New Deal Documents

An Open Letter to President Roosevelt

John Maynard Keynes, *New York Times*, 1933

Dear Mr President,

You have made yourself the Trustee for those in every country who seek to mend the evils of our condition by reasoned experiment within the framework of the existing social system. If you fail, rational change will be gravely prejudiced throughout the world, leaving orthodoxy and revolution to fight it out. But if you succeed, new and bolder methods will be tried everywhere, and we may date the first chapter of a new economic era from your accession to office. This is a sufficient reason why I should venture to lay my reflections before you, though under the disadvantages of distance and partial knowledge.

At the moment your sympathisers in England are nervous and sometimes despondent. We wonder whether the order of different urgencies is rightly understood, whether there is a confusion of aim, and whether some of the advice you get is not crack-brained and queer. If we are disconcerted when we defend you, this may be partly due to the influence of our environment in London. For almost everyone here has a wildly distorted view of what is happening in the United States. The average City man believes that you are engaged on a hare-brained expedition in face of competent advice, that the best hope lies in your ridding yourself of your present advisers to return to the old ways, and that otherwise the United States is heading for some ghastly breakdown. That is what they say they smell. There is a recrudescence of wise head-waging by those who believe that the nose is a nobler organ than the brain. London is convinced that we only have to sit back and wait, in order to see what we shall see. May I crave your attention, whilst I put my own view?

You are engaged on a double task, Recovery and Reform;--recovery from the slump and the passage of those business and social reforms which are long overdue. For the first, speed and quick results are essential. The second may be urgent too; but haste will be injurious, and wisdom of long-range purpose is more necessary than immediate achievement. It will be through raising high the prestige of your administration by success in short-range Recovery, that you will have the driving force to accomplish long-range Reform. On the other hand, even wise and necessary Reform may, in some respects, impede and complicate Recovery. For it will upset the confidence of the business world and weaken their existing motives to action, before you have had time to put other motives in their place. It may over-task your bureaucratic machine, which the traditional individualism of the United States and the old "spoils system" have left none too strong. And it will confuse the thought and aim of yourself and your administration by giving you too much to think about all at once.

Now I am not clear, looking back over the last nine months, that the order of urgency between measures of Recovery and measures of Reform has been duly observed, or that the latter has not sometimes been mistaken for the former. In particular, I cannot detect any material aid to recovery in N.I.R.A., though its social gains have been large. The driving force which has been put behind the vast administrative task set by this Act has seemed to represent a wrong choice in the order of urgencies. The Act is on the Statute Book; a considerable amount has been done towards implementing it; but it might be better for the present to allow experience to accumulate before trying to force through all its details. That is my first reflection--that N.I.R.A., which is essentially Reform and probably impedes Recovery, has been put across too hastily, in the false guise of being part of the technique of Recovery.

My second reflection relates to the technique of Recovery itself. The object of recovery is to increase the national output and put more men to work. In the economic system of the modern world, output is primarily produced <u>for sale</u>; and the volume of output depends on the amount of purchasing power, compared with the prime cost of production, which is expected to come n the market. Broadly speaking, therefore, and increase of output depends on the amount of purchasing power, compared with the prime cost of production, which is expected to come on the market. Broadly speaking, therefore, an increase of output cannot occur unless by the operation of one or other of three factors. Individuals must be induced to spend more out o their existing incomes; or the business world must be induced, either by increased confidence in the prospects or by a lower rate of interest, to create additional current incomes in the hands of their employees, which is what happens when either the working or the fixed capital of the country is being increased; or public authority must be called in aid to create additional current incomes through the expenditure of borrowed or printed money. In bad times the first factor cannot be expected to work on a sufficient scale. The second factor will come in as the second wave of attack on the slump <u>after</u> the tide has been turned by the expenditures of public authority. It is, therefore, only from the third factor that we can expect the initial major impulse.

Now there are indications that two technical fallacies may have affected the policy of your administration. The first relates to the part played in recovery by rising prices. Rising prices are to be welcomed because they are usually a symptom of rising output and employment. When more purchasing power is spent, one expects rising output at rising prices. Since there cannot be rising output without rising prices, it is essential to ensure that the recovery shall not be held back by the insufficiency of the supply of money to support the increased monetary turn-over. But there is much less to be said in favour of rising prices, if they are brought about at the expense of rising output. Some debtors may be helped, but the national recovery as a whole will be retarded. Thus rising prices caused by deliberately increasing prime costs or by restricting output have a vastly inferior value to rising prices which are the natural result of an increase in the nation's purchasing power.

I do not mean to impugn the social justice and social expediency of the redistribution of incomes aimed at by N.I.R.A. and by the various schemes for agricultural restriction. The latter, in particular, I should strongly support in principle. But too much emphasis on the remedial value of a higher price-level as an object in itself may lead to serious misapprehension as to the part which prices can play in the technique of recovery. The stimulation of output by increasing aggregate purchasing power is the right way to get prices up; and not the other way round.

Thus as the prime mover in the first stage of the technique of recovery I lay overwhelming emphasis on the increase of national purchasing power resulting from governmental expenditure which is financed by Loans and not by taxing present incomes. Nothing else counts in comparison with this. In a boom inflation can be caused by allowing unlimited credit to support the excited enthusiasm of business speculators. But in a slump governmental Loan expenditure is the only sure means of securing quickly a rising output at rising prices. That is why a war has always caused intense industrial activity. In the past orthodox finance has regarded a war as the only legitimate excuse for creating employment by governmental expenditure. You, Mr President, having cast off such fetters, are free to engage in the interests of peace and prosperity the technique which hitherto has only been allowed to serve the purposes of war and destruction.

