

**Trade Policy and National Identity:
Why Keynes was opposed to Protectionist policies?**

Elise S. Brezis*

Abstract

The views of Keynes on Trade policy are clear: Protectionism and as well as hoarding a surplus in the balance of payment are wrong. This paper analyzes the optimality of protectionist policies and having a surplus in the context of the international political system.

I show that in the situation of a hegemonic country, all classes - the working class as well as the elite - opt for free trade. But, in a balance of power context, wherein no single actor on the international scene possesses hegemonic status, the working class will choose protectionism, having a surplus, asking for harsh reparations, while the transnational elite and Keynes will not.

Keywords: Balance of Power, Carthaginian Peace, Hegemony, Reparations, National Sovereignty, Trade Policy

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* *Department of Economics, Bar-Ilan University, Israel.*

E-mail: elise.brezis@biu.ac.il

I. Introduction

The Economic Consequences of the Peace was first published in 1919, and since then, changed the economic discourse surrounding reparations and Carthaginian peace. The entire book is a thoughtful *plaidoirie* against the peace treaty signed in Versailles. It contains some 180 pages of data, calculations, and projections, reshuffling the data as a deck of cards in the hands of a virtuoso player. Keynes' conclusion is cut and dried: Reparations are bad.

The book begins in another sphere altogether. The first two chapters do not even mention reparations. Why? Recall the movies based on the books of Agatha Christie: The movie begins with one or two frames that appear unrelated to the rest of the story. It is these frames that hold the solution to the mystery: a seeming digression, that contains the explanation for what happens at the end. If you missed this first frame, you missed the entire plot of the movie. Likewise, if you seek to understand why Keynes claims that "the purpose of [his] book is to show that the Carthaginian peace is not practically right or possible." (p.18), then focus on the first two chapters of his book.

In my search for the Holy Grail of understanding Keynes, I follow Skidelsky's and Keynes's hints that the key to Keynes lies not in the economic realm (it would be too obvious to discuss Economics in a book entitled *The Economic consequences of the Peace!*). But, it is about ideas:

But apart from this contemporary mood, the ideas of economists and political philosophers, both when they are right and when they are wrong, are more powerful than is commonly understood. Indeed the world is ruled by little else. Practical men, who believe themselves to be quite exempt from any intellectual influences, are usually the slaves of some defunct economist. Madmen in authority, who hear voices in the air, are distilling their frenzy from some academic scribbler of a few years back. I am sure that the power of vested interests is vastly exaggerated compared with the gradual encroachment of ideas. Not, indeed, immediately, but after a certain interval; for in the field of economic and political philosophy there are not many who are influenced by new theories after they are twenty-five or thirty years of age, so that the ideas which civil servants and politicians and even agitators apply to current events are not likely to be the newest. But, soon or late, it is ideas, not vested interests, which are dangerous for good or evil.

The General Theory, Ch. 24, Section V

What ideas do we find in the first two chapters, which are essential for understanding reparations and the Carthaginian peace, and which are not exactly economics? Three main subjects are developed in these two chapters: three subjects

that are hinted at in the introduction and that are essential to understanding reparations and the Carthaginian peace: (i) the 'International Political system', (ii) the notions of 'social identity' and 'national sovereignty', and (iii) the fact that 'social identities' differ for the various social classes, i.e., the elite versus the working class.

About the international political system, Keynes made a clear dichotomy between periods of rivalries and periods of internationalization.¹ About national sovereignty and power, Keynes stressed that the notion of nation and nationalism enter the economic realm:²

Finally, the difference between social classes is crucial in Keynes writings. The first page of the introduction begins with this statement: "All classes alike thus build their plans, the rich to spend more and save less, the poor to spend more and work less." (p.2), and thereafter, "Thus the bluff is discovered; the laboring classes may be no longer willing to forgo so largely and the capitalists classes no longer confident of the future, may seek to enjoy more fully their liberties of consumption so long as they last, and thus precipitate the hour of their confiscation. (p.11).

These three elements – the international political system, national sovereignty, and the differences between the elite and the working class are the hints given by Keynes in the introduction and which enable understanding of his position on reparations.

This paper's purpose is to indicate how these three elements can explain Keynes's assessment on trade policy and reparations. More specifically, I show that when there is a hegemonic state, it is optimal for all classes to ask for free trade: the working class as well as the elite find free trade to be optimal, and there is no need for harsh reparations.

However, when countries are in a 'balance-of-power' system, then the elite and the working class have differing optimal policies. While, for the working class, it is optimal to claim for protectionism and harsh reparations, the transnational elite find it optimal to opt for free trade.

This paper shows that Keynes exhibits in his writing a 'transnational elite' assessment, and is sympathetic to the exhortation (paraphrasing Marx): Capitalists of the world unite! As Keynes is part of this intellectual transnational elite, he chooses to

¹ He wrote: "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 this paradise, were little more than the amusements of his daily newspaper, and appeared to exercise almost no influence at all on the ordinary course of social and economic life, the internationalization of which was nearly complete in practice" (p. 6).

