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THE MEANS

TO

PROSPERITY

BY

JOHN MAYNARD KEYNES

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JOHN MAYNARD KEYNES

FELLOW OF KING'S COLLEGE, CAMBRIDGE

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CHAPTER I

THE NATURE OF THE PROBLEM

If our poverty were due to famine or earthquake or war—if we lacked material things and the resources to produce them, we could not expect to find the Means to Prosperity except in hard work, abstinence, and invention. In fact, our predicament is notoriously of another kind. It comes from some failure in the immaterial devices of the mind, in the working of the motives which should lead to the decisions and acts of will, necessary to put in movement the resources and technical means we already have. It is as though two motor-drivers, meeting in the middle of a highway, were unable to pass one another because neither knows the rule of the road. Their own muscles are no use; a motor engineer cannot help them; a better road would not serve. Nothing is required and nothing will avail, except a little, a very little, clear thinking.

So, too, our problem is not a human problem of muscles and endurance. It is not an engineering problem or an agricultural problem. It is not even a business problem, if we mean by business those calculations and dispositions and organising acts by which individual entrepreneurs can better themselves. Nor is it a banking problem, if we mean by banking those principles and methods of shrewd judgement by which lasting connections are fostered and unfortunate commitments avoided. On the contrary, it is, in the strictest sense, an economic problem, or, to express it better, as suggesting a blend of economic theory with the art of statesmanship, a problem of Political Economy.

I call attention to the nature of the problem, because it points us to the nature of the remedy. It is appropriate to the case that the remedy should be found in something which can fairly be called a *device*. Yet there are many who are suspicious of devices, and instinctively doubt their efficacy. There are still people who believe that the way out can only be found by hard work, endurance, frugality, improved business methods, more cautious banking, and, above all, the avoidance of devices. But the lorries of these people will never, I fear, get by. They may stay up all night, engage more sober chauffeurs, install new engines, and widen the road; yet they will never get by, unless they stop to think and work out with the driver opposite a small device by which each moves simultaneously a little to his left.

It is the existing situation which we should find paradoxical. There is nothing paradoxical in the suggestion that some immaterial adjustment—some change, so to speak, “on paper”—should be capable of working wonders. The paradox is to be found in 250,000 building operatives out of work, when more houses are our greatest material need. It is the man who tells us that there is no means, consistent with sound finance and political wisdom, of getting the one to work at the other, whose judgement we should instinctively doubt. The calculations which we ought to suspect are those of the statesman, who, being already burdened with the support of the unemployed, tells us that it would involve him in heavy liabilities, present and to come, which the country cannot afford, if he were to set the men to build the houses; and the sanity to be questioned is his, who thinks it more economical and better calculated to increase the national wealth to maintain unemployed shipbuilders, than to spend a fraction of what their maintenance is costing him, in setting them to build one of the greatest works of man.

When, on the contrary, I show, a little elaborately, as in the ensuing chapter, that to create wealth will increase the national income and that a large proportion of any increase in the national income will accrue to an Exchequer, amongst whose largest outgoings is the payment of incomes to those who are unemployed and whose receipts are a proportion of the incomes of those who are occupied, I hope the reader will feel, whether or not he thinks himself competent to criticise the argument in detail, that the answer is just what he would expect,—that it agrees with the instinctive promptings of his commonsense.

Nor should the argument seem strange that taxation may be so high as to defeat its object, and that, given sufficient time to gather the fruits, a reduction of taxation will run a better chance, than an increase, of balancing the Budget. For to take the opposite view to-day is to resemble a manufacturer who, running at a loss, decides to raise his price, and when his declining sales increase the loss, wrapping himself in the rectitude of plain arithmetic, decides that prudence requires him to raise the price still more;—and who, when at last his account is balanced with nought on both sides, is still found righteously declaring that it would have been the act of a gambler to reduce the price when you were already making a loss.

At any rate, the time seems ripe for reconsidering the possibilities of action. In this belief I here reexamine the advantages of an active policy, beginning with our own domestic affairs and proceeding to the opportunities of the

World Conference. This Conference may be well-timed in spite of its delay. For it will come at a season when bitter experience makes the assembled nations readier to consider a plan. The world is less and less disposed "to wait for the miracle"—to believe that things will right themselves without action on our part.

CHAPTER II

INTERNAL EXPANSION

The reluctance to support schemes of capital development at home as a means to restore prosperity is generally based on two grounds—the meagreness of the employment created by the expenditure of a given sum, and the strain on national and local budgets of the subsidies which such schemes usually require. These are quantitative questions not easily answered with precision. But I will endeavour to give reasons for the belief that the answers to both of them are much more favourable than is commonly supposed.

It is often said that it costs £500 capital expenditure on public works to give one man employment for a year. This is based on the amount of labour directly employed on the spot. But it is easy to see that the materials used and the transport required also give employment. If we allow for this, as we should, the capital expenditure per man-year of additional employment is usually estimated, in the case of building for example, at £200.

