Chapter 4

THE NEW DEAL

Keynes's guest for the Founder's Feast at King's College, Cambridge on 6 December 1933 was Felix Frankfurter, then Professor of Administrative Law at Harvard, who was spending the year as a visiting professor at Oxford. During Frankfurter's visit to Cambridge, the two men talked of Keynes's writing a letter of advice to President Roosevelt. Keynes agreed to write an open letter to the President which he would send to him via Frankfurter before publication. Keynes then made arrangements for the letter to appear in *The New York Times* on 31 December. He also offered *The Times* of London a shortened version for publication on 2 January.

From The New York Times, *31 December 1933*

London, December 30

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.

Opinion in England

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 aims, and whether some of the advice you get is not crack-brained and queer.

If we are disconcerted when we defend you, this is partly due to the influence of our environment in London. For almost every one here has a wildly distorted view of what is happening in the United States.

The average City man believes 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. This is what they say they smell.

There is a recrudescence of wise head-wagging by those who believe the nose is a nobler organ than the brain. London is convinced that we only have to sit back and wait to see what we shall see. May I crave your attention, while I put my own view?

The present task

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 its existing motives to action before you have had time to put other motives in their place. It may overtask 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.

N.R.A. aims and results

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, though its social gains are considerable, I cannot detect any material aid to recovery in the N[ational] [Industrial] R[ecovery] A[ct]. 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 toward 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.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 for sale; and the volume 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 of 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 only come in as the second wave of attack on the slump, after 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 insure that the recovery shall not be held back by the insufficiency of the supply of money to support the increased monetary turnover.

The problem of rising prices

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 results 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 the N.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 of the part prices can play in the technique to recovery. The stimulation of output by increasing aggregate purchasing power is the right way to get prices up; and not the other way around.

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 is not merely a transfer through taxation, from existing incomes. Nothing else counts in comparison with this.

Boom, slump and war

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 obtaining 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 government 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 American recovery experienced this past Autumn was the predictable consequence of the failure of your Administration to organize any material increase in new loan expenditure during your first six months of office. The position six months hence will depend entirely 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 to date. Our own experience has shown how difficult it is to improvise useful loan expenditures at short notice. There are many obstacles to be patiently overcome, if waste, inefficiency and corruption are to be avoided. There are many factors 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 Secretary 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 setback 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 today 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 overvaluation 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.

Currency and exchange

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 of the immediate future, I would reply thus:

Constructive criticism

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 exist 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 control the dollar exchange by buying and selling gold and foreign currencies at a definite figure 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 relative to price levels abroad.

The favoured policy

This appears to me your best policy during the transitional period. You would be waiving your right to make future arbitrary changes which did not correspond to any relevant change in the facts, but in other respects you would retain 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 expenditure 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 toward prosperity, if a good hard shove can be given in the next six months. Could not the energy and enthusiasm which launched the N.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.

Plenty of cheap credit

I put in the second place the maintenance of cheap and abundant credit, in particular the reduction of the long-term rate 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 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 $2\frac{1}{2}$ 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 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 restoration of their faith in the wisdom and the power of government!

With great respect,

Your obedient servant,

J. M. KEYNES

From The Times, *2 January 1934*

MR ROOSEVELT'S EXPERIMENTS

Mr Roosevelt has made himself 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 he fails rational change will be gravely prejudiced throughout the world, leaving orthodoxy and revolution to fight it out. But if he succeeds new and bolder methods will be tried everywhere.

It is for this reason, and not merely because we should all like to escape from the slump, that a more than ordinary importance attaches to the outcome of the President's experiments.

At the moment even his sympathisers in England are somewhat disconcerted. They wonder whether the order of different urgencies is rightly understood, whether there is not a confusion of aim, and whether some of the advice he gets is not crack-brained and queer; while the average City man is convinced that the President is engaged on such a hare-brained expedition that, unless he rids himself of his present advisers, the country is heading for a shocking breakdown. Yet I believe that the prevailing British idea is based on a seriously distorted view of what is happening in the United States. In spite of obvious disappointments, I do not see the prospects in a gloomy light.

The position is much complicated by the fact that Mr Roosevelt has been 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 quick results are essential. The second may seem urgent, too, in the eyes of the first liberal Administration in effective power in the United States for many years; but here wisdom of long-range purpose is more necessary than immediate achievement. It will be through raising the prestige of his Administration by success in short-range recovery that the President will gain the driving force to accomplish long-range reform. Moreover, even wise and necessary reform is liable to impede and complicate recovery. For it upsets the confidence of the business world and weakens their motives to action. It may overtask the 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 the Administration by giving them too much to think about all at once.

Some fallacies

Looking back over the last nine months, it seems that the order of urgency between measures of recovery and measures of reform has not been duly observed, and that the latter has sometimes been mistaken for the former. In particular it is hard to detect any material aid to recovery in N[ational] I[ndustrial] R[ecovery] A[ct], though its social gains may be considerable, or in the Securities Act.

Thus too much of the energy of the Administration has been occupied hitherto with reform and too little with recovery. And when we turn to the technique of recovery itself the attainment of the best results has been interfered with by certain fallacies of thought—in particular as 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 turnover. 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. 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.

Increase of output

In the second place, the setback which American recovery experienced this autumn has been the predictable consequence of the failure to organise any material increase in new loan expenditure during the new Administration's first six months of office. Indeed, it seems probable that up to the end of October such expenditure had actually been on a smaller scale than under Mr Hoover. 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 for sale, and the volume 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 of 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 not much can be expected from the first factor. The second factor cannot be relied on in the United States today except to supply a second wave of attack on the slump, after the tide has been turned by the expenditure of public authority. Thus I lay overwhelming emphasis as the prime mover in the first stage of the technique of recovery on the increase of national purchasing power resulting from governmental expenditure financed by loans. Nothing else will count in comparison with this. The position six months hence will mainly depend on whether the foundations have been laid for larger loan 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 expenditure at short notice. There are many obstacles to be patiently overcome if waste, inefficiency, and corruption are to be avoided, and there are special factors which in the United States render the rapid improvisation of a vast programme of public works more than usually difficult. I do not blame Mr Ickes for having been cautious and careful, provided he has made sure that loan expenditure will shortly be incurred on a much larger scale. Everything depends on whether or not this is the case. The latest information suggests that such expenditure is now increasing rapidly. If the substantial increase which first showed itself in November is continued and improved upon in the ensuing months, an unmistakable business improvement will be in full swing before the summer.

A further fallacy of thought, of which one detects the influence, is due to a crude economic doctrine commonly known as the quantity theory of money. Rising output and rising incomes will suffer a setback 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 today the belt is plenty big enough for the 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 price of those goods which enter into international trade. In so far as an overvaluation 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 a 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. To suppose otherwise is another example of trying to put on flesh by letting out the belt. The recent gyrations of the dollar have looked to me more like a gold standard on the booze than the ideal managed currency which I hope for.