² Nations are real things, of whom you love one and feel for the rest indifference – or hatred. The glory of the nation you love is a desirable end – but generally to be obtained at your neighbour's expense. The politics of power are inevitable.... the balance of power in one's own interests (p.17).

reduce reparations since identity and nationalistic values are for him no more than “non-sense” despite his having lived during a period of balance of power.³

Of course Keynes’s views differ from those of Clemenceau and of the working class of France that cares about national sovereignty. Keynes believed in a top-down flow of ideas, while Clemenceau understood that the rage of the working class burst from the bottom-up. And indeed Keynes’s remarks about Clemenceau and the French are harsh: “He [Clemenceau] had one illusion – France, and one disillusion – mankind... Their preoccupations related to frontiers, nationalities, to the balance of power, to imperial aggrandisements, to the future enfeeblement of a strong and dangerous enemy (p. 27).

Before presenting the various parts of this patchwork, be aware of the similarities between 1919 and 2019, both belonging to a period of ‘balance of power’, with politicians *à l’écoute* of the working class’ desire for national sovereignty.

II. Hegemony, Balance of Power and Trade Policy

The historical record of the past 350 years shows cycles in which there are periods where a nation-state is dominant and has leadership, while there are periods of ‘balance of power’ in which there is no dominant state, and many nations are similar in their power.

The historical record of the past 350 years also shows cycles in which waves of protectionism alternate with periods of free trade, and these two cycles are correlated: Hegemony is related to periods of free trade while protectionism occurs in periods of balance of power. These facts are well documented. The Navigation Act of 1651 is widely held to have represented the end of effective Dutch commercial hegemony in Europe and to have marked the beginning of the British challenge.

By the end of the second decade of the 19th century, Britain had set about dismantling its own protectionist apparatus and had initiated an era of free trade which lasted as long as the *Pax Britannica* endured.⁴

The rise in German power in the 1870s went hand in hand with protectionism driven by nationalistic fervor.⁵ The rise of American power in the pre-World War II

³ See also Mantoux (1946), Katiforis (2004), and Binkley (1929).

⁴ Gilpin (1975) writes that: “Britain’s interest lay in universal free trade and the removal of all barriers to the exchange of goods.”(p.84).

⁵ Lawson (1983) summarizes the views of Gilpin and Krasner on this issues as follows: “Gilpin and Stephen Krasner suggest that after the 1870s Britain was no longer in a position to prevent Germany, France, and Italy from adopting protective tariffs and destroying an international order in which free trade had been the rule.” (pp.317-339).

years was associated with a succession of protectionist measures, whereas the establishment of American hegemony after the war led to the pursuit of free-trade.⁶

The relationships between protectionist commercial policy, power, nationalism and balance of power have been explored at some length in the works of a number of contemporary political scientists. One of the most widely accepted paradigms linking the structure of the international political system with protectionism is the theory of hegemonic stability.⁷

Kindleberger (1973), following in the footsteps of Frohlich, Oppenheimer and Young (1971), argues that international security is a collective good. Since free trade can arise only in a climate of international security, it is only when some power is dominant enough to enforce security that a regime of free trade will arise. Given the inevitable tendency of weaker states to free-ride on the provision of the collective good by a hegemonic power, the absence of a hegemonic state leads to the erosion of free trade and to the growth of protectionism. Gilpin (1975) writes that "a liberal international economy cannot come into existence and be maintained unless it has behind it the most powerful state(s) in the system.... A liberal economic system is not self-sustaining, but is maintained only through the actions -- initiatives, bargaining, and sanctions of the dominant power(s)."⁸

A related literature, typified by Gallagher and Robinson (1953), considers the "imperialism of free trade."⁹ This process, which purports to explain the development of the world trading system in the presence of a hegemonic power, argues that "the hegemonic power is expected to extend its control -- and the open international trading order-- over local economies by informal or indirect means whenever possible, since this constitutes the cheapest way to create and maintain its predominant position in the world."

In conclusion, the literature relating trade policy to the international system is vast. But the idea of 'imperialism of free trade' and 'collective good' are too general statements. There is a need to pinpoint the essential elements which are the thread between trade policy and the international system. Some of the political scientists stress that in a period of balance of power, keeping with power necessitate to increase foreign reserves. Already Adam Smith laid out the reasons for increasing foreign reserves in periods of balance of power:

The real wealth or poverty of the country ... would depend altogether upon the abundance or scarcity of those consumable goods. But ... they

⁶ See, for example Calleo and Rowland (1973). Cline (1980) argues that tendencies toward what he calls "neomercantilism" were visible at the end of the seventies, which corresponds to the end of American hegemony in the world system; also see Malmgren (1970).

⁷ A precursor is Hirschman (1945); see also Kindleberger (1975), Whitman (1975), Krasner (1976), Keohane and Nye (1977), Gilpin (1977), MacEwan (1978), Keohane (1980), Wallerstein (1980), and Gilpin (1981).

⁸ Gilpin (1975), p.85. See also Coleman (1969), and Brezis (2003).

