

## **[Provisional Version]**

### **On Keynes's Activities in the Financial Negotiation with the US**

#### **- The Lend-Lease and the Anglo-American Mutual Aid Agreement**

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### **1. Introduction**

**The main purpose of this paper is to examine the process of negotiation of the mutual aid agreement between the UK and the US during the years 1941-43, and to clarify what sort of stance Keynes took throughout it. We may well begin by outlining the backdrop to this issue.**

**In September 1939, the UK and France declared war in the wake of Germany's invasion of Poland – this was the outbreak of the war to be remembered as World War II. Under the circumstances, at the request of the UK, the US, in substance, repealed the Neutrality Act (1935) and came to export arms to the UK – amounting to de-facto participation with the Allies.**

**The first and crucial phase of the war occurred in May 1940, when the German army invaded the Netherlands and Belgium. The UK managed to avoid the calamitous loss of military resources with the retreat from Dunkirk, while France was forced to succumb and came under German occupation. (Henceforth the Western Front was to be held by Germany until the Normandy operations [D-Day] in June of 1944.)**

The next crucial phase was the outbreak of war between Germany and the Soviet Union in June 1941. The East Front saw extremely fierce warfare, as epitomized by the Stalingrad battle [August 1942 - July 1943].

Under the circumstances, the “Atlantic Charter” (August 1942) was declared by the US and the UK, asserting the Anti-Fascist stance. Then, in December, the Pacific War broke out in the wake of the Pearl Harbor Attack by the Japanese army, resulting in, literally, World War. In January 1942 “The Joint Declaration by Members of the United Nations” was announced. The Allies came to land Sicily, Italy, through North Africa. As a result the Mussolini Government collapsed, and Italy soon concluded a single armistice agreement with the Allies in September 1943. Immediately after, however, Italy was divided between the Kingdom of Italy (under the rule of the Allies), in southern Italy, and the Italian Social Republic (under the rule of Germany) in central and northern Italy. The two sides met to fight it out at, among other places, Monte Cassino (January - May 1944).

The above brief outline of World War II sets the scene for this paper. Viewed from the UK side, it was a matter of being forced to continue the war in devastating circumstances, as the capitulation of France in June 1940 and the progressive occupation of Europe by Germany in 1941 proceeded.

Continuation of this war entailed huge military expenses, most of which had to be met by the UK. It was the “Sterling Bloc” (established in the Ottawa Conference in 1932), composed of the tariff bloc and the currency bloc which the UK could initially make use of, made up of the UK itself, the Dominions and India.

Clearly enough, however, that was not sufficient. As stated above, the US, albeit a Neutral Country, evidently sided with the UK in November 1939 and came to export arms to it. However, this was essentially a commercial deal, which meant that the UK was always forced to think about how they were to be paid for.

Under these conditions, a godsend arrived for the UK – “The Lend Lease idea” was announced by President Roosevelt at the press conference on December 17, 1940. The principle there was that materials required for the defense of the US, which the President would judge to be very important, could be provided to the UK (granted that some ‘consideration’ should be left to later negotiations)<sup>1</sup>.

On January 10, 1941 the Lend-Lease Act was submitted to Parliament and was enacted in March. The Act allowed the US to provide arms on conditions beyond the usual financial treatment (simply put, gratis).

As the main target of this Act was the UK, negotiation with it was indispensable

for its implementation. What became a central moot point in the negotiation thus conducted was the “Sterling Bloc”. The US demanded a quid quo pro for generous provision of armaments due to the Lend Lease Act. This was a problem which could bring about deterioration, if not disintegration, of the Bloc as the actual organ of the British Empire. Geopolitically speaking, it also showed an aspect of the challenge of the US as the new hegemon, which now came to enjoy overwhelming power in military and economic terms, surpassing the British Empire as the established one.

The negotiation finally produced the “Anglo-American Mutual Aid Agreement” in February 1942, and various adjustments were to be made thereafter as the economic and military situation developed.

The present paper has, as stated above, the purpose of examining this negotiation process and Keynes’ s involvement it as a leading figure in the UK. In Section 2 we will take a look at the pre-Lend-Lease situation. Then, in Section 3, we go on to consider the Lend Lease Act. In Section 4, we will examine how, after enactment of the Lend-Lease Act, the UK came to conclude the Anglo-American Mutual Aid Agreement with the US through complicated negotiations, and what followed. In Section 5 we go on to assess his fundamental stance, recognizable in Keynes throughout these negotiation. Among other things, this problem differs markedly in nature from the problem of the post-war international monetary system, for here Keynes was participating in the negotiation as a representative of the British Empire. The problem was how to procure resources from the US in that truly dire situation - a situation that was very different from the circumstances in which proposals for the future could be discussed.

## **2. Pre-Lend Lease Act**

In July 1940 Keynes was appointed consultant to the Chancellor of the Exchequer. Around this period the UK’s foreign economic position saw a momentous change. It had been estimated, until June, that the balance of gold and dollars and foreign securities was sufficient for the UK to continue waging war for three years. However, due to the crucial defeat on the Western Front this was no longer the case. Moreover, the UK’s debts soared when the French contracts in the US were

taken over<sup>2</sup>.

In that situation, Keynes became a member of a newly set-up consultative organization for the Chancellor of the Exchequer, the “Exchange Control Conference”. Hereafter ECC).

An urgent initial priority on the agenda was how to control expenditure on foreign exchange. On this issue Keynes prepared “Foreign Exchange Control and Payments Agreements”<sup>3</sup> for the Chancellor’s Consultative Council, and in fact it was discussed at the first meeting of the ECC.