The set-back which American recovery experienced this autumn was the predictable consequence of the failure of your administration to organise any material increase in new Loan expenditure during your first six months of office. The position six months hence will entirely depend on whether you have been laying the foundations for larger expenditures in the near future.

I am not surprised that so little has been spent up-to-date. Our own experience has shown how difficult it is to improvise useful Loan-expenditures at short notice. There are many obstacle to be patiently overcome, if waste, inefficiency and corruption are to be avoided. There are many factors, which I need not stop to enumerate, which render especially difficult in the United States the rapid improvisation of a vast programme of public works. I do not blame Mr Ickes for being cautious and careful. But the risks of less speed must be weighed against those of more haste. He must get across the crevasses before it is dark.

The other set of fallacies, of which I fear the influence, arises out of a crude economic doctrine commonly known as the Quantity Theory of Money. Rising output and rising incomes will suffer a set-back sooner or later if the quantity of money is rigidly fixed. Some people seem to infer from this that output and income can be raised by increasing the quantity of money. But this is like trying to get fat by buying a larger belt. In the United States to-day your belt is plenty big enough for your belly. It is a most misleading thing to stress the quantity of money, which is only a limiting factor, rather than the volume of expenditure, which is the operative factor.

It is an even more foolish application of the same ideas to believe that there is a mathematical relation between the price of gold and the prices of other things. It is true that the value of the dollar in terms of foreign currencies will affect the prices of those goods which enter into international trade. In so far as an over-valuation of the dollar was impeding the freedom of domestic price-raising policies or disturbing the balance of payments with foreign countries, it was advisable to depreciate it. But exchange depreciation should follow the success of your domestic price-raising policy as its natural consequence, and should not be allowed to disturb the whole world by preceding its justification at an entirely arbitrary pace. This is another example of trying to put on flesh by letting out the belt.

These criticisms do not mean that I have weakened in my advocacy of a managed currency or in preferring stable prices to stable exchanges. The currency and exchange policy of a country should be entirely subservient to the aim of raising output and employment to the right level. But the recent gyrations of the dollar have looked to me more like a gold standard on the booze than the ideal managed currency of my dreams.

You may be feeling by now, Mr President, that my criticism is more obvious than my sympathy. Yet truly that is not so. You remain for me the ruler whose general outlook and attitude to the tasks of government are the most sympathetic in the world. You are the only one who sees the necessity of a profound change of methods and is attempting it without intolerance, tyranny or destruction. You are feeling your way by trial and error, and are felt to be, as you should be, entirely uncommitted in your own person to the details of a particular technique. In my country, as in your own, your position remains singularly untouched by criticism of this or the other detail. Our hope and our faith are based on broader considerations.

If you were to ask me what I would suggest in concrete terms for the immediate future, I would reply thus.

In the field of gold-devaluation and exchange policy the time has come when uncertainty should be ended. This game of blind man's buff with exchange speculators serves no useful purpose and is extremely undignified. It upsets confidence, hinders business decisions, occupies the public attention in a measure far exceeding its real importance, and is responsible both for the irritation and for a certain lack of respect which exists abroad. You have three alternatives. You can devalue the dollar in terms of gold, returning to the gold standard at a new fixed ratio. This would be inconsistent with your declarations in favour of a long-range policy of stable prices, and I hope you will reject it. You can seek some common policy of exchange stabilisation with Great Britain aimed at stable price-levels. This would be the best ultimate solution; but it is not practical politics at the moment unless you are prepared to talk in terms of an initial value of sterling well below $5 pending the realisation of a marked rise in your domestic price-level. Lastly you can announce that you will definitely control the dollar exchange by buying and selling gold and foreign currencies so as to avoid wide or meaningless fluctuations, with a right to shift the parities at any time but with a declared intention only so to do either to correct a serious want of balance in America's international receipts and payments or to meet a shift in your domestic price level relatively to price-levels abroad. This appears to me to be your best policy during the transitional period. In other respects you would regain your liberty to make your exchange policy subservient to the needs of your domestic policy--free to let out your belt in proportion as you put on flesh.

In the field of domestic policy, I put in the forefront, for the reasons given above, a large volume of Loan-expenditures under Government auspices. It is beyond my province to choose particular objects of expenditure. But preference should be given to those which can be made to mature quickly on a large scale, as for example the rehabilitation of the physical condition of the railroads. The object is to start the ball rolling. The United States is ready to roll towards prosperity, if a good hard shove can be given in the next six months. Could not the energy and enthusiasm, which launched the N.I.R.A. in its early days, be put behind a campaign for accelerating capital expenditures, as wisely chosen as the pressure of circumstances permits? You can at least feel sure that the country will be better enriched by such projects than by the involuntary idleness of millions.

I put in the second place the maintenance of cheap and abundant credit and in particular the reduction of the long-term rates of interest. The turn of the tide in great Britain is largely attributable to the reduction in the long-term rate of interest which ensued on the success of the conversion of the War Loan. This was deliberately engineered by means of the open-market policy of the Bank of England. I see no reason why you should not reduce the rate of interest on your long-term Government Bonds to 2½ per cent or less with favourable repercussions on the whole bond market, if only the Federal Reserve System would replace its present holdings of short-dated Treasury issues by purchasing long-dated issues in exchange. Such a policy might become effective in the course of a few months, and I attach great importance to it.

With these adaptations or enlargements of your existing policies, I should expect a successful outcome with great confidence. How much that would mean, not only to the material prosperity of the United States and the whole World, but in comfort to men's minds through a restsration of their faith in the wisdom and the power of Government!
With great respect,
Your obedient servant
J M Keynes