But if the new expenditure is additional and not merely in substitution for other expenditure, the increase of employment does not stop there. The additional wages and other incomes paid out are spent on additional purchases, which in turn lead to further employment. If the resources of the country were already fully employed, these additional purchases would be mainly reflected in higher prices and increased imports. But in present circumstances this would be true of only a small proportion of the additional consumption, since the greater part of it could be provided without much change of price by home resources which are at present unemployed. Moreover, in so far as the increased demand for food, resulting from the increased purchasing power of the working classes, served either to raise the prices or to increase the sales of the output of primary producers at home and abroad, we should to-day positively welcome it. It would be much better to raise the price of farm products by increasing the demand for them than by artificially restricting their supply.

Nor have we yet reached the end. The newly employed who supply the increased purchases of those employed on the new capital works will, in their turn, spend more, thus adding to the employment of others; and so on. Some enthusiasts, perceiving the fact of these repercussions, have greatly exaggerated the total result, and have even supposed that the amount of new employment thus created is only limited by the necessary intervals between the receipt of expenditure of income, in other words by the velocity of circulation of money. Unfortunately it is not quite as good as that. For at each stage there is, so to speak, a certain proportion of leakage. At each stage a certain proportion of the increased income is not passed on in increased employment. Some part will be saved by the recipients; some part raises prices and so diminishes consumption elsewhere, except in so far as producers spend their increased profits; some part will be spent on imports; some part is merely a substitution for expenditure previously made out of the dole or private charity or personal savings; and some part may reach the Exchequer without relieving the taxpayer to an equal extent. Thus in order to sum the net effect on employment of the series of repercussions, it is necessary to make reasonable assumptions as to the proportion lost in each of these ways. I would refer those who are interested in the technique of such summations to an article by Mr. R. F. Kahn published in *The Economic Journal*, June 1931.

It is obvious that the appropriate assumptions vary greatly according to circumstances. If there were little or no margin of unemployed resources, then, as I have said above, the increased expenditure would largely waste itself in higher prices and increased imports (which is, indeed, a regular feature of the later stages of a boom in new construction). If the dole was as great as a man's earnings when in work and was paid for by borrowing, there would be scarcely any repercussions at all. On the other hand, now that the dole is paid for by taxes and not by borrowing (so that a reduction in the dole may be expected to increase the spending power of the taxpayer), we no longer have to make so large a deduction on this head.

My own estimate, taking very conservative figures in the light of present circumstances, makes the multiplier to be at least 2. It follows that the loan-expenditure per man-year of employment is, not the figure of £500 with which we began, but £100. Since, however, I am anxious not to overstate what will be a sufficiently striking conclusion anyhow, let us take it at $1\frac{1}{2}$, i.e. that two men employed by loan-expenditure lead indirectly to the employment, not of two further men, which represents my own belief, but of one further man. I do not think that anyone who goes through the detailed calculation can bring it out at less than this; which means that additional loan-expenditure of £200 on materials, transport, and direct employment puts, not one man to work for a year, but—taking account of the whole series of

repercussions—one and a half men. This gives us a figure of £133 as the amount of additional loan-expenditure required to-day to stimulate a man-year of employment. But let us, in order to give ourselves a further margin of safety, base our argument on the figure of £150. This answers, most conservatively, the first of our two questions.

Next consider the magnitude of the relief to the Budget. For purposes of broad calculation, the average cost of a man on the dole is usually taken, I think, at £50 a year. Since, on the basis of the above calculation, a loan-expenditure of £3,000,000 will employ at least 20,000 men for a year directly or indirectly, it follows that it will save the dole £1,000,000. Here is one-third of the expenditure already accounted for.

But there is a further benefit to the Budget. The yield of the taxes rises and falls more or less in proportion to the national income. Our budgetary difficulties to-day are mainly due to the decline in the national income. Now for the nation as a whole, leaving on one side transactions with foreigners, its income is exactly equal to its expenditure (including in expenditure both consumption-expenditure and new capital-expenditure, but excluding intermediate exchanges from one hand to another);—the two being simply different names for the same thing, my expenditure being your income. Thus new capital-expenditure of £3,000,000, paid for by an additional loan and not by reducing consumption-expenditure or existing capital-expenditure, increases the national income by more than £3,000,000 if we allow for repercussions. The calculation to obtain the appropriate multiplier is much the same as in the case of employment; except that it is somewhat greater, since to obtain the national money-income we do not have to make the same deduction for a rise in prices. However, to be on the safe side, let us, as before, take the multiplier as being $1\frac{1}{2}$.

It follows that our capital expenditure of £3,000,000 will increase the national income, subject to taxation, by £4,500,000. Now on the average about 20 per cent of the national income is paid to the Exchequer in taxes. The exact proportion depends on how the new income is distributed between the higher ranges of income subject to direct taxation, and the lower ranges which are touched by indirect taxes; also the yield of some taxes is not closely correlated with changes in national income. To allow for these doubts, let us take the proportion of the new income accruing to the Exchequer at 10 per cent, *i.e.* £450,000. There will, it is true, be some time-lag in the collection of this, but we need not trouble about that; though it is a powerful argument in favour of proposals for modifying the rigidity of our annual Budget and for making our estimates, on this occasion, cover a longer period than one year. Owing to the time-lag in the effect of increased taxation in reducing the national income our existing budgetary procedure is open to the serious objection that the measures which will balance this Budget are calculated to unbalance the next one; and *vice versa*.