There were two main points. One was a policy to prevent decrease in the balance of gold and dollars held by the UK. He mentions the following measures: (i) to impose a limit on exchanging pounds earned by foreigners within the British Empire for dollars (i.e. to make the present rule more restrictive); (ii) to prohibit re-importing pounds possessed abroad (i.e. to prohibit exchanging pounds for dollars); (iii) to simplify coding in order to make exchange control in the Sterling Area easier.

The other was a yet more important proposal for a multi-national payments agreement between the Sterling Bloc and other neutral countries (except for the US). The main gist of it was: (i) not to settle deficits with gold or its equivalent; (ii) in the case of deficits, the UK should meet them by buying up the debts of the country concerned possessed by British investors (the country concerned should sell their debts at appropriate prices); (iii) in the case of surpluses, the UK should lend them to a third country or deposit them with the Bank of England. In order to make this system work, a single institution should be set up to take on the task.<sup>4</sup>

Around this period, due to pressure from the US and the need for foreign resources, the Treasury was forced to check on all the securities and direct investment in the US.

In this connection, Keynes proposed “Notes for U.S.A.”<sup>5</sup> for the ECC on 31 October. The fundamental stance there runs as follows.

Concerning the sales of the foreign assets the UK possesses to the US: In the case of Malaya, albeit economically and financially possible, it would involve a problem such as a deliberation in the Parliament; in the case of India, it would involve a political problem such as indifference to the aggregate problem there.<sup>6</sup>

In that respect, the sales of assets possessed in South America might not be

problematic because there does not exist a problem of the Empire Colonies (Keynes discusses it rather at length. What underlies his argument is a recognition that in the case of Empire Colonies, it might be problematic that the US would work as a pure rentier without taking business and managerial responsibility accompanied by the development of these resources, while in the case of South America there might not occur so complicated problem between the UK and the US.<sup>7</sup>) Even in this case, however, if the amount involved was small, a significant consequence might be brought about to the commercial network between the US and the UK.<sup>8</sup>

It seems rather desirable that the financial aid we should ask the US for should be confined to the program for the US by the British Purchasing Commission (Hereafter BPC)<sup>9</sup>. Additionally, if the US would make a separate deal with Canada due to which the UK need not pay the amount of the goods which Canada would purchase in dollars, the UK could then wage war self-sufficiently in terms of finance through payment by means of the remaining gold or gradual liquidation of securities salable in the US.

This method would be possible largely due to (i) the foreign exchange control and payments agreement with most of neutral countries except for the US that the UK concludes, and (ii) transactions established in the Sterling Bloc<sup>10</sup>.

On October 31, 1940, the EEC agreed that all the goods purchased by the BPC from January 1, 1941 on should preferably obtain aid from the US, provided that (i) the US should not force the UK to sell securities, (ii) the UK endeavored to obtain gold from the Allies to make good the commitment (not the United Nations, to be formed later), and (iii) the UK should take into consideration sale of the public utilities in South America<sup>11</sup>.

### **3. Lend Lease**

It was on March 11, 1941, that the 'Lend-Lease Act' (hereafter LLA) was enacted. This was a great advance from the situation which resulted when the US revised (in substance, abolished) the 'Neutrality Act' in November 1939, exporting armaments to the UK.

With regard to the LLA, which took off from Jove's idea, two alternative proposals emerged. One was a proposal by the State Department, to the effect that the UK was to provide what it possessed outside the British Empire as guarantee for loans. The other was a proposal by the Department of Treasury, which required no loan guarantee of the UK - including the assets remaining in the US. Although heated controversy arose between the two, the Treasury proposal won the battle thanks to Treasury Secretary Morgenthau's exceptional efforts.

It goes without saying that this was greatly favorable to the UK<sup>12</sup>. The LLA was, indeed, an act which would guarantee a supply of armaments in quantities from the US.

This Act entitles the President to require from us 'payment or repayment in kind or property or any other direct or indirect benefit which the President deems satisfactory'. ... So far, as a purely interim arrangement, he has agreed to goods being handed to us under the Lend Lease Act with our merely tacit acceptance of the terms of that Act. (JMK23, p.205. correspondence to Catto and Hopkins dated August 28, 1941)

In a letter dated April 2, 1941 to Catto and Wilson, Keynes stated that Hopkins, the Administrator of the Lend-Lease Act, told him:

...the Lend Lease Bill had been a great inspiration of the President for getting away from the purely business aspect of things ...(JMK23, p.62)

#### **4. The Financial Negotiation with the US**

The Lend-Lease Act has been framed in terms of U.S. law, of course, and yet it chose to target the UK. It allowed the U.S. to send armaments to the UK only if the President regarded them as indispensable for the defense of the U.S. The idea behind the act was to provide the UK – which found itself in dire straits – with substantial aid.

It was, thus, a somewhat makeshift act whose articles remained to be interpreted, and which lacked any precedent for implementation, so there was a desperate need

for the two countries to enter into negotiations. So it was that the Anglo-American financial negotiations came under way. Based on the LLA, the two sides put forward proposals, and after much discussion they finally arrived at the Anglo-American Mutual Aid Agreement.

Leading negotiations for the UK was Keynes. As we will see later, his conduct of them was outstanding. On top of this, however, as discussed in other papers, he was simultaneously involved in a leading role for the UK in the field of an international buffer stock plan, a rescue and relief program, and an international monetary system for the Post-world period.

At this point it is worth dwelling briefly on the important principle Keynes established in applying the LLA to the UK.

This came from bitter experience in the First World War. When the US entered the war, the UK had lost practically all its assets. It had to borrow money from the US for the purchase of almost everything, so troubles were recurrent and, as a result, there was a rapid increase in war debts.

