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RULES AND DISCRETION IN THE MAKING OF ECONOMIC POLICY

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ABSTRACT

This article exhibits some caution in deploying the polarity between 'rules' and 'discretion' in an historical context before first establishing the context in which these terms originated and have been used. It takes Nigel Lawson, a British Treasury minister in the 1980s, as one example of a policymaker who consciously favoured rules over discretion, and likewise takes the economist H.C. Simons as an academic economist who did likewise in the 1930s. In establishing how Keynes saw this issue, the centrality of the gold standard as the prime example of a rules-based system becomes apparent. The evolution of Keynes's own views here is the main theme. As a young economist he accepted the authority of the gold standard as an impartial arbiter, governed by 'the rules of the game'. But he came to see that its ostensible lack of bias was compromised in practice by the interests of creditor countries and their power to enforce their own priorities upon debtors. In this sense, it was the replacement of Britain as the international hegemon by the United States after the First World War that opened Keynes's eyes to the defects of a rules-based system that, to modern eyes, has parallels with the workings of the euro today.

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As a Cambridge historian, I am acutely conscious of the methodological hazards of simply searching for the *origins* of what we *now* suppose to be important or true. Did the ideas that we seize upon as important or interesting to us today actually have that kind of significance for the historical figures whom we confidently cite? Were they knowing participants at the time in the discourse and debates that we now find interesting? Or have

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they been subsequently conscripted into rival armies for which we have acted as the recruiting officers?

With my historical background, then, I naturally think we need to look for the main clues in interpreting historical ideas in the context of the time in which they originated. It is not enough to find precursors who *now* seem, in a suggestive way, to employ the terminology that we use today – the maxim that everything has been said before by someone who did not discover it is worth remembering here. Likewise, in pursuing a keen scholarly search for predecessors, and thus for laudable premonitions of our own thinking, we can end up with little more than an amusing parlour-game – hunt the intellectual ancestor.

Keynes himself engaged in some similar pursuits, notably in chapter 23 of the *General Theory*, "Notes on mercantilism, the usury laws, stamped money and theories of under-consumption". There he commends an assortment of poets and polemicists who had, over the centuries, scouted the orthodox economic maxims of their day and thus (he suggests) uncannily anticipated some of the propositions of the *General Theory* itself. So Keynes now hails them as "the brave army of heretics" and awards them posthumous campaign medals [Keynes 2013 (1936) 7: 371]. His strait-laced colleagues, of course, thought he was bringing the profession into disrepute by praising these cranks.

So much for prolegomenon. But I think this may be necessary in considering the problem of rules and discretion, which is an aspect of a familiar modern debate in economic policy-making, not just in a theoretical sense but as a practical maxim for policy-makers. It is with this modern debate that I shall begin, simply in order to identify some of the key issues at stake, both in economic policy and theory; and here I am concerned with identifying a general mindset rather than any specific proposals. Having done this, I shall move to a consideration of Keynes's thinking in this context, once I have established that this was a debate that he would have recognised in much the same terms that we use today. This is my logic in departing from a strict chronological treatment – in effect, using flashback in telling the story.

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I will take, as an illustrative example of modern policy debates, Nigel Lawson, a British Treasury minister during the 1980s under Margaret Thatcher. He had studied economics at Oxford; he had worked as a financial journalist; he served as Financial Secretary, Number 2 in the British Treasury, 1979-81, and, after a brief spell at the Department of Energy (meaning North Sea oil), he became Chancellor of the Exchequer in 1983.

Six years later, in 1989, he spectacularly resigned, ostensibly over Thatcher's refusal to join the Exchange Rate Mechanism of the EU. So, on the face of it, a 'good European'. Not exactly; appearances can be deceptive. Lord Lawson, as he became after leaving office, returned briefly to prominence in the 2016 referendum, campaigning for Brexit. How can we make sense of all of this?

