Space for Notes
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"How to Organize a Wave of Prosperity"

In the spring of every year there is a seasonal recovery of certain industries which have been held back by the winter. This comes handy for the annual speeches of the chairmen of the big banks and for the Chancellor of the Exchequer introducing his Budget. So at each of their annual celebrations the professional optimists assure us, on the strength of the spring trade, that at last the revival is at hand.

By July we always know that we have been had again. This year particularly so. It is certain that trade on the whole is bad. There are 200,000 more unemployed than at this date a year ago. Indeed, there are as many unemployed as in any July in the last six years except during the great strike.

The railway traffics confirm these figures. So does the condition of the staple industries considered separately-coal, agriculture, cotton, shipbuilding, iron and steel, motors, and (more doubtfully) building and construction. A small increase in certain classes of exports is the only favourable feature.

In short, both profits and employment are disastrously poor. Moreover, the more successful the efforts which are being made to restore the margin of profits by 'rationalisation', the greater the likelihood-at first anyhow-of increasing unemployment.

And the more successful the efforts of the Treasury, in the pursuit of so-called `Economy', to damp down the forms of capital expansion which they control-telephones, roads, housing, etc., again the greater the certainty of increasing unemployment.

The post-war building programmes of local authorities will begin to peter out before long, and, unless their place is taken by something else, the building trades will join the depressed industries.

Since there can be no doubt about the explanation, it is well to remind ourselves from time to time what it is. Labour costs, measured by the wage index of eleven leading industries, are exactly what they were three years ago or four years ago.

Meanwhile wholesale prices have fallen 9 per cent compared with three years ago and 13 per cent compared with four years ago, whilst the cost of living has fallen 5 per cent. But many industries have not enough margin of profit to employ men at the same wages as before and to sell their products 5 to 10 per cent cheaper.

This situation is what I ventured to predict when I wrote in *The Evening Standard* three years ago, shortly after the return to the gold standard. We have deflated prices by raising the exchange value of sterling and by controlling the volume of credit; *but me have not deflated costs.*

The fundamental blunder of the Treasury and of the Bank of England has been due, from the beginning, to their belief that if they looked after the deflation of prices the deflation of costs would look after itself.

Regarding these two different things as though they were practically the same thing, they did not hesitate to commit us to a deflation of costs without having any idea or any plan as to how it was to be brought about. Yet, as I pointed out when they made the commitment, it is extraordinarily difficult to deflate costs. Broadly, there are three ways of doing it.

The first is a general assault on the level of money wages. The coal lock-out of 1926 represented an attempt along this line of advance, and if the employers had been allowed to press home their advantages after the defeat of the General Strike some success might have been achieved. But Mr Baldwin decided quite rightly-that it would be socially and politically inexpedient to take advantage of the situation in this way.

The events of this period confirmed the conclusion that in modern conditions an assault on wages is not only politically impossible, but also maladroit, because the wage rates which will be most likely to yield before the assault will be those in which wages are already relatively low because of bargaining weakness.

Today, on the eve of a general election, a general assault on wages is more entirely out of the question than ever.

The second way of deflating costs is that which is now being adopted in the best-led industries-namely, the restoration of the normal margin of profit by concentration of production on the most profitable lines and the curtailment of unprofitable business. This is called rationalisation.

The reason why we are only feeling now at this late date, when there are no other clouds on the horizon, the full effects on employment of the disequilibrium set up by our monetary policy three and four years ago is because many employers have been prepared, for a time and in hopes of the turn for the better which has been promised them, to continue without profit or at a loss.

But they will not do so indefinitely. In present circumstances there is for them no alternative to pressing on with rationalisation-which is likely, moreover, to achieve some economies and increased efficiencies which were already overdue. But this is bound to aggravate, rather than cure, the problem of unemployment.

The third way of deflating costs is to take advantage of the economies of successful bold enterprise and the working of plant and productive resources to a hundred per cent of capacity.