Conditions of success

Yet, in spite of these criticisms, the President remains the outstanding statesman who sees the necessity of a profound change of methods and is attempting it without intolerance, tyranny, or destruction. He is feeling his way by trial and error, and is felt to be entirely uncommitted in his own person to the details of a particular technique. Here, as in his own country, his position remains singularly untouched by criticisms of this or the other detail. I have, therefore, some confidence that he will, by trial and error, find his way out. If I were asked to say in concrete terms upon what action in the immediate future his success will chiefly depend, I would reply thus:—

In the field of gold devaluation and exchange policy the time has obviously 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 exist outside the United States. The President has three alternative exits. He can devalue the dollar in terms of gold, returning to the gold standard at a new fixed ratio. But that would be seriously inconsistent with his declarations in favour of a long-range policy of stable prices. He might seek a policy of exchange stabilisation in conjunction with Great Britain aimed at stable price levels for the future by concerted management. This would be the best ultimate solution; but it is not practical politics at the moment, unless he is prepared to talk in terms of an initial value of sterling well below $5 pending the realisation of a marked rise in his domestic price level. Lastly, he could announce that he will control the dollar exchange by buying and selling gold and foreign currencies at a definite figure 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 want of balance in America's international receipts and payments or to meet a shift in the domestic price level relatively to price levels abroad. This is probably the best policy open to him during the transitional period. He would be waiving his right to make future arbitrary changes which did not correspond to any relevant change in the facts; but in other respects he would retain his liberty to make his exchange policy subservient to the needs of his domestic policy—free to let out his belt in proportion as he put on flesh.

In the field of domestic policy I put in the forefront, for the reasons given above, a large volume of loan expenditure under government auspices. 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. The task which the President is attempting is essentially an easy one in the conditions of today.

The interest rate

Finally, there is the maintenance of cheap and abundant credit by the Federal Reserve System, and in particular the reduction of the long-term rate of interest, ready for the expansion of private enterprise as soon as the increase in profits resulting from state expenditure has changed the business atmosphere. 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, deliberately engineered by means of the open-market policy of the Bank of England. I see no reason why the American Treasury should not reduce the rate of interest on their long-term Government bonds to $2\frac{1}{2}$ 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.

With these adaptations or enlargements of the President's existing policies, I should expect a successful outcome with great confidence. I was brought up to think that it is only too easy for a Government to inflate by its expenditures the incomes of its subjects—so easy as to be dangerous. I am still unable to accept the view that this object is so difficult that even a determined Government, ready to use all instruments within reason, will fail to accomplish it. I believe, therefore, that the President is much more likely to succeed than to fail, and that the gloomy views so prevalent in London are the result of an error in prognosis.

Keynes's article in *The Times* brought a critical letter from Ian Macdonald Horobin, a Conservative M.P., suggesting that Keynes's apologia for Roosevelt included open attacks on the N.R.A. and the Securities Act and that many of his other suggestions merely reflected sensible English policies already adopted. Keynes replied.

To the Editor of The Times, *5 January 1934*

Sir,

Mr I. M. Horobin alleges that in my recent article in your columns I 'openly attack the N.R.A. and the Securities Act'. Actually I described these measures as reform but not recovery, adding 'though their social gains may be considerable'. In Mr Horobin's vocabulary to describe a measure as a reform may be to attack it, but it has not this significance in mine.

I am your obedient servant,

J. M. KEYNES

Keynes's January article did have some impact, as a later letter from Walter Lippmann indicates.

From W. LIPPMANN, *17 April 1934*

My dear Keynes,

I have been on the point of writing you for sometime to urge you to write another article, following up your letter to the President of December last. I don't know whether you realise how great an effect that letter had, but I am told that it was chiefly responsible for the policy which the Treasury is now quietly but effectively pursuing of purchasing long-term Government bonds with a view to making a strong bond market and to reducing the long-term rate of interest.

Our greatest difficulty now lies in the President's emotional and moral commitments to the N.R.A. and to the various other measures which he regards as the framework of a better economic order. As they are being administered, they are a very serious check to our recovery, for the obvious reason that they have raised costs faster than production has increased.

Nobody could make so great an impression upon the President as you could if you undertook to show him the meaning of that part of his policy.

With cordial regards,

Yours sincerely,
WALTER LIPPMANN

On 13 January, Keynes made further comments on the American situation in a broadcast which the B.B.C. subsequently published.

From The Listener, *17 January 1934*

ROOSEVELT'S ECONOMIC EXPERIMENTS

The economic experiments of President Roosevelt may prove, I think, to be of extraordinary importance in economic history, because, for the first time—at least I cannot recall a comparable case—theoretical advice is being taken by one of the rulers of the world as the basis of large-scale action. The possibility of such a remarkable event has arisen out of the utter and complete discredit of every variety of orthodox advice. The state of mind in America which lies behind this willingness to try unorthodox experiments arises out of an economic situation desperate beyond precedent.

Although we here feel ourselves to have suffered a pretty severe slump, it is, all the same, hard for us to conceive the pass that things had reached in America a year ago. Unemployment nearly twice as bad as the worst we ever had; the farmers ruined; the banks insolvent; no hope apparent in any direction; and all this only three years after such a pinnacle of pride and prosperity as no other country in the world had ever reached. Moreover, the culminating point of these economic disasters had been reached after a period during which orthodox financial advice and high financial circles of the United States were believed to be exerting great influence over President Hoover and his advisers. This, then, seemed to be the result of following so-called sound opinion. Then, on the top of this, came the financial scandals, which were taken by the general public to discredit the financial leaders morally as much as the ruinous state of affairs had appeared to discredit them intellectually.

It is impossible to appreciate what is now happening in the United States unless one realises this background for the so-called New Deal, with orthodox advice contemptuously rejected and the head of the government turning right away from the financiers and all the so-called practical men to theorists and idealists with little or no experience of affairs.

It is not surprising that some confusion should result. The President himself is not, and does not pretend to be, an economist. Economics, one must confess, is at the moment a backward science, whatever one's hopes are for the future, in which semi-obsolete ideas are widely influential, hardly less in academic circles than elsewhere. It must have been difficult for the President to know in what direction to turn for the best available advice. In practice he has shown himself extraordinarily accessible to anyone with new ideas to air whom he believed to be independent and disinterested. Naturally he had received a great deal of advice, some of it inconsistent with the rest and not all of it of equal quality. Himself an empiricist, not wedded to any particular doctrine or any one technique, tolerant, optimistic, courageous and patient, he has been happy to provide the political skill and the power of authority to give some sort of a run to all kinds of *ideas*, ready to judge by results, but admittedly experimenting and watching carefully to drop in time schemes, the actual operation of which began to seem dangerous or disappointing.

Thus, the President himself has been content with general notions, a conduit pipe for the more general ideas of others, considering quite rightly that detail is not his business. He has not been solely concerned with lifting the United States out of its disastrous slump. He is just as much interested, perhaps even more, in many liberal reforms, some of them long overdue. Above all, he has been deliberately standing for the small man, the employee, the small investor, the small farmer, the bank depositor, the owner of small savings, against high finance and big business. Everyone has felt that this was his general position. That without doubt is the main explanation of the extraordinary popularity which has made him for the moment as powerful a dictator in the United States as any of the other less constitutional dictators of the contemporary world.

It would be a big jog even to run through the headings of the measures already taken to carry the New Deal into law. I can only mention one or two. The National Industrial Recovery Act, or N.R.A., includes such social legislation as, for example, for the abolition of child labour and the regulation of hours. It also tries to provide for organised planning, industry by industry, whilst avoiding the abuses of the trust or the cartel. Apart from this Act there are the measures to help the farmers—provisions for the reduction of their mortgage interest, funds to buy up and hold surplus crops, and inducements to restrict crops where there has been overproduction. Then there are the President's financial measures to enable depositors in insolvent banks to get their money back and to guarantee them against similar losses in future. Help, too, for small investors through the Securities Act, which is largely based on our own legislation for the protection of investors, though in some respects it goes beyond our own Acts.