We can start with his thousand pages of memoirs, published in 1992. This is how he told the story soon after departing from power, having played a key role in both inaugurating the Thatcherite experiment and in engineering the political demise of Thatcher herself. Lawson quotes an article he published in *The Times*, 14 September 1978, on the need for a new approach to economic policy in Britain:

> At the head of such a programme must lie a firm commitment to a steady and gradual reduction in the rate of growth of the money supply, until it is consistent with our best guess at a potentially sustainable rate of economic growth. Only in this way can inflation be wrung out of the system.

So far, so monetarist, we might think. But Lawson gave his version of monetarism a fiscal twist, arguing that, equally important, "something akin [...] to the old balanced Budget discipline needs to be restored: the secret of practical economic success, as overseas experience confirms, is the acceptance of known rules. Rules rule: OK?" (Lawson 1992: 66-67). This was all declared in the streetwise idiom of the time, and attracted publicity accordingly. But what we see here is surely an over-arching priority for rules over discretion. And the problem of *which* rules to choose is really a second-order issue.

Lawson was clear on the need to challenge a Keynesian concentration on employment and output. "The key is to abandon the attempt to set 'real' variables – objectives for real economic growth, full employment or whatever – and instead to define objectives in money terms" (Lawson 1992: 416). In this version of monetarism, there were four candidates for which a nominal target could be chosen as the governing principle: either GDP; or the money supply; or the price level; or the exchange rate. Lawson acknowledges a case for money supply – the Chicago doctrine at the time of course. "But it can never be an automatic pilot", he argues. "Judgement is always required: in selecting the monetary rule, in deciding how to enforce it, and in assessing when short-term departures in either direction are acceptable" (Lawson 1992: 417). This seems to license a degree of discretion here, which in turn suggests that rigid adherence to public targets for any particular definition of money supply is not the real point. GDP and the price level also meet his objections. Residually, Lawson suggests that exchange rate has some advantage. Hence his conclusion: "It is obvious that

an exchange-rate objective is monetarism at one remove; and that is indeed its attraction" (Lawson 1992: 419).

This is the logic that led someone who was by no means an enthusiast for the European project to advocate British membership of the ERM at this time, thus locking sterling to an exchange rate that was in reality (as Lawson perceived) a proxy for the German DM. Hence his argument that Thatcher's veto on British entry to ERM in the mid-1980s made errors more likely, especially, in not checking a domestic inflationary boom that his own discretion at the Treasury was evidently incapable of controlling (Lawson 1992: 503-504).

Moreover, this option for a rules-based policy remains consistent with Lawson's over-arching faith, as expressed demotically ten years previously: "Rules Rule, OK". Not just in monetary but in fiscal policy too. As he puts it: "I took advantage of the strong fiscal position in 1988 to reinstate the doctrine of a balanced Budget" (Lawson 1992: 811). This was to be applied over the economic cycle. Moreover, faced with explaining the rapid deterioration of the British overseas trade figures on his watch, he also takes the opportunity to add an interesting historical comment – or rather a nostalgic sigh – that in the golden era before 1914 no British Chancellor of the Exchequer "lost any sleep over the balance of payments" (Lawson 1992: 857). And the reason for this now strikes him as instructive – it was because of the gold standard's historic role in "providing an invaluable financial discipline" (Lawson 1992: 911).

The inference is that, with a fixed exchange rate, and with a balanced-budget mantra at the Exchequer, the primacy of rules over discretion would be – or would have been – within grasp. Here was Lawson's proposed counter-revolution to the Keynesian orthodoxies that had allegedly led not only Britain but much of the western world astray by the 1970s. In fairness, I should also add a final quotation from Lawson which, not for the first time, shows him pragmatically covering himself from the charge that he was simply an ideologue who had forgotten everything and learnt nothing. "On the other hand", he adds, "had the circumstances arisen, the counter-revolutionary approach was meant to be as vigilant as Keynes could have desired in fighting off any cumulative contraction of national or global income" (Lawson 1992: 422). Such vigilance would indeed have been welcome in large parts of southern Europe in recent years.