Industry might afford the higher wages imposed on it if it could work at full steam. The wastefulness of plant employed 10 or 20 or 30 per cent below capacity is extreme. Moreover, the increased purchasing power of a working population in full employment would react quickly and cumulatively on the prosperity of numberless industries and occupations.

Probably, even so, it would be impossible to bridge the existing gap between costs and prices without the assistance of some inflation of the latter. In any case, to organise a wave of prosperity which shall sweep us out of the pool of stagnation in which we are decaying is extremely difficult, involves some risks, and might be unsuccessful. But it ought to be tried.

Unfortunately, it lies entirely outside the power of individual business men to take the initiative. The first steps can be taken only by the Bank of England and the Chancellor of the Exchequer. Yet the consequences of their policy so far has been to ensure that businesses shall be unprofitable and that the level of unemployment shall not fall below the million level.

Nevertheless, it is well to recognise squarely the nature of the risks which stand in the way of any departure from the Bank of England's present policy. Unemployment will not decline unless business men have the incentive of plentiful credit, high hopes and a slightly rising level of prices-a slight inflation of prices *but not of costs.*

The newly employed men will need increased imports of raw materials to work on, and as their earnings improve their consumption will increase. Yet owing to the length of the period of production, they will not have much to show for it for six months or a year, and, if they are producing capital goods, adjustments of the capital market will be required. In the meantime one would expect the visible balance of trade to move against us.

Thus the process of getting more men to work is calculated to cause a drain on the resources of the Bank of England, just as the depression has raised its resources to a record level.

The practical steps which ought to be taken if we really want to reduce unemployment are, I suggest, the following:-

First, as Mr McKenna has consistently maintained, the Bank of England must gradually increase the reserve resources of the joint stock banks up to (say), £I0,000,000 above their present figure-an augmentation of the basis of credit which will ensure that no worthy business borrower will be turned down by his bank.

Secondly-since this would greatly reduce and perhaps avoid altogether the risks of the experiment-the Governor of the Bank must induce his colleagues throughout the world to change their tune when he changes his, instead of his encouraging a general deflationary atmosphere by insisting on every state bank in Europe locking up its gold against note issues which do not need it.

Thirdly, the Chancellor of the Exchequer must remove and reverse his pressure against public spending on capital account.

Every public department and every local authority should be encouraged and helped to go forward with all good projects for capital expansion which they have ready or can prepare-roads, bridges, ports, buildings, slum clearances, electrification, telephones, etc., etc.

When we have unemployed men and unemployed plant and more savings than we are using at home, it is utterly imbecile to say that we cannot *afford* these things. *For it is with the unemployed men and the unemployed plant, and with nothing else, that these things are done.*

To have labour and cement and steel and machinery and transport lying by, and to say that you cannot *afford* to embark on harbour works or whatever it may be is the delirium of mental confusion.

For several years past these policies have not lacked powerful advocates who have some claim to wisdom and experience-Mr McKenna, Lord Melchett, Sir Josiah Stamp, for example, amongst business authorities, Mr Lloyd George and Lord Beaverbrook amongst public men, and many economists and journalists.

I do not believe that the Chancellor of the Exchequer is naturally unsympathetic to this outlook. But he has succumbed, just as Mr Snowden did before him, to the timidities and mental confusions of the so-called `sound' finance, which establishes as an end to be worshipped what should only be pursued so long as it is successful as a means to the creation of wealth and the useful employment of men and things.

According to the census of production, the average net output of an employed person in this country is £220. Therefore, the output of a million persons over five years is £ 1,100.000,000.

It is very possible, therefore, that the policy of the Bank of England over this period has reduced the wealth of the country by not less than £500,000,000.

The nature of the error committed will never be exactly understood by the public. But its consequences will have a profound effect on the general election and on the future government of this country.

* 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 II*, London: Macmillan (Cambridge University Press) 1981, pp.pp. 761-766.