Most important of all in the short run, and also most dubious and controversial, are the President's monetary measures; partly designed to help the debtor class by raising prices, and partly aimed at curing unemployment. One half of this programme has consisted in abandoning the gold standard, which was probably wise, and in taking various measures—very technical, but, in my opinion, not very useful—to depreciate the gold value of the dollar below its natural level. It is important that monetary arrangements should not hamper business expansion, but it is not easy to bring about business expansion *merely* by monetary manipulation. The other half of his programme, however, is infinitely more important and offers in my opinion much greater hopes. I mean the attempt to cure unemployment by large-scale expenditure on public works and similar purposes. This part of his programme has been very slow to get moving. As recently as the end of October practically nothing had been spent, and as a result of this, employment and output were again falling away. But recently the expenditure seems to have been more substantial. The President's recent sensational budget statement which was in the papers a fortnight ago means vast expenditure on these heads in the near future—if he is able to live up to his programme. Public works, railway renewals, unemployment relief, subsidies to local authorities, further aid to farmers and so forth make up the enormous so-called deficit—much of which, however, will be covered by valuable assets. I doubt whether it will prove practicable for his Administration to live up to their full programme. It may take more time to put it into effect than is now intended. But, if the President succeeds in carrying out a substantial part of his programme, for my part

I expect a great improvement in American industry and employment within six months.

At any rate those of us—and we are many—who hate the idea of revolution and the uprooting of all those good things which grow slowly, yet are disconcerted at our present failure to seize our opportunity to solve the problem of poverty, will hope to the bottom of our hearts that a man who is thus trying new ways boldly and even gaily with no object but the welfare of his people will manage to succeed.

I believe he will win the first round. The testing time, the more difficult task, will come afterwards—to hold the gains once made and to avoid the fatal relapses which in recent times have always characterised our economic system.

On 15 January President Roosevelt moved to remove one of the sources of uncertainty about which Keynes had complained. He asked Congress for legislation 'to organise a sound and adequate currency system'. Amongst his proposals was that the President should be empowered to fix the gold value of the dollar at between 50 and 60 per cent of its old value. Keynes commented in the next issue of *The New Statesman.*

From The New Statesman and Nation, *20 January 1934*

PRESIDENT ROOSEVELT'S GOLD POLICY

Up to this week President Roosevelt's powers in relation to gold have been permissive only. It has been uncertain how he would exercise them, how far the policy of the moment would be adhered to, and, recently, whether there was any serious intention of making paper declarations effective. The vital importance, therefore, of the measures announced in Washington last Monday is that within certain prescribed limits the gold policy of the United States becomes not merely permissive but mandatory. The dollar is to be definitely devalued down to a level not exceeding 60 per cent of the old parity with permissive powers to fix it from time to time at a discretionary figure between 60 per cent and 50 per cent of the old value. At the moment of writing the *de facto* gold value of the dollar is not yet equal to its *de jure* value under the new legislation. But it is only common sense to assume that the two values must after a short time come together. The definiteness thus introduced into the situation sets our authorities a new problem, but it also represents some progress towards the final solution.

At the present time France is on the gold standard, whilst we are not. The effect of the President's declaration, therefore, is to set a maximum value to the dollar in terms of francs so long as France remains on the gold standard; but it still leaves sterling to find a level somewhere between francs and dollars as determined by the policy of the Exchange Equalisation Fund and the pressure of business and speculative forces. Unless prices in America are to rise far more than seems likely, France is put in a position which is very difficult and probably in the long run untenable. But since the United States has now returned to gold within certain maximum limits of fluctuation, it leaves France free to rectify her position whenever she is prepared to do so by altering her own gold parity. Meanwhile we are in a middle position, free to allow sterling to depreciate on the franc or to appreciate on the dollar or to enjoy and suffer a bit of both.

The provisional position of equilibrium when it is reached will probably leave France and the other gold countries with currencies seriously overvalued in terms of sterling as well as in terms of dollars, and with sterling overvalued in relation to the dollar. The position may be appreciably aggravated compared with what it has been until recently, but not in the short run sensationally worse. The adjustment required between the franc and the dollar as compared with a month ago is of the order of 7 or 8 per cent, of which about half has been accomplished already. Thus the fluctuations involved are not large compared with those to which we have become accustomed. We are faced, therefore, with a situation which is not untenable in the short run, but is likely, nevertheless, to become intolerable in course of time.

This brings us to the second and more important phase introduced by the President's announcement. He has virtually offered this country and France an invitation to a monetary conference. At the same time he has set sufficient limits to the uncertainty of his own future policy to provide a basis for discussion. Apart from the difficulties of the transition, I see nothing in the President's scheme which need upset us and much that we should do well to approve. It is true that the rest of us will not find it easy to come to terms with him unless we substantially accept his view as to the future value of gold in terms of the leading world currencies. But why not? A high value for gold is in fact in our interests as much as in his, since it diminishes the burden of national debts through the profit on central bank reserves, a profit, probably, of more than £200,000,000 in our case, and increases the nominal value of these reserves to an extent which should free central banks of needless anxiety if on other grounds they are moved to adopt expansionist policies. At the same time the permitted variation in the gold value of the dollar will allow sufficient latitude for price changes in the United States on a somewhat larger scale than those elsewhere, the margin of 20 per cent [*sic*] thus provided being sufficient for any probable contingency.

The task of coming to terms with the President sets a more anxious problem for the gold currency countries than it does for us. It is reasonably certain that the existing gold value of the franc and the florin can scarcely be compatible in the long run with the new gold value of the dollar. The gold currency countries have to choose whether they will embark on an expensive campaign probably doomed to ultimate failure, or whether they will eat some of their many unnecessarily brave words about maintaining their existing parities with gold at all costs. If, in the end, the result of the President's action is to knock them off their gold perches, the final result will surely be in the interest of their citizens.

If the President's phrases about his ultimate objective of stabilising the purchasing power of the dollar are meant seriously, the purpose of a monetary conference would not be to return to an old-fashioned gold standard. Initial relative exchange values for the several currencies having been fixed, the conference would presumably aim for the future not at rigid gold parities, but at provisional parities from which the parties to the conference would agree not to depart except for substantial reasons arising out of their balance of trade or the exigencies of domestic price policy.

I cannot doubt but that the President's announcement means real progress. He has adopted a middle course between old-fashioned orthodoxy and the extreme inflationists. I see nothing in his policy which need be disturbing to business confidence. In conjunction with his spending programme, which seems at last to be getting under way, it is likely to succeed in putting the United States on the road to recovery. If America is able to emerge from the trough of the slump, it is probable that the industrial activity of the whole world will move upwards for some months to come. It is the problem of how to avoid falling into another slump after no long interval which will be still unsolved.

The Gold Reserve Act of 1934, which gave the President the powers he sought, passed Congress on 30 January. The next day, the President made the Act effective and fixed a new gold price of $35 per fine ounce.

During the rest of the winter, Keynes remained out of the press, devoting himself instead to the composition of his *General Theory*, and beginning work on his project for a theatre in Cambridge. On one occasion, however, he caused a public stir. It came on 21 February when during his statement to the annual meeting of the National Mutual Life Assurance Society he discussed the rate of interest in such a way that gilt-edged prices rose sharply in ensuing days.

The decline of the net rate of interest which we are able to earn on the investment of new money to a figure not much in excess of 4 per cent raises, however, questions of the greatest possible importance and interest to all investment institutions and not least to insurance offices, and I should like to take this opportunity of considering the general problem which this phenomenon presents in a little more detail.

In 1932 long-term British Government securities moved from a 5 per cent to a $3\frac{1}{2}$ per cent basis. This was largely the result of the steps taken by the Bank of England to facilitate the conversion of the War Loan, including open-market operations on an unprecedentedly large scale, which raised the resources of the London clearing banks by £246,000,000, out of which they invested £176,000,000 in British Government securities.