⁹ Also see MacDonagh (1962), Moore (1964), Mathew (1968), and Platt (1968, 1973).

are obliged to carry on foreign wars, and to maintain fleets and armies in distant countries. This, cannot be done, but by sending abroad money to pay them with; and a nation cannot send much money abroad, unless it has a good deal at home, Every such nation, therefore, must endeavour in time of peace to accumulate gold and silver, that when occasion requires, it may have wherewithal to carry on foreign wars. ¹⁰

Wallerstein (1980) also emphasized the importance of foreign reserves: "control of an adequate bullion stock was. . . a crucial variable in the struggle between core powers."¹¹ Colbert, much before, also claimed: "trade is the source of public finance and public finance is the vital nerve of war." With more foreign reserves available in the economy, the nation-state could increase its success at war, and even in 'balance of power' system refrain from war. Moreover, Kinder and Hilgemann (1964) note that "the duration of campaigns depended on finances."¹²

Today, foreign reserves continues to be an important factor of national sovereignty. As Lampton (2006) noted: "Most outside observers exaggerate China's strength as a seller and underestimate its capacities as a buyer, investor, and aid provider. This is partly because of China's dramatically rising global trade surplus. It holds \$1 trillion in foreign exchange reserves—a significant fraction in U.S. government debt instruments—and surpassed Japan as the holder of the most foreign exchange reserves" (p.121)

In this vein, this paper asserts that the main reason for asking for protectionism is the desire to increase net exports in periods of balance of power in order to increase 'national sovereignty' and thus national power. ¹³ Requesting a trade surplus (or reparations after war) is one of these means in the hands of a nation to maintain its national sovereignty, especially when the other country is slightly more developed. In periods of hegemony, then, reparations are not necessary, as countries can free-ride on the power of the hegemonic nation-state.

But why do the individual citizen care so much about national sovereignty? This is the topic of the next section. We could of course posit that power and national sovereignty have a direct effect on individuals' utility. But to be consistent with the first two chapters of Keynes and with the import of "ideas' vs. 'vested interest', we introduce national sovereignty through 'social identity' as we now present.

¹⁰ Smith (1937), p. 399.

¹¹ Wallerstein (1980), p. 277.

¹² Kinder and Hilgemann (1964), p. 253.

¹³ And in periods of war, requesting reparations is one of these means in the hands of a nation to maintain its national sovereignty, especially when the other country is slightly more developed. In periods of hegemony, then, asking for reparations is not necessary, as countries can free-ride on the power of the hegemonic nation-state.

III. National Sovereignty and National Identity

One of the main shifts in the history of economic theory lay in the introduction of Behavioral Economics in mainstream theory, which opened the floodgates to many other innovative lines of thinking. In consequence, it not only became 'kosher' to speak of culture and psychology in the economic realm, it became 'in'.¹⁴

Sociology also slowly penetrated the field of economic theory. In 2000, Akerloff and Kranton introduced 'identity' as an element affecting economic choices. In the field of social psychology, Tajfel developed the 'theory of social identity'. He contended that individuals have an inherent tendency to categorize themselves into one or more "in-groups", building a part of their identity based on membership in that group and enforcing boundaries with other groups.

The social identity theory posits the fact that a person's self-concept and self-esteem derive not only from personal identity and accomplishments, but from the status and accomplishment of the groups to which s/he belongs (Tajfel and Turner, 1979). In their experiments, they have shown that humans have a need for 'us/them' distinctions. Thus, social identity theory suggests that people identify with groups in such a way as to *maximize positive distinctiveness*.

They have shown that social identity leads to discrimination. When being divided into two groups, and asked to split budgets between the two groups, individuals had the choice between giving \$100 to each member of both groups, or receiving \$50 for each person in their group, but only \$10 to the other group. Most individuals chose the second option. Making the other group worse off is more important than making your group better.¹⁵

Recall that group selection was chosen almost randomly, and in some of the experiments, it was chosen completely randomly by tossing a coin. Yet, the results were significant. If these are the results for a random selection of groups, what happens when the group has some sort of common trait or culture, such as being white? Or being French?

Metzl (2019) discussed discrimination between whites and non-whites. He shows that individuals belonging to a given group can make decisions that are not "rationally" productive for them, just to feel part of the group and to separate themselves from the other group. An example he gives is that young white individuals belonging to the working class who were sick and in need of Medicare, chose "to be

¹⁴ In reference to Temin (1997): "Is it Kosher to talk about Culture?"

¹⁵ Moreover, it was shown that those who had been allowed to engage in intergroup discrimination had higher self-esteem than those who had not been given the opportunity to discriminate (Lemyre and Smith 1985, Oakes and Turner 1980).

broke, but not to let the other group get it for free".¹⁶ They are willing to make choices that harm themselves in order to maintain their class identity (see also Reicher, 2015).

Another clear grouping is the nation itself. One speaks today about the identity of being American: While "Being an American is an element of the self-concept of most Americans", it leads to discrimination and to in-group favoritism.

What are the 'markers' of national identity of the nation? Following Metzl (2019), the main elements defining working-class identity are the symbols of nationalism, which alongside sovereignty, is always part of the identity of the working class. Thus national sovereignty and power influence the sense of well-being of the working class.