Thus the total benefit to the Exchequer of an additional loan-expenditure of £3,000,000 is at least £1,000,000 *plus* £450,000; or, in round figures, £1,500,000, *i.e.* a half of the loan-expenditure; or two-thirds of it, if we were to take the multiplier as 2. We need see nothing paradoxical in this. We have reached a point where a considerable proportion of every further decline in the national income is visited on the Exchequer through the agency of the dole and the decline in the yield of the taxes. It is natural, therefore, that the benefit of measures to increase the national income should largely accrue to the Exchequer.

If we apply this reasoning to the projects for loan-expenditure which are receiving support to-day in responsible quarters, we see that it is a complete mistake to believe that there is a dilemma between schemes for increasing employment and schemes for balancing the Budget,—that we must go slowly and cautiously with the former for fear of injuring the latter. Quite the contrary. There is no possibility of balancing the Budget except by increasing the national income, which is much the same thing as increasing employment.

Take, for example, the proposal to spend £7,000,000 on the new Cunarder. I say that this will benefit the Exchequer by at least a half of this sum, *i.e.* by £3,500,000, which vastly exceeds the maximum aid which is being asked from the Exchequer.

Or take the expenditure of £100,000,000 on housing, whether for rebuilding slums or under the auspices of a National Housing Board, this would benefit the Budget by the vast total of some £50,000,000—a sum far exceeding any needful subsidy. If the mind of the reader boggles at this and he feels that it must be too good to be true, let him recur carefully to the argument which has led up to it. And if he distrusts his own judgement, let him wait and see if any competent person has been able to confound the bases of the argument, where I first offered it *coram publico* in the forum of *The Times*.

Substantially the same argument also applies to a relief of taxation by suspending the Sinking Fund and by returning to the practice of financing by loans those services which can properly be so financed, such as the cost of new roads charged on the Road Fund and that part of the cost of the dole which can be averaged out against the better days for

which we must hope. For the increased spending power of the taxpayer will have precisely the same favourable repercussions as increased spending power due to loan-expenditure; and in some ways this method of increasing expenditure is healthier and better spread throughout the community. If the Chancellor of the Exchequer will reduce taxation by £50,000,000 through suspending the Sinking Fund and borrowing in those cases where formerly we thought it reasonable to borrow, the half of what he remits will in fact return to him from the saving on the dole and the higher yield of a given level of taxation;—though, as I have pointed out above, it will not necessarily return to him in the same Budget. I strongly support, therefore, the suggestion which has been made that the next Budget should be divided into two parts, one of which shall include those items of expenditure which it would be proper to treat as loan-expenditure in present circumstances.

I should add that this particular argument does not apply to a relief of taxation balanced by an equal reduction of Government expenditure (by reducing school teachers' salaries, for example); for this represents a redistribution, not a net increase, of national spending power. It is applicable to all *additional* expenditure made, not in substitution for other expenditure, but out of savings or out of borrowed money, either by private persons or by public authorities, whether for capital purposes or for consumption made possible by a relief of taxation or in some other way.

It is often pointed out that, when loan-expenditure was on a larger scale as a result of official encouragement, this did not prevent an increase of unemployment. But at that time it was offsetting incompletely an even more rapid deterioration in our foreign balance. The effects of an increase or decrease of £100,000,000 in our loan-expenditure are, broadly speaking, equal to the effects of an increase or decrease of £100,000,000 in our foreign balance. Formerly we had no visible benefit from our loan-expenditure, because it was being offset by a deterioration in our foreign balance. Recently we have had no visible benefit from the improvement in our foreign balance, because it has been offset by the reduction in our loan-expenditure. To-day for the first time it is open to us, if we choose, to have both factors favourable at once.

If these conclusions cannot be refuted, is it not advisable to act upon them? The contrary policy of endeavouring to balance the Budget by impositions, restrictions, and precautions will surely fail, because it must have the effect of diminishing the national spending power, and hence the national income.

CHAPTER III

THE RAISING OF PRICES

It is the declared policy of the Government, and also of the representatives of the Empire assembled at Ottawa, to raise prices. How are we to do it?

To judge from some utterances of the Chancellor of the Exchequer, he has been attracted to the idea of raising the prices of commodities by restricting their supply. Now, it may well benefit the producers of a particular article to combine to restrict its output. Equally it may benefit a particular country, though at the expense of the rest of the world, to restrict the supply of a commodity which it is in a position to control. It may even, very occasionally, benefit the world as a whole to organise the restriction of output of a particular commodity, the supply of which is seriously out of balance with the supply of other things. But as an all-round remedy restriction is worse than useless. For the community as a whole it reduces demand, by destroying the income of the retrenched producers, just as much as it reduces supply. So far from being a means to diminish unemployment, it is, rather, a method of distributing more evenly what unemployment there is, at the cost of somewhat increasing it.