I am sure that it is of the utmost importance for future relations that the Lend Lease Bill should only be used to finance clearly defensible transactions, namely, munitions proper and certain foods. (JMK23, p.47. This was written on the day the Lend Lease Act was enacted.)

#### **4.1 The Major Moot Points**

There were several major moot points between the two countries, worth mentioning before entering into the complicated negotiations.

- (1) 'considerations' — The US demanded some form of considerations in return for the generous provision due to the LLA. The problem for the UK was how to address the matter.

This point became a burning issue during the period between the submission and enactment of the LLA (January 10 – March 11). The US demanded sale of direct investment possessed by the UK in the US.

Keynes was against this sort of hasty selling, doubting whether it would

benefit both countries<sup>13</sup>.

However, in a letter dated June 21, 1941 to the Chancellor of the Exchequer, Wood, Keynes recommended conceding the above-mentioned titles in South America to the US. Keynes saw a strong possibility that Roosevelt would desire them as ‘considerations’ and that he would hand them over to South American governments in accordance with his approach to Pan-Americanism.<sup>14</sup>

(2) Treatment of “old commitments” — This is a problem of how the debt which the UK had already owed prior to the LLA and the debt which it had owed prior to implementation due to the LLA should be treated. That is, a problem of what part should be incorporated into the LLA and of how the part not incorporated should be repaid. This problem had some significance for the UK, for if it were to be granted, it would mean that the US would take over the debt and the UK would be financially emancipated to some degree, and could increase its financial independence.<sup>15</sup>

(3) “Reciprocal or reverse lend lease” — This meant that while the UK would gain some benefits from the LLA, it would grant benefits to the US along the same lines. This would make the expression “mutual aid” more truly meaningful. What was to be agreed upon, in any case, was the Anglo-American ‘Mutual’ Aid Agreement.<sup>16</sup>

Concretely, the following were mentioned: the American service expenditure in the Sterling Bloc and all imports from the Sterling Bloc should be free of charge.

(4) The “Article 7” Problem — This emerged when a plan for financial agreement was put forward as negotiations proceeded. The word, ‘discrimination’ in this proposed agreement became a burning issue between the two. The UK saw that the US inserted it with the intention of demanding abolition of the Imperial Preferential Tariff and exchange control.

## **4.2 The Process Leading up to the Anglo-American Mutual Aid Agreement**

In May 8, 1941 Keynes arrived in New York as a negotiator (until the end of July).

The main task was to negotiate with the US how the UK could obtain the financial aid required to continue the war efforts, based on the LLA.<sup>17</sup> The LLA had just been enacted, so it was not decided within the Administration on how it should be implemented. Under these circumstances, Keynes went to Washington, and was actively involved in the negotiations with the US high officials while liaising with the British government.

Keynes met Morgenthau on May 13 and 14. Then, on May 16, he wrote a letter to Morgenthau outlining his position<sup>18</sup>. He suggested that what should be found difficult to be dealt with in the LLA should be excluded from the outset, and that the resources thus freed should be used for “old commitments”. This method would be feasible without increasing the resources for the LLA, and the UK could regain some financial strength freeing itself from the debt of the “old commitments”.

At the end of May there emerged a joint plan by the State Department and the Treasury Department<sup>19</sup>. It was written in the form of eleven items, which included: (i) the balances left after the war should be treated in terms of politico-economic considerations rather than in terms of economic considerations; (ii) Freedom, indiscrimination, and equality should be declared and yet some consideration should be given to the need for the UK to control exchange and imports; and so forth.

Keynes's Skeleton Plan<sup>20</sup> (June 21, 1941) — The plan for the Anglo-American Mutual Aid Agreement consisted of five items.

What is important in the first item is the assertion that it should be mutual aid, and if not so (i.e. one-sided aid) no debt should arise. The third item is that the UK would be ready to provide “reverse lend lease” at any time at the request of the US. The fourth item mentions a wide range of cooperation in the field of relief and reconstruction, and trade and economic policy, in the postwar world. The fifth item declares establishment of the Anglo-American Commission for implementing the fourth item.

Around this period, Keynes expressed the following view on Anglo-American commercial policy. Although the US demanded abolition of import control and exchange control immediately after the war, the UK should be permitted to act

freely during the transition period. It was better to go into renegotiation when the world prospect became clear thereafter<sup>21</sup>.

When he met Hawkins of the State Department on June 25, he stressed the need to continue 'discrimination' along the above-mentioned line after the war, which led to commercial negotiation stalling (It should be noted that this idea was also put forward by the prime minister, Secretary of Commerce and Foreign Secretary as evidenced in a telegraph dated July 16<sup>22</sup>).

On the latter part of 'Article 7' — On July 28, 1941, Dean Acheson of the State Department handed over to Keynes a US plan (pp.173-175) for aid agreement. It was what the President found satisfactory as a temporary plan, and in fact it became the original plan leading up to the Anglo-American Mutual Aid Agreement. The plan was composed of eight articles. It was Article 7 that gave rise to dispute. In regard to the former part, Keynes understood that "[it] in effect relieved us of any possibility of war debts" (p.172), so he welcomed it. What Keynes felt problematic was the latter part.

(The terms and conditions upon which the United Kingdom and the United States should receive benefits) shall provide against discrimination in either the United States of America or the United Kingdom against the importation of any produce originating in the other country; and they shall provide for the formulation of measures for the achievement of these ends [of promoting mutually advantageous economic relations between the two countries and the betterment of world-wide economic relations] (JMK23, p.175).

