notwithstanding the dominance of Mars in Keynes's life, his thoughts on war, and especially its causes, have been largely ignored by scholars of his work. What has been written is mostly concerned with *Economic Consequences of the Peace* and its controversies - and, within this heated (and longstanding!) conversation, the truth or otherwise in the startling (1946) claim of Etienne Mantoux that Keynes's polemic inadvertently helped cause World War Two.

Of Keynes's three (major) biographers it is only the most recent, Skidelsky (1983-2000), who has dealt at any length with Keynes's thoughts on the causes of war. Devoting twelve pages in the final volume of his trilogy to Keynes's pronouncements on foreign policy in the lead up to the Second World War, Skidelsky's assessment of Keynes's competence on the subject is not positive. Keynes's writings on foreign policy, he tells us, were not 'of the same quality as his economic pronouncements...his approach was often amateurish...he ruminated from a distance; his writing was untypically vague' (Skidelsky 2000, p.27). Skidelsky suggests that a primary reason for this was Keynes's lack of contacts with those sections and those people of government concerned with foreign policy. He notes that this was in contrast to Keynes's relationship to the 'official' economics world - though he somewhat ambitiously extends this to the claim that 'Keynes's genius as an economist owed a *great deal* to his intimate knowledge of the workings of Whitehall and the City of London' (Skidelsky 2000, p.27, emphasis added).

The purpose of this paper is to suggest that Keynes's writings on war were, pace Skidelsky, of a high quality and more than worthy of consideration when examining important questions on economics and war. The times in which Keynes ruminated on such questions were unusually fraught and complex, and on certain issues it is clear that he made some 'bad calls'. It is also the case that his ideas on the way that economics and war might be linked underwent a substantial change between the world wars. This in itself should not be proof of poor thinking - on questions of war even more than on questions of economics, Keynes's famous injunction on the importance of being able to change one's mind in the face of changing facts holds force - but it is noteworthy that this change was as stark as his changing economic ideas more generally.

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<sup>1</sup> Given his exertions during the Second World War, Lionel Robbins's claim (in a letter to Keynes's widow) that 'Maynard has given his life to his country, as surely as if he had fallen on the field of battle' seems an utterly reasonable one (Robbins cited in Skidelsky 2000, p.xv).

The argument thus outlined proceeds as follows. Section II examines Keynes's early thoughts on economic causes of war. Using *The Economic Consequences* as the most complete and thoughtful statement of his early position, it finds Keynes to be an exponent of that most British liberal tradition that equated free trade with the advancement of peace and prosperity. Nevertheless, even at this stage Keynes scented trouble - and more than most liberals of the day he identified the essential fragility of the *pax per mercaturam*. Section III leaps forward a decade and into the lead up to the Second World War. The 'low dishonest' decade of the 1930s provided a rich empirical backcloth against which to test theoretical musings on the causes of war. Few muses were left unembarrassed. Keynes by this stage had abandoned the liberalism of his youth in favour of what could be described as 'armed deterrence' as the best policy by which a state, specifically Britain, could avoid war. Keynes's position during these 'appeasement' years was quite similar in many respects to the emerging 'realist' school of international relations. Section IV outlines Keynes's blueprints for the post-World War Two order, especially his 'Clearing Union' proposal for reforming the international monetary system. It argues that this offered a truly liberal adjunct to Keynes's realism, a progressive component to a doctrine otherwise barren and amoral. Section V concludes the paper.

## **II. The Cobdenite Liberal**

The Keynes who wrote *The Economic Consequences of the Peace* (hereafter, ECP) was a believer in free trade. As Skidelsky (2000, p.121) reminds us, 'free trade was [Keynes's] only political cause before the First World War'. A characteristic outburst in 1903 had him declaring that he hated 'all priests and protectionists...Free Trade and free thought! Down with pontiffs and tariffs! (Keynes cited in Skidelsky 1983, p.122). He remained an ardent free trader as late as the early 1920s, when he campaigned against Baldwin's Conservatives and their advancement of the 'elementary folly' that tariffs could ever be a cure for unemployment.<sup>2</sup>

Keynes's early ardour for free trade was for the full Cobdenite vision of the creed. Thus free trade was not just about commerce, but about establishing that 'harmony of interests' that would establish the basis of world peace as well. This most attractive of visions, which continues to dominate the thinking of economists on questions of economics and peace, held that it was through trade and commerce, rather than military conflict, that nations could achieve security, prosperity, power and growth.<sup>3</sup> Trade also created interdependencies between countries, supposedly fostering cooperative relations, rather than competition and conflict.

Such liberalism is forever identified with the campaigns of the great tariff reformers, Richard Cobden and John Bright, whose peak of influence came with the repeal of the so-called 'Corn Laws' in England in 1846. Cobden stamped the campaigns with an evangelical zeal that was long to be a feature. In 1846 he wrote that he saw

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<sup>2</sup> Article in *The Nation*, 24 November 1923. The article is reproduced in *The Collected Writings of John Maynard Keynes* (hereafter *CW*), Volume XIX, pp.151-154.

<sup>3</sup> The World Trade Organisation lists the contribution to peace as the first of the many benefits of international trade. On its website it declares that '...sales people are usually reluctant to fight their customers...if trade flows smoothly and both sides enjoy a healthy commercial relationship, political conflict is less likely. What's more, smoothly-flowing trade also helps people all over the world become better off. People who are more prosperous and contented are also less likely to fight' (WTO 2002).

in the Free-trade principle that which shall act on the moral world as the principle of gravitation on the universe – drawing men together, thrusting aside the antagonism of race, and creed, and language, and uniting us in the bonds of eternal peace (Cobden 1995 [1846] Vol.3, pp.362-363).