Let me offer my own summary of what I think we can learn from this account of Lawson's progression. For it surely exemplifies a search for the kind of rules that would justify the faith that was then invested in them as a policy guide. It did not depend on a prior revelation of some infallible principle that was to be adopted on its own intrinsic merit as true; instead we have the view that *rules in themselves* constitute a benign discipline, with the

implication that discretion is likely to be abused and to license bad practice and bad results. In short, it is a consequential test, rather like the Voltairean advocacy of Christian doctrine, not because it was revealed truth but because, if it was widely enough believed, it would serve as useful restraint upon the ignorant passions of the great unwashed.

In focusing on policy, it is surely appropriate to cite the thinking of an actual policy-maker in the contemporary world. One valid point, to which I shall return, is indeed the sort of retrospective fellow-feeling Lawson exhibits for his distant predecessors as policy-makers in the British Treasury and Bank of England, in the era in which Keynes lived. But the policy issue of rules and discretion, of course, has also been a staple of economic theory, in terms which also require attention.

A sophisticated theoretical approach to some of the underlying issues can be found in the writings of H.C. Simons, often hailed as the doyen of the Chicago school, with its later fame as the monetarist nemesis of Keynesian economics. Simons, who was to die in 1946 at only 47 years of age, is remembered in particular for an article, published ten years previously, "Rules versus authorities in monetary policy". I am not going to attempt to recapitulate the debate to which it influentially contributed, nor to reproduce Simons's own scrupulous arguments, weighing alternative policy options.

The key point, I suggest, is again the mindset with which Simons approached what he saw as a crucial problem. He did so self-consciously proclaiming himself "a liberal". He sometimes writes of a liberal viewpoint or position or policy; alternatively of a liberal strategy or system; but more often of liberal principles, the liberal creed or (most prominently) the liberal faith. And the issue he addressed, defined as rules versus authorities, is one that he thought of as a crucial test and exemplar of this faith. This sense of liberalism is plainly what we generally call economic liberalism, with a declared free-market orientation. Thus at the outset: "The liberal creed demands the organization of our economic life largely through individual participation in a game with definite rules" (Simons 1936: 1). Simons regretted that "we seem largely to have lost sight of the essential point, namely, that definite, stable, legislative rules of the game as to money are of paramount importance to the survival of a system based on freedom of enterprise" (Simons 1936: 3).

Writing at a fraught moment during the American depression, he did not deplore pragmatic government intervention as such nor simply defend traditional orthodoxies. And it would be anachronistic to suppose that, like a conjuror, he produced a Chicago-style monetarist rabbit out of the hat by simply demanding a rule to fix the quantity of money in circulation. Instead: "With all its merits, however, this rule cannot now be recommended

as a basis for monetary reform" (Simons 1936: 5). As he put it in the context of 1936, "the writer feels that his earlier attraction to the merits of the rule of a fixed quantity of money was fundamentally correct, although the scheme is obviously too simple as a prescription under anything like present conditions" (Simons 1936: 16).

His priority, in short, is not to give partisan support to his particular team in a competition but to frame the terms on which the competition would take place. "In a free-enterprise system we obviously need highly definite and stable rules of the game, especially as to money", he argues. And once these monetary rules are established, "they should work mechanically, with the chips falling where they may". The problem was "to design and establish with the greatest intelligence a monetary system good enough so that, hereafter, we may hold to it unrationally – on faith as a religion, if you please" (Simons 1936: 13-14). Back to Voltaire, in short.

