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How the Soviets saved capitalism

ERIC RAUCHWAY

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B enn Steil THE BATTLE OF BRETTON WOODS John Maynard Keynes, Harry Dexter White, and the making of a New World Order 449pp. Princeton University Press.

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978 0 691 14909 7 On July 1, 1944, with Allied soldiers still fighting their way inland from the Normandy landings, the United Nations Monetary and Financial Conference convened in Bretton Woods, New Hampshire.

"The United Nations" was not yet an institution, just a name Franklin Roosevelt liked to use for the allies joined in the fight against fascism. But the Bretton Woods agreements began to give the UN substance, by establishing an economic basis for the peace.

Governments agreeing to Bretton Woods would set exchange rates between their currencies.

Policymakers understood that stable currency conversion eased international trade, and a resumption of international trade would restore what John Maynard Keynes called the "economic Utopia" that prevailed before the world wars, when countries kept exchange rates steady by committing to maintain their currency's convertibility to a set sum of gold. But the Great Depression showed that the gold standard came at a price - it bound governments to worsen the economic slump, forcing prices to fall further by seeking to preserve convertibility to gold. As countries left gold - Britain went off in 1931, the United States in 1933 - they began to recover from the crisis. The Bretton Woods system acknowledged this lesson by permitting nations to adjust the peg that fixed their currencies to each other in case of need.

To prevent such adjustments from coming too often, members chipped in to the International Monetary Fund, on which they could draw to cover short-term international imbalances.

And to enable more nations to join the system, signatories also contributed to the International Bank for Reconstruction and Development (generally known as the World Bank) which would guarantee and make loans to rebuild war-torn countries and develop poor ones.

Thus the exchange rate regime would establish a prosperous status quo of trade at levels that would ensure full employment and high real incomes; the Fund would help maintain this status quo; the Bank would ensure over time that more nations could join the ranks of the prosperous and participate in this status quo.

The Bretton Woods system operated for twenty-five years, until in 1971 the United States, under President Richard Nixon, abandoned it. The Bretton Woods era saw low, stable inflation rates and high, stable economic growth. Indeed, the economic historian Michael Bordo's comparative examination of monetary systems (including the old gold standard and the modern regime of floating currencies) shows that Bretton Woods performed "by far the best on virtually all criteria". Capitalism has never looked more attractive than during this short happy period.

Which puts a sharper point on one of the most peculiar, if not poignant paradoxes of Bretton Woods: its major US architect was a Soviet spy. The outline for the monetary arrangements predated the conference, and resulted from a British plan written by Keynes combined with an American plan by a US Treasury official, Harry Dexter White, who had provided information to Soviet military intelligence (the GRU) in the 1930s and who would provide information to Soviet state intelligence (the NKVD; precursor to the KGB) during the New Hampshire conference.

The presence of a Soviet spy in the Bretton Woods story makes for difficult history. There are few subjects that attract outsized claims of conspiracy like international monetary policy and Soviet espionage (both of which, conspiracists tend to believe, involved a disproportionate number of Jews - such as White); put them together and the uncareful writer can easily go wrong.

Although Benn Steil's The Battle of Bretton Woods is published by Princeton University Press and Steil holds a DPhil from Oxford, he is not an academic, which entails certain advantages. Steil writes fluidly and often well, livening up his style by using unconventional words ("fugacious" and "timeous"). Unfortunately, Steil's breeziness extends beyond his style to his treatment of evidence and scholarship.

Steil presents a case that Harry Dexter White was not only responsible for the postwar arrangements agreed in New Hampshire, but for the entry of the United States into the war itself. Allegedly contacted by Soviet agents in May 1941, and asked whether the US would "do something to counter Japanese aggression", White wrote a set of memoranda outlining proposed diplomacy towards Japan, culminating in a note sent in November to his superior, the Secretary of the Treasury, Henry Morgenthau, Jr. Some of White's ideas ended up in the memorandum delivered by the US Secretary of State, Cordell Hull, to the Japanese on November 26, 1941.