Cobden and Bright were liberal politicians and populists, and their ideas were based on a mix of Kantian idealism and the insights of the classical economists as they understood them. The most influential amongst these at the time of the Corn Law campaigns were David Ricardo and John Stuart Mill - whose writings were not out of sympathy with the Cobden/Bright thesis. In his famous treatise, *On the Principles of Political Economy and Taxation*, Ricardo implicitly accepted that commerce could be a powerful brake on war when he argued that wars should be financed by taxation, and not by borrowing: 'When the pressure of war is felt at once, without mitigation, we shall be less disposed wantonly to engage in an expensive contest, and if engaged in it, we shall be sooner disposed to get out of it...' (Ricardo 1951 [1817], p.186). Mill, in his *Principles of Political Economy*, similarly argued that war and modern exchange economies were incompatible and, as such: 'Wars, and the destruction they cause, are now usually confined, in almost every country, to those distant and outlying possessions at which it comes into contact with savages' (Mill 1965 [1848], p.707).

Unlike many of their popularisers, however (then and later), the leading thinkers of classical political economy were not naïve in their perceptions of the malleability of human nature in response to economic circumstances. As demonstrated by Goodwin (1991, p.34), the same Mill who wrote that the *appetite* for war was now confined to the economic periphery, was not about to suggest that war would not be visited upon what he would have regarded as civilisation: 'War may be stigmatized universally, and we are quite ready to give our vote for its abolition in a universal congress of mankind: but while the enemies of freedom are allowed to levy their vassals, embattle their slaves, and organize their dupes, assuredly the friends of freedom have a right to employ their own thews and sinews to check the onward flow of barbarism and tyranny' (Mill 1989 [1837], p.364). Adam Smith likewise held a complex view on the economic causes of war. On the one hand Smith famously rejected the Mercantilist view of trade as a zero-sum game of endemic conflict. Less well known was his concern that prosperity made states 'unwarlike' while simultaneously provoking the envy of less affluent neighbours. Thus:

An industrious, and upon that account a wealthy nation, is of all nations the most likely to be attacked; and unless the state takes some new measures for the public defence, the natural habits of the people render them altogether incapable of defending themselves (Smith 1976 [1776], pp.697-698).

It was, accordingly, the responsibility of the government of such a state to create a standing army of sufficient strength such as to deter would-be attackers. More hopefully for the inhabitants of the affluent parts of the world (but not for those outside it), Smith held that the balance of power had substantially shifted in their favour:

In modern war the great expense of firearms gives an evident advantage to the nation that can best afford that expense, and consequently to an opulent and civilised over a poor and barbarous nation. In ancient times the opulent and civilised found it difficult

to defend themselves against the poor and barbarous nations. In modern times the poor and barbarous find it difficult to defend themselves against the opulent and civilised (Smith 1976 [1776], p708).

In the early years of the twentieth century a new bout of populist enthusiasm connecting economics with the obsolescence of war was stimulated by the publication of a book which pronounced that, in the modern world, war created only losers - whatever the outcome on the battlefield. *The Great Illusion*, published in 1910, was the product of Norman Angell. A journalist and sometime politician (who was to win the Nobel Peace Prize in 1933 for his lifetime work), Angell evocatively pointed out the folly of war as an instrument of national gain. Countries in the industrial era he believed, were so linked to each other - via international trade, international finance and factor flows - that the dislocation of economic activity occasioned by war ensured that territorial expansion, even the seizure of 'treasure', was no longer profitable. As such:

What is the real guarantee of the good behaviour of one state to another? It is the elaborate independence which, not only in the economic sense, but in every sense, makes an unwarrantable aggression of one state upon another react upon the interests of the aggressor (Angell 1913, p.295).

Angell's work was enormously influential. *The Great Illusion* was not only a bestseller (it sold two million copies and was translated into 25 languages), it also attracted the attention of various philanthropic institutions that helped spread its message via all manner of 'ginger groups' characteristic of the era. One of the more important of these was the Carnegie Endowment for International Peace, founded in the same year that *The Great Illusion* was published, and which financed the translation of the book for the German market. Other foundations, explicitly established to propagate what was sometimes referred to as 'Norman Angellism', were also established.<sup>4</sup>

Keynes thought well of Angell and his ideas. As Skidelsky (1983, p.234) notes, Angell's rationalist and meliorist philosophy fitted in well with Keynes's own deepest beliefs. Keynes invited Angell to speak at his Political Economy Club in February 1912, and they were to remain in irregular contact for many years after (Skidelsky 1983, p.213).<sup>5</sup>

### ***The Economic Consequences of the Peace***

The ECP is Keynes's most famous, and influential, foray into international relations. In it, Keynes's voice is that of the Cobdenite liberal. This is apparent in his vision of the pre-war world - a world in which, for a middle-class Englishman such as himself:

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

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<sup>4</sup> The most important of these was the Garton Foundation, established by the philanthropist Sir Richard Garton, in 1912.

<sup>5</sup> They were also to share a similar outlook on what should be done to avoid war - this time the Second World War - two decades later. Like Keynes, Angell was a bitter opponent of the appeasement policy of the British Government. Favourable comment on some of Angell's work by Keynes in this regard can be found in *CW XXVIII*, p.57.

this paradise, were little more than amusements of his daily newspaper, and appeared to exercise almost no influence at all on the ordinary course of social and economic life, the internationalisation of which was nearly complete in practice (*CW* II, p.7).

Underlying this world was an international economy in which, for those parts of the world connected to it,

[t]he various currencies, which were all maintained on a stable basis in relation to gold and to one another, facilitated the easy flow of capital and of trade to an extent the full value of which we only realise now, when we are deprived of its advantages. Over this great area there was an *almost absolute security of property and of person* (*CW* II, p.9, emphasis added).

Keynes the Cobdenite liberal in ECP was also apparent in his vision for the future - in particular, his proposal for a 'free trade union' to be established under the League of Nations. Under this device, no country could impose protectionist barriers against the wares of fellow members, and it would be the vehicle through which

some part of the loss of organisation and economic efficiency may be retrieved which must otherwise result from the innumerable new political frontiers now created between greedy, jealous, immature, and economically incomplete, nationalist states...A free trade union, comprising the whole of Central, Eastern and south-Eastern Europe, Siberia, Turkey, ...the United Kingdom, Egypt and India, might do as much for the peace and prosperity of the world as the League of Nations itself (*CW* II, p.169).