However, national identity is not a value assimilated across society in a one-size-fits-all manner. Within each nation-state, the various in-groups - especially the working class and the elite - do not share the same identity.

The literature on 20th century elites pinpoints the interconnection of all elites, and their transnational values.¹⁷ Weber (2008) showed that at the beginning of the 20th century, the elite of Germany and England had connections between them, and shared the same values despite the tensions between the countries, and acted to improve Anglo-German relations: "The British and German ruling elites tried to ease the tensions between the two empires." (p. 49).¹⁸

Weber showed that militarist nationalism and European transnationalism were not mutually exclusive concepts: militarist nationalism appealed to the working class and transnationalism to the elites. He stressed that the elite of various countries feel related by their culture, and feel themselves to be part of the same group - the transnational elite of Europe. They emphasize humanistic, universal values and do not relate to values such as militarism, power and nationalism.

This is also the position of Lasch (1994). According to Lasch, the new elites, through globalization which allows total mobility of capital, no longer live in the same world as their fellow-citizens. In this, they oppose the old bourgeoisie of the nineteenth and twentieth centuries, which was constrained by its spatial stability to a minimum of rooting and civic obligations.

¹⁶ Medicare might improve life for all groups, but as it would improve the well-being of the non-white group more, working class 'white' Americans actively oppose it.

¹⁷ See Brezis and Temin (1999, 2008).

¹⁸ Indeed Weber brings Britain and Germany's preeminent universities and playgrounds for political and social elites back to life to reconsider whether any truth is left in the old contrast between British liberalism and German illiberalism.

Ciampani and Tolomeo (2015) follow a similar reasoning about the elite: "In effect, the research avenue that focuses on the meetings of the European elites aims to account for the progressive "amalgam" of the European elites' national groups, their coming together both to initiate the processes to form new generations of élites, and to broaden (or restrict) the means of access to decision-making" (pp. 10-11).

Globalization, according to Lasch, has turned elites into tourists in their own countries. The de-nationalization of society tends to produce a class who see themselves as "world citizens, but without accepting ... any of the obligations that citizenship in a polity normally implies". Their ties to an international culture of work, leisure, information - make many of them deeply indifferent to the prospect of national decline.

Therefore, we obtain a dual social identity.¹⁹ On the one hand, the working class of each country cares about national sovereignty and power. On the other, the elite in each country want a globalized economy with interdependence between countries. The transnational elite identity values internationalism, humanism, and universalism.

And to which group did Keynes belong? Did his feelings pulled towards the working class? or the elite? As he mentioned in *Essays in Persuasion*, commenting about Marxism (1931):

How can I adopt a creed which, preferring the mud to the fish, exalts the boorish proletariat above the bourgeois and the intelligentsia who, with whatever faults, are the quality in life and surely carry the seeds of all human advancement? Even if we need a religion, how can we find it in the turbid rubbish of the Red bookshops? It is hard for an educated, decent, intelligent son of Western Europe to find his ideals here, unless he has first suffered some strange and horrid process of conversion which has changed all his values." (p. 298)

Let us now turn to the model that analyzes the effects of trade policy and reparations incorporating these following elements: the social identity theory, the concept of national sovereignty for the working class, and the concept of humanism for the transnational elite.

IV. The Model

4.1 Introduction

Since the model relates the decisions about reparations and trade policy to the international political system, we should first ask when in history did we face a balance of power situation. In 1919, at the time of the Treaty of Versailles, is the international system in a hegemonic or a 'balance of power' system?

The data are presented in Figures 1-8. From 1850 to 1910, there is *Pax Britannica*; the UK has leapfrogged the Dutch, and is the hegemonic power (see Figure 1). After

¹⁹ See also Brezis and Hellier (2017).

1945, we are in period of *Pax Americana*, and the US has leapfrogged the UK. From 1945 until 2008, the US is the hegemonic power of the world (see Figure 2).²⁰

But, during the period 1910-19, the data display that GDP per capita among the main powers are very similar, (although Germany has higher GDP than France from 1900 and on). This is a pure 'balance of power' system which will be de facto until 1945, the end of World War II (see Figure 3).²¹

This model will show that in the context of a hegemonic country, all classes - the working class and the elite - opt for free trade and no reparations. However, in a balance-of-power situation, wherein no single actor on the international scene possesses hegemonic status, the working class will choose protectionism, while the elite and Keynes will not. The model is based on the notions of hegemony, balance of power and social identity presented above. Let us start by modelling social identity.

4.2. The social identity of the elite and the working class

1. The basic framework

There are two social classes and as presented above, each class has its own identity, which has an impact on the individual's utility. One of the main elements defining the working class is its attachment to symbols of nationalism, as 'national sovereignty'.

In opposite, the elite of the various countries feel related by their culture, they are part of the same group --the transnational elite of Europe. They put the emphasis on humanistic values similar in all countries. They do not relate to values as army, power and nationalism.