Simons reiterates this claim in measured terms later. "That the old moral prohibitions have lost their force is here not altogether an occasion for regret", he concedes. "But we cannot get along without some such rules – without some moral sanctions and mandates which politicians must obey in matters of finance" (Simons 1936: 25). The ghastly alternative is that the necessary decisions should be left in the hands of the monetary authorities, which would thus be "(Heaven forbid!) obliged to use discretion"; and such discretionary action is characterised as "dictatorial, arbitrary", without further argument (Simons 1936: 5 and 13n.). In the era of the dictators, this spoke to Simons's own lively fears. So the case for *rules* is axiomatically the case against *discretion*.

Simons's article of 1936 is hailed by Herbert Stein in *The New Palgrave* as an "essay whose title defined the issue for years to come" (Eatwell, Milgate and Newman 1987, 4: 334). And the essay's title, as we have seen, could equally well have been expressed as "rules versus discretion", in a way that is entirely consistent with Simons's own declared intention. Keynes, if only as the editor of the *Economic Journal*, would naturally have become well aware that the issue had become polarised in these terms.

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It is little surprise, then, that Keynes himself explicitly adopted such language in his proposals, formulated as early as 1941, for the creation of an international clearing union. This is part of a complex debate over the shape of a postwar international monetary system which I will not explore here except to note this one particular point about the options as they seemed at the time. Compared with a national bank within a closed system, in an *international* bank "more must be settled by rules and by general

principles agreed beforehand and less by day-to-day discretion", Keynes wrote in December 1941. "Perhaps the most difficult question to determine, is how much to decide by rule and how much by discretion". And this led him to a general maxim: "If rule prevails, the scheme can be made more water-tight theoretically. If discretion prevails, it may work better in practice". And at this point he declared that he was now veering to the side of discretion in this context, as against, in his earlier drafts, an inclination towards rules [Keynes 2013 (1980) 25: 73].

The general problem, as he identified it, in seeking to devise radically new ways of dealing with international transactions and settlements, was to replace a system that exerted a contractionist pressure on world trade with a new one that would exert an expansionist pressure. He reiterated this point slightly later, at the end of January 1942. By this point, the United States was in the war and Anglo-American negotiations were in progress, not only about Roosevelt's visionary proposal for Lend-Lease to support the British war effort, but already about postwar reconstruction – prospects that were still very far distant.

It was in this context that Keynes reiterated his essential point (which I have just quoted) on the rules-discretion trade-off, posing the theoretical beauty of rules as against the practical advantages of discretion. He now added by way of comment: "Only by collective wisdom and discussion can the right compromise be reached between law and licence". And he also added, more specifically, that his proposal for a clearing union "differs in one important respect from the pre-war system because it aims at putting some part of the responsibility for adjustment on the creditor country as well as on the debtor" [Keynes 2013 (1980) 25: 117].

It was partly the rigidity of laying down precise rules in advance that made him wary of how they might be applied in practice. And he also made an appeal to a collective good that could be achieved through some surrender of national sovereignty, by inviting "the member states and groups to abandon that licence to promote indiscipline, disorder and bad-neighbourliness which, to the general disadvantage, they have been free to exercise hitherto" [Keynes 2013 (1980) 25: 131]. Since he had explicitly pointed out that it was only the pre-war *creditor* countries that had been able to exercise any such licence, in effect he was identifying the 'bad neighbours' as those countries that had previously hoarded their own gold reserves, to the detriment of the general good. France had sought to do this; but the vast accumulating gold reserves of the United States, as the great interwar creditor country, were on another scale (Carabelli and Cedrini 2014: 118-125).

Obviously the pre-war system that Keynes disparaged in 1942, and explicitly wished to replace, was that of the gold standard. And he was concerned to understand the way it had worked – or failed to work – from

the the mid-1920s to the mid-1930s, when the system virtually collapsed in face of a worldwide slump of which the gold standard had arguably been one cause. Keynes himself had been identified as a prominent public critic of Britain's return to gold, ever since Churchill as Chancellor of the Exchequer took this step in 1925. Thus when the British Ministry of Information, in its attempts in 1940 to respond to German propaganda about a (Schachtian) 'New Order' for the European economy, approached Keynes for comment, he responded with some under-statement: "Well, obviously I am not the man to preach the beauties and merits of the pre-war gold standard" [Keynes 2013 (1980) 25: 2].