How, then, are we to raise prices? It may help us to think clearly, if I proceed by means of a series of very simple, but fundamental propositions.

(1) For commodities as a whole there can be no possible means of raising their prices except by increasing expenditure upon them more rapidly than their supply comes upon the market.

(2) Expenditure can only be increased if the public spend a larger proportion of the incomes they already have, or if their aggregate spending power is increased in some other way.

(3) There are narrow limits to increasing expenditure out of existing incomes,—whether by saving less or by increased personal expenditure of a capital nature. Incomes are so curtailed to-day and taxation so much increased, that many people are already, in the effort to maintain their standard of life, saving less than sound personal habits require. Anyone who can afford to spend more should be encouraged to do so, particularly if he has opportunities to spend on new capital or semi-capital objects. But it is an evasion of the magnitude of the problem to believe that we can solve it in this way. It follows, therefore, that we must aim at increasing aggregate spending power. If we can achieve this, it will partly serve to raise prices and partly to increase employment.

(4) Putting on one side the special case of people who can earn their incomes by actually producing gold, it is broadly true to say that aggregate spending power within a country can only be raised either (i.) by increasing the loan-expenditure of the community; or (ii.) by improving the foreign balance so that a larger proportion of current expenditure again becomes income in the hands of home producers. By means of public works the Labour Government—though rather half-heartedly and in adverse attendant circumstances—attempted the first. The National Government has successfully attempted the second. We have not yet tried both at once.

(5) But there is a great difference between the two methods, inasmuch as only the first is valid for the world as a whole. The second method merely means that one country is withdrawing employment and spending power from the rest of the world. For when one country improves its foreign balance, it follows that the foreign balance of some other country is diminished. Thus we cannot increase total output in this way or raise world prices, unless, as a by-product, it serves to increase loan-expenditure by strengthening confidence in a financial centre such as Great Britain and so making it a more ready lender both at home and abroad.

Currency depreciation and tariffs were weapons which this country had in hand until recently as a means of self-protection. A moment came when we were compelled to use them, and they have served us well. But competitive currency depreciations and competitive tariffs, and more artificial means of improving an individual country's foreign balance such as exchange restrictions, import prohibitions, and quotas, help no one and injure each, if they are applied all round.

We are left, therefore, with the broad conclusion that there is no effective means of raising world prices except by increasing loan-expenditure throughout the world. It was, indeed, the collapse of expenditure financed out of loans advanced by the United States, for use both at home and abroad, which was the chief agency in starting the slump.

A number of popular remedies are rightly popular because they tend to facilitate loan-expenditure. But there are several stages in the task of increasing loan-expenditure; and, if there is a breakdown at any one of them, we shall fail to attain our object. I must ask the reader, therefore, to be patient with a further attempt at orderly analysis.

(1) The first necessity is that bank-credit should be cheap and abundant. This is only possible if each Central Bank is freed from anxiety by feeling itself to possess adequate reserves of international money. The loss of confidence in bank balances held in leading financial centres as constituting international money for this purpose, has greatly aggravated the shortage of reserves. So has the accumulation of a large proportion of the world's gold in a few Central Banks. On the other hand, we all welcome an increased output of the gold mines or a reduction in India's sterile hoards, because the quantity of reserve money is thus increased. The devaluation of national currencies in terms of gold is another remedy belonging to this category. Or, again, the abandonment of rigid gold parities may help the case, since a Central Bank which can, if necessary, relieve a strain by allowing the foreign exchanges to move against it, will be satisfied with a smaller reserve of international money. The abatement of the legal proportion of international money, which a bank must hold against its note issue, might also help on a minor scale.

But this is only the first stage. In the early phase of recovery there is not much loan-expenditure which can be safely financed by short-term bank-credit. The rôle of bank-credit is to finance the restoration of working capital after business recovery has definitely set in. In ordinary times we were able to rely on the first stage leading automatically to the subsequent stages. But not in the conditions of to-day.

(2) The second stage, therefore, must be reached, at which the long-term rate of interest is low for all reasonably sound borrowers. This requires a combination of manœuvres by the Government and the Central Bank in the shape of open-market operations by the Bank, of well-judged Conversion Schemes by the Treasury, and of a restoration of financial confidence by a Budget policy approved by public opinion and in other ways. It is at this stage that a certain dilemma exists; since it may be true, for psychological reasons, that a temporary reduction of loan-expenditure plays a necessary part in effecting the transition to a lower long-term rate of interest. Since, however, the whole object of the policy is to promote loan-expenditure, we must obviously be careful not to continue its temporary curtailment a day longer than we need.