Keynes saw that the expression "against discrimination ... against the importation" indicated that the US was demanding abolition of the Imperial Preferential Tariff system as well as exchange control.

The memos and letters that Keynes and Acheson wrote about the meeting have been conserved.

Keynes, in his memo, interprets Article 7 as follows: The first part of it means avoiding the accrument of war debts, while the latter part indicates that the President would expect from the UK a certain quid pro quo in return. That is why the expression "discrimination" is inserted. It might have indicated the demand to

abolish the Imperial Preferential Tariff system and import-exchange control <sup>23</sup>.

In Acheson's memo he writes that Keynes criticizes Article 7 somewhat excessively, as follows: It imposes an old 19<sup>th</sup>-century formula, which the UK would find difficult to observe. Article 7 allows for many types of cunning tariffs and prohibits the truly needed exchange control.

Acheson considered Keynes's response exaggerated<sup>24</sup>.

On the next day Keynes sent a letter to Acheson. After praising the first part of Article 7 as well as the proposal as a whole, Keynes repeated the argument about the word "discrimination", saying that the word represents the old institution like the "stick of the deceased" in the nineteenth century<sup>25</sup> (like the most favored treatment clause).

What emerges is Keynes's basic stance, insisting on the importance of maintaining the Imperial Preferential Tariff System and import-exchange control after the war, so he expresses himself in strong terms with regard to the word "discrimination" which seems to infringe them. The letter ends with the following.

... forgive my vehemence which has deep causes in my hopes for the future. This is my subject. I know, or partially know, what I want. I know, and clearly know, what I fear. (JMK23, p.178)

On August 2 Keynes wrote a note, "consideration", about the latter part of Article 7 of the US proposal handed over by Acheson (this was also sent to Churchill). The outline runs as follows: I cannot understand the word "discrimination" although I heard Acheson's explanation. Unlike the President, the State Department uses it as having a technical meaning. So it would be best to approve Article 7 of the US proposal subject to the statement that the word "discrimination" is not used here as having a technical meaning<sup>26</sup>.

[the absence of 'discrimination'] did not mean that we were cut off from specific technical solutions of the problems of the post-war world. In particular, it did not necessarily mean complete freedom of trade and absence of all currency and other restrictions between each separate country and political unit in the world (JMK23, pp.195-196).

**This expression seems to imply maintenance of the Imperial Preferential Tariff System and the Sterling Bloc (and the exchange control related to it) after the war.**

**The Process Thereafter — In a letter to Lord Catto and Richard Hopkins dated August 28, 1941 Keynes came up with the following idea: Although the Imperial Preference should not be abandoned, we might, in fact, gradually decrease the degree of the Imperial Preference in return for a substantial decrease in the tariff in the Hawley=Smoot Act which the US is considering. And appreciating the idea of the US, Keynes suggested that Article 7 should be revised with the addition of an authoritative argument, as early as possible, as to what lies behind Article 7.**

**[The revised formula] shall provide joint and agreed action by the U.S. and U.K., each working within the limits of their governing economic conditions, directed to the progressive attainment of a balanced international economy which would render unnecessary policies of special discrimination. (JMK23, p.204)**

**On December 2, 1941, the State Department put forward an alternative proposal. The UK Foreign Office urged Keynes to accept it from the point of view of a long-term advantage. However, Keynes responded pointing out the danger of accepting an unreasonable demand from the US so easily, citing the passage “in the long run we are all dead”<sup>27</sup>.**

**The point in question is the following.**

**To that end, they shall include provision for agreed action by the United Kingdom, ... [open] to the elimination of all forms of discriminating treatment in international commerce, and to the reduction of tariffs and other trade barriers (JMK23, p.224)**

**This was quite different from Keynes’s idea, advanced on August 28, to the effect that the UK should decrease the degree of the Imperial Preference in return for the US concession.**

**When the US participated in the war in the wake of the Pearl Harbor Attack by the Japanese Army on December 8, 1941, a rumor was briefly aired that this could**

cause the US to change the financial articles in the LLA considerably. Keynes was against a proposal for a new agreement, for he thought that it might need new talks with Congress, which should turn out to be disadvantageous to the UK. Keynes thought, rather, that the negotiation should be made under the present framework of the LLA, with addition to the mutual aid by the UK<sup>28</sup>.

In a letter to Horace Wilson dated February 12, 1942, Keynes stated that an instant and friendly settlement for financial agreement should be important, mentioning two reasons: (i) it would financially enable the UK to implement a “reverse” lend lease for the US army operating outside UK territory, (ii) When Article 7 was successfully settled, it was expected that the State Department should take over the old commitments. On that occasion, the proposal that all the military materials from the Sterling Bloc could be provided to the US on the same terms as the LLA could be combined with it<sup>29</sup>.

On February 12, 1942, Roosevelt sent a telegram to Churchill to the effect that the US proposal should aim not so much at the quid pro quo deal between the LLA and the Imperial Preferential Tariff as, rather, radical and comprehensive discussion to implement a free and fruitful economic policy for the Post War World. Given this confirmation, the UK turned down a proposal to insert a note to qualify Article 7. Thus, after consultation with the Dominions, the UK agreed to the US proposal on February 23. This was the Anglo-American Mutual Aid Agreement (hereafter AAM).

#### **4.3 Development after the AAM**

**Changed financial situation of the UK** (Problem of Sterling balances increase) — It was in May 1942 that the “early commitments” problem was settled with \$292m. The amount was much lower than the UK hoped for, and yet sufficed to address the immediate difficulties.

