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MR. LANKESTER

It might be useful to draw to the Prime Minister's attention the fact that the traditional economic establishment, Lord Balogh, Walter Heller, John Kenneth Galbraith and others were convinced in 1948-50 that Erhardt's reforms would be disastrous. They were all proved wrong in a matter of months after they were written. There is a nice succinct footnote in Gottfried Haberler's paper "The Great Depression of the 1930s Could it Happen Again?" which I have copied. It might be useful for some future Question Time or some other occasion. Balogh and Galbraith are convinced opponents of our policies and it might be useful to show that they got it all wrong before, so why not now?

AW

3 April 1981

The price level, unlike that in the United States, remained remarkably stable.

It would be tempting to attribute the rapid recovery to large spending on armaments. Heavy government spending there was, but massive rearmament came later. Possibly German public spending was comparatively larger than in the United States, but this would not explain the different price performance. The main difference between the American and German recovery policy lies elsewhere. In the United States the New Deal combined deficit spending with deliberate wage and price boosting, through NRA, AAA, the Wagner Act and other measures. Thus, an exceptionally large part of the rising nominal GNP took the form of higher prices rather than larger output and employment.[28] In Germany, by contrast, money wage rates remained fairly constant, although the average annual earnings of labor rose rapidly in monetary and real terms, because unemployment disappeared and the workweek lengthened.[29]

True, under the Hitler dictatorship there were wage and price controls which later, after full employment was reached and massive preparation for war came into full swing, became very oppressive. Scarcities, unavailabilities and quality deterioration of numerous commodities combined with rationing made the stable price index increasingly unreal. But this does not alter the fact that the recovery from the depression was handled very effectively. Hitler was able quickly to liquidate the miseries of the depression and to provide guns and butter at the same time. The great economic successes strengthened his hold on the German people enormously. The gold parity of the mark was formally not altered. There was no devaluation, but an increasingly tight web of exchange control, import restrictions and export subsidies amounted to a disguised, messy, discriminatory and exploitative devaluation of the currency—the Schachtian System.[30] Hitler's economic success made a deep impression on many economists, on Keynes himself, who however soon changed his mind,[31] and on Keynes'

[28] Keynes sympathized with Roosevelt's reform measures but felt that "undue haste in the reform program" would prejudice recovery; and recovery should have priority over reform. For Keynes' criticism of the New Deal see R. F. Harrod, "The Life of John Maynard Keynes." London-New York, 1951, p. 447.

[29] See Gerhard Bry, "Wages in Germany 1871–1945," National Bureau of Economic Research, Princeton University Press, 1960.

[30] So named after Hjalmar Schacht, Hitler's economic wizard.

[31] Richard (Lord) Kahn in his paper "Historical Origins of the International Monetary Fund" (in Keynes and International Monetary Relations, The Second Keynes Seminar held at the University of Kent at Canterbury, 1974, edited by A. P. Thirlwall, St. Martin's Press, New York 1974) quotes a memorandum that Keynes distributed in the Treasury in September 1941 entitled "Post-War Currency Policy." In this memorandum Keynes said "It was only in the last years, almost in the last months, before the crash, that . . . Dr. Schacht stumbled in desperation on something new which had in it the germs of a good technical idea. . . . Dr. Schacht's idea was to introduce 'what amounted to barter'. . . . In this way he was able to return to the essential character and original purpose of trade whilst discussing the apparatus which . . . had been supposed to facilitate, but was in fact strangling it. This innovation worked well, indeed brilliantly." Two years later (October 1943) Keynes wrote in the same vein to a U.K. Treasury official: "I believe that the future lies with (I) state trading for commodities; (II) international cartels for necessary manufacturers; and (III) quantitative import restrictions for non-essential manufactures. Yet all these instrmentalities for orderly economic life in the future you (and the U.S. State Department) seek to outlaw" (quoted in R. F. Harrod, "The Life of John Maynard Keynes," London-New York 1951, p. 568.) Harrod remarked: "In the preceding ten years he (Keynes) had gone far in reconciling himself to a policy of planned trade: these ideas had sunk deeply in. Even for him, with . . . his power of quick adaptation, it was difficult to unlearn so much." (loc. est.) But unlearn he did, and very fast indeed. In May 1944 in a letter to The Times defending the Bretton Woods agreement against criticism by Thomas Balogh, Keynes wrote: "Since we are not (so far as I am aware), except perhaps Dr. Balogh, disciples of Dr. Schacht, it is greatly to our interest that others should agree to refrain from such disastrous (Schachtian) practices." (The Times, May 20, 1944,