Indeed not. But by then he was by no means alone. By this time, the gold standard had relatively few admirers of its beauties and merits. It is worth noting that even Simons, in his 1936 commendation of rules, had commented: "it is to the writer a source of continued amazement that so many people of insight should hold unwaveringly to the gold standard as the best foundation of national policies (Simons 1936: 11). The general case for rules, then, did not in principle stand or fall by the particular example of the gold standard; and perhaps the Chicago school's famous quest for a *monetarist* embodiment of a rule-based system was one indication of this. But that is not a suggestion that I shall pursue any further at present.

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Instead, my focus in the rest of this paper is on the example of the gold standard as the prime historical monument to a rules-based system. True, there was a natural affinity with two other hallowed doctrinal commitments: that free trade was the concomitant of an international gold standard in external policy, and that the national budget must always be balanced. Here was a holy trinity of verities that had been established in Britain since the time of Gladstone, the revered Liberal Prime Minister and Chancellor of the Exchequer who, from the 1850s to the 1890s, had not only held both posts intermittently but sometimes held both together. These verities, I suggest, depended less upon economic theory than upon the heavily moralised maxims of a particular kind of Gladstonian 'common sense' (Clarke 2015: 18-25). This was the orthodoxy upon which the financial authorities in Britain – the Treasury, working with Bank of England – faithfully based their policies in the era in which Keynes came to maturity.

Now the young Keynes, aged thirty-one, was himself recruited to the Treasury in 1915 and remained there during the First World War, subsequently resigning in 1919 over the terms of the Versailles peace treaty. Previously barely known outside Cambridge, he thus became a significant figure in Whitehall, the administrative hub of British government. It was his

book *The Economic Consequences of the Peace*, published at the end of 1919, that then suddenly transformed him into an internationally renowned pundit, with his views widely publicised: first in denouncing the scale of reparations upon Germany, then in arguing for stimulus measures to tackle unemployment in Britain, and, even more, in criticising Winston Churchill's decision, as Chancellor of the Exchequer in 1925, to put Britain back on the gold standard. In short, we see the emergence of the Keynes whom we know and recognise: the Keynes who contested the economic orthodoxies of the day and their rules-based precepts. But if Keynes thus became the arch-critic, it was of a system that he had known as an insider and indeed as a believer.

Keynes's first contact with the Treasury had been in August 1914. Still a junior Cambridge don at that point, he was hurriedly recruited for advice in the fast-developing war crisis, through a personal contact with a well-placed civil servant. In the event, Keynes's advice was adopted by the Chancellor of the Exchequer himself. This was David Lloyd George, a left-wing Liberal, the second man in the government, a dynamic figure and a quick learner – just as well for a Chancellor with so much to learn so quickly at this moment, notably about a subject on which young Keynes had already made himself an expert. Keynes thus had his chance to comment on the crucial issue of whether to suspend 'specie payment'. This would have meant, in effect, defaulting on obligations under the gold standard in the face of the war emergency. In fact, this was already happening all over Europe.

In this peculiar situation – a sudden crisis, a need for immediate action, an initially uninstructed Chancellor – Keynes became instrumental in giving advice that Britain should *not* freeze its international gold reserves. Instead, specie payment should be honoured. The behaviour of the high-street banks in already refusing to pay out gold to their customers, thus making them queue up at the Bank of England instead, was to be publicly termed a "shameful sight" by Keynes, resorting here to the language of moral repugnance [Keynes 2013 (1983) 11: 254]. The Bank of England itself continued to pay out gold; specie payment was maintained externally, while paper currency was printed for internal circulation, thus introducing 'fiat money'. But Britain, unlike almost every other country, did not lock up its own international gold reserves. Hence Keynes's proud, patriotic public boast: "The Bank of England alone met the international catastrophes of August, 1914, without suspending specie payments and without availing herself of emergency privileges" [Keynes 2013 (1983) 11: 278]. For Keynes, "the vital point is that we should not repudiate our external obligations to pay gold, until it is physically impossible for us to fulfil them" [Keynes 2013 (1983) 16: 13].