What became problematic, rather, was how the UK should report to the US the financial situation to be faced up to, for a demand emerged for a decrease in the Lend Lease, and the risk arose of an aversion to possession of sterling balances throughout the world due to lack of confidence in sterling<sup>30</sup>.

It became an urgent matter for the UK to make the above-mentioned report, for the Lend-Lease Administration had submitted to Congress the confidential document on the foreign financial position of the UK on October 1941.

With regard to this problem, Keynes expressed his view thus: If, on the one hand, the amount of UK reserves were reported to be very low, it would do serious damage to its credit in the world. On the other hand, if the amount should not appear to be so low, then it would give the Isolationists the power to cut Lend Lease. This would be a dilemma.

Having made this point, Keynes suggested providing information on the gold and dollar balances only on confidential conditions, while only the changes to the foreign debts outside the US should be reported to the US treasury<sup>31</sup>.

In the letter dated April 20, 1942 to Catto and Hopkins, Keynes made the following suggestion concerning public announcement of the reserves position of the UK to the US Congress “(1) that the figures for gold are not given separately; (2) that the absolute figures are not given henceforward, but an accurate comparison of the deterioration or improvement of our position compared with what it was last time we reported”<sup>32</sup>.

However, Keynes wrote in his note “The Financial Deal with U.S.A.”<sup>33</sup> to Phillips dated June 9, 1942 what should amount to the really important problem had already changed.

That is, the central problem was to secure dollars in the pre-Lend Lease period and the initial stage of the Lend-Lease, while at present the central problem was a rapid increase in sterling debts, which would seriously overcast the post-war UK position<sup>34</sup>.

This changed situation occurred due to the fact that notwithstanding the US engagement in the war the agreement on the financial burden between the two countries remained unchanged. Now the UK needed a financial agreement to cut increase in sterling debts without increasing its dollar assets. For that purpose, an agreement was required that some portion of an increase in foreign balances in foreign countries could be represented in the form of dollar balances.

This was to become the so-called “Sterling Balances” problem, which was to plague the UK in the post-war period.

Keynes went on to point out that all this was due to the fact that only the UK had been bearing the costs for the war areas in the world. Would it not be a smart move to address this problem by an application of the “inverse lend-lease”?

He repeated this argument in a conversation with Stettinius on July 21, 1942. If confined to the UK only, the present dollar balances would be sufficient. But, in fact, the UK owed sterling debts resulting from the war throughout the world, so the UK financial position was becoming progressively worse<sup>35</sup>.

This concern is clearly shown in the note, "Our Prospective Dollar Balances" dated September 10. The UK had been driven into a situation in which it seemed to accumulate excessively in spite of the fact that it accumulated far from sufficiently given the total debts.<sup>36</sup> It was now important not to increase dollar balances while increasing sterling debts.

A similar view is expressed in the document, "Supplementary Note on Our Prospective Dollar Balances" dated September 30.<sup>37</sup> Moreover, these debts would increase not only during the war but also very likely for several years after the war due to the deficits in the balance of trade<sup>38</sup>.

... then we shall be under the greatest pressure both from withdrawal of existing balances, from our current adverse balance of trade and from there being no longer war reasons for assistance from U.S. and the Dominions. (JMK23, p.254)

The passage which is worth noting in this supplementary note is where Keynes refers to, among other things, India and Egypt, taking into consideration a method of holding together the British Empire<sup>39</sup>.

Keynes's solution of war debts was "the general principle of our paying the capital sum over a period of years, ... without the payment or accumulation of interest on the unpaid portion" (JMK23, p.260). Although India and Egypt as creditors to the UK are discussed here, Keynes emphasizes that this method would also be applicable should the UK become a creditor.<sup>40</sup>

Thus we see an increase in gold and dollar balances for the UK, but we do not see debts increasing more in consequence. Keynes shows concern that in spite of the fact that the UK is really suffering from an increase in debts, the US judges aid was no longer necessary due to an increase in gold and dollar balances.

In January 1943 Roosevelt stated that the permissible range of the reserves balances of the UK should be \$600-1000m. In fact, however, by the end of December 1942 they had exceeded the range, so calls for a cut in the Lend Lease became ever louder.

In order to address this, in 1943 Keynes tried to work out a method of using reserves to minimize the war debts.<sup>41</sup>

Thereafter requests from the US continued --- for example, a proposal to treat primary materials provided to the US government as “mutual aid” items, and a request to show the amount of “mutual aid”.<sup>42</sup>

## 5. Keynes’s Observations on High Officials and Political Institutions

During his visit to the US, Keynes was energetically engaged with conferences and interviews with many high officials in the Roosevelt Administration. He continued to report the proceedings of the conferences, sending many correspondences to the UK high officials concerned. On these occasions, he also evaluated high officials and came up with sharp observations on the US political system. These offer extremely valuable evidence about the characters and personalities of the US top politicians in the Roosevelt Administration, as well as the political atmosphere.

### 5.1 The Top Officials

President Roosevelt — Keynes met Roosevelt on June 2, and July 7, 1941 accompanied by the ambassador to the US.<sup>43</sup>

In a letter to Wood, Chancellor of Exchequer, dated June 2, Keynes reported a talk with the President lasting 2 hours and a half in detail. He described the President’s ideas about the war situation. It emerges that he was not contemplating abolition of the Neutrality Act because it would only give Isolationists an opportunity for discussion in Congress (unlike the Roosevelt Administration, the Isolationists had strong influence in the US). What he had in mind was an enlargement of the area designated as the “dangerous zone” and transformation of commercial ships into governmental ships (Keynes thought that the President was expressing his individual view as he had had no specific talks with the advisers).<sup>44</sup>

The President had declared the state emergency in the radio speech on May 27, vowing to adopt a measure to strengthen the US defense stance. Keynes responded as a British citizen saying he was touched by the sympathetic attitude, and yet felt something was lacking.