Even in 1919, however, Keynes's faith in the liberal order, or more particularly that such an order would spontaneously emerge through the pursuit of national self-interest, was beginning to fade. In ECP Keynes made much of the fragility of the old order, for all its virtues. Excessive population growth, a more or less constant anxiety of Keynes mostly ignored by scholars of his work, was especially a concern. Such population growth was allowed before the war only because of a 'complicated and artificial organisation' and a 'claim...on the food supplies of the New World'. With the pre-war 'organisation' now destroyed, a new Europe seemed to be in the offing - a Europe that was 'inefficient, unemployed, disorganised', a Europe 'torn by internal strife and international hate, fighting, starving pillaging and lying' (*CW* II, p.15).

Of course all this was exacerbated by the 'Carthaginian peace' imposed by Versailles - the folly of which was Keynes's central concern in ECP. In an oft-cited passage of ECP discomfiting in its prescience, Keynes warned:

If we aim deliberately at the impoverishment of Central Europe, vengeance, I dare predict, will not limp. Nothing can then delay for very long that final civil war between the forces of reaction and the despairing convulsions of revolution, before which the horrors of the late German war will fade into nothing, and which will destroy, whoever is victor, the civilisation and the progress of our generation (*CW* II, p.170).

### III. Realism on the Road to the Second World War

#### *Losing Faith in Free Trade*

The fragility of the pre-war system, and the changed circumstances of the post-war world meant that, as Keynes insisted in ECP, 'the clock cannot be set back'. Setting the clock to its proper time or, more pertinently, reforming monetary and other institutions to meet the new realities, was Keynes's self-appointed task through the 1920s. These were the years of his most prolific public policy advocacy, years in which he became 'the leading intellectual critic' of the economic policies of the British, and other, governments (Skidelsky 1992, p.147). In these fertile years, when Keynes's policy advocacy ran substantially ahead of his theory, a series of 'polemics' flowed from his pen - *The Economic Consequences of Mr Churchill*, *The Means to Prosperity*, *The End of Laissez-Faire*, *Can Lloyd George Do It?*, and the more substantial policy/theory volumes - *A Tract on Monetary Reform* and *A Treatise on Money*. All of these were fashioned around the theme of obsolescent thinking, and most advanced some sort of scheme aimed at reforming the international monetary system such that 'harmony' might be restored.

In 1931 Keynes broke from his advocacy of free trade, coming out publicly in favour of protection in articles in the *New Statesman* and *Daily Mail* in March of that year. His conversion at this point, however, was equivocal and had more to do with his conviction that the old mechanism - Bank Rate, the gold standard and free trade - could no longer deliver simultaneous internal and external macroeconomic balance, than any desire for protection itself. Keynes's movement towards a more identifiably protectionist leaning came as the Depression dragged on, and after Britain's abandonment of the gold standard rendered his original concerns largely irrelevant. This movement reached its apogee in his famous 'Let Goods be Homespun' article in the *New Statesman* in July 1933:

I sympathise...with those who would minimise, rather than those who would maximise, economic entanglement between nations. Ideas, knowledge, art, hospitality, travel - these are the things which should of their nature be international. But let goods be homespun whenever it is reasonably and conveniently possible... (CW XXI, p.238).

Keynes's apostasy on free trade was exceeded, in terms of the Cobdenite canon, by an even greater affront when, in 1936, he came to reject free trade not only on the basis of its economics, but on its pacific qualities too. This rejection of all that he had once stood for was most prominent in his own canonical work, *The General Theory on Employment, Interest and Money*. Contained in the 'Concluding Notes' to the work, and newly armed with the theoretical insights of his broader thesis, Keynes demonstrated the extraordinary distance he had travelled:

War has several causes. Dictators and others such, to whom war offers, in expectation at least, a pleasurable excitement, find it easy to work on the natural bellicosity of their peoples. But, over and above this, facilitating their task of fanning the popular flame, are the economic causes of war, namely, the pressure of population and the competitive struggle for markets. It is the second factor, which probably played a

predominant part in the nineteenth century, and might again, that is germane to this discussion.

...under the system of domestic *laissez-faire* and an international gold standard such was orthodox in the latter half of the nineteenth century, there was no means open to a government whereby to mitigate economic distress at home except through the competitive struggle for markets. For all measures helpful to a state of chronic or intermittent under-employment were ruled out, except measures to improve the balance of trade on income account.

Thus whilst economists were accustomed to applaud the prevailing international system as furnishing the fruits of the international division of labour and harmonising at the same time the interests of different nations, there lay concealed a less benign influence; and those statesman were moved by common sense and a correct apprehension of the true course of events, who believed that if a rich, old country were to neglect the struggle for markets its prosperity would droop and fail. But if nations can learn to provide themselves with full employment by their domestic policy...there need be no important economic forces calculated to set the interest of one country against that of its neighbours... (*CW VII*, pp.381-382).

### ***Dealing with the 'Brigand Powers'***

During the time that Keynes was writing *The General Theory* questions relating to the causes of war moved from the theoretical and abstract, and into the realm of practical politics. The rise of Nazism in Germany, fascism in Italy, and the emergence of a militarist regime in Japan, set in train a sequence of international crises that would culminate in the Second World War. Throughout this period Keynes had an outlet for his thoughts on foreign policy via the *New Statesman and Nation* (NSN), for which he was Chairman of the Board. He sent a more or less continual stream of articles, notes and letters-to-the-editor to the journal in the latter half of the 1930s, and an even larger volume of private correspondence to its editor, Kingsley Martin.