How national sovereignty affects the utility of the working class? We could, of course, introduce national sovereignty directly into the utility function. In this paper, I try a more "subtle" line of modeling. Following the research presented above, I assume that the working class does not have utility from the size of national sovereignty per se, it is the comparison with the other country which affects utility. If national sovereignty is less than a required amount in competition with another country, then the utility is affected.

²⁰ Brezis, Krugman and Tsiddon (1993) present a model explaining endogenously the changes in hegemony, and about the data on the Balance of payments, see Brezis (1995).

²¹ The data on population emphasizes a very similar path among the three leaders of the world, but the US has a different path than the three other nations. Although, the demographic transition of France took place before the 19th century, so that the population increase of Germany was much higher. See Figures 1-2.

2. National Sovereignty for the working class

Let us develop what are the 'markers' of national sovereignty. It is what the theory of international relations denote as power. Power is the only means of maintaining one's sovereignty, of winning at war, or of deterring attack. Thus, I assume that the marker for national sovereignty is power.²²

How to define power? The debates over the definition and measurement of power are endless. Despite the lack of consensus on precise definitions, most scholars of the "realist" school agree that economic and military factors are crucial. We thus begin with the premise that the national sovereignty, i.e. power of a nation depends both on its economic and on its military power. Mathematically, we express this assumption as:

$$NS_i = PW_i = F(EPW_i, MPW_i) \quad (1)$$

where NS_i , PW_i , EPW_i , MPW_i are national sovereignty, total, economic and military power respectively. Without loss of generality, we take a Leontief form of relationship between both powers:²³

$$NS_i = PW_i = \text{Min}(EPW_i, MPW_i) \quad (2)$$

All suggested measures of economic power are intrinsically ad hoc. The proxy for economic power is total consumption – private and public. A priori, a more natural choice might be output. This choice has the inconvenience that in the case where a country decides to allocate its output to exports and leave very little for consumption, this country would be said to have economic power. Consumption is therefore a more appropriate proxy in the context of our model. Thus:

$$EPW_i = C_i + G_i = c_i \quad (3)$$

where c_i is the output allocated to consumption.

Military power is a function of the stock of military equipment and infrastructure of war owned by the country (planes, missiles, artillery, warships...), but also of the possibility of immediately financing new equipment, and ammunition. The stock of military equipment, as well as the stock of foreign reserves hoarded in the past, M_i is given exogenously at the start of the period and there is no depreciation of materials

²² The national identity theory have shown that in time of frustration, there are more discrimination. In other words, during time of balance of power, the necessity of net exports surplus and reparations increases in each country.

²³ I choose this discontinuous functional form for convenience, and in order to ensure transparency of the results, but any functional form in the class of the CES function yields the same results.

during periods of peace. The possibility of being ready for war is then a function of the stock of foreign reserves.

Therefore the increase in foreign reserves, denoted by O_i is a factor influencing the military power of a country. (Note that the accumulation of foreign reserves in the past is included in M_i).

We therefore have the specification

$$MPW_i = O_i + M_i \quad (4)$$

Therefore the power of a nation, PW_i is:

$$NS_i = PW_i = \text{Min}(c_i, O_i + M_i) \quad (5)$$

From the national income identity, we have that:²⁴

$$Y_i = C_i + G_i + NX_i \quad (6)$$

The flow of foreign reserves and the trade balance are linked by the simple expression:

$$O_i = R_i + NX_i \quad (7)$$

where O_i is the increase in foreign reserves, NX_i is the current account surplus, and R_i represents the reparations paid by a foreign country (only a country having won a war can ask for reparations).

In consequence we have:

$$NS_i = PW_i = \text{Min}(c_i, R_i + y_i - c_i) \quad (8)$$

where $y_i = Y_i + M_i$.

3. Objectives and Payoffs for the working class

There are two countries: Country 1 and Country 2. Let us define the country with slightly higher output as country 2. There is no hegemonic nation in the world. Each country is represented by an individual of the working class, and which faces the following payoffs:²⁵

²⁴ Recall that investments are equal to the savings of the elite, a small group of size 0 not included in this part.

²⁵ If we want to describe history, let us say that France is country 1, and Germany country 2 after World War I, since as shown in Table 1, GDP of Germany is higher than that of France. Moreover, France could ask for reparations, since it was a winner at war.

$$V_1 = \begin{cases} c_1 & PW1 \geq PW2, \\ c_1 - K & PW1 < PW2 \end{cases}, \quad (9)$$

Equation (9) is presented for country 1. For country 2, it is the same equation, with the suffixes inverted. Equation (9) 'translates' the notion of social identity so that the French working class would feel 'insulted' by an equivalent quantity of size K when the power of Country 2 is greater than the one of Country 1. In equilibrium, the countries choose c and O as to maximize (9). They also choose the amount of reparations, R (in case of war). Remember that we assume $y_2 \geq y_1$.

Lemma 1.

Given the possibility of asking for reparation of size R , consumption which lead to maximum power is:

$$c_i^* = (y_i + R_i) / 2 \quad (10)$$

Proof.

Equate the two elements of equation (8). See also Figure 4.