**The general sympathy and magnanimity of mind towards us is touching. But, all the same, it leaves one extremely homesick, missing the complete feeling of unity of purpose and of decisions finally made which we have in England. (JMK23, p.103)**

**The impression which Keynes received when he met the President on June 2 is described as follows.**

**I had heard many reports how I should find him much older and very tired compared with my memories of what is now seven years ago. He was also said to have been pulled down by his recent prolonged attack of acute diarrhea. One is told that sometimes life and force goes out of his face and that he looks like a tired old *woman* with all the virility departed. But this was certainly untrue that morning. Perhaps his speech and its success had raised his spirits. I thought him calm and gay and in full possession of his own personality and of his will and purpose and clarity of mind. He still had that supreme equanimity which I have seen in him before, and I again felt an extraordinary charm in his upward glancing quizzical expression when he has used some teasing or half serious expression. I do not see how anyone can doubt in his presence that he is the outstanding American to-day, head and shoulders above everyone else. (JMK23, p.108)**

**Keynes refers to two points which Roosevelt emphasized during the conversation about the Postwar system. First, unlike the previous case [the post-WW1 situation], Europe must unilaterally carry out disarmament (we need not listen to what Europe has to say), while the US and the UK should maintain sufficient armaments as a police force in Europe. Then, and again unlike post-WW1, this time the US would take on some responsibility for the economic and political situation in Postwar Europe.<sup>45</sup> (cf. pp.109-110)**

**The Europeans, according to his view of the matter, are to be told just where they get off. Whatever federal or other arrangement may be set up between groups of European states, he clearly contemplated that a British-American police force should take all the necessary responsibility for maintaining order for some time to come. (JMK23, p.110)**

**Keynes also states that the President emphasized Pan-Americanism strongly.**

**[The President] seems to attach importance to carrying the South American states with him and associating them in any project, so far as possible. (JMK23, p.110) ... He is very strong on pan-Americanism and anxious to bring the South American Republics in to the utmost possible extent. (JMK23, p.136)**

**Morgenthau, Treasury Secretary — Keynes had many talks with Morgenthau. He reported them in the letters, including, amusingly enough, description of his character.**

**In the letter to Ronald dated March 11, 1941, Keynes describes Morgenthau's approach, seeking to make the UK exhaust its liquid assets in such a way that it uses up investment in the US as well as the gold that the Bank of England possesses. This is a method that would force us into a humiliating position, he says.**

**There is indeed every indication that the man is not merely tiresome but an ass. If we were to acquiesce in his policy, we should be laying up great store of trouble for everyone concerned. (JMK23, p.46)**

**On May 8 Keynes arrived in New York. The initial relationship was fraught with friction. The main reason for this was because Morgenthau entertained a suspicion that the aim of Keynes's visit to the US was to prevent the sale of the American Viscose Corporation (AVC). The company was an American subsidiary of Courtaulds Co. Morgenthau wanted it to be sold, consistent with the view that the UK should sell investments which it held in the US to cover war costs.<sup>46</sup>**

**This sort of impression also emerges in Keynes's letter to Wilson dated May 19.**

**...Walter Stewart told me confidentially that Morgenthau was a little surprised that I had not brought a letter of credentials from the Chancellor of the Exchequer and had begun by being suspicious of what I was here for, probably wondering whether it was not direct investment. (JMK23, p.83)**

**And Morgenthau himself recorded this suspicion in his diary.<sup>47</sup>**

In his letter to Wilson dated May 20, Keynes illustrated Morgenthau's staff, dividing them into two types – usual officials and New Dealers (under the influences of White). Keynes also wrote that he had been told by Stewart, a New Dealer, that he was regarded as a member of it.

This letter contains a heading, 'Mr Morgenthau' in which Keynes describes Morgenthau's character in detail, as in the following passage.

He is certainly a difficult chap to deal with. I have seldom struck anything stickier than my first interview. One seemed to be able to get no human reaction whatever, which is, I suppose, his method of protection until he is quite sure what you are after. It is also most difficult to get him to see one's real point, and misunderstandings peep out of every corner. Everybody agrees that he is jealous and suspicious and subject to moods of depression and irritation. ... (But) he really wants to do his best for us.

... On the other hand, a certain firmness in his character and a persistency and freedom from wrong motives does seem, in the course of years, to have built up a position for him which is exceedingly strong. ... He will do one no harm *on purpose*. But how easily he might without intending it! (JMK23, pp.87-91)<sup>48</sup>

The feeling of those close to the President — The inner circle of the Roosevelt Administration showed some frustration that the US failed to take action as the war developed. A feeling developed among them that there should be an opportunity to take positive action in aid of the UK.

In the letter to Wilson dated May 25, 1941, Keynes refers to a heated debate between Acheson and Frankfurter (Supreme Court Judge who was very close to the President, and met him every week). While Acheson advocated immediate war action, Frankfurter argued that if the consent of Congress could be obtained for war action, everything would go well in consequence (Keynes understood that Hull was on the same side as Frankfurter. Anyway, a shift was underway toward entering war, and the difference was only in timing and method<sup>49</sup>).

## 5.2 Political Institutions — Fragile relations between the departments

Moreover, in his letters to the UK high officials Keynes made various observations

on the US political structure which he saw through the negotiations. They constitute valuable evidence on the inner structure of the Roosevelt Administration.

