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THE GREAT SLUMP OF 1930

By

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I.

The world has been slow to realize that we are living this year in the shadow of one of the greatest economic catastrophes of modern history. But now that the man in the street has become aware of what is happening, he, not knowing the why and wherefore, is as full to-day of what may prove excessive fears as, previously, when the trouble was first coming on, he was lacking in what would have been a reasonable anxiety. He begins to doubt the future. Is he now awakening from a pleasant dream to face the darkness of facts? Or dropping off into a nightmare which will pass away?

He need not be doubtful. The other was *not* a dream. This *is* a nightmare, which will pass away with the morning. For the resources of nature and men's devices are just as fertile and productive as they were. The rate of our progress towards solving the material problems of life is not less rapid. We are as capable as before of affording for everyone a high standard of life—high, I mean, compared with, say, twenty years ago—and will soon learn to afford a standard higher still. We were not previously deceived. But to-day we have involved ourselves in a colossal muddle, having blundered in the control of a delicate machine, the working of which we do not understand. The result is that our possibilities of wealth may run to waste for a time—perhaps for a long time.

I doubt whether I can hope, in these articles, to bring what is in my mind into fully effective touch with the mind of the reader. I shall be saying too much for the layman, too little for the expert. For—though no one will believe it—economics is a technical and difficult subject. It is even becoming a science. However, I will do my best—at the cost of leaving out, because it is too complicated, much that is necessary to a complete understanding of contemporary events.

First of all, the extreme violence of the slump is to be noticed. In the three leading industrial countries of the world—the United States, Great Britain, and Germany—10,000,000 workers stand idle. There is scarcely an important industry anywhere earning enough profit to make it expand—which is the test of progress. At the same time, in the countries of primary production the output of mining and of agriculture is selling, in the case of almost every important commodity, at a price which, for many or for the majority of producers, does not cover its cost. In 1921, when prices fell as heavily, the fall was from a boom level at which producers were making abnormal profits; and there is no example in modern history of so great and rapid a fall of prices from a normal figure as has occurred in the past year. Hence the magnitude of the catastrophe.

The time which elapses before production ceases and unemployment reaches its maximum is, for several reasons, much longer in the case of the primary products than in the case of manufacture. In most cases the production units are smaller and less well organized amongst themselves for enforcing a process of orderly contraction; the length of the production period, especially in agriculture, is longer; the costs of a temporary shut-down are greater; men are more often their own employers and so submit more readily to a contraction of the income for which they are willing to work; the social problems of throwing men out of employment are greater in more primitive communities; and the financial problems of a cessation of production of primary output are more serious in countries where such primary output is almost the whole sustenance of the people. Nevertheless we are fast approaching the phase in which the output of primary producers will be restricted almost as much as that of manufacturers; and this will have a further adverse reaction on manufacturers, since the primary producers will have no purchasing power wherewith to buy manufactured goods; and so on, in a vicious circle.

In this quandary individual producers base illusory hopes on courses of action which would benefit an individual producer or class of producers so long as they were alone in pursuing them, but which benefit no one if everyone pursues them. For example, to restrict the output of a particular primary commodity raises its price, so long as the output of the industries which use this commodity is unrestricted; but if output is restricted all round, then the demand for the primary commodity falls off by just as much as the supply, and no one is further forward. Or again, if a particular producer or a particular country cuts wages, then, so long as others do not follow suit, that producer or that country is able to get more of what trade is going. But if wages are cut all round, the purchasing power of the community as a whole is reduced by the same amount as the reduction of costs; and, again, no one is further forward.

Thus neither the restriction of output nor the reduction of wages serves in itself to restore equilibrium.

Moreover, even if we were to succeed eventually in re-establishing output at the lower level of money-wages appropriate to (say) the pre-war level of prices, our troubles would not be at an end. For since 1914 an immense burden of bonded debt, both national and international, has been contracted, which is fixed in terms of money. Thus every fall of prices increases the burden of this debt, because it increases the value of the money in which it is fixed. For example, if we were to settle down to the pre-war level of prices, the British National Debt would be nearly 40 per cent. greater than it was in 1924 and double what it was in 1920; the Young Plan would weigh on Germany much more heavily than the Dawes Plan, which it was agreed she could not support; the indebtedness to the United States of her associates in the Great War would represent 40-50 per cent. more goods and services than at the date when the settlements were made; the obligations of such debtor countries as those of South America and Australia would become insupportable without a reduction of their standard of life for the benefit of their creditors; agriculturists and householders throughout the world, who have borrowed on mortgage, would find themselves the victims of their creditors. In such a situation it must be doubtful whether the necessary adjustments could be made in time to prevent a series of bankruptcies, defaults, and repudiations which would shake the capitalist order to its foundations. Here would be a fertile soil for agitation, seditions, and revolution. It is so already in many quarters of the world. Yet, all the time, the resources of nature and men's devices would be just as fertile and productive as they were. The machine would merely have been jammed as the result of a muddle. But because we have magneto trouble, we need not assume that we shall soon be back in a rumbling waggon and that motoring is over.