A few countries have reached the first stage. But we alone have reached the second stage. It is a great achievement of the Treasury and the Bank of England to have effected so successfully a transition which France and the United States, for whom the task was, until recently, much easier, have bungled so badly.

(3) But there remains a third stage. For even when we have reached the second stage, it is unlikely that private enterprise will, on its own initiative, undertake new loan-expenditure on a sufficient scale. Business enterprise will not seek to expand until *after* profits have begun to recover. Increased working capital will not be required until *after* output is increasing. Moreover, in modern communities a very large proportion of our *normal* programmes of loan-expenditure are undertaken by public and semi-public bodies. The new loan-expenditure which trade and industry require in a year is comparatively small even in good times. Building, transport, and public utilities are responsible at all times for a very large proportion of current loan-expenditure.

Thus the first step has to be taken on the initiative of public authority; and it probably has to be on a large scale and organised with determination, if it is to be sufficient to break the vicious circle and to stem the progressive deterioration, as firm after firm throws up the sponge and ceases to produce at a loss in the seemingly vain hope that perseverance will be rewarded.

Some cynics, who have followed the argument thus far, conclude that nothing except a war can bring a major slump to its conclusion. For hitherto war has been the only object of governmental loan-expenditure on a large scale which governments have considered respectable. In all the issues of peace they are timid, over-cautious, half-hearted, without perseverance or determination, thinking of a loan as a liability and not as a link in the transformation of the community's surplus resources, which will otherwise be wasted, into useful capital assets.

I hope that our Government will show that this country can be energetic even in the tasks of peace. It should not be difficult to perceive that 100,000 houses are a national asset and 1,000,000 unemployed men a national liability.

(4) Yet if we are to raise world prices, which is our theme, there is yet a fourth stage. Loan-expenditure must spread its beneficent influence round the world. How to assist that will be the subject of the next chapter.

CHAPTER IV

A PROPOSAL FOR THE WORLD ECONOMIC CONFERENCE

We have reached the conclusion that there is no means of raising world prices except by an increase of loan-expenditure throughout the world. How to achieve this should, I suggest, be the central theme of the World Economic Conference. There are, I think, three, and only three, possible lines along which we can lend assistance.

(1) The first, and perhaps the most obvious, means is that of direct foreign loans, in the style to which we have been accustomed in the past, from the strong financial countries, which have a favourable foreign balance or excessive reserves of gold, to the weaker, debtor countries.

The time may be coming for a return to this traditional policy, as opportunity offers. But it would be chimerical to suppose that such foreign loans can play a large part to-day in bringing about recovery. Those countries which are best able to make them are least likely to do so. Nor is it reasonable to expect private investors to assume new risks of this kind, when those which they have already assumed are turning out so badly.

(2) The second, and more promising, means is for the stronger financial countries to increase loan-expenditure *at home*, on the lines recommended in Chapter II above. For such expenditure will be twice blessed. In so far as it sets up a stream of expenditure on home-produced goods, the favourable repercussions of the initial loan-expenditure on employment will be multiplied. In so far as it leads to expenditure on imported goods, it will set up similar favourable repercussions abroad, and will strengthen the position of the countries from which we buy, both to make reciprocal purchases and also to augment their own loan-expenditure. It will have set the ball rolling.

It may be better, therefore, to use our available resources to finance the additional imports, to which a bold policy of loan-expenditure at home is likely to lead, than to make foreign loans. This will be just as beneficial to the outside world, and decidedly more healthy than further additions to international indebtedness.

(3) Yet, once again, it seems obvious that we are discussing, so far, remedies of which the quantitative effect is hopelessly disproportionate to the problem of raising world prices. I see no reliable prospect of a sufficient rise in world prices within a reasonable time, except as the result of a substantial, and more or less simultaneous, relief of taxation and increase of loan-expenditure in many different countries. We should attach great importance to the *simultaneity* of the movement towards increased expenditure. For the pressure on its foreign balance, which each country fears as the result of increasing its own loan-expenditure, will cancel out if other countries are pursuing the same policy at the same time. Isolated action may be imprudent. General action has no dangers whatever.

We are now advanced a stage further in our argument. We have reached the point where combined international action is of the essence of policy. We have reached, that is to say, the field and scope of the World Economic Conference. The task of this Conference, as I see it, is to devise some sort of joint action of a kind to allay the anxieties of Central Banks and to relieve the tension on their reserves, or the fear and expectation of tension. This would enable many more countries to reach the first of the stages which I distinguished in Chapter III—the stage at which bank-credit is cheap and abundant. We cannot, by international action, make the horses drink. That is their domestic affair. But we can provide them with water. To revive the parched world by releasing a million rivulets of spending power is the primary task of the World Conference.

For the Conference to occupy itself with pious resolutions concerning the abatement of tariffs, quotas, and exchange restrictions will be a waste of time. In so far as these things are not the expression of deliberate national or imperial policies, they have been adopted reluctantly as a means of self-protection, and are symptoms, not causes, of the tension on the foreign exchanges. It is dear to the heart of Conferences to pass pious resolutions deploring symptoms, whilst leaving the disease untouched. It should be the rôle of the British Government to make a reality of this forthcoming Conference by concrete proposals which would go to the root of the disease.