In a letter to H. Wilson dated May 19, Keynes refers to the divided situation of the US administrative system.

For example, due to reorganization of institutes, the Budget Office is independent of the Treasury, so it need not follow the directives of the Treasury Secretary. The Treasury Department's task is confined to raising tax revenues, so that even if the Treasury Secretary were to appeal to Congress to cut taxes, the Budget Office would oppose it with Congress. Furthermore, even if the Treasury Secretary submitted a proposal for taxation, cases occurred of the departments concerned opposing it. Amazingly enough, these were not discussed among the departments concerned, but were made public through Congress and media.

The result is that no one is safe and on one can really decide anything except the President. My particular problem [the problem of early commitments rather than the new commitments being take[n?] over by an aid from the Lend Lease] cannot be solved unless I can simultaneously square Morgenthau about the old commitments, Harry Hopkins about the new commitments and the Director of the Budget about the relation of these to the appropriations. (JMK23, p.85)

The same observation is found in a letter to the Chancellor of the Exchequer, K. Wood, dated June 2, 1941.

One wonders how decisions are ever reached at all. There is no clear hierarchy of authority. The different departments of the Government criticize one another in public and produce rival programmes. ... Members of the so-called Cabinet make public speeches containing urgent proposals which are not agreed as part of the Government policy. In the higher ranges of government no work ever seems to be done on paper; no decisions are recorded on paper; no-one seems to read a document and no-one ever answers a communication in writing. ... There is just endless debate and sitting around. ... Suddenly some drastic, clear-cut decision is reached, by what process one cannot understand ...

**Nothing is secret ... There is practically no information you cannot get by just asking for it. When I emerge from Mr Morgenthau's room, I am immediately surrounded by pressmen who sit all day in anteroom to note the name of every private visitor and ask him to tell them what he has been talking about with the Secretary and what was said. The same thing occurs immediately outside the President's study. (JMK23, p.106)**

**In the letter to Wood dated June 21, Keynes refers to a talk with the President over 'considerations'. He points out that he had been advised by Hopkins, the State Department, that this talk should be decisively important for the success of the matter (considerations), for the President thinks that this is a matter which he should decide.**

**The President, who had declined the State Department proposal, had given no clear indication of an alternative proposal as yet. But Hopkins told Keynes that the President would talk about the gross outline to Keynes, and Hopkins felt that matters would proceed from there. Keynes's account of the proceedings is indeed surprising.**

**Methods in this country are so odd that it is probably I who will have to pass on to the State Department the President's instructions on the matter ['consideration']! (JMK23, p.134)**

**The surprises did not finish here, moreover; Keynes reports that when he met the President on July 7, and referred to the above, the President asked him to pass on his instructions to the State Department. Furthermore, when Keynes talked about this to Acheson at the State Department, Acheson was highly amused.<sup>50</sup>**

**In a letter to Wood dated June 2, 1941, Keynes stated that of the top officials of the Roosevelt Administration none were young and active. Hopkins was an imbecile, while the other three were very old. They could not shift their minds to new issues which arose suddenly, and failed to understand what was explained about them.<sup>51</sup>**

**In a letter to Wood dated July 13, a similar state of affairs is described. Not only were the President and Hull (the State Secretary) ill, but also Stimson (the War Secretary) was very old.**

... as Lippmann expresses it, there is a certain atmosphere of invalidism very disadvantageous for waging a war. The will and the intention and the sentiment and the good heart are all that we could wish. But the executive drive and the organs of decision are defective. (JMK23, p.155)

## 6. Conclusion — On Keynes's stance

Relations between the UK and the US were basically cooperative, and yet episodes of conflict often occurred due to geopolitical interests.

Among other things, the UK took for granted the maintenance of the Sterling Bloc as the symbol of the British Empire, so that even if the UK got aid from the US, it aimed at a financial agreement which should as far as possible not interfere with the Bloc. Keynes himself took maintenance of the Sterling Bloc for granted.

The US asked for 'consideration(s?)' as quid pro quo for aid to the UK. The most heated debate occurred around the latter part of Article 7. The US suggested abolition of the Imperial Preferential Tariff and exchange control as "abolition of discrimination".

The fundamental line which Keynes took in the negotiation runs thus: The UK should always endeavor to keep resources at her own disposal. It is essential that the UK would be ready to preserve its independence by using resources at any time when necessary. If the UK made any excessive concessions, and did not keep adequate economic resources at her own disposal, she would not be able to pursue independent action. So, in order to avoid that situation, how could the UK secure the most possible dollar resources? Keynes did the calculations many times.

He argued that the UK should not sell its direct investments in the US because it could run the risk of destroying important connections between the British headquarters and their American subsidiaries. Keynes went into meticulous calculations on this matter.

As the US came to participate in the war in December 1941, the UK became aware that the relationship had changed from a giver and receiver one to one of allies on an equal footing. Under the circumstances, the financial agreement evidently strengthened the nature of mutual aid. At the same time, however, the UK struggled to maintain this relationship while maintaining the functioning of the

**British Empire.**

Aware of these circumstances, Keynes evidently threw himself into the task. This was a super-human activity from the point of view of an excellent planner of economic war for the British Empire rather than from that of a planner based on internationalism.<sup>52</sup>

It was remarked at the time that while the US thought of the benefits it was granting to the UK, Keynes participated in the negotiation as if he had an unquestionable right.<sup>53</sup>

There may well be something in this. In fact, when we consider Keynes as a negotiator, there is a sense that although the UK was in the position of asking for aid in distress, Keynes lured the US high officials into his realm, and made them work in a cooperative way. In spite of the fact that the UK was naturally placed in the weak position of borrower, an atmosphere was created in which Keynes worked as if he could bring the US round to his point of view and obtain a favorable deal with the negotiation. The LLA was a US act, in which the UK had no voice. And yet the atmosphere was such that the borrower seemed to be at least on equal terms with the lender, if not even stronger.