Steil writes, "That White was the author of the key ultimatum demands [that is, the Hull memo of November 26] is beyond dispute. That the Japanese government made the decision to move forward with the Pearl Harbor strike after receiving the ultimatum is also beyond dispute". Not only are both statements widely disputed, the truth is almost entirely the opposite.

White offered Morgenthau his memorandum on November 17, suggesting Japan give up expansionist ambitions in exchange for US economic assistance and aiming at "the successful transformation of a threatening and belligerent powerful enemy into a peaceful and prosperous neighbor". Morgenthau forwarded it to the State Department where, the historians William Langer and S. Everett Gleason wrote, it would "lose its identity and become merged in the final draft of a State Department document".

By the time Hull delivered his ultimate memorandum to the Japanese on November 26, the administration had evidence the Japanese were deploying military forces in Southeast Asia and therefore abandoned White's expressed goal of peace with Japan. So some provisions of the White memorandum, aimed at peace, turned up as futile offers in the Hull memorandum, resigned to war. And neither memorandum may have mattered much, as the historian Roberta Wohlstetter observes; when Hull tendered his note, the task force bound for Pearl Harbor had already sailed.

To make the extraordinary Pearl Harbor claims, Steil relies on the reminiscences, more than five decades afterwards, of an NKVD officer who remembers trying to get the US to fight against the fascist powers in May 1941 - at a time when the USSR had non-aggression pacts with both Germany and Japan. For historical backup, Steil cites a book by Jerrold and Leona Schecter called Sacred Secrets (2002). Reviewing the Schecters' book, the historian Harvey Klehr noted that decisionmaking about war in the Roosevelt administration did not rest principally with the Treasury. but with the President and the State Department, and diffidently wrote, "White hardly was the decisive figure in preventing an American-Japanese agreement that might have averted Pearl Harbor". Since then, Klehr and his co-author John Earl

Haynes have been able to look at the documents on which the Schecters relied for their discussion of White. These documents turned out to be, Haynes and Klehr wrote in 2011, "fake".

Steil's account of how White caused the attack on Pearl Harbor comes so early in the book that a faint-hearted reader might be tempted to put it aside. But then one would miss seeing Steil mount his major claim - that Bretton Woods was "an economic apocalypse in the making", that put the US in "an impossible position ... hopelessly trying to guarantee more and more dollars with less and less gold".

Gold transfixes Steil. In other writings he has described gold as "real wealth" and "the natural alternative to the dollar as a global currency" because it is "the world's most enduring form of money". In this book he writes about the economic proposals of White and Keynes mainly by arguing with their respective characterizations of the gold standard. Keynes, Steil claims, "blamed much on the gold standard that he might just as well have blamed on the weather". White, he says, appears not to understand "the pre-1914 classical gold standard, with its automatic mechanisms for regulating the price of credit and the cross-border flows of gold". It is Steil who italicizes automatic, just as he contrasts Keynesian interventionism with the gold standard, "wherein the authorities behaved much more mechanically in response to movement in the monetary gold stock across borders: when gold flowed in they loosened credit, and when it flowed out they tightened credit". Steil's summary of the gold standard's operation is concise and, like his description of the run-up to Pearl Harbor, at odds with historical evidence.

Contrary to Steil's account, monetary gold stock did not generally move across borders. It does in theoretical models of the gold standard, which show importers buying foreign goods, paying in bulk gold that exporters take to the bank to be coined. If a country imports more than it exports, it loses gold and therefore prices fall. But life is not as elegant as a Steil model.

During the heyday of the gold standard from about 1870 to 1914, countries generally used paper money based on gold, not gold itself, as a circulating medium. In theory, central banks were supposed to match the model by lowering interest rates (increasing the availability of credit) when trade came into the country and raising interest rates (decreasing the availability of credit) when trade went out; these were what Keynes called "the rules of the gold standard game". But in actuality, central banks were loath to play by these rules. Raising interest rates above the market would deprive the central bank of a profit opportunity and also make it difficult for the government to borrow money. In consequence, rather than play by the rules, and respond automatically - as Steil would have it - to trade balances, central banks maintained a gold reserve large enough to assure anyone that they could convert paper on demand.