There are certain preliminaries which must be accomplished before positive remedies will have a fair chance. We all agree that the settlement of War Debts and of Reparations are, first of all, indispensable. For these are of primary importance in creating fear of acute tension on the foreign exchanges. But have we a positive scheme of action wherewith to seize the opportunity which the settlement of these issues would create?

No remedies can be quickly efficacious which do not allay the anxieties of Treasuries and Central Banks throughout the world by supplying them with more adequate reserves of international money. There is a considerable variety of schemes which can be devised with this end in view, having a close family resemblance to one another. After much private discussion and borrowing the ideas of others, I am convinced that the following scheme is the best one. If other variants command more support, that would be a reason for preferring them.

There are certain conditions which any scheme for increasing the reserves of international money should satisfy. In the first place, the additional reserves should be based on gold. For whilst gold is rapidly ceasing to be national money, it is becoming, even more exclusively than before, the international money most commonly held in reserve and used to meet a foreign drain. In the second place, it should not be of an eleemosynary character, but should be available, not only to the exceptionally needy, but to all participating countries in accordance with a general formula. Indeed there are few, if any, countries left to-day which are so entirely without anxiety that they would not welcome some strengthening of their position. In the third place, there should be an elasticity in the quantity of the additional reserves outstanding, so that they would operate, not as a net permanent addition to the world's monetary supply, but as a balancing factor to be released when prices are abnormally low as at present, and to be withdrawn again if prices were to be rising too much. These conditions can be satisfied as follows:

(i) There should be set up an international authority for the issue of gold-notes, of which the face value would be expressed in terms of the gold content of the U. S. dollar.

(ii) These notes would be issuable up to a maximum of \$5,000,000,000, and would be obtainable by the participating countries against an equal face value of the gold-bonds of their governments, up to a maximum quota for each country.

(iii) The proportionate quota of each country would be based on some such formula as the amount of gold which it held in reserve at some recent normal date, *e.g.*, at the end of 1928, provided that no individual quota should exceed \$450,000,000, and with power to the governing board to modify the rigidity of this formula where special reasons could be given for not adhering to it strictly. (Some provision, for example, would be required for silver-using countries.) The effect of this formula would be that the quota of each country would add to its reserves an amount approximately equal to the gold which it held in 1928, subject to the above maximum proviso. The detailed allocation for each country is given in an [Appendix](#) to this chapter.

(iv) Each participating government would undertake to pass legislation providing that these gold-notes would be acceptable as the equivalent of gold, except that they should not enter into the active circulation but would be held only by Treasuries, Central Banks, or in the reserves against domestic note-issues.

(v) The governing board of the institution would be elected by the participating governments, who would be free to delegate their powers to their Central Banks, each having a voting power in proportion to its quota.

(vi) The gold-bonds would carry a rate of interest, nominal or very low in the first instance, which could be changed from time to time by the governing board subject to (viii) below. They would be repayable at any time by the government responsible for them, or on notice given by the governing board subject to (viii) below.

(vii) The interest, after meeting expenses, would be retained in gold as a guarantee fund. In addition, each participating government would guarantee any ultimate loss, arising through a default, in proportion to the amount of its maximum quota.

(viii) The governing board would be directed to use their discretion to modify the volume of the note-issue or the rate of interest on the bonds, solely with a view to avoiding, so far as possible, a rise in the gold price-level of primary products entering into international trade

above some agreed norm between the present level and that of 1928—perhaps the level of 1930.

APPENDIX

Under the formula on [p. 27](#) above for distributing the \$5,000,000,000 gold-notes in proportion to the gold held in reserve by each country at the end of 1928 subject to a maximum of \$450,000,000 to any one country, the allocation would work out as follows:

Seven countries (Great Britain, United States, France, }
 Germany, Spain, Argentine, and Japan) would } \$450,000,000 each
 qualify for the maximum }

	\$		\$
Italy	266,000,000	Poland	70,000,000
Holland	175,000,000	Uruguay	68,000,000
Brazil	149,000,000	Java	68,000,000
Belgium	126,000,000	Sweden	63,000,000
India	124,000,000	Denmark	46,000,000
Canada	114,000,000	Norway	39,000,000
Australia	108,000,000	South Africa	39,000,000
Switzerland	103,000,000	New Zealand	35,000,000
	\$		\$
Hungary	35,000,000	Bulgaria	10,000,000
Czecho-Slovakia	34,000,000	Portugal	9,000,000
Roumania	30,000,000	Finland	8,000,000
Austria	24,000,000	Greece	7,000,000
Colombia	24,000,000	Chile	7,000,000
Peru	20,000,000	Latvia	5,000,000
Jugoslavia	18,000,000	Lithuania	3,000,000
Egypt	18,000,000	Esthonia	2,000,000