Keynes, soon himself a Treasury official with responsibility for Britain's external payments, maintained this position throughout the war. A memorandum he wrote in January 1917, before the United States became a belligerent, conveys his steadfast moral commitment to maintaining Britain's stance. "In the past we have made a fetish of the gold standard", he writes, with full approval. "We have taken immense pride in it and constantly proclaimed to the world that it is the cornerstone of our policy". And he still insists that this is correct, above all in maintaining confidence. To abandon gold, he suggests, "is gravely injurious to our credit; and it affords encouragement to the enemy". He concludes accordingly with the remarkable words: "It is not so much a possible policy for deliberate adoption, as the symptom, if it occurs, of a grave disease" [Keynes 2013 (1983) 16: 222].

My point is that these are not simply economic arguments for the expediency of one policy option as against another. They surely suggest a much deeper moral commitment to playing by the rules in an honourable way. We might ask, did he always insist that it was right to obey general rules? Scholars of his early beliefs, on which he wrote himself with beguiling but misleading literary artifice, have shown that his own philosophical position was highly sophisticated. In particular, he confronted the issue of rules by acknowledging their general social utility but also by claiming an individual's right to judge personally and, if necessary, disobey on the grounds of conscience. His own refusal in principle to submit to military conscription in 1916 was argued on this moral basis; yet in 1917 he seemed to grant rules some higher kind of legitimacy when applied to the gold standard. Admittedly, participation in the gold standard could be considered different because it was optional; only the members who have chosen to join a club are bound by its rules. But opting to resign from a club is not normally described as the symptom of a grave disease.

The legitimacy of rules surely rests on an implicit assumption that the rules are fair, and that they bear equally and equitably upon all the parties concerned. At what point the gold standard failed to meet this test in Keynes's eyes is perhaps the real question. In answering it, I must admit that I have been impressed by the arguments of Anna Carabelli and Mario Cedrini, in particular, in giving enhanced significance to what Keynes wrote in the *Economic Consequences of the Peace* in 1919; especially to his abiding concern with the organic interdependence of all the European countries, rather than fallaciously supposing them as engaged in a zero-sum game between winners and losers (Carabelli and Cedrini 2014: 101-102, 107).

Nor should it be forgotten – Keynes himself was keenly aware of this – that, in economic terms at least, Britain was suddenly among the losers. In surrendering its long-run financial supremacy as a creditor country to the United States, Britain lost its pre-1914 status as the hegemon of this system,

in effect able to impose British prices upon the whole world. This had always seemed so effortless – at least, to well-placed bankers in London, or to elite Treasury officials, or even to Cambridge dons, sipping their morning tea in bed. When Britain returned to the gold standard in 1925, it did so as yet another debtor country that had to obey the rules as interpreted by the only country that could now call the shots.

Keynes had put his point a couple of years previously. In hoarding gold inflows instead of stemming them by lowering interest rates, the United States was only *pretending* to play by the rules. "*In fact* it has established a dollar standard; and, instead of ensuring that the the value of the dollar shall conform to that of gold, it makes provision, at great expense, that the value of gold shall conform to that of the dollar. This is the way by which a rich country is able to combine new wisdom with old prejudice" [Keynes 2013 (1923) 4: 155]. Back on gold, then, British prices now had to follow the dollar. Welcome to the American century!