Lemma 2

Given that $K \gg y_1 / 2$ then the optimal amount of reparations is:

$$R_1^* = -R_2^* = (y_2 - y_1) / 2 \quad (11)$$

And therefore we get:

$$c_1^* = c_2^* = (y_1 + y_2) / 4 \quad (12)$$

$$NX_1^* = (3y_1 - y_2) / 4 - M_1 \quad O_1^* = (y_1 + y_2) / 4 - M_1 \quad (13)$$

$$NX_2^* = (3y_2 - y_1) / 4 - M_2 \quad O_2^* = (y_1 + y_2) / 4 - M_2 \quad (14)$$

Proof

The equilibrium is a perfect Nash equilibrium of a one period decision game. In the case of balance of power, which is defined such as $y_2 - y_1 \leq c_1$, then the Nash equilibrium necessitates that $PW_2 = PW_1$.

In consequence, given equation (10), we get the equations (11) to (14) and especially that $c_1^* = c_2^* = (y_1 + y_2) / 4$. By substituting equations of power, we get equation (10).

QED

Let us then turn to Proposition 1.

Proposition 1

When countries are in a balance of power regime, with output quite similar, then in the unique equilibrium, the working class (and the politicians listening to the working class) will choose to increase their national power by hoarding foreign reserves until they attain maximum power. In case, one country can ask for reparations, then, the optimal size of reparations is:

$$R_1^* = -R_2^* = (y_2 - y_1)/2 \quad (11)$$

To conclude, in case of Balance of power, and when one takes into consideration the aspirations of the working class, then it is optimal to ask for harsh reparations. This was the point of view of Clemenceau, in the name of the “people of France”. The optimal size of reparations is given by equation (11). The transnational elite put the emphasis on humanism, i.e., consumption and economic growth of the world. Moreover, recall that the elite are the individuals who are investing (as underlined by Keynes in the introduction). So their utility function is:

4.3 Objectives and Payoffs for the transnational elite

The transnational elite put the emphasis on humanism, i.e., consumption and economic growth of the world. Moreover, recall that the elite are the individuals who are investing (as underlined by Keynes in the introduction). So their utility function is:

$$V_E = U(C_E, I) \quad (15)$$

where C_E is the consumption of the elite, and I are investments, since the savings of the elite finance the investment of the nation. In their utility, there is no national sovereignty so that foreign reserves are not important. And since we have:²⁶

$$S = I + NX \quad (16)$$

Then, they are better off, when hoarding foreign reserves and reparations are zero.

Proposition 2

In a balance of power system, the transnational elite choose not to hoard foreign reserves and not to ask for reparations.

4.4. Hegemony

How do we define hegemony, in our framework? The intuitive answer is that the power of this country is so important that without getting reparations or hoarding foreign reserves, no country compares itself to this country, and no country think to

²⁶ Government expenditures are included in the maximization of the working class.

start a war with her. In this case, for all countries under the influence of this hegemonic state, it is easy to show that we get the following proposition:

Proposition 3

In a hegemonic system, the goal of the working class, as well as the transnational elite is increasing consumption (and investments). Countries aim at free trade, and no reparations. Countries will not squander resource in an attempt to increase reserves. Recall that indeed the facts presented in Section II show that periods of hegemony were correlated with periods of free trade.

V. Conclusion

There is no better conclusion of Keynes' *Economic Consequences of the Peace* than to quote Skidelsky:

Keynes was also a product of the old Europe, of which Britain was an integral part. He was brought up by a German governess, married a Russian ballerina, and was at home in France and Italy. He looked forward to an era of small political and cultural units combined into 'larger, and more or less closely knit economic units.(2010, 191-192).

The writing is angry, scornful and, rarely for Keynes, passionate: never again were his denunciations of bungling and lying, or his moral indignation, to ring so loud and clear. Giving shape to the whole is a brooding sense of menace; a sense of the travails of a civilization in extremis; of the mindless mob waiting its turn to usurp the collapsing inheritance; of the futility and frivolity of statesmanship. The result is a personal statement unique in twentieth-century literature. Keynes was staking the claim of the economist to be Prince. All other forms of rule were bankrupt. The economist's vision of welfare, conjoined to a new standard of technical excellence, were the last barriers to chaos, madness and retrogression. (1983, p. 384)

This paper seeks to explain the disagreements between Keynes and Clemenceau. I show that the various in-groups' national identities between the working class and the elite explain their opposing views on reparations. For the working class, national sovereignty is essential, despite "the apparent inability of the intelligentsia to understand and appreciate power-problems". This difference in identity can explain why the optimal policy for the working elite differs from that of the elite.

This paper has shown that in the context of a hegemonic country, all classes, the working class and the elite opt for no reparations. But, in a "balance of power" situation, wherein no single actor on the international scene possesses hegemonic status, the working class will choose harsh reparations, while the elite will not.