In 1933 Government securities marked time, improving in price by only some 2 per cent and the year was occupied by other fixed-interest securities rising to their usual parity with Government securities, and in some cases beyond it. This was in spite of a further increase of £93,000,000 in the investments held by the banks—no longer out of additional resources provided by the Bank of England, but through the shrinkage of their other assets. Meanwhile the Treasury bill rate has averaged less than 1 per cent, and for more than a year there has been a spread of $2\frac{1}{2}$ per cent between the yield on long-term Government securities and the rate at which the money market has been able to borrow against them. This abnormal and anomalous relationship indicates a grave doubt in the mind of the market as to whether the existing price of long-term securities will be maintained.

Two views

Two views can be held. Those who are afraid of holding long-term securities point out with truth that the rise in their prices is largely due to the purchases of the banks; and they invoke, again with truth, the evidence of past experience to the effect that, as trade recovers, the banks have been accustomed to sell their investments to provide the means of increased advances to industry. They argue, therefore, believing that history will repeat itself, that long-term Government securities will fall in price as soon as there is a material improvement in the demand for advances. It would be rash to affirm that the course of events will be different this time. But I would like to give some grounds for this conclusion, before passing to what seem to me to be more fundamental reasons for expecting a further fall in the long-term rate of interest.

In pre-war days the resources of the banking system were somewhat rigidly linked to the gold reserves of the Bank of England. Open market operations were unimportant and, broadly speaking, the assets of the clearing banks went up and down according as gold was moving into, or out of, the Bank of England. Now in times of good trade this country tended to expand, and in bad times to contract, its foreign lending more rapidly than its favourable balance; the effect of which on movements of gold was to prevent the assets of the banks from increasing in good times, while sometimes the tendency for these assets to increase was actually stronger in times of depression. It is not to be wondered at, therefore, that with improving trade it was often impracticable for the banks to accommodate industry except by selling their investments. This is the historical origin of the expectation that Consols will fall when trade recovers.

Resources of the banks

Today, however, there is no necessity for events to follow this course. The resources of the banks depend at least as much on changes in the volume of securities purchased by the Bank of England as on changes in the Bank's stock of gold. Thus the technique of management lately evolved by the Bank puts it in its power to adjust the resources of the clearing banks to the needs of trade and employment. We are no longer at the mercy of the blind and perverse forces which ensured in pre-war days that, as soon as we began to move towards prosperity and optimum employment, factors would begin to be generated which would shortly throw us back again into the pit which we had lately climbed out of.

Moreover, in present circumstances the increased basis of credit which the Bank of England would have to provide might prove to be moderate in amount. In the first place, part of the clearing banks' existing advances represents frozen rather than active credit, so that increased demands for current credit will be partly met by the repayment of old advances; while some of the largest concerns in the country are now much less dependent on bank borrowing than was the case with the constituent businesses out of which they have been formed. But, apart from this, an increase of (say) £20,000,000 in the Bank of England's assets would enable the clearing banks to increase their aggregate advances by 25 per cent, which should be fully adequate to all requirements unless there is to be a large rise in wages and other costs.

It is clear, therefore, that there is no necessity for reviving trade to break the gilt-edged market unless the authorities desire this to happen. So I return to the fundamental reasons, as I see them, why the authorities should in fact desire just the contrary.

Return on gilt-edged stocks

There is, surely, overwhelming evidence that even the present reduced rate of $3\frac{1}{2}$ per cent on long-term gilt-edged stocks is far above the equilibrium level—meaning by 'equilibrium' the rate which is compatible with the full employment of our resources of men and of equipment. It is often forgotten that $3\frac{1}{2}$ per cent is much in excess of the average yield on Consols, which ruled over the 40 years previous to the War—namely, just under 3 per cent—or even the average yield which ruled over the 80 years from 1835 to 1914—namely, just over 3 per cent.

The argument that this comparison is vitiated by the income tax which the lender must now pay is quite invalid if we are considering the 'equilibrium' rate, rather than the actual market rate; for the rate which the borrower can afford to pay depends in the long run on the yield of capital assets and is not increased by reason of taxes on the lender. Yet during the nineteenth century the annual amount which the community was disposed to save when it was fully employed was much below what it is today, whereas the outlets for profitable investment were vastly greater on account of the rapid growth of population and the opening up of new worlds overseas.

Curtailment of the investment field

With the opportunities for safe and profitable investment abroad greatly curtailed, as much by the unfortunate results of past investment as by the diminished opportunities for new investment, Great Britain and the United States would, if they were to return to the full employment of their resources, save sums so vast that they could not possibly be invested to yield anything approaching $3\frac{1}{2}$ per cent. No one can foretell at what point the rate of interest will reach its equilibrium level until we actually approach it. But it is highly probable that the equilibrium rate is not above $2\frac{1}{2}$ per cent for long-term gilt-edged investment, and may be appreciably less. In the early days of a recovery, while working capital is being restored and various postponements of renewals and fresh development are being overtaken, it is true that business can temporarily stand a higher rate. But the longer the recovery lasts the further will the appropriate long-term rate of interest have to fall. If when the recovery is well on its way the Bank of England so manages the basis of credit as to force the clearing banks to sell their investments on a substantial scale or otherwise to weaken the long-term loan market, then, indeed, it is as certain that depression will follow recovery as that night follows day.

Downward tendency of interest rates

But why, in making our prognostications, should we attribute such disastrous ideas to our financial authorities? No institution is more interested than the Treasury in a falling rate of interest. The further we move from the abnormal rates of the War period, the clearer, I believe, will it become to every one that our economic health needs a rate of interest appreciably below, and not above, the nineteenth-century level. There is no harm in the fall of the rate of interest being gradual, but it is a necessity for the epoch into which we are now entering that there should be a steady movement in the downward direction. In each of the last three years, I have ventured, in addressing you, to predict a falling rate of interest. I say today with undiminished conviction that we are still some way from the end of the journey, and that the course of events which I forecast three years ago will still continue in the same direction.

However, Keynes maintained a watching brief on events elsewhere, as shown by a letter to his American friend Walter Case.

To WALTER CASE, *1 March 1934*

Dear Walter,

I. Though one never knows, it looks as if the gold bloc countries were definitely not coming off their perch this journey. I am told on fairly good authority that they had a meeting together a few days ago, renewed their oaths and roped themselves together even tighter than before, to give one another mutual support and encouragement to maintain the *status quo*.

As you know, I am not surprised at this. It seemed to me the most probable outcome taking a short view.

I still, however, think that taking a longer view the gold bloc countries are getting themselves into an untenable position. Sooner or later domestic political events in one or other of the countries will force their hands. The recent devaluation in Czecho-Slovakia involved the resignation of Pospiscil, the Governor of the State Bank, and all his board, they having nailed their colours to the gold mast. But that did not prevent political pressure from prevailing. So I feel it is bound to be sooner or later with one or other of Holland, Switzerland, Italy, Belgium or France. Switzerland, Holland and France are, all of them, countries where a far reaching political turnover might take place at quite short notice.

Meanwhile, as it seems to me, sterling has been edging its way rather cleverly between the opposing currents. It would be disastrous for us to appreciate too much in terms of the dollar. On the other hand, if we were to depreciate too much in terms of gold, it would certainly bring the gold bloc countries nearer to the edge—an event which we expect sooner or later, but by no means desire to precipitate, since the existing state of the sterling gold exchanges suits our trade admirably.