II.

We have magneto trouble. How, then, can we start up again? Let us trace events backwards:—

1. Why are workers and plant unemployed? Because industrialists do not expect to be able to sell without loss what would be produced if they were employed.

2. Why cannot industrialists expect to sell without loss? Because prices have fallen more than costs have fallen—indeed, costs have fallen very little.

3. How can it be that prices have fallen more than costs? For costs are what a business man pays out for the production of his commodity, and prices determine what he gets back when he sells it. It is easy to understand how for an individual business or an individual commodity these can be unequal. But surely for the community as a whole the business men get back the same amount as they pay out, since what the business men pay out in the course of production constitutes the incomes of the public which they pay back to the business men in exchange for the products of the latter? For this is what we understand by the normal circle of production, exchange, and consumption.

4. No! Unfortunately this is not so; and here is the root of the trouble. It is not true that what the business men pay out as costs of production necessarily comes back to them as the sale-proceeds of what they produce. It is the characteristic of

a boom that their sale-proceeds exceed their costs; and it is the characteristic of a slump that their costs exceed their sale-proceeds. Moreover, it is a delusion to suppose that they can necessarily restore equilibrium by reducing their total costs, whether it be by restricting their output or cutting rates of remuneration; for the reduction of their outgoings may, by reducing the purchasing power of the earners who are also their customers, diminish their sale-proceeds by a nearly equal amount.

5. How, then, can it be that the total costs of production for the world's business as a whole can be unequal to the total sale-proceeds? Upon what does the inequality depend? I think that I know the answer. But it is too complicated and unfamiliar for me to expound it here satisfactorily. (Elsewhere I have tried to expound it accurately.) So I must be somewhat perfunctory.

Let us take, first of all, the consumption-goods which come on to the market for sale. Upon what do the profits (or losses) of the producers of such goods depend? The total costs of production, which are the same thing as the community's total earnings looked at from another point of view, are divided in a certain proportion between the cost of consumption-goods and the cost of capital-goods. The incomes of the public, which are again the same thing as the community's total earnings, are also divided in a certain proportion between expenditure on the purchase of consumption-goods and savings. Now if the first proportion is larger than the second, producers of consumption-goods will *lose* money; for their sale proceeds, which are equal to the expenditure of the public on consumption-goods, will be less (as a little thought will show) than what these goods have cost them to produce. If, on the other hand, the second proportion is larger than the first, then the producers of consumption-goods will make exceptional *gains*. It follows that the profits of the producers of consumption goods can only be restored, either by the public spending a larger proportion of their incomes on such goods (which means saving less), or by a larger proportion of production taking the form of capital-goods (since this means a smaller proportionate output of consumption-goods).

But capital-goods will not be produced on a larger scale unless the producers of such goods are making a profit. So we come to our second question—upon what do the profits of the producers of capital-goods depend? They depend on whether the public prefer to keep their savings liquid in the shape of money or its equivalent or to use them to buy capital-goods or the equivalent. If the public are reluctant to buy the latter, then the producers of capital-goods will make a loss; consequently less capital-goods will be produced; with the result that, for the reasons given above, producers of consumption-goods will also make a loss. In other words, *all* classes of producers will tend to make a loss; and general unemployment will ensue. By this time a vicious circle will be set up, and, as the result of a series of actions and reactions, matters will get worse and worse until something happens to turn the tide.

This is an unduly simplified picture of a complicated phenomenon. But I believe that it contains the essential truth. Many variations and fugal embroideries and orchestrations can be superimposed; but this is the tune.

If, then, I am right, the fundamental cause of the trouble is the lack of new enterprise due to an unsatisfactory market for capital investment. Since trade is international, an insufficient output of new capital-goods in the world as a whole affects the prices of commodities everywhere and hence the profits of producers in all countries alike.