An early indication of the stance that Keynes believed the democracies should take to (what he always referred to as) the 'brigand powers' came in a letter-to-the-editor published in the NSN in July 1936. Sent five days before a group of generals seized power in Spain and began what became known as the Spanish Civil War, but after Nazi Germany's reoccupation of the Rhineland (March 1936) and Italy's attack on Abyssinia (October 1935), it urged collective security and armed deterrence:

I desire those countries, whose fundamental policies are peaceful, to be as formidable as possible...The leadership of this group obviously belongs to ourselves, France, Russia, and the United States; its membership includes the whole world except Germany, Italy and Japan...to make it collectively so formidable that only a madman will affront it.<sup>6</sup>

This required re-armament in most of the democracies - within which calls for *disarmament* had hitherto been dominant:

...a state of inadequate armament on our part can only encourage the brigand powers who know no argument but force, and will play, in the long run, into the hands of those who would like us to acquiesce by inaction in these powers doing pretty much

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<sup>6</sup> Letter to MSN, 13 July 1936, reproduced in *CW XXVIII*, p.47.

what they like in the world...Can I not persuade you that the collective possession of preponderant force by the leading pacific powers is, in the conditions of to-day, the best assurance of peace...?<sup>7</sup>

In the letter Keynes acknowledged that there were groups who would vigorously oppose such a stance. These groups came from both sides of the ideological fence - from the Labour Party and the left generally who opposed re-armament - but also from sections of the right (including the Prime Minister, Stanley Baldwin and the Chancellor of the Exchequer, Neville Chamberlain) which favoured a negotiated settlement of German 'grievances'. Keynes was critical of both groups, but he was especially scathing about his critics on the left. This reached something of a crescendo following the opening of the civil war in Spain, when these (mostly) hitherto pacifists now loudly demanded that the British Government intervene militarily on the side of the Republican forces. In response to these demands, Keynes wrote again to the NSN in August 1936:

Those today who cannot endure uncertainty alternate between joining...[the] faith of non-resistance and asking us to take up arms of violence on all occasions to defend the world against Fascism. There is something to be said for both. Nevertheless, these are refuges, escapes from the torment of thinking. What relief, what emotional comfort to get amongst like-minded friends with no obligations to talk realities! But this is the cloister, not the world.<sup>8</sup>

Keynes was a believer in the collective security aspect of the League of Nations - the commitments to which were the core elements of the League's Covenant. As such, he was perturbed that by not responding to Italy's aggression in Abyssinia, and the weak response to the earlier aggression of Japan in Manchuria, member governments had gravely weakened the League in its most important role. Once again though, on this topic he reserved his most strident criticisms for this sidelining of the League to those on the left, and to the spirit of pacifism in general:

...you underestimate the effect on others of the pacifist movement of the last ten years. When the League was set up in 1919, the country was not pacifist in the sense that it is now. The pacifism of the average League supporter to-day has, unavoidably, weakened the League.

...The dominating factor behind this country's policy is...the blind determination of the average man to keep out of war, including preventative wars, and out of threats of war, including those which may not, in fact, involve it, and out of hypothetical commitments for war, including those which may help to keep the peace.

...There is - there always was - much to be said against a too unqualified pacifism.<sup>9</sup>

If Keynes's criticisms of the left was that of muddle-headed principles getting in the way of prudent policy, his disagreements with those on his political right concerned their seeming lack of principles. His attack on the right in this context first emerged in the wake of the Baldwin Government's *mishandling* of Italy's invasion of Abyssinia.<sup>10</sup>

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<sup>7</sup> *ibid.*, pp.47-48.

<sup>8</sup> Letter to NSN, 15 August 1936, reproduced in *CW* XXVIII, pp.53-54.

<sup>9</sup> Letter to NSN, 12 September 1936, reproduced in *CW* XXVIII, pp.56-57.

<sup>10</sup> That is, over the controversial plan of the British and French foreign ministers, the 'Hoare-Laval Pact', which was designed to pressure Abyssinia into acceding to many of Mussolini's demands. This

This, he wrote in August 1936, had been 'cowardly and misguided' and the Foreign Office 'guilty of the gravest and most disastrous error of policy in recent history'. Recalling these events later in a letter to Galdwyn Jebb of the Foreign Office, Keynes declared that he was

...convinced that near the beginning of the Abyssinian affair we could, by firm action, have simply put a stop to the whole thing, and could have done so without material risk...

By this means we should have saved the League of Nations, and the whole situation would be completely different.<sup>11</sup>

Keynes also saw few reasons why business and trade links - favoured by members of the Conservative government (and, of course, central to Cobenite liberalism) - would be of any use in facilitating peace:

I do not believe that the time has yet come when one can do any real business with the Totalitarians...Until they are really ready to come to terms I am a little scared of doing anything which would mitigate in the slightest degree their financial stringency...<sup>12</sup>

### ***Munich***

An issue used by Skidelsky to shed light on Keynes's foreign policy thoughts in the 1930s - and in so doing to emphasise inconsistencies and a lack of judgement - was the 'Munich crisis' of September 1938. This drama, indelibly carved into the collective memory of the appeasement years, reached its apogee with the theatrical return of Neville Chamberlain from his meeting with Hitler, brandishing their agreement over the future of the so-called Sudetenland and declaring 'peace for our time'.<sup>13</sup> Of course, behind this was a most sordid act. In exchange for an agreement that the rest of the country would remain independent, the Czechoslovakian government had essentially been forced to cede to Germany its territories in which more than half of the population was 'German'. There were fig leaves regarding plebiscites and an international commission to redraw frontiers, but annexation was the unpalatable reality.

Keynes thoughts on the Munich crisis were guided by competing, and to some extent, incompatible, hopes and objectives. On the one hand, for example, Keynes did not believe that the national borders established in the wake of World War One should be inviolable. Indeed the territorial revisions from Versailles - which created 'pockets' of former German nationals in a number of sensitive areas (Poland, and the 'free city' of Danzig were, of course, next on Hitler's shopping list) - was just one of the 'grievances' from that Treaty that generated international sympathy for *some* of the

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secret pact, which was being negotiated even while the British and French governments were publicly pursuing a tough line on Italy, was abandoned after it was leaked to the press. Britain's Foreign Secretary, Sir Samuel Hoare, subsequently resigned.

<sup>11</sup> Keynes's letter to Jebb, who was then the Private Secretary to the Permanent Under-Secretary of State for the Foreign Office, was sent on 12 July 1937. It is reproduced in *CW XXVIII*, pp.65-66.

<sup>12</sup> These comments were made in a private letter to Kingsley Martin, 28 May 1938, and reproduced in *CW XXVIII*, p.111.

<sup>13</sup> Often incorrectly quoted, the details of Chamberlain's speech upon his return from Munich are given in Parker (1993), p.181.