If your President goes in for any further devaluation which at this distance I cannot see as likely in the near future, it might precipitate things. Failing that, I should not be surprised if the exchange jogged along for some little time without any wide divergence (meaning by 'wide' more than 5 per cent) from the present figures. On [a] short view sterling might tend to appreciate. But, on a longer view, on the whole I share the opinion that sterling is intrinsically weak. So far as I can make out, this is the conclusion of the Bank of England, and their reason for still maintaining the embargo on foreign loans. The evidence which is available to me is far from conclusive one way or the other. But they have more evidence than I have, and it is not impossible that they are right.

II. I should like to put before you what may be impertinent, namely, an opinion concerning your markets rather than ours. The more I consider the future course of events, the more convinced do I feel that in certain respects developments in America will follow much the same order as they have here. I mean by this that unless the recovery plans break down completely and end in universal disorder and discredit and fear, interest rates in America are almost certain, sooner or later, to take the same course they they have over here. It seems to me that it must be right to back this opinion, since, if this is wrong, all other forms of investment in America, except possibly the flight of capital from the country, are certain to turn out disastrously. It seems to me almost absurd to suppose that an investment either in common stocks or in actual cash can turn out well and that an investment in fixed-interest securities of the second class can turn out badly. If there is a class of securities on which the rate of interest falls from $7\frac{1}{2}$ per cent to 5 per cent there is a 50 per cent capital profit. There are innumerable instances of profits on that scale in this country during the last two years on the most steady going securities. It is obvious, looking back, that opportunities which offered profit out of all proportion to possible loss were missed. My feeling is that this is now the position in the United States. If you have any belief in your own prospects at all, this strikes me as the outstanding certainty.

If you are held back, I cannot but suspect that this may be partly due to the thought of so many people in New York being influenced, as it seems to me, by sheer intellectual error. The opinion seems to prevail that inflation is in its essential nature injurious to fixed-interest securities. If this means that an extreme inflation such as is not at all likely is more advantageous to equities than to fixed charges, that is of course true. But people seem to me to overlook the fundamental point that attempts to bring about recovery through monetary or quasi-monetary methods operate solely or almost solely through the rate of interest and that they only do the trick, if they do it at all, by bringing the rate of interest down. The whole subject has, of course, many more ramifications than can be discussed in a letter, but almost everyone who has any pretensions to being a sound or orthodox thinker on financial problems in New York probably has his brain stuffed with fallacies on this particular matter. So there is an opportunity for anyone, if there is anyone, who can think (or so it seems to me) scientifically straight on this issue.

Yours ever,
[copy not signed or initialled]

The spring brought Keynes an opportunity to examine American conditions at first hand when Columbia University offered him an honorary Doctor of Laws degree. Amongst the others to be honoured were Cordell Hull, the American Secretary of State, J. B. Conant, the President of Harvard and C. B. Hoover, an economist from Duke University whom Keynes had met several years earlier. Working his schedule around the Columbia Convocation on 5 June, Keynes planned a three-week visit to America, spending most of his time in New York and Washington.

Keynes sailed to America on the *Olympic* on 9 May and arrived in New York six days later. Using Case Pomeroy and Company as his base he moved widely in New York financial circles, attending, for example, a dinner in his honour sponsored by the Council on Foreign Relations on 21 May. Among the others present were Frank Altschul, Walter Case, Allen Dulles, John Foster Dulles, Russell Leffingwell, Walter Lippmann, Ogden Mills, Wesley C. Mitchell, Walter Stewart and John Henry Williams.

After his initial stay in New York he went on to Washington for a series of meetings that covered 25–30 May. His schedule was a full one: on 25 May he saw Frances Perkins, the Secretary of Labour, Justice Brandeis and Rexford Tugwell before an evening dinner party at Herbert Feis's home; the next day he saw Kenneth Bewley of the U.K. Embassy and Henry Morgenthau, the Secretary of the Treasury, before having dinner with Calvin Hoover, then 'a minor brain-truster'; on the Sunday he managed four further appointments. The Monday, 28 May, saw him with three meetings before he met the President at 5.15. Keynes's interview lasted an hour. He reported it as 'fascinating' and later made some notes on the President's appearance.[1] The President himself reported he had 'a grand talk with Keynes and liked him immensely'.[2] The following day Keynes addressed a luncheon meeting of Senators on his proposals for internal recovery and a dinner meeting of advisers from the Research and Planning Division of the N.R.A., as well as seeing Lewis Bean of the Agricultural Adjustment Administration. He returned to New York the next day.

The remaining days in New York saw Keynes further involved in affairs. On the weekend of 1–4 June he took part in a National Industrial Conference Board Conference at a farm near New York City, while the next week saw not only the Columbia Convocation, but also a speech to the American Political Economy Club (*JMK*, vol. XIII, p. 456) and a special farewell dinner at Case Pomeroy and Co. Keynes sailed from New York on 8 June.

Reactions to Keynes's many activities were favourable. After lunch with the Senators on 29 May, W. W. Reifler commented

From W. W. RIEFLER, *6 June 1934*

Dear Mr Keynes,

I was under the impression they you were already returning to England, or I would have written before.

Your conversations with the Senators had a most salutary effect and may have constituted the turning point in passing the housing legislation. I can't thank you enough for your help.

Sincerely yours,
W. W. RIEFLER

Similarly, his N.R.A. talk brought the following remark from Victor von Szeliski, the Chief Statistician of the Research Planning Division of N.R.A.

From V. S. VON SZELISKI, *11 June 1934*

Dear Professor Keynes,

Here are the national income figures which I promised you, together with the Department of Commerce study of which they are meant to be a continuation. I also enclose an explanatory memorandum of how the figures were derived.

There is one question I did not think to ask you on the occasion of your visit: How do you reconcile the fact that England has had a fair measure of recovery while making every effort to balance the national budget, with

[1] R. F. Harrod, *The Life of John Maynard Keynes* (London, 1951), p. 20.
[2] Felix Frankfurter to Keynes, 23 June 1934.

your contention that the way to get out of a depression is through government loan expenditures at a brisk rate?

I saw Mr Sachs in New York two days ago and he appeared to think that you had definitely given up your belief in government expenditures as a method of recovery, and now regard them only as a transitional device until private capitalism can resume, the latter bringing about the real recovery from depression, while the former merely holds the lines. Either he or I have misinterpreted your position.

The whole Division felt greatly stimulated by your visit. One man told me afterward: 'That was a fine talk, just what we needed to realise just where our efforts fitted into the whole recovery picture'.

Very truly yours,
VICTOR S. VON SZELISKI

Before leaving the United States, Keynes prepared a sequel to his open letter of 31 December. He sent an advance copy to the White House on 5 June. It appeared in the United States in *The New York Times* of 10 June and in London the next day.

From The Times, *11 June 1934*

AGENDA FOR THE PRESIDENT

These are a few notes on the New Deal by one who has lately visited the United States on a brief visit of pure inquisitiveness—made under the limitations of imperfect knowledge but gaining, perhaps, from the detachment of a bird's-eye view. My purpose is to consider the prospects rather than the past—taking the legislation of this Congress for granted and examining what might be done on the basis thus given. I am in sympathy with most of the social and reforming aims of this legislation; and the principal subject of these notes is the problem of consolidating economic and business recovery.

For this reason I have not much to say about N.R.A. I doubt if this is either such an advantage to recovery or such a handicap as its advocates and its critics suppose. It embodies some important improvements in labour conditions and for securing fair trade practices. But I agree with the widespread opinion that much of it is objectionable because of its restrictionist philosophy (which has a proper place in agricultural adjustment today but not in American industry) and because of its excessive complexity and regimentation. In particular it would be advisable to discard most of the provisions to fix prices and to forbid sales below an alleged but undefinable cost basis. Nevertheless, its net effect on recovery can easily be overestimated either way. I find most Americans divided between those who believe that higher wages are good because they increase purchasing power and those who believe that they are bad because they raise costs. But both are right, and the net result of the two opposing influences is to cancel out. The important question is the proper adjustment of relative wage rates. Absolute wage rates are not of primary importance in a country where their effect on foreign trade has been offset by exchange devaluation.

