Space for Notes
↓

From *The Manchester Guardian Commercial*, 15 October1925*

> Mr Keynes said that if the Treasury and the Bank of England had listened to the advice which the Federation of British Industries had pressed on them at frequent intervals during the past three years employment today would have been exceedingly good. The F.B.I. had been all through not only moderate and reasonable in its officially expressed policy, but right.

We may also differ about the cure [continued Mr Keynes], but we cannot differ about the character of our difficulties. It is no longer true that there is a world depression. The United States has never in its history experienced such unmitigated prosperity as at the present day. It is not true that our principal customers are abnormally impoverished, unless it be in China. Home trade is good on the whole. Wheat, sugar, cotton, copper, steel, oil, and coal-to take some of the commodities which to us are the most important in the world-are in abundant supply. It is not true that we are technically inefficient. We are not backward in the new industries-artificial silk, motor-cars, oil-driven ships, electrical engineering. In all those things we hold our own with the whole world. The foundations for prosperity exist.

The reason why unemployment does not diminish and certain industries are half-bankrupt lies in the fact that our manufacturing costs of production, measured in gold, are higher than those of our chief industrial competitors. That is the result of our having used financial devices to fix the gold value of sterling at a value above that which, in fact, it has measured by its command over home services.

These excess costs of production may be divided into two parts. One part is due to the fact that the real wages of our workers are higher than those in the rest of Europe. The other part is because our cost of living, when converted into gold at the current rate of exchange, is higher than the corresponding cost abroad, so that we have to pay our workers higher money wages before they are dead level with wages elsewhere. Thus the second factor has nothing to do with the efficiency or inefficiency of capital or of labour, but is just a symptom of monetary maladjustment.

So far we all agree. But when we come to the cure, one can distinguish three schools of opinion. The first school I will call the pious school. The pious school thinks that the monetary factor is not very important one way or the other. It stresses the high level of taxation and the high real wages of our workers, their relatively short hours, and their tendency to ca'canny. In its hysterical moments it is occupied with something said to be prevalent in this country which it calls Communism. According to this school, there is very little that the Government can do except to economise drastically in its own expenditure. Apart from Government economy there is nothing to be done except to exhort everybody in terms of copybook maxims. We must forget party differences, we must all pull together, we must work much harder, employers and employed must be at peace, those whose wages are relatively high must be willing to reduce them for the benefit of others, and the old country will pull through yet.

The ablest representative of this school in the daily press is, perhaps, the City Editor of *The Morning Post.* Gentlemen who write to the newspapers belong to this school more often than not. So does Mr Baldwin, except in the matter of governmental economics-about which as a sensible man he has no illusions. The first leader in today's Times is a perfect example of this philosophy. All the same, this school, I am afraid, though vocal and more than respectable doesn't cut much ice. In practice its precepts boil down to demands for reduced Government expenditure and reduced real wages. Now, though it is not good manners to cast doubt on such admirable sentiments, I do doubt whether these measures are practicable and even-in general desirable. I do not believe that important economies in Government expenditure are possible except in the fighting services-while the latter, though desirable, are not compatible with our present foreign policy of guaranteeing distant frontiers against the Turk, and of undertaking to defend Germany disarmed against France in the plentitude of her military power-two steps in the highest degree imprudent.

As for our real wages, while they are higher, I am glad to say, than in the rest of Europe, they are not so high as in the United States. I am not convinced that they are higher on the average than we can afford. Ca'canning is a degrading and antisocial practice. Wages are too high in particular grades and particular industries relatively to others. But I sympathise with the working classes in resisting a general reduction of real wages. I am sure that no material reduction is possible in the near future without engaging on a social struggle of which no one could foretell the outcome.

The second school is the strait-laced school. This school recognises the existence of monetary disequilibrium and would like to cure it by carrying out, pretty ruthlessly the orthodox rules of the pre-war gold standard. If British prices are relatively too high, this means that credit is relatively too abundant. If the markets for capital and goods are left perfectly free and unrestricted, as they ought to be---so runs the teaching of this school-gold will flow out and credit will be restricted until equilibrium has been restored. This may involve temporary sacrifices, but they are necessary and worthwhile.

The ablest exponent of this philosophy in the daily press has been the distinguished and well-informed City Editor of *The Manchester Guardian.* Now the fault of this school is that it depends too much on applying to new conditions rules which were drawn up with a view to old conditions, without considering in sufficient detail how they will work out in these new conditions. The only method by which the high Bank rate and credit restriction can lower prices is, so to speak, by deliberately organising a depression. These measures aim at depriving the business men of sufficient cash for carrying on at the existing level of prices; and rely on this to effect the necessary reduction of prices.