German demands. In March 1938 Keynes wrote (in language that grates to modern ears all too used to attempts to create ethnically homogenous states) that

Czecho-Slovakia should at least attempt to negotiate with Germany a reasonable solution of the problem of the Sudeten Germans...Racial frontiers are safer and better to-day than geo-physical frontiers...<sup>14</sup>

But Keynes was also anxious that Hitler's brinkmanship not be seen to be rewarded. Thus while 'in the long run frontier revision [was] a cleaner and safer remedy', Britain and its allies had to 'back up the Czechs, and particularly not suggest to Hitler that he can get what to him seems more'. Backing up Czechoslovakia did not extend to going to war, however, *over the Sudetenland* question :

In a world war Hitler will be beaten and knows it. I agree with you that we should bluff to the hilt; and if the bluff is called, back out. I prefer, meanwhile, meiosis and bogus optimism in public.<sup>15</sup>

This was a spectacular misjudgement of Hitler's tenacity in pursuing war, but Keynes went on to add (more consistently with his general theme of deterrence) that:

What we ought to work for is a maintenance of Sz-Slo's (sic) integrity apart from frontier revisions.<sup>16</sup>

Notwithstanding his support for frontier revisions, Keynes had ambiguous feelings over Chamberlain's agreement at Munich. The guilty relief, however, and the anger of being momentarily saved by a sordid deal was palpable. As Rock (1977, p.14) notes, such an emotional response to Chamberlain's return was widely shared - 'momentarily engulfing nearly all of those who earlier counselled resistance to Hitler's demands'. In a letter to Kingsley Martin two days after Chamberlain's seemingly triumphant return, Keynes vented his frustration:

We have suffered one of the worst pieces of trickery in history. Honourable international policy has suffered a terrific reverse by the unscrupulous intrigues...

And yet:

It is *not certain* that the present settlement may not be a good thing in the long run...This time they may, by historic luck, have carried through a necessary thing which decent men could not have accomplished...

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<sup>14</sup> In *Morality and War*, written in 1939, Gerald Vann put the moral case for asking Czechoslovakia to consider a revision of its borders:

If a nation finds itself called upon to defend another nation which is unjustly attacked and to which it is bound by treaty, then it is bound to fulfill its obligations...It may, however, be its right, and even its duty, to try to persuade the victim of aggression to avoid the ultimate evil of a general conflict by agreeing to terms less favourable than those which it can claim in justice...provided always that such a surrender of rights would not mean in fact a surrender once and for all to the rule of violence.

The trouble with Vann's position, of course, was that his last proviso was precisely *all* that was likely when negotiating with Nazi Germany. Vann is here cited from Walzer (1977), p.68.

<sup>15</sup> Keynes to Kingsley Martin, 26 August 1938, *CWXXVIII*, p.117.

<sup>16</sup> *ibid.*, p.118.

One's own state of mind at the moment is painful in the way in which only a *mixed* state can be. Intense relief and satisfied cowardice joined with rage and indignation, *plus* that special emotion appropriate to the state of having been *swindled*; the whole nation *swindled* as never in its history.<sup>17</sup>

A week later, Keynes outlined how peace *with honour* might have been achieved in the pages of the NSN:

It can scarcely be questioned that at several stages in the negotiations an honourable settlement could have been secured without any risk to peace, if an unambiguous stand had been taken by this country, France *and Russia* speaking with one voice...<sup>18</sup>

The Russian aspect was, he thought, especially important since

...the position of Czechoslovakia, with a well-armed force of a million men, strongly entrenched, and in alliance with Russia, presented a danger to his [Hitler's] flank...

Presciently, Keynes concluded the piece with the observation

...who knows but that in the end Herr Hitler will be the second dictator to retreat from Moscow.<sup>19</sup>

Keynes's suggestion of an alliance with the Soviet Union is ridiculed by Skidelsky (2000, p.31), who cites Kingsley Martin's response that the idea was a 'delusion'. It was, however, an option championed by many at the time, including some in the British government, the armed forces and official circles generally.<sup>20</sup> More importantly perhaps - it was an idea championed by the Soviets themselves.

The real intentions of the Soviet Union in the lead up to the Second World War remain contentious. Throughout the 1930s Soviet foreign policy was 'a picture of uncertainty and vacillation' - the product, not least, of the regular and brutal purges of the country's diplomats, senior military officers and its society more generally (Overy 1997, p.42). The one constancy, however, was its search for collective security. This search led to its joining the League in 1934, the signing of a pact of friendship with France in 1935 and non-aggression pacts soon after with Finland, Estonia, Latvia and Poland (all to be betrayed later). Around the time of Munich the Soviets were floating suggestions through unofficial channels of an alliance with Britain and France to protect Czechoslovakia. As Overy (1997, p.40) notes, new evidence from Soviet archives indicates that these were more than empty gestures. They were not taken up, however, and the Soviets were not consulted over the outcome at Munich.

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<sup>17</sup> Letter to Kingsley Martin, 1 October 1938, *CWXXVIII*, pp. 122-124.

<sup>18</sup> This was in an article entitled 'Mr Chamberlain's Foreign Policy' that appeared in the 8 October edition of the NSN. The article is reproduced in *CWXXVIII*, p.125.

<sup>19</sup> *ibid*, p.126.

<sup>20</sup> One such advocate was Winston Churchill who, like Keynes, was not against a revision of political arrangements on the German/Czech border. Also like Keynes though, Churchill was 'adamant' that Britain should stand behind the survival of Czechoslovakia itself - a stance, if it were to 'make strategic sense...required the closest possible collaboration with the Soviet Union' (Jenkins, p.525). Throughout the Munich crisis and beyond, Churchill urged the British government to take the Soviet Government into its confidence, regarding its refusal to do so at the time of Munich as Chamberlain's 'fundamental mistake' (Churchill cited in Nicolson, p.367).