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As Keynes's career illustrates, his economic insights were often generated by real-world problems that he saw around him. The link between policy and analysis was unusually close in his case, and often with a symbiotic effect, not simply a process of deriving policy options from pre-existing theoretical axioms. Austin Robinson, who worked with Keynes closely as a supportive junior colleague through two decades, wrote in his obituary essay published in 1946 in the *Economic Journal*: "never, so far as I remember, did Keynes in late life devise an economic tool purely for its own sake rather than to solve an immediate practical problem in the application to government of the problems of economic analysis; his absorbing interest in politics and government made Keynes, in the very best sense of those words, a political economist" (Robinson 1947: 10).

It is in the inter-war debates about the gold standard that we can find significant manifestations of Keynes's disillusion with a system that purported to be simultaneously *neutral* in its impact on each participating country and *benign* in its capacity to foster the prosperity of all. He certainly ceased to invest the gold standard and financial orthodoxy with any moral claims, writing scathingly in 1923 that

> many conservative bankers regard it as more consonant with their cloth, and also as economising thought, to shift public discussion of financial topics off the logical on to an alleged 'moral' plane, which means a realm of thought where vested interest can be triumphant over the common good without further debate [Keynes 2013 (1923) 4:57].

Keynes's political philosophy, as he self-consciously declared it in 1926, made a repudiation of laissez-faire. "The world is *not* so governed from above that private and social interests always coincide", he wrote. "It is *not* so managed here below that in practice they coincide. It is *not* a correct deduction from the principles of economics that enlightened self-interest always operates in the public interest" [Keynes 2013 (1931) 9: 287-288]. But this simply set the parameters for the pragmatic task of reforming the market system. "For my part I think that capitalism, wisely managed, can probably be made more efficient for attaining economic ends than any alternative system yet in sight, but that in itself it is in many ways extremely objectionable" [Keynes 2013 (1931) 9: 294]. Keynes thus remained a liberal, but of a very different stripe from H.C. Simons, with his priority of a rule-bound, free-market system.

Now one of the essential virtues claimed for the gold standard was indeed the priority of rules, understood in a sense that Keynes himself helped to establish. Here is what he wrote in 1925 in his polemical pamphlet, 'The economic consequences of Mr Churchill':

> The Bank of England is *compelled* to curtail credit by all the rules of the gold standard game. It is acting conscientiously and 'soundly' in doing so. But this does not alter the fact that to keep a tight hold on credit – and no one will deny that the Bank is doing that – necessarily involves intensifying unemployment in the present circumstances of this country... Deflation does not reduce wages 'automatically'. It reduces them by causing unemployment [Keynes 2013 (1931) 9: 220].

We see here a very different view of the gold standard from that taken by Keynes in his Treasury years, and one identifying three salient features. First, then, it was a country in deficit that *had* to act; it was a country in surplus that could *choose* to act. This is fundamental. A creditor country might choose to act as a good neighbour, following a course of enlightened self-interest that fostered expansionist tendencies; or it might not, thus forcing any debtor country into measures of contractionist effect. Seen through Keynes's British spectacles, it often seemed that Britain had duly fulfilled its previous hegemonic role in its days of power whereas the United States had inherited the power without choosing to fulfil the responsibilities. Secondly, the supposed automacity of a rules-based system in achieving necessary adjustments is challenged by Keynes's stark identification of the actual impact of the mechanisms involved. Thirdly, Keynes points to both the social inequity and to the economic inefficiency of this process. These are rules that inflict heavy penalties; yet they have to be accepted by a debtor country.

This pamphlet of 1925 seems to be the origin of the term 'rules of the game' as applied to the gold standard, especially in the sense of an obligation on a creditor country not to hoard gold surpluses but to recycle them

(through foreign investment). It was a usage reinforced in evidence later given to a government inquiry, the Macmillan Committee on Finance and Industry, of which Keynes was a leading member. "You so conduct your affairs that you tend neither to gain not to lose large quantities of gold", was how Keynes glossed 'the rules of the game' in 1930 [Keynes 2013 (1981) 20: 42]. And it was now that he was permitted, in effect, to lead the committee through an informal seminar on how the gold standard actually worked. His exposition became canonical. The leading orthodox economist on the committee (Professor Theodore Gregory) simply added: "I accept everything that Mr Keynes has said, but I should like to emphasise that this is not only a beautiful series of assumptions, but assumptions which translated into action have worked" [Keynes 2013 (1981) 20: 54].