What, then, does this paper teach us? There are two main conclusions: The first is that if we ask why 1945 is so different from 1918; and why the peace treaties after 1945 differ from those of the 1919 Treaty of Versailles, the answer is:

Because in 1945, there was a hegemonic state - the US - while in 1919, the world was in a balance of power system. As this paper has shown, this fact changes countries' entire perspective on reparations and free trade. Under a hegemonic system, there is no "Clemenceau" to ask 'in the name of the people' for harsh reparations, in order to enhance national identity. In periods of hegemony, there is room for coordination, for the UN, for the GATT, for the Marshall plan; There is no room for harsh reparations.

Being part of the intellectual transnational elite, Keynes understood this already in 1919. He fought for a treaty of reconciliation. But Clemenceau could not accept this. On behalf of the French working class, Clemenceau cared about national sovereignty and national identity, for which the French were willing to pay the price. They did not know that the price will be so high.

The second main conclusion of this paper is that the small framework presented in the previous section helps us to understand the success of Trump in the US. Trump is the outcome of a world of balance of power between the US and China.

Indeed, the hegemony of the US extended from 1945 until 2008. Since then, we are back in a balance of power between the US and China. From 2008 and on, the world has entered a new balance of power system. Therefore, Trump who represents the working class, opposes free trade.

Those are the conclusions of my paper, and let me now make a confession: While I am aware that, paraphrasing Keynes, *this model will give food to the cynic*, I am persuaded that it will shed new light on Keynes' view of the Carthaginian peace.

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Table 1.

Year	Germany	France	United Kingdom	United States
GDP per capita in 2011 US\$				
1860	3312	3113	4988	3425
1870	3715	3086	5716	3736
1880	4023	3488	5879	4866
1890	4904	3909	6711	5184
1900	6029	4731	7446	6252
1910	6763	4878	7567	7586
1920	5647	5309	6881	8485
1930	8027	7455	8504	9490
1940	10914	6650	10716	11307
1950	7840	8531	10846	15241
Population, in thousands				
1850	33746	36350	27181	23580
1860	36049	37300	28888	31839
1870	39231	38440	31400	40241
1880	43500	39045	34623	50458
1890	47607	40014	37485	63302
1900	54388	40598	41155	76391
1910	62884	41224	44916	92767
1920	60894	39000	46821	106881
1930	65084	41610	45866	123668
1940	69835	41000	48226	132637
1950	68375	42518	50127	152271

Source: Maddison.

Figure 1: Hegemony of Britain: 1850-1910

Maddison data - GDP per capita - 1850-1940

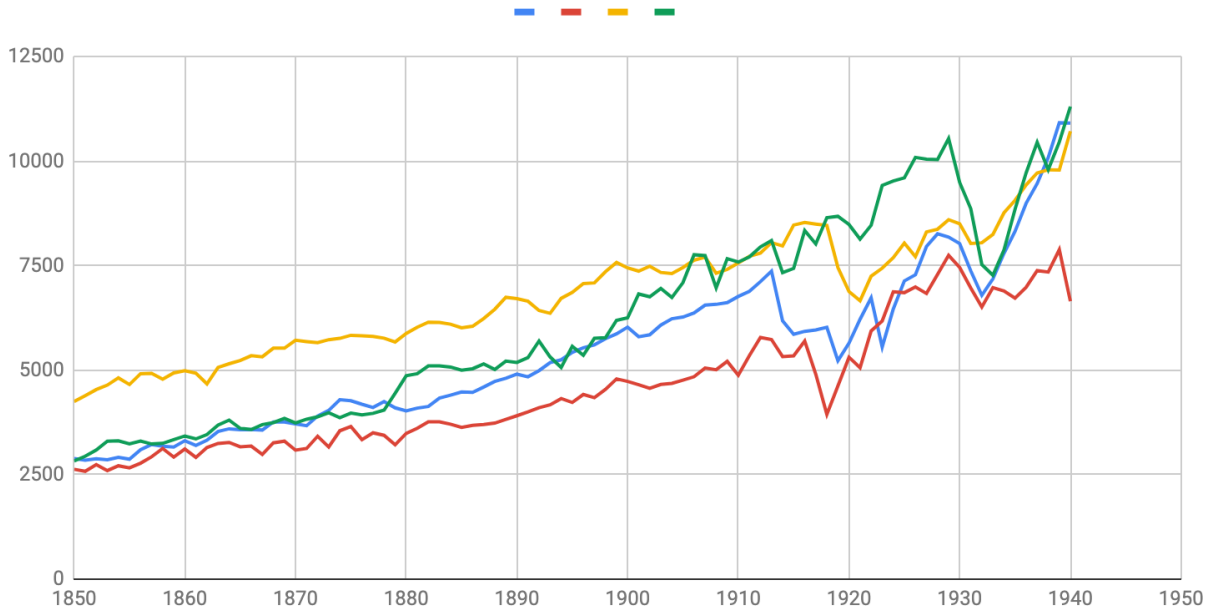


Figure 2: Hegemony of the US: 1945-2008.