Now in conditions of boom or incipient boom it is necessary and desirable to use this method to damp down business enthusiasm. But at a time of depression deliberately to organise more depression simply breaks the heart of the employer of labour. Moreover, when it is wages which which the policy aims at reducing, it may, in modern conditions of organised labour and impaired mobility of labour, merely produce the depression without bringing about an adequate reduction of prices. The reason why we are still full of unemployment when the rest of the world is recovering from the depression of 1921 is because for three years past whenever business was raising its head the Bank of England has seized the opportunity to restrict credit and so organise a depression with a view to lowering prices in the interests of the dollar exchange. When the adjustment has at last been affected, this school will have done its worst and its best for the time being. But, meanwhile, the consequences of this policy are disastrous. Indeed another five years of this policy might bring us to the edge of revolution, if revolution is ever possible in this country.

The third school I will venture to call the sensible school. It has included the Federation of British Industries, Mr McKenna, Sir Alfred Mond; and the leading weekly newspapers, *The Nation, The New Statesman,* and *The Spectator*. I even notice a slightly greater wisdom in the weekly *Manchester Guardian* than in the daily. This school believes that prosperity is more important than the dollar exchange, that prosperity is cumulative, that prosperity by allowing production up to capacity and full-time employment may enable us at the same time to pay present real wages and, nevertheless, reduce our costs. This school, therefore, would set itself in every possible way to organise prosperity instead of depression, would stimulate new capital developments of every kind, would encourage the business world to launch out, and would give it the confidence and the credit to do so.

Up to the date of the reintroduction of gold convertibility this spring, it was easy to combine these aims with an absolutely sound financial policy. It is not so easy now. The prosperity policy will probably lead in its early stages to a loss of gold, perhaps on a large scale, and we must be prepared to take no notice of this, which would, in normal times, be incompatible in the long run with a sound gold-standard policy. It involves a risk. Nevertheless, the risk should, I think be taken. Having made the mistake of returning to the gold standard before we were ready for it-the only remedy is to be found in not taking the gold standard too seriously for the time being.

In classifying the schools of opinion I have not yet placed the authorities of the Bank of England-for that reason that I simply do not know where they stand. At one time I thought that they belonged to the strait-laced school. But their latest actions no longer bear this out. Lenin and Mussolini have at least explained what they were at. But our despots are dumb. The veiled prophetess of Threadneedle Street speaks in the riddles of Bank rate, the City reverently accepts her word, but no one, it seems, has any idea what the old lady really means.

The recent policy of the Bank of England is capable of two opposite interpretations. The Bank of England may wish quite deliberately to lose a certain amount of gold in order to have a good excuse for curtailing credit once again, and for raising the Bank rate to 5 per cent after an interval. The object of the recent recoil of Bank rate may be *pour mieux sauter*.

On the other hand, it may mean that at last the Bank has come over to the sensible school, that the object of the present cheap money is to revive trade, that we can rely on a continuance of cheap money until trade does revive, that gold will be allowed to flow out on a large scale if necessary without any restriction of credit ensuing, and that the Bank's resources in America will be used if they are needed. If this is the policy, our prospect may be fairly bright.

Take Manchester for example. If Lancashire was producing up to capacity, would it not be possible to reduce costs materially, without any reduction of wages? Is this not a better programme than to curtail credit in the hope that the resulting unemployment will lead to a fall in real wages? Cheap money is a dangerous thing. Cheap money in the right conditions can work wonders. I would run the risk of cheap money at the present juncture. With abundant cotton plus abundant credit is not a remarkable revival in the textile industries perfectly possible?

It may be that the Bank of England has no steady or thought-out policy at all, but lives empirically day by day-by cunning rather than science. It is absurd that we do not know. For the immediate future of this country depends on the answer. The premature return to gold renders what I call the prosperity policy more difficult and more risky than it would have been otherwise. I urge, all the same, that the Federation of British Industries should use its influence to make sure that it is the prosperity policy and not the suicide policy which wins the day.

* Scanned from Donald Moggridge (ed), *The Collected Writings of John Maynard Keynes, Volume XIX, Activities 1922-1929, The Return to Gold and Industrial Policy, in Two Volumes, Part I,* London: Macmillan (Cambridge University Press) 1981, pp. 442-447.