Whether they had in fact worked, at least for Britain since it returned to gold in 1925, was really the point. The problem had been to bring down British prices; and nobody questioned Keynes's statement that "the essence of our actual situation is that you have no corrective other than Bank rate" [Keynes 2013 (1981) 20: 43]. The next step was inexorable. "There is no way by which Bank rate brings down prices except through increase of unemployment", Keynes explained. "It brings down prices by causing enterprises to sell at a loss, but it does not bring them down to the equilibrium price level except by operating through unemployment" [Keynes 2013 (1981) 20: 49-50]. This process was "of the essence of the classical theory which, as I say, no one would deny before the War", he argued; and he himself met no denial now in expounding this historic doctrine [Keynes 2013 (1981) 20: 51]. "You see what a very good doctrine it is", Keynes claimed, somewhat archly, "because the completely harmonious disposition of the economic forces of the world is preserved merely by the Bank of England changing the Bank rate from time to time in an appropriate way and leaving all the rest to the operation of *laissez faire*" [Keynes 2013 (1981) 20: 53].

And had it done the trick, here and now, since 1925? Manifestly not. There was no dissent when Keynes said that Britain was now further off equilibrium after five years of the prescribed medicine. "I would not put forward the United States as the main criminal, except for short periods", he said. "It was, really, the return to the gold standard in many other countries which caused them to behave just as we have; they were struggling to deflate. That is the root cause of the situation" [Keynes 2013 (1981) 20: 57].

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In a competitive race to the bottom, there were thus no winners, just a reinforcement of the contractionary forces endemic in the system itself: the many losers unable to act otherwise. Keynes did not have our economic

terminology about 'policy space' at his disposal in 1930; but I do not think it is anachronistic to infer that he was already thinking of a successful international system as "one which establishes its 'rules of the game' on the need to enlarge, rather than restrict, national autonomy and policy space" (Carabelli and Cedrini 2010: 320).

And this the gold standard failed to do. Its failure was most dramatically signalled in the 1930s by the successive abandonment of gold by Britain in 1931 and by the United States in 1933 – first by the old and then by the new hegemonic power in the functioning of this system. As the newly-inaugurated President Roosevelt put it, it was time to reject the "old fetishes of the so-called international bankers". Many Europeans, hearing this, were shocked and disapproving; so in hailing Roosevelt as "magnificently right", Keynes found himself a lonely voice in commending the rationality of this step. "The Treasury and the Bank of England have depended on their sense of smell alone", he wrote [Keynes 2013 (1982) 21: 273-275]. Perhaps he meant that they had only used their discretion in order to follow the wrong rules, and were then forced to dissimulate about the consequences.

For until the eve of the Second World War, the authorities in Britain, unlike the USA, continued to pretend that they had been forced off the gold standard and were eager to return to it. It was a story that failed to impress the economists of the League of Nations in 1938, since in practice it was obvious how much Britain benefited from its new ability to keep the exchange rate of sterling low enough for domestic recovery (Clavin 2013: 214). The official line was still that the authorities abhorred having to exercise such discretion (Heaven forbid!) and simply pined for the old rules of the game to be reinstated. Britain was able, for the moment, to enjoy the luxury of such hypocrisy. Other countries have not been so lucky in our own era, when the national dilemmas created by the euro sometimes look all too similar to those created by the old gold standard, with Germany as the new master – or mistress – of the situation (e.g. Stiglitz 2016: 187). In this context, that of the world that we now live in, the debate over rules and discretion is surely one in which Keynes's views retain their relevance today.

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