Why is there an insufficient output of new capital-goods in the world as a whole? It is due, in my opinion, to a conjunction of several causes. In the first instance, it was due to the attitude of lenders—for new capital-goods are produced to a large extent with borrowed money. Now it is due to the attitude of borrowers, just as much as to that of lenders.

For several reasons lenders were, and are, asking higher terms for loans, than new enterprise can afford. First, the fact, that enterprise could afford high rates for some time after the war whilst war wastage was being made good, accustomed lenders to expect much higher rates than before the war. Second, the existence of political borrowers to meet Treaty obligations, of banking borrowers to support newly restored gold standards, of speculative borrowers to take part in Stock Exchange booms, and, latterly, of distress borrowers to meet the losses which they have incurred through the fall of prices, all of whom were ready if necessary to pay almost any terms, have hitherto enabled lenders to secure from these various classes of borrowers higher rates than it is possible for genuine new enterprise to support. Third, the unsettled state of the world and national investment habits have restricted the countries in which many lenders are prepared to invest on any reasonable terms at all. A large proportion of the globe is, for one reason or another, distrusted by lenders, so that they exact a premium for risk so great as to strangle new enterprise altogether. For the last two years, two out of the three principal creditor nations of the world, namely, France and the United States, have largely withdrawn their resources from the international market for long-term loans.

Meanwhile, the reluctant attitude of lenders has become matched by a hardly less reluctant attitude on the part of borrowers. For the fall of prices has been disastrous to those who have borrowed, and anyone who has postponed new enterprise has gained by his delay. Moreover, the risks that frighten lenders frighten borrowers too. Finally, in the United States, the vast scale on which new capital enterprise has been undertaken in the last five years has somewhat exhausted for the time being—at any rate so long as the atmosphere of business depression continues—the profitable opportunities for yet further enterprise. By the middle of 1929 new capital undertakings were already on an inadequate scale in the world as a whole, outside the United States. The culminating blow has been the collapse of new investment inside the United States, which to-day is probably 20 to 30 per cent. less than it was in 1928. Thus in certain countries the opportunity for new profitable investment is more limited than it was; whilst in others it is more risky.

A wide gulf, therefore, is set between the ideas of lenders and the ideas of borrowers for the purpose of genuine new capital investment; with the result that the savings of the lenders are being used up in financing business losses and distress borrowers, instead of financing new capital works.

At this moment the slump is probably a little overdone for psychological reasons. A modest upward reaction, therefore, may be due at any time. But there cannot be a real recovery, in my judgment, until the ideas of lenders and the ideas of productive borrowers are brought together again; partly by lenders becoming ready to lend on easier terms and over a wider geographical field, partly by borrowers recovering their good spirits and so becoming readier to borrow.

Seldom in modern history has the gap between the two been so wide and so difficult to bridge. Unless we bend our wills and our intelligences, energized by a conviction that this diagnosis is right, to find a solution along these lines, then, if the diagnosis *is* right, the slump may pass over into a depression, accompanied by a sagging price-level, which might last for years, with untold damage to the material wealth and to the social stability of every country alike. Only if we seriously seek a solution, will the optimism of my opening sentences be confirmed—at least for the nearer future.

It is beyond the scope of this article to indicate lines of future policy. But no one can take the first step except the central banking authorities of the chief creditor countries; nor can any one Central Bank do enough acting in isolation. Resolute action by the Federal Reserve Banks of the United States, the Bank of France, and the Bank of England might do much more than most people, mistaking symptoms or aggravating circumstances for the disease itself, will readily believe. In every way the more effective remedy would be that the Central Banks of these three great creditor nations should join together in a bold scheme to restore confidence to the international long-term loan market; which would serve to revive enterprise and activity everywhere, and to restore prices and profits, so that in due course the wheels of the world's commerce would go round again. And even if France, hugging the supposed security of gold, prefers to stand aside from the adventure of creating new wealth, I am convinced that Great Britain and the United States, like-minded and acting together, could start the machine again within a reasonable time; if, that is to say, they were energized by a confident conviction as to what was wrong. For it is chiefly the lack of this conviction which to-day is paralyzing the hands of authority on both sides of the Channel and of the Atlantic.

[End of *The Great Slump of 1930* by John Maynard Keynes]