No country would have injustice done to it by this particular choice of date except Chile, whose case might deserve special consideration, and, to a lesser extent, Greece and Canada. If we were to take the *highest* figure held at the end of any year from 1925 to 1928, the following would be the only changes in the above total:

	1928.	Highest of 1925 to 1928.
	\$	\$
Denmark	46,000,000	56,000,000
Greece	7,000,000	10,000,000
Holland	175,000,000	178,000,000
Canada	114,000,000	158,000,000
Chile	7,000,000	34,000,000
New Zealand	35,000,000	38,000,000
Java	68,000,000	79,000,000
South Africa	39,000,000	44,000,000

CHAPTER V

THE INTERNATIONAL NOTE ISSUE AND THE GOLD STANDARD

In the last chapter I have proposed the creation of an International Note Issue designed to relieve the anxieties of the world's Central Banks, so as to free their hands to promote loan-expenditure and thus raise prices and restore employment. The necessity of this policy is a consequence of the conclusion, which I reiterate with emphasis, that there is no means of raising world prices except by increasing loan-expenditure. But it is desirable that I should attempt to fill in some further details in this far-reaching proposal.

Its adoption would afford a good opportunity, if sufficient agreement could be obtained, to secure promises that the assistance thus given would be used, in the first instance, to abate certain unsound international practices which have become common under stress of hard circumstances. Exchange restrictions should be abolished. Standstill agreements and the immobilisation of foreign balances should be replaced by definitive schemes for gradual liquidation. Tariffs and quotas imposed to protect the foreign balance, and not in pursuance of permanent national policies, should be removed. The stronger financial centres should re-open their money markets to foreign loans. Defaults on public debts held abroad should be terminated, with the aid of the postponement of sinking funds and some writing down of interest or principal, perhaps based on an index number of prices, where incapacity, even in the new circumstances, is proved to the satisfaction of an independent expert body. For my own part, I should withhold participation in the scheme from any country which was acting in defiance of its international agreements and obligations.

Subject to these external conditions, it would be advisable to leave to each participant an unfettered discretion as to the best means of utilising its quota. For there is great variety in the needs of different countries. Some would discharge pressing foreign obligations; some would restore budgetary equilibrium; some would re-establish commercial credit; some would prepare for conversion schemes; some would organise schemes of national development; and so on. But all uses alike would tend in the desired direction.

There remains, however, one essential condition, upon which I have not yet touched. The notes would be gold-notes, and the participants would agree to accept them as the equivalent of gold. This implies that the national currencies of each participant would stand in some defined relationship to gold. It involves, that is to say, a qualified return to the gold standard.

It may seem odd that I, who have lately described gold as "a barbarous relic", should be discovered as an advocate of such a policy, at a time when the orthodox authorities of this country are laying down conditions for our return to gold which they must know to be impossible of fulfilment. It may be that, never having loved gold, I am not so subject to disillusion. But, mainly, it is because I believe that gold has received such a gruelling that conditions might now be laid down for its future management, which would not have been acceptable otherwise. At any rate my advocacy is subject to the qualifications which follow.

It would be a necessary condition for the adoption of the proposed International Note Issue that each participating country should adopt a *de facto* parity between gold and its national currency, with buying and selling points for gold separated by not more than 5 per cent. With the increased supply of gold and its equivalent brought into existence by the new Note Issue, such a commitment by this country would be, in my judgement, both safe and advisable. The *de facto* parity should be alterable, if necessary, from time to time if circumstances were to require, just like bank-rate,—though by small degrees one would hope. An unchangeable parity would be unwise until we know much more about the future course of international prices, and the success of the board of the new international authority in influencing it; and it would, moreover, be desirable to maintain permanently some power of gradual adjustment between national and international conditions. In addition, the governing board should have some discretionary power to deal with emergencies and exceptional cases. The margin of 5 per cent between the gold points would be essential, in the light of recent experience, as a deterrent and a protection against the wild movements of liquid funds from one international centre to another, and to allow a reasonable independence of bank-rate and credit policy to suit differing national circumstances,—though there would be nothing to prevent a Central Bank from maintaining the gold equivalent of its national money within narrower limits in normal practice.

With these precautionary safeguards there would be much to gain and little to lose from the greater stability of the foreign exchanges which would ensue. There can be no object in exchange fluctuations except to offset undesired

changes in the international price level, or, occasionally, to make an adjustment, with the minimum of friction, to special national conditions, temporary or permanent; and they should not be allowed to occur for any other reason.