## ***Broader Strokes***

In addition to 'reacting' to the various political crises of the late 1930s, Keynes also penned, in July 1937 and March 1938 respectively, two lengthy commentaries on British foreign policy. Published as usual in the NSN, in these Keynes was able to articulate more fully his views on armed deterrence, and his thoughts on the nature of the 'brigand powers'. With regard to the latter Keynes dispensed with the diplomacies. Of course, some unfortunate phrasing in the German preface of *The General Theory* aside, Keynes's hostility to Nazism and Fascism is well known.<sup>21</sup> Nevertheless, his language in the 1937 commentary (before Munich, before the Anschluss with Austria, before the widespread revulsion of *Kristallnacht* and other atrocities) is remarkable. Once more too there is a prescience with respect to the ultimate fate of these regimes. They were, he wrote,

...outraging every creed in turn. If they could find another institution or another community to insult or injure, they would do so. Both are spending a lot of money on an intensive propaganda to persuade the rest of the world that they are the enemies of the human race. It is having the desired result... Yet even so, all this needs to sink in... The full abomination is understood to-day in a degree and over an area much greater than a year ago. These tactics are not characteristic of great statesman and conquerors. They appear to be morbid, pathological, diseased. I gravely doubt their technical efficiency and expect that every sort of idiocy is going on behind the scenes. It is unlikely that those who talk so much nonsense will act quite differently: or that they, who persecute the mind and all its works, will be employing it to the best advantage. It is very probable that, given time, they will over-play their hands, overreach themselves and make a major blunder.<sup>22</sup>

In the third volume of his Keynes biography, Skidelsky uses the 1937 article in support of his thesis that Keynes's voice was an uninformed and amateurish one when it came to foreign policy. In particular, he chooses the following passage to make his point (firstly, and reasonably, to highlight the influence of Burke on Keynes's foreign policy caution - secondly [and less reasonably in the view of this author], to suggest that Keynes's position was less honourable than it could be):

I maintain that the claims of peace are paramount... 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 disadvantage of 'the short run' we are still alive. Life and history are made up of short runs. If we are at peace in the short run, that is something. The best we can do is put off disaster, if only in the hope, which is not necessarily a remote one, that something will turn up. While there is peace, there is peace.<sup>23</sup>

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<sup>21</sup> As Skidelsky (2000, p.28) notes, Keynes 'never visited Germany after 1933, and never drew attention to the successes of Hitler's economic policies – a commendable feat of self-denial in the circumstances'.

<sup>22</sup> Keynes's article, titled simply 'British Foreign Policy', was published in the NSN on 10 July 1937. The article is reproduced in *CW* XXVIII, pp.61-65.

<sup>23</sup> *ibid.*, p.62.

Skidelsky reasonably asserts that this passage is evidence of the on-going influence of Burke on Keynes, noting its similarity in this respect to Keynes's oft-quoted view on Burke: 'Burke ever held, and held rightly, that it can seldom be right...to sacrifice a present benefit for a doubtful advantage in the future...'.<sup>24</sup> Less reasonably, however, Skidelsky goes on to suggest that an *alternative* Burkean response to the international political crises of the 1930s might be: 'if one cannot calculate the probability of an outcome, one should simply do what history and honour teaches is right'. Rubbing it in he adds, '[t]his was Churchill's view' (Skidelsky 2000, p.29). The implication is clear - Keynes position was in essence little different from those seeking to appease the totalitarian states - buying present peace at the expense of principle and, quite probably, a reckoning down the track.

Skidelsky's line would be more defensible if he had included in his citation the paragraph that followed the selection above, but excised from the biography:

...But I do not therefore claim that war can always be avoided. I do not need to answer the question whether war is even defensible. The question does not arise, inasmuch as our knowledge of human nature tells us that in practice there are circumstances when war on our part, whether defensible or not, is unavoidable. We are brought, therefore, to the second aspect of foreign policy. The first duty of foreign policy is to avoid war. Its second duty is to ensure that, if it occurs, the circumstances shall be the most favourable possible for our cause.<sup>25</sup>

Keynes's position, in short, was no different here than that which had, consistently, informed his commentary throughout these final pre-war years: governments could, and should, avoid war when prudence suggested it could. Otherwise, armed deterrence and collective security were the foundations of *national* security.

In March 1938, Keynes's most complete statement of this broad philosophy came in the second of his 'long articles' on foreign policy that appeared in the NSN. This article, titled 'A Positive Peace Programme', ambitiously advocated what was essentially a recreation of the League of Nations in Europe - albeit with all the 'teeth' of collective security intact. What was envisaged was

...a new European pact open to all the European members of the League, who would give definite undertakings to one another...[Who]...would bide themselves to abide by a majority vote as to the fact or imminence of aggression involving two European powers, the appropriate action to avert or meet it...following in general the procedure and principles of the existing League, without, however, any specific guarantee of the *status quo*. It is not essential that all eligible powers should adhere from the outset. The Pact should begin to function with the three major powers and any others who were ready to join.

...The sanctions attaching to the new Pact would be of three orders. The first, financial assistance and the rupture of relations. The second, a blockade. The third, a full military alliance.

There was a rhetorical call to arms

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<sup>24</sup> Keynes cited in Skidelsky (2000, pp.28-29).

<sup>25</sup> *ibid.*, pp.62-63.

...we are suffering to-day from the worst of all diseases, the paralysis of will. Nothing can be more dangerous than that...We are without conviction, without foresight, without a resolute will to protect what we care for...Our strength is great, but our statesmen have lost the capacity to appear formidable. It is in that loss that our greatest danger lies....our power to avoid a war depends much more on our recovering that capacity to appear formidable...

We are learning to honour more than formerly the achievements of our predecessors and the Christian civilisation and fundamental laws of conduct which they established in a savage world. We are seeing and enduring events, worse than which have not seen and endured since man became himself. If we still recognise the difference, not merely between peace and war, but between good and evil and between right and wrong, we need to rouse up and shake ourselves and offer leadership...