This variation from the model matters, because it undermines the whole story Steil is telling, of an unwise move from an automatic, rules-based system - one that was, therefore, reliable - to a system that relied on unreliable policymakers. In truth, the ease of credit under the gold standard was subject to political pressure and human failings, much like the ease of credit in the post-war years, but the political pressure in question did not come from the unruly masses. As the economic historian Barry Eichengreen observes, the gold standard prevailed in a period when workers were only just getting the vote and organizing. Central bankers could impose deflation to keep currencies convertible to gold with little regard for the effect on employment. By the 1930s, increasingly democratic electorates had made gold an unsustainable standard by which to manage an economy. Steil thinks that by putting Bretton Woods, or today's managed currencies, in place of a gold standard, the world has replaced a fine machine with fallible human discretion, but the gold standard was a fallible human system too. It was responsive, but chiefly to the interests of the rich.

Keynes and White set out to keep currencies relatively stable without crushing the working classes under the weight of a cross of gold. Bretton Woods solved this problem for a time, and even though this system soon ended, it inaugurated a period of - well, one would like to say international monetary cooperation, but in truth it was, as Keynes might say, spirited discussion - that persists to this day and functions better for the world's people than the gold standard did.

In the end, it remains difficult to say why Harry Dexter White acted as he did. Why did a Soviet spy construct a system that helped save and indefinitely prolong world capitalism? It is in the nature of espionage that documentation is rare and inaccessible, and witnesses lie. What evidence we have suggests something like the following about White's career: in 1934, when he was an academic, the US Treasury asked him to report on the problem of a monetary standard. His response already included basics of what became the Bretton Woods system: a case against both the gold standard and floating exchange rates (the latter of which White regarded as practically feasible, but politically unlikely) and a case for the adjustable peg, to be kept in place by an international monetary fund. This report got him a longerterm job at the Treasury. Sometime after this, White began passing information to Whittaker Chambers, a GRU agent. One memorandum in White's handwriting survives, and though it contains little if anything that qualifies as actual confidential information, perhaps other, vanished memos contained secrets for the Soviets. According to Chambers, White was keen also to send the Soviets his plan for monetary reform in the USSR, and the Soviets were eager to have it.

After a religious revelation, Chambers left the Soviet service in about 1938, and said he warned White to do the same. Beginning in 1941, messages from NKVD's Moscow headquarters to their New York office expressed the desire to make White an effective source; replies from New York said White was uninterested and expressed doubt as to whether he knowingly aided GRU (the two agencies were sufficiently separate that one did not know the other's sources). Finally, in 1944, as Bretton Woods was being negotiated, Moscow directed New York to tell White he "must" co-operate - a phrasing that contained at least an implicit threat of exposure, or worse. Then, and for a time afterward, White spoke to NKVD agents. His 1948 Congressional testimony denying connections to Soviet espionage was false.

And yet White did not substantially accede to Soviet demands for alterations to Bretton Woods, either in private meetings at the Treasury early in 1944, or at the conference itself. His economics never appeared to derive from or aim at Marxism. Keynes certainly was not a Marxist, and the disagreements between them derived from White's being more conservative - more attached to traditional money, less willing to extend indefinite credit - than Keynes.

Steil writes at one point that Franklin Roosevelt, who took the US off the gold standard in 1933 and oversaw planning for Bretton Woods, "had only the foggiest grasp of macroeconomics". Perhaps, but to be fair, nobody else had much more. The Great Depression so demolished preconceptions that it left what the economist John Kenneth Galbraith calls "a poor state of economic intelligence". What Roosevelt understood clearly, and aimed at from the time he took the US off the gold standard through to the time he committed the US to Bretton Woods, was the principle that economics needed to aim at general prosperity - a goal his policies, domestic and foreign, achieved better than their gilded forebears.