Maddison Data - GDP per capita, index set at 100 for 1850

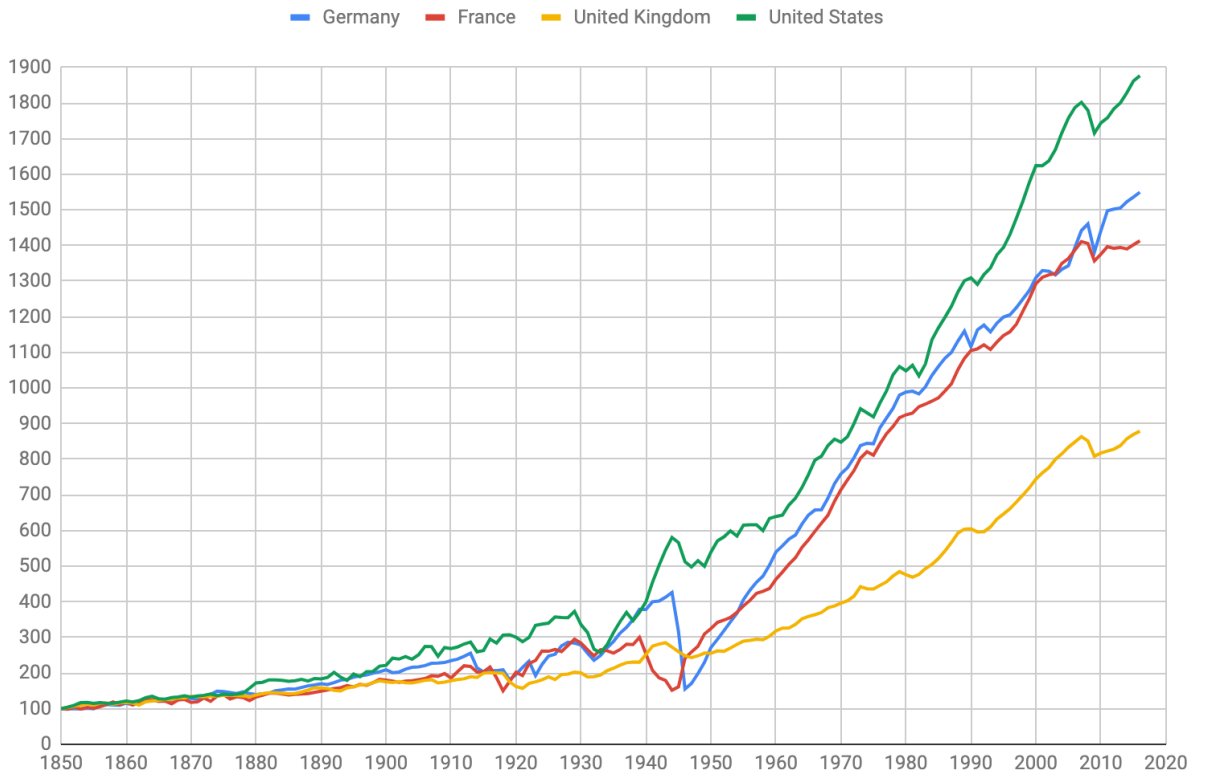


Figure 3. Balance of Power: 1910-1945.

Maddison data - 1910- 1960

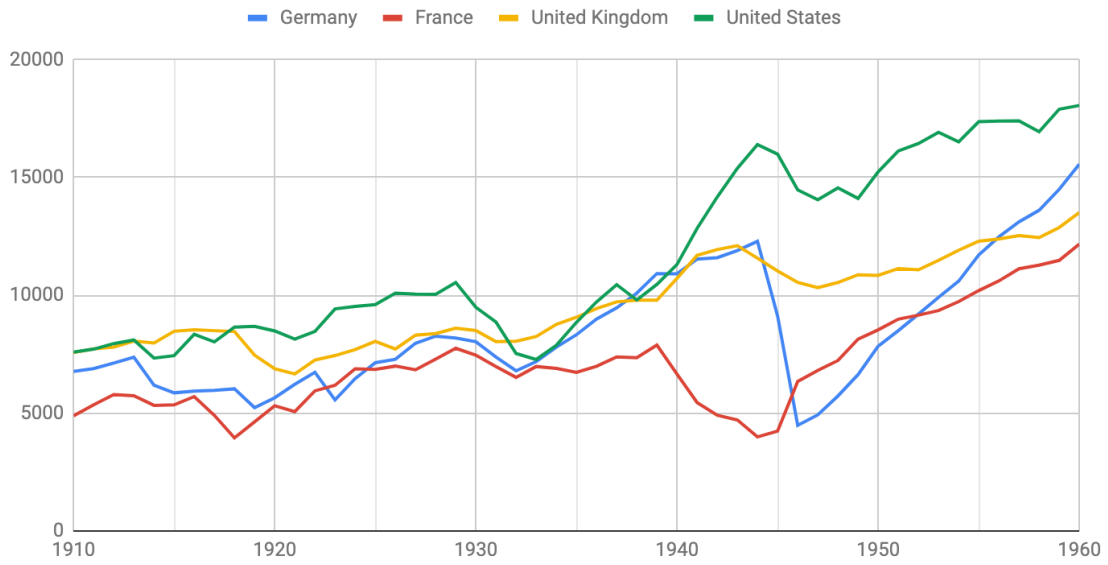


Figure 4 – Equilibrium