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radical followers who were strengthened in their conviction that only comprehensive controls and central planning can assure full employment and rapid growth without inflation. Fortunately, another German economic miracle, the sustained economic recovery and growth after World War II, conclusively demonstrates that liberal trade policy and sound finance, the "classical medicine" as Keynes called it, works even better than the Schachtian system of comprehensive controls. Equally important, the German economic success also shows that a liberal policy can successfully be carried out in a democracy.[32]

## IV. The International Monetary System During the Interwar Period

It is misleading to speak of an international explanation of the Great Depression in contrast to explanations in terms of mistakes of U.S. monetary policy, or other domestic circumstances in the United States or elsewhere.[33] There can be no doubt, however, that the world

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reprinted in Thomas Balogh's "Unequal Partners," Vol. II, Oxford 1963, p. 118.) Keynes, reconversion to liberalism (which was probably due largely to listening to James Meade, Redvers Opie, and Lionel Robbins) is described in detail in Harrod's book (see especially p. 609.) In his famous posthumously published article, "The Balance of Payments of the United States" (The Economic Journal, June 1946) Keynes urged that "the classical medicine" should be allowed to work and concluded "that the chances of the dollar becoming dangerously scarce . . . are not very high," thus rejecting the theory of the permanent dollar shortage which was propounded by his radical disciples as the basis of their violent objections to the policy of non-discrimination. Keynes criticized these theories "as modernist stuff, gone wrong and turned sour and silly." (See ibid. pp. 185–186.) In a letter to Lord Halifax he expressed himself even more strongly (see "The Collected Writings of John Maynard Keynes," Vol. 24, "Activities 1944–1946, The Transition to Peace," edited by Donald Moggridge, Cambridge 1979, p. 626).

[32] It is not surprising that the German economic "miracle" which started with the currency reform of 1948 and the simultaneous abolition of all controls by Ludwig Erhard, was completely unforeseen and misjudged, even after its early success had become apparent, by British admirers of Schacht. On this see T. W. Hutchison "Notes on the Effects of Economic Ideas on Policy: The Example of the German Social Market Economy" in Zeitschrift für die Gesamte Staatswissenschaft. Currency and Economic Reform, West Germany after World War II, A Symposium, Vol. 135, Tübingen, September 1979, pp. 436–441. I cite only one example: Thomas (Lord) Balogh predicted that the policies of Erhard could not be sustained. "The currency was reformed according to a wicked formula." It "helped to weaken the Trade Unions . . . . Their weakness may even inhibit increases in productivity, since large scale investment at high interest does not pay at the present low relative level of wages. In the long run the income pattern will become intolerable and the productive pattern unsafe." Balogh said that Dr. Erhard and his "satellite economists" are trying to discredit "enlightened Keynesian economic policies" and "to apply to real life an abstract obsolescent and internally inconsistent economic theory and certainly did not succeed." Balogh predicted alarming political consequences and pointed in "a final warning to the gains which the Soviet Zone of Germany has been able to record." Balogh was however right in pointing out the extreme contrast between the economic ideas and policies prevailing in the Federal Republic of Germany and those in Britain. However, the results were the opposite of what Balogh and the other critics had predicted: German real GNP per capita has grown to almost twice that of Britain. (See T. W. Hutchison, op. cit. pp. 435–439 and Thomas Balogh "Germany: an Experiment in 'Planning' by the 'Free' Price Mechanism", Banca Nazionale Del Lavoro Quarterly Review 3, Rome 1950, pp. 71–102.) Hutchison also shows that German economic policies were similarly misjudged by American representatives of the "New Economics", Walter Heller among them.

I offer a supplement to Hutchison's list of misjudgments by advocates of central planning and comprehensive controls of the German revival of laissez faire liberalism: In 1948, criticizing the view "that if, somehow, the German economy could be freed from material and manpower regulations, price controls and other bureaucratic paraphernalia, then recovery could be expedited", John K. Galbraith concluded: ". . . There never has been the slightest possibility of getting German recovery by this wholesale repeal [of controls and regulations]". (J. K. Galbraith, "The German Economy" in Foreign Economic Policy for the United States, edited by Seymour E. Harris, Harvard University Press, Cambridge, Mass. 1948, p. 95). Galbraith's paper abounds with predictions of dire political and economic consequences of Erhard's dash for economic freedom. To quote Keynes again: Rarely has "modernist stuff gone wrong and turned sour and silly" so fast!

[33] Charles P. Kindleberger "takes exception to the findings of those" who stress monetary policy in the United States and other major countries, slower population growth or autonomous changes in the propensity to spend, and "insists that the origins of the Great Depression were international." Charles P. Kindleberger "The International Causes and Consequences of the Great Crash", The Journal of Portfolio Management, Fall 1979, p. 11. This paper summarizes Kindleberger's full-dress analysis, *The World in Depression 1929–1939,* London-New York 1973.