It can be claimed, I think, as a considerable incidental advantage of the plan here set forth, that it would enable the condition to be satisfied which our authorities have laid down for even a qualified return to gold on the part of this country, namely, that there must be a more equal distribution of the world's gold reserves. Indeed I can imagine no other way by which this condition could be satisfied within a reasonable time. For if it means that the Bank of France and the Federal Reserve System of the United States are to share out their gold reserves with the impecunious countries of the world, it is clearly quite remote—to-day more than ever—from anything which can possibly happen. Equally if it means that these countries are to lend abroad sums so much greater than their foreign balance as to lead to a heavy outward drain of gold, this also is what no reasonable person would expect. Moreover, in the conditions of to-day, with the employment of foreign balances as reserve money completely at an end, and after the experiences by the world's strongest financial centres of the scale on which balances can seek to move, it is not merely a question of the maldistribution of gold. We need a much greater absolute amount of reserve money to support a given level of world-prices, than was necessary before the recent shocks to international credit. This may not be a permanent requirement. But it exists to-day, and it must be satisfied before we can expect that ease of mind and absence of anxiety on the part of Central Banks which is a condition of their freely encouraging the increased loan-expenditure without which world prices cannot rise. Some such plan, therefore, as that which I have proposed has become an indispensable condition of world recovery. It is useless to do lip-service to the need of raising world prices if we neglect the only measures which can have that result.

The alternative, sometimes suggested, of a simultaneous devaluation of all national currencies in terms of gold, whilst offering some advantages, has the great defect that it would only strengthen the position of those countries which already hold large reserves of gold and are, therefore, relatively strong.

CHAPTER VI

CONCLUSION

I have endeavoured to cover a wide field in a few words. But my theme has been essentially simple, and I am hopeful, therefore, that I have been able to convey it to the reader.

Many proposals now current are substantially similar in intention to the proposals of this pamphlet. Some deal with one part of the field; some with another. We shall have need of more than one, if our action is to be adequate to the problem. After making all due allowances for the factors which will cause a larger number of men to appear in the unemployment returns even in good times, we have the task of putting at least 1,000,000 men back to work. On the figure of £150 primary expenditure to put one man to work for a year, which I have adopted above as my working hypothesis, we should need an increased loan-expenditure *plus* an increased foreign balance amounting altogether to £150,000,000. If we take the more optimistic figure of £100 per man, which I am myself disposed to favour, the primary expenditure required will be £100,000,000 per annum. We cannot rely on much further assistance towards this total from the foreign balance, until after world recovery has set in. Thus it would be prudent to assume that we have urgent need of the addition of at least £100,000,000 to our annual primary expenditure from increased loan-expenditure at home.

This is a formidable, but not an impossible, figure to attain. At least £50,000,000 might reasonably come from a relief of taxation as a result of suspending the sinking fund and borrowing for appropriate purposes; though this would not lead to increased primary expenditure of so much as £50,000,000. On this basis an additional loan-expenditure of (say) £60,000,000 by private enterprise, assisted and unassisted, local authorities, public boards, and the Central Government, would be a substantial step towards re-establishing employment.

We are, I think, too much discouraged as to the potentialities of fruitful action along these lines, because the effect of previous efforts has been masked by offsetting influences. It is most important to understand that the effects of loan-expenditure and of the foreign balance are *in pari materia*. Thus it was the rapid decline of the foreign balance by £75,000,000 in 1930 and by £207,000,000 in 1931 as compared with 1929,^[1] which defeated the attempt of the Labour Government to increase employment by loan-expenditure; the additional loan-expenditure for which they were responsible being on a much smaller scale than this. But, again, the improvement of the foreign balance in 1932 by £74,000,000 as compared with 1931 has brought no increase in employment, because it has been offset by the drastic measures of the National Government to reduce loan-expenditure. Heaven knows to what plight a combination of the policy of the Labour Government in doing nothing to protect the foreign balance, with the policy of the National Government to curtail loan-expenditure might not have brought us! Business losses would have risen to a figure comparable with those in the United States,^[2] bankrupting our railways and bringing the industry of the country virtually to a standstill. On the other hand, we have the other combination still untried—the policy of protecting the foreign balance and at the same time doing all in our power to stimulate loan-expenditure.

I plead, therefore, for a trial of this untried combination in our domestic policy; and for the World Economic Conference an advocacy by our representatives of an expansion of international reserve money on the general lines proposed above.

For we have reached a critical point. In a sense, it is true that the mists are lifting. We can, at least, see clearly the gulf to which our present path is leading. Few of us doubt that we must, without much more delay, find an effective means to raise world prices; or we must expect the progressive breakdown of the existing structure of contract and instruments of indebtedness, accompanied by the utter discredit of orthodox leadership in finance and government, with what ultimate outcome we cannot predict.

The authorities in power have pronounced in favour of raising world prices. It is, therefore, incumbent upon them to have some positive policy directed to that end. If they have one, we do not know what it is. I have tried to indicate some of the fundamental conditions which their policy must satisfy if it is to be successful, and to suggest the kind of plan which might be capable of realising these conditions.

FOOTNOTES:

These figures are the estimates of the Board of Trade, except that the American debt payment in 1932, which was paid for in gold, has been omitted. I believe myself that in all these years the absolute figures may have been some £25,000,000 better than the Board of Trade allows. But this would not affect the comparative figures given above.

I should attribute the extremity of the plight of the United States largely to the combined effect of their having no dole financed out of loans, as there was in this country prior to 1932, and no means of improving the foreign balance such as we employed after September 1931.

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