Finally,

Mr Churchill understands this vital element of policy, but Mr Chamberlain seems to forget it...<sup>26</sup>

#### **IV. Restoring a Liberal Order**

Keynes (literally) worked himself to death in the Second World War. He held no official position in the British government during the war, but was formally simply an (unpaid) adviser to the Chancellor of the Exchequer. Informally he was a dominating and ubiquitous figure. Working initially on efforts to develop internal mechanisms of war finance (from which emerged his influential *How to Pay for the War*), Keynes was to spend much of the latter part of the war on the torturous negotiations, mostly in and with the United States, aimed at securing Britain's external solvency. Throughout, however, he was intricately connected with the British Government's efforts to plan for the post-war world. Gripped by the desire to make something better out of the ruins, Keynes planned the creation of imaginative institutions designed to create an international economic order conducive to world peace. It was 'liberal' vision, but had as a guiding principle the restoration of 'the proper liberty of each country over its own economic fortunes'.<sup>27</sup>

The Cobdenite vision of free trade that had exercised Keynes in his youth had no part in these plans. Fresh from the experiences of another war, and the 'realpolitik' of bargaining with the US and other allies, Keynes's conviction in the position he adopted in *The General Theory* - that through measures designed to ensure full employment at home countries blessed themselves *and* their neighbours - remained strong. But identifying this objective he regarded as the easy part, even if it did amount to a rejection of previous orthodoxy as to means. What was much more difficult was 'the transition to this end and the establishment of an international economic system, capable of translating the technical possibilities of production into actual plenty and maintaining the whole population in continuous fruitful activity'.<sup>28</sup>

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<sup>26</sup> The 'Programme' is reproduced in *CW* XXVIII, pp.100-104.

<sup>27</sup> This statement, which comes from the first draft of Keynes's Clearing Union proposal, can be found in *CW* XXV, p.11.

<sup>28</sup> *ibid.*, p.14.

### *The 'Clearing Union'*

Establishing such a system was what Keynes set out to do in what was to be his greatest *intellectual* contribution during the Second World War - his proposal for an 'International Clearing Union' (ICU). The purpose of the ICU was to create an international currency system that would allow countries to pursue domestic policies of full employment while maintaining equilibrium in the balance of payments between them. Such an equilibrium, Keynes wrote (somewhat rhetorically), had not hitherto been achieved since 'methods of barter gave way to the use of money'.<sup>29</sup> Worse, 'the failure to solve this problem has been a major cause of impoverishment and social discontent and even of wars and revolutions'. Economists meanwhile had been content to assume the problem away - but their supposition that there existed 'some smoothly functioning automatic mechanism of adjustment which preserves equilibrium if only we trust to methods of *laissez-faire* is a doctrinaire delusion which disregards the lessons of historical experience without having behind it the support of sound theory'.<sup>30</sup>

International currency *laissez-faire*, which for Keynes meant the pre-war gold standard, was the edifice that he wanted to destroy. Not only did it not work in maintaining equilibrium, it was destructive of the prevailing social order, nationally and internationally. According to Keynes the reason for this was the asymmetries of adjustment it imposed on debtor and creditor countries. Under *laissez-faire* adjustment was compulsory for debtor countries, voluntary for creditors. Debtor countries, which by their nature tended to be poorer, had to become poorer still as their reserves approached zero. Deflation (forced reductions in prices and wages - and, to the extent that these were inelastic, reduced output) was not optional for these countries. By contrast there was no limit to the amount of reserves a creditor could stockpile, and no compulsion to 'inflate' their economies in the ways assumed by the 'rules' of the gold standard. Moreover, 'the social strain of an adjustment downwards is much greater than that of an adjustment upwards'.<sup>31</sup>

The ICU aimed to remedy the inherent fault in the pre-war arrangements by creating a system that required the 'chief initiative' for adjustment from creditor countries, while 'maintaining enough discipline in the debtor countries to prevent them from exploiting the new ease allowed them in living profligately beyond their means'. Keynes warned that to bring this about the ICU would appear to the reader as 'complicated and novel and perhaps Utopian'. It was utopian, however, not in that it was 'impracticable, but that it assumes a higher degree of understanding, of the spirit of bold innovation, and of international co-operation and trust than it is safe or reasonable to assume'.<sup>32</sup>

At the heart of the ICU was the replacement of gold as the fixed international standard with newly-created 'bank money' (called 'bancor' in later drafts of the proposal) issued by the ICU itself.<sup>33</sup> Countries would maintain, via their central banks, accounts at the ICU denominated in bancor. These would fluctuate according to a country's balance

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<sup>29</sup> 'Post-war currency policy', 8 September 1941, reproduced in *CW* XXV, p.21.

<sup>30</sup> *ibid.*

<sup>31</sup> *ibid.*, p.28.

<sup>32</sup> *ibid.*, p.33.

<sup>33</sup> What follows is a composite description of the notable features of the ICU, from a number of its many drafts. Details of the various versions are outlined in *CW* XXV.

of payments position. Countries with balance of payments surpluses would accumulate bancor, countries with deficits would see their accounts fall. So far so good, but what made the ICU revolutionary was that, by issuing its own currency, the ICU could create reserves as required (for all countries, or to lend to particular countries in difficulty). The fixed reserves which had constrained the global economy since 'barter gave way to the use of money', would now be finally replaced with the 'principle of banking'.

The creation of new reserves allowed for the substitution of an 'expansionist' rather than a 'contractionist' pressure on world trade. Bringing this into effect, however, were other critical features of the ICU. Firstly, at day one of the ICU coming into operation each member country would be allocated a stock of bancor - which Keynes called an 'index quota' - equal to 'half the sum of its imports and exports...on the average of the previous five years'. This allocation would be made regardless of its current holdings of gold and other reserves and, as such, greatly increased international liquidity. Most importantly - and again akin to a banking system domestically - countries also had access to an 'overdraft' facility at the ICU, up to a quarter of its index-quota. According to Keynes this 'substitution of a credit mechanism in place of hoarding would have repeated in the international field the same miracle, already performed in the domestic field, of turning a stone into bread'.<sup>34</sup>

Ensuring that pressure in the system was equally applied to both creditors and debtors were interest charges and possible (forced) exchange rate changes. Regarding the former, interest was to be paid by debtors on overdrafts but, critically, it would also be levied against excessive surplus bancor balances (applied at varying proportions of the index quota). In an early draft of the ICU Keynes even proposed the forfeiture of high and sustained credit balances. Such symmetry was replicated with respect to exchange rates. Though normally fixed against bancor, excessive and unsustainable debit *or* credit balances could bring from the board of the ICU an order to devalue or revalue a national currency.