The case of A.A.A. (Agricultural Adjustment [Administration]), on the other hand, is much stronger. For the farmer has had to shoulder more than his share of the trouble and also has more lasting difficulties ahead of him than industry has. A.A.A. is organising for the farmer the advisable measure of restriction which industry long ago organised for itself. Thus, the task which A.A.A. is attempting is necessary though difficult; whereas some part of what N.R.A. seems to be aiming at is not only impracticable but unnecessary.

Problem of recovery

I see the problem of recovery, accordingly, in the following light. How soon will normal business enterprise come to the rescue? What measures can be taken to hasten the return of normal enterprise? On what scale, by which expedients and for how long is abnormal Government expenditure advisable in the meantime? For this, I think, is how the Administration should view its task. I see no likelihood that business of its own initiative will invest in durable goods of a sufficient scale for many months to come, for the following reasons.

In the first place, the important but intangible state of mind, which we call business confidence, is signally lacking. It would be easy to mention specific causes of this, for some of which the Administration may be to blame. Probably the most important is the menace of possible labour troubles. But the real explanation, in my judgement, lies deeper than the specific causes. It is to be found in the perplexity and discomfort which the business world feels from being driven so far from its accustomed moorings into unknown and uncharted waters. The business man, who may be adaptable and quick on his feet in his own particular field, is usually conservative and conventional in the larger aspects of social and economic policy. At the start he was carried away, like other people, by the prevailing enthusiasm—without being converted at bottom or suffering a sea-change. Thus he has easily reverted to where he was. He is sulky and bothered; and, with the short memory characteristic of contemporary man, even begins to look back with longing to the good old days of 1932. This atmosphere of disappointment, disillusion, and perplexity is not incurable. The mere passage of time for business to work out its new bearings and recover its equanimity should do much. If the President could convince business men that they know the worst, so to speak, that might hasten matters. Above all, experience of improving conditions might work wonders.

Serious obstacles

In the second place there are still serious obstacles in the way of reopening the capital market to large-scale borrowing for new investment; particularly the attitude of the finance houses to the Securities Act and the high cost of borrowing to those who need loans most. Moreover, many types of durable goods are already in sufficient supply and businesses will not be inclined to repair or modernise plant until they are experiencing a stronger demand than they can meet with their existing plant; to which should be added the excessively high cost of building relatively to rents and incomes.

None of these obstacles can be overcome in a day or by a stroke of the pen. The notion that if the Government would retire altogether from the economic field business left to itself would soon work out its own salvation is foolish; and even if it were not, it is certain that public opinion would allow no such thing. This does not mean that the Administration should not be assiduously preparing the way for the return of normal investment enterprise. But this will unavoidably take time. When it comes it will intensify and maintain a recovery initiated by other means. But it belongs to the second chapter of the story.

I conclude, therefore, that for six months at least, and probably for a year, the measure of recovery to be achieved will mainly depend on the degree of the direct stimulus to production deliberately applied by the Administration. Since I have no belief in the efficacy for this purpose of the price and wage raising activities of N.R.A., this must chiefly mean the pace and volume of the Government's emergency expenditure.

Up to last November such expenditure, excluding refinancing and advances to banks, was relatively small—about $90,000,000 a month. For November onwards the figure rose sharply and for the first four months of this year the monthly average exceeded $300,000,000. The effect on business was excellent. But then came what seems to me to have been an unfortunate decision. The expenditure of the Civil Works Administration was checked before the expenditure of the Public Works Administration was ready to take its place. Thus the aggregate emergency expenditure is now declining. If it is going to decline to $200,000,000 monthly, much of the ground already gained will probably be lost. If it were to rise to $400,000,000 monthly I should be quite confident that a strong business revival would set in by the autumn. So little divides a retreat from an advance. Most people greatly underestimate the effect of a given emergency expenditure because they overlook the multiplier—the cumulative effect of increased additional individual incomes (volume of income rather than merely of money) because the expenditure of these incomes improves the incomes of a further set of recipients and so on. $400,000,000 monthly is not much more than 11 per cent of the national income; yet it may, directly and indirectly, increase the national income by at least three or four times this amount. Thus the difference between a monthly emergency expenditure of $400,000,000 (financed out of loans, and not out of taxation, which would represent a mere redistribution of incomes) and a $100,000,000 expenditure may be (other things being equal) to increase the national money income by 25 to 30 per cent.

But the full benefit of a given rate of emergency expenditure may not be obtained until it has been continued for a full year. For there are two dead-points to reach and pass. After a long depression, a man will spend a large proportion of this first increment of income in getting financially straight—in paying back taxes, back rents, back interest, back debts. But eventually he will raise the level of his own standard of life. As he does so, demand will revive to a scale which business cannot easily satisfy without spending money on repairs and renewals of plant—which again will put increased incomes into circulation. Thus it is essential for the scale of the emergency expenditure to be large enough to pass by these two dead-points. The best calculation I can make suggests that a monthly figure of $400,000,000, exclusive of re-financing, should be sufficient. This could be attained without reaching the maximum figure which the President has promised not to exceed. But it will not be attained unless the object is pursued more whole-heartedly than in the past three months.

A suggested agenda

This brings me to my agenda for the President:—

1. A small office should be set up, attached presumably to the Executive Committee, to collate the spending programmes, both realised and prospective, of the various emergency organisations, to compare estimates with results, and to report to the President weekly. If the volume or pace of prospective estimates appears to be deficient, the emergency organisation should be instructed to report urgently on further available projects. Housing and the railroads appear to offer the outstanding opportunities. The new Housing Bill is brilliantly consure that normal enterprise will take the place of the emergency programmes as soon as possible. Much progress has already been made with the problem of remedying the widespread and paralysing loss of liquidity. But that task must still be carried on. With the Securities Act and the Stock Exchange Act carried into law, the battle is over and the time has come for sincere efforts on both sides to establish co-operative and friendly relations between the Commission which will work the Acts and the leading financial interests. For it is vital to reopen the capital market.

3. Continuous pressure should be exerted by the Treasury and the Federal Reserve System to bring down the long-term rate of interest. For it assuredly lies in their power, and it is a mistake to suppose that because the Government will be a large borrower interest rates will rise; inasmuch as the Treasury's resources in gold and the Reserve System's excess reserves put the market wholly in their hands. If a year hence the Administration cannot borrow for 20 years below $2\frac{1}{2}$ per cent, the Treasury willhave muddled its task, which their performance up to date gives one no reason to expect. Meanwhile, it would

seem advisable to reduce the maximum rate which Member Banks are allowed to pay on savings deposits to $2\frac{1}{2}$ per cent immediately, then to 2 per cent, and ultimately to 1 per cent.

4. To an Englishman the high level of building costs in America appears to be scandalous, both of building materials and of direct labour. They must be nearly double what they are in England. So long as the volume of work remains as low as it is now, these high costs do not mean high incomes to producers. Thus no one benefits. It is of the first importance for the Administration to take whatever steps are in its power to reduce unit costs in these industries against an undertaking to increase the volume of business sufficiently to maintain and probably to increase actual earnings. This might involve a national programme of building working-class houses to rent, in itself beneficial.