Keynes was a New Liberalist while at the same time he made a great effort to maintain the British Empire. We could say that the stance Keynes took in various international negotiations in the 1940s — a buffer stock plan, a rescue and relief plan, an international monetary system plan and so forth — was essentially that of an internationalist, but at the same time he made great efforts to maintain the British Empire, securing among other things, an equal position with the emerging hegemon, the US.

\* \* \*

It is, perhaps, worth noting that during his energetic activities as negotiator in the US, Keynes found time for discussion with several economists. One of them was J. M. Clark, an Institutionalists. In his letter to Keynes, Clark refers to the popularity of the “Income Flow Approach” in the US academic world, the most famous scholar being Keynes. He observed that it had grown to such an extent that one could call it a ‘school’. In his reply, Keynes wrote that his own *How to Pay for the War* was finding wide circulation among economists. He then went on to refer to

the danger of a 'school', pointing out that "There is great danger in quantitative forecasts which are based exclusively on statistics relating to conditions by no means parallel."<sup>54</sup>

- 1) JMK23, p.29.
- 2) JMK23, p.1.
- 3) JMK23, pp.2-10.
- 4) JMK23, pp.6-9.
- 5) JMK23, pp.13-26.
- 6) JMK23, pp.15-16.
- 7) JMK23, p.18.
- 8) JMK23, p.20.
- 9) On this point, Keynes emphasized the importance of not repeating the blunder experienced during World War 1, when the UK, having exhausted all its foreign assets, was forced to depend on borrowing from the US, which resulted in continuous financial conflicts between the two. See JMK23, p.22.
- 10) JMK23, p.23.
- 11) JMK23, p.26.
- 12) JMK23, p.88.
- 13) April 16. JMK23, pp.67-69. As stated above, in his note dated October 27, Keynes opposed the proposal of the sale of assets which the UK possessed in India and Malaya and the proposal to provide rights of railroads and infrastructure which the UK possessed in South America.
- 14) JMK23, p.136.
- 15) For example, p.71. The final settlement was made at \$290m in May 1942. See JMK23, p.214.
- 16) See JMK23, pp.128, 226, 276, 308.
- 17) In the letter to Wood dated June 22, Keynes wrote that around this period, departing from the hostile stance of six months before, depriving the UK of everything, the US became very friendly and cooperative. See JMK.23, p.140.
- 18) "Memorandum" (JMK23, pp.74-78).
- 19) JMK23, pp.101-102.
- 20) JMK23, pp.137-140.
- 21) JMK23, pp.146-147.

- 22) JMK23, p.144.
- 23) JMK23, p.172.
- 24) JMK23, p.176.
- 25) JMK23, p.178.
- 26) JMK23, p.195.
- 27) December 31. See JMK23, pp.224-225.
- 28) JMK23, p.218.
- 29) JMK23, p.226.
- 30) JMK23, p.229.
- 31) JMK23, pp.217-8.
- 32) JMK23, p.230.
- 33) JMK23, pp.233-236.
- 34) JMK23, p.233.
- 35) JMK23, p.237. The problem of ‘considerations’ was there at this time in the US. Stettinius stated that many congressmen entertained this view (see JMK23, note on p.239). Moreover, Brown mentioned the sale of UK investments in the US. See JMK23, p.241.
- 36) JMK23, p.246. Ironically, this occurred due to the Pooling Arrangements within the Sterling Bloc. For its mechanism, see JMK23, p.280. Incidentally, Canada provided huge financial assistance from 1942 on, which was of great help to the UK. See pp.331 n.b.11 and 277.
- 37) JMK23, pp.252-262.
- 38) JMK23, p.254.
- 39) This is strongly reflected in the tone of argument in JMK.23, pp.259-260.
- 40) As an alternative, another method of using the International Clearing Union was put forward: (i) The ICU takes over all the debts, (ii) The creditor country can use them at any moment, (iii) The debtor country continues to make annual payment (without interest and for, say, fifteen years). See JMK.23, p.262.
- 41) JMK23, p.264.
- 42) JMK23, p.276. In the fall of 1943, the five branches were announced to be integrated into the Foreign Economic Administration. The personnel was decided in such a way that the OEW (Office of Economic Warfare) overwhelmingly gained control over the OLLA (Lend Lease Administration), which was a great blow to the UK. See JMK23, p.312.
- 43) Prior to that, Keynes met the President in July, 1934.
- 44) JMK23, pp.110-111.

- 45) JMK23, pp.109-110.
- 46) See JMK23, p.72, n. 1 and 4.
- 47) JMK23, p.93.
- 48) For further deep insight into Morgenthau's psychology, see JMK23, pp.98-99.
- 49) JMK23, pp.95-96.
- 50) JMK23, p.134 n.2.
- 51) JMK23, p.107.
- 52) For the view Keynes took of the US, see, for example, his opinion in September 1942. See JMK23, pp.254-255.
- 53) JMK23, p.79.
- 54) JMK23, pp.192. This reminds us of Keynes's concept of economics expressed in the correspondence with Harrod in relation to Tinbergen's econometrics. See JMK.14, pp.296-7, where Keynes regards economics as a branch of logic and moral science.

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**Paper 1: Commodity Control Scheme**

**Paper 2: Relief and Reconstruction Plan**

**Paper 3: Keynes’s Battle over the International Monetary System**

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