The ICU was the core of Keynes's efforts to reconstruct the international economy after the Second World War. It was a truly liberal institution whose objective was to allow countries freedom of action to pursue their own ends – a freedom promised but not delivered by the restrictions and discrimination of the collapsing pre-war gold standard. The ICU was finally also a powerful statement of confidence in the potential for enlightened policy - over both excessive optimism in blind and anonymous forces, and the pessimism that no better way existed:

It used to be supposed, without sufficient reason, that effective demand is always properly adjusted throughout the world; we tend to assume, equally without sufficient reason that it never can be. On the contrary, there is a great force in the contention that, if active employment and ample purchasing power can be sustained in the main centres of world trade, the problem of surpluses and unwanted exports will largely disappear...(CW XXV, p.180)

Orbiting around the ICU were other institutions tasked with the same liberal (but not free trade) ends: an international commodity (buffer stocks) scheme, a 'Board for International Investment', an 'Anti-Depression Board', an international development

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<sup>34</sup> CW XXV, p.171.

bank, even an international police force financed from the profits of the ICU. Keynes also had something to say on Germany. As might be expected from the author of *The Economic Consequences*, he was not about revisiting a Carthaginian peace:

Their opportunities of recovery shall not be less than those of their liberated neighbours...It would be senseless to suppose that her neighbours can develop an ordered, prosperous, or a secure life with a crushed and ruined Germany in their midst.<sup>35</sup>

#### **IV. Some Concluding Thoughts on Keynes and 'Realism'**

On the eve of the Second World War another book appeared which, like Keynes's *General Theory*, was to revolutionise the discipline that was its subject. *The Twenty Years Crisis* was the product of E.H. Carr, a near contemporary of Keynes who likewise had been at Versailles.<sup>36</sup> Intended as a polemic on western foreign policy since the First World War, the book became a seminal work in the nascent discipline of international relations – especially in establishing the 'realist' and 'liberal' parameters within which much of the debate in the field came to be conducted.<sup>37</sup>

Carr described his own position on international relations as 'realism' - a doctrine forever identified with him and, for most of its history, the dominant strain of thought in international relations theory. Realism was, and is, above all concerned with power - its necessity, its distribution, its continuity, its evolution, its sources. Other motivations for state action emerged from time to time but power - the means to survive in a largely anarchic international environment - was the one universal, infinite and overriding necessity. Carr argued in *The Twenty Years Crisis* that realism was a necessary corrective to the excessive 'utopianism' 'idealism' and 'liberalism' (labels he used more or less interchangeably) that had dominated thinking in the 'science' of international relations. Utopian tendencies were always common, he believed, in new sciences 'in which wishing prevails over thinking, generalization over observation, and in which little attempt is made of a critical analysis of existing facts or available means' (Carr 1939, p.8).

Carr was no economist, and at Cambridge (Trinity rather than Kings') he read classics, but it was in the economic sphere that his ire with 'liberalism' was most acute. Put simply, Carr blamed economics (and economists) for spreading what he regarded as the most pernicious feature of liberal thought on international relations - the idea that there was a 'harmony of interests' between states:

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<sup>35</sup> *ibid.*, p.15.

<sup>36</sup> In the inter-war years Carr had alternated between being a diplomat, an historian and a 'leader writer' for *The Times*, before being appointed (in 1936) Wilson Professor of International Relations at University College, Wales. In 1939 Carr produced *The Twenty Years' Crisis 1919-1939*.

<sup>37</sup> Evans (1975, p.77) noted that the publication of *The Twenty Years' Crisis* represented 'a turning point in international theory' that brought to an end the traditional dominance in the field of 'idealist' thought. *The Twenty Years' Crisis* was the first of four books that were to stake out Carr's contributions to international political thought – the other three, all completed in the 1940s, were *Conditions of Peace* (1940), *Nationalism and After* (1945) and *The Soviet Impact on the Western World* (1947).

It was the *laissez-faire* school of political economy created by Adam Smith which was in the main responsible for popularising the doctrine of the harmony of interests ... (Carr 1939, p.43).

What was true of individuals was assumed to be also true of nations. Just as individuals, by pursuing their own good, unconsciously compass the good of the whole community, so nations in serving themselves serve humanity. Universal free trade was justified on the ground that the maximum economic interest of each nation was identified with the maximum economic interest of the whole world (Carr 1939, p.45).

But, according to Carr (in phraseology reminiscent of Keynes's own injunctions against the assumptions of 'classical' economists):

To make the harmonization of interests the goal of political action is not the same thing as to postulate that a natural harmony of interests exists; and it is this latter postulate which has caused so much confusion in international thinking (Carr 1939, p.50).

Stuck in their wrong-headed theoretical models, Carr argued that economists missed that the clash of interests of states had reasserted its dominance over the relations between states after the First World War. It was a costly mistake:

The fundamental character of this clash of interests became obvious to all except those confirmed utopians who dominated economic thought in the English-speaking countries. The hollowness of the glib nineteenth-century platitude that nobody can benefit from what harms another was revealed. The basic presupposition of utopianism had broken down (Carr 1939, p.58).

Carr was unfair to Smith, arguably so to the economics profession generally and, as this paper has demonstrated, certainly with respect to Keynes.

Keynes once famously warned that 'economists set themselves too easy, too useless a task if in tempestuous seasons they can only tell us that when the storm is long past the ocean is flat again'. It was a warning he took to heart in his economics, but it was also one that informed his views on war. Keynes did not allow himself the luxury of the harmony of interests (too easy, and too useless). Like Smith he believed that deterrence - the ability to appear formidable - was often the best guarantor of peace. In this his position was a 'realist' one. But realism is a barren and amoral doctrine in its purest form, and Keynes did not slip into these easy shoes either. His, rather, was an approach that was neither blind to the realities of the world, nor to the hopes that must sustain it.

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