5. Either by skill or by good fortune the United States seems to me to have arrived at an excellent currency policy. It was right to devalue. It is right to have a value for the dollar currently fixed in terms of gold. It is prudent to keep a discretionary margin to allow future changes in the gold value of the dollar, if a change in circumstances makes this advisable. But all these measures have been carried fully far enough. Thus there would be no risk, in my judgement, if the President were to make it plain that he has now successfully attained his objects so far as they can be attained by monetary policy, and that henceforth a wise spending policy and a gradual but obstinate attack on high interest rates through the agency of the Federal Reserve System and otherwise will occupy the foreground of the economic programme.

Some five months ago I wrote that the relapse in the latter half of 1933 was the predictable consequence of the failure of the Administration to organise new loan expenditure (as distinct from refinancing) on an adequate scale and that the position six months later would entirely depend on whether the foundation had been laid for larger expenditures in the ensuing week. Fortunately the expenditures did increase, rising from less than

$100,000,000 in the month preceding my letter to an average of $300,000,000 in the next four months. As I predicted, the fruits of this have been enjoyed, and I estimate that there has been an improvement of something like 15 per cent in output, incomes and employment. This is an immense achievement in so short a time. But latterly, the expenditures have been declining and, once more as a predictable result, a recession of 3 per cent and perhaps 5 per cent is impending. The present indications suggest an improvement by August or September. But the position in the latter part of this year will depend on wise decisions as to emergency expenditure which have not yet been taken.

After his return to London, Keynes supplemented his article with a letter.

To the Editor of The Times, *23 June 1934*

THE AMERICAN RECOVERY

Sir,

I should be grateful if you would allow me to supplement briefly my notes on the economic position in the United States which you published on June 11 last. In particular I have now obtained a more exact computation of the rate of the net loan expenditure of the American Treasury.

The United States Budget is by no means so heavily unbalanced as the crude figures suggest, the ordinary Budget being in fact fully balanced including a substantial sinking fund ($600,000,000) for the redemption of debt, while a considerable proportion of the emergency expenditure is represented by more or less valuable capital assets, much of it being merely refinancing and the substitution of one document for another. I believe, however, that the following table gives a fairly accurate impression of the rate of Government expenditure not covered by taxation, which gives rise to new purchasing. These totals are arrived at by taking a three months' moving average (so that the figure against any month is the average for that and the two preceding months) of the expenditures which clearly lead to new incomes, plus the excess of payments to farmers in any month over the corresponding processing taxes (or minus the deficiency), plus a half of the advances which in the first instance increase liquidity rather than new purchasing.

	$1,000,000		$1,000,000
September 1933	102	January 1934	369
October	123	February	422
November	158	March	435
December	231	April	348
		May	311

The statistics for the first half of June indicate that the figure for June calculated on the same basis will be in the neighbourhood of $300,000,000. Nor, on the information available, should I expect the three months' moving average to fall appreciably below $300,000,000 for the present, while there is some hope of an increase by the late summer. To indicate the order of magnitude of these figures, I may mention that $100,000,000 a month is about 3 per cent of the national income.

Admittedly there is at the present time some recession in factory output in the United States, due partly to seasonal influences, partly to the falling away of Government expenditure as shown in the above table, and partly to business optimism in the first quarter of 1934 having encouraged industry, particularly in the case of textiles and automobiles, to provide for a somewhat larger effective demand than is in fact maturing today. But I should doubt if this recession will go very far, since a mere continuance of the present rate of Government loan expenditure should gradually provide more stimulus than has yet been experienced. For Americans have not unnaturally used much of their first increment of income to repay debts of all kinds rather than to keep rolling the ball of new purchasing.

Both here and in the United States I have found a tendency to underestimate the extent of the American recovery up to date as compared with the recovery in this country. One has to remember, of course, that the American recovery started from a much lower point than ours. There is also the difficulty that the only satisfactory American index of employment is confined to industrial employment in factories and does not include building, transportation, or distribution. It is possible, however, to arrive at certain broad conclusions. In both countries a peak of unemployment was reached in January 1933. Since that date the increase in the number of men employed in Great Britain as shown by our own statistics is almost exactly 10 per cent, two-thirds of this improvement having occurred in 1933 and one-third in the first five months of 1934. There can be no doubt that the percentage improvement in the United States greatly exceeds this. Factory employment shows an increase exceeding 40 per cent between January 1933, and May 1934; and it would, I think, be generally agreed that a more comprehensive index would show an improvement in excess of 25 per cent. Even more notable is the increase in the factory pay rolls, which have increased over the same period by fully 70 per cent. I should suppose that the American national income must have increased by at least 12 to 15 per cent in 1933 and probably by a further 12 to 15 per cent in the first half of 1934, which is a colossal achievement in the time.

Different authorities will differ in their estimates of the relations of cause and effect. But the above figures may perhaps help all alike to see the matter in a more accurate perspective. The exaggerated improvement during the first three months of office of the new Administration, based almost entirely on psychological excitement and not on real factors, which was inevitably followed by a steep recession, has tended to obscure the extent of the ground gained over the period up to date, taken as a whole.

If we take the average of the pre-boom years 1923–25 as 100, the schematic picture, which I see in my own mind, of the rate of progress of the American economy towards normal, after smoothing out the excessive rise and subsequent fall in the middle of 1933, is—very broadly—as follows:

	1933	1934
1st quarter	63	79
2nd quarter	67	83
3rd quarter	71	—
4th quarter	75	—

I feel that the maintenance of existing policies might continue this rate of a quarterly rise of four points during the rest of 1934. But I cannot see how 1935 can achieve a figure of 95 and better, unless the United States enjoys the two advantages which mainly explain the measure of improvement achieved in this country—namely, a large reduction in the long-term rate of interest and a high degree of activity in the building industry.

Your obedient servant,

J. M. KEYNES

In the months that followed, Keynes provided two additional comments on American events. In November, he supplied the Committee on Economic Information of the Economic Advisory Council with further details on American emergency expenditures.

ECONOMIC ADVISORY COUNCIL COMMITTEE ON ECONOMIC INFORMATION

EMERGENCY EXPENDITURE OF THE UNITED STATES TREASURY

The emergency expenditure of the United States Treasury financed by loans can be approximately estimated as follows:

1. The normal budget is not far from balancing. Indeed there is some provision for a sinking fund. Thus it is safe to restrict one's calculations to the emergency expenditure.

2. Some of the emergency expenditures, however, are merely re-financing, i.e. the exchange of one document for another. I believe, however, that a fairly good result is obtained by taking first of all the R.F.C. items exclusive of re-financing and then adding to them 50 per cent of the re-financing items which, since many of them serve to make various institutions more liquid, partly lead to new expenditure.

3. The total thus arrived at has to be adjusted by reference to the net A.A.A. expenditure. In the long run it is expected that the subsidies to farmers etc. will be approximately balanced by the processing taxes. Over any given short period, however, there is a wide discrepancy between the two, since the processing taxes have been collected much in advance of the money being expended. Thus to the extent that the processing taxes exceed the subsidies the figure is deducted from the total arrived at as above and contrariwise.

The monthly figures thus calculated work out as follows:—

Date	Total monthly disbursements ($ million)	Three months moving average ($ million)
July 1933	92·1	
Aug.	105·7	
Sept.	107·7	101·8
Oct.	155·7	123·0
Nov.	212·3	158·5
Dec.	325·9	231·3
Jan. 1934	568·7	368·9
Feb.	372·8	422·4
Mar.	363·0	434·8
Apr.	309·7	348·5
May	259·9	310·9
June	335·5	302·0
July	314·0	309·0
Aug.	285·0	311·0
Sept.	308·0	302·0
Oct.	292·0	295·0

The next month, he provided an American popular magazine with a positive answer to the question 'Can America spend its Way into Recovery?'[3] Harold Laski provided the negative answer in the same issue.

From Redbook, *December 1934*

CAN AMERICA SPEND ITS WAY INTO RECOVERY?

Why, obviously!—is my first reflection when I am faced by this question. No one of common sense could doubt it, unless his mind had first been muddled by a 'sound' financier or an 'orthodox' economist. We produce in order to sell. In other words, we produce in response to spending. It is impossible to suppose that we can stimulate production and employment by *refraining* from spending. So, as I have said, the answer is obvious.

But at a second glance, I can see that the question has been so worded as to inspire an insidious doubt. For spending means extravagance. A man who is extravagant soon makes himself poor. How, then, can a nation become rich by doing what must impoverish an individual? By this thought the public is bewildered. Yet a course of behaviour which might make a single individual poor *can* make a nation wealthy.

For when an individual spends, he affects not only himself but others. Spending is a two-sided transaction. If I spend my income on buying something which you can make for me, I have not increased my own income, but I have increased yours. If you respond by buying something which I can make for you, then my income also is increased. Thus, when we are thinking of the nation as a whole, we must take account of the results as a whole. The rest of the community is enriched by an individual's expenditure—for his expenditure is simply an addition to everyone else's income. If everybody spends more

[3] Richard Kahn provided a first draft of this article. However, his draft was extensively rewritten and reshaped by Keynes.

freely, everybody is richer and nobody is poorer. Each man benefits from the expenditure of his neighbour, and incomes are increased by just the amount required to provide the wherewithal for the additional expenditure. There is only one limit to the extent to which a nation's income can be increased in this manner, and that is the limit set by the physical capacity to produce. To refrain from spending at a time of depression, not only fails, from the national point of view, to add to wealth—it is profligate: it means waste of available man-power, and waste of available machine power, quite apart from the human misery for which it is responsible.

The nation is simply a collection of individuals. If for any reason the individuals who comprise the nation are unwilling, each in his private capacity, to spend sufficient to employ the resources with which the nation is endowed, then it is for the government, the collective representative of all the individuals in the nation, to fill the gap. For the effects of government expenditure are precisely the same as the effects of individuals' expenditure, and it is the increase in the income of the public which provides the source of the extra government expenditure.

It may sometimes be advantageous for a government to resort for part of its borrowing to the banking system rather than to the public. That makes no difference of principle to the effects of the expenditure. There are many who will raise the horror-struck cry of 'Inflation!' when borrowing from the banks is suggested. I doubt if any of those who speak in this way have a clear idea what they mean by inflation. Expenditure is either beneficial or it is harmful. I say it is beneficial, but whether I am right or wrong, it is hard to see how the effect can be altered if the money spent by the government comes from the banks rather than from the public.

When the government borrows in order to spend, it undoubtedly gets the nation into debt. But the debt of a nation to its own citizens is a very different thing from the debt of a private individual. The nation *is* the citizens who comprise it—no more and no less—and to owe money to them is not very different from owing money to one's self. Insofar as taxes are necessary to shift the interest payments out of one pocket and into the other, this is certainly a disadvantage; but it is a small matter compared with the importance of restoring normal conditions of prosperity. If private individuals refuse to spend, then the government must do it for them. It might be better if they did it for themselves, but that is no argument for not having it done at all.

It is easy, however, to exaggerate the extent to which the government need get into unproductive debt. Let us take, for purposes of illustration, a government hydro-electric power scheme. The government pays out money, which it borrows, to the men employed on the scheme. But the benefit does not stop there. These men who, previously unemployed, are now drawing wages from the government, spend these wages in providing themselves with the necessaries and comforts of existence—shirts, boots and the like. The makers of these shirts and boots, who were hitherto unemployed, spend their wages in their turn, and so set up a fresh wave of additional employment, of additional production, of additional wages, and of additional purchasing power. And so it goes on, until we find that for each man actually employed on the government scheme, three, or perhaps four, additional men are employed in providing for his needs and for the needs of one another. In this way a given rate of government expenditure will give rise to four or five times as much employment as a crude calculation would suggest. Thus there would be some advantage even if the scheme itself were to yield but little revenue hereafter. If, however, it is even a moderately sound scheme capable of yielding (say) three per cent on its cost, the case for it is overwhelmingly established.

That is not all. Unemployment involves a serious financial strain to the municipal, state, and federal governments. The alleviation of unemployment, as a result of government expenditure, means a considerable reduction in outgoings on the support of the unemployed. At the same time the receipts from taxation mount up as the nation's taxable income increases, and as real property values are re-established. These important factors must be allowed for before it is possible to say how far government expenditure involves additional unproductive government debt. The residue cannot be very large. Depression is itself the cause of government deficits, resulting from increased expenditure on the support of the unemployed and the falling-off in the yield of taxation. Public debt is inevitable at a time when private expenditure is inadequate: it is better to incur it actively in providing employment and promoting industrial activity than to suffer it passively as a consequence of poverty and inactivity.

So far I have been advocating government expenditure without much reference to the purpose to which the money is devoted. The predominant issue, as I look at the matter, is to get the money spent. But productive and socially useful expenditure is naturally to be preferred to unproductive expenditure. The arguments for expenditure are very much strengthened if the government, by spending a small sum of money, can induce private individuals and corporations to spend a much larger sum. Thus a government guarantee to facilitate the building of houses is, perhaps, the best measure of all. The government is here operating under the advantage of very considerable leverage; every dollar which there is any risk of the government having to find under its guarantee means a vastly greater number of dollars spent by private persons. There is no better way by which America can spend itself into prosperity than by spending money on building houses. The need is there waiting to be satisfied; the labour and materials are there waiting to be utilised. It will spread employment through every locality. There is no greater social and economic benefit than good houses. There is probably no greater material contribution to civilisation and a sound and healthy life which it lies within our power to make. The man who regards all this as a senseless extravagance which will impoverish the nation, as compared with doing nothing and leaving millions unemployed, should be recognised for a lunatic.

I stress housing, for this seems to me the happiest of the Administration's schemes. But it is difficult to organise quickly any one type of scheme on a sufficient scale. Meanwhile other forms of government expenditure, not so desirable in themselves, are not to be despised. Even pure relief expenditure is much better than nothing. The object must be to raise the total expenditure to a figure which is high enough to push the vast machine of American industry into renewed motion. If demand can be raised sufficiently by emergency measures, business men will find that they cannot meet it without repairs and renewals to their plant, and they will then once again take heart of grace to recover the care-free optimism without which none of us ever has the courage to live our lives as they should be lived.

Keynes's associations with the New Deal naturally left him open to journalistic attack. Normally Keynes made no reply to such comments but he made an exception on one occasion. The case was an article in *The Independent* of 5 January 1935, in which Sir Ernest Benn, warning Americans about being misled by Keynes, used as evidence of his soundness the results of the Independent Investment Company of which Keynes (together with O. T. Falk) was a director.[4] Keynes replied:

To the Editor of The Independent, *13 January 1935*

Sir,

You have done an unworthy thing in writing without knowledge of the essential facts an article which has just reached me through my press-cutting agency.

You have seen fit to write this article (1) without possessing knowledge as to how far my advice was in fact followed by the Board of the company to which you refer, of which I was not

[4] See *JMK*, vol. XII for much more on Keynes's involvement in this firm.

chairman, and which I did not control; (2) on a matter to which it is impossible for me to reply publicly because matters of no public concern may be involved; and (3) on lines which would be extremely dubious, as a method of controversy, even if you were sure of your facts. These are the methods of the gutter press.

Yours, etc.,
J. M. KEYNES