

KING'S COLLEGE,
CAMBRIDGE.

Private personal

February 1, 1938

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Dear Mr President,

You received me so kindly when I visited you some three years ago that I make bold to send you some bird's eye impressions which I have formed as to the business position in the United States. You will appreciate that I write from a distance, that I have not re-visited the United States since you saw me, and that I have access to few more sources of information than those publicly available. But sometimes in some respects there may be advantages in these limitations! At any rate, those things which I think I see, I see very clearly.

1. I should agree that the present recession is partly due to an "error of optimism" which led to an over-estimation of future demand, when orders were being placed in the first half of this year. If this were all, there would not be too much to worry about. It would only need time to effect a readjustment; - though, even so, the recovery would only be up to the point required to take care of the revised estimate

of current demand, which might fall appreciably short of the prosperity reached last spring.

2. But I am quite sure that this is not all. There is a much more troublesome underlying influence. The recovery was mainly due to the following factors:-

(i) the solution of the credit and insolvency problems, and the establishment of easy short-term money;

(ii) the creation of an adequate system of relief for the unemployed;

(iii) public works and other investments aided by Government funds or guarantees;

(iv) investment in the instrumental goods required to supply the increased demand for consumption goods;

(v) the momentum of the recovery thus initiated.

Now of these (i) was a prior condition of recovery, since it is no use creating a demand for credit, if there is no supply. But an increased supply will not by itself generate an adequate demand. The influence of (ii) evaporates as employment improves, so that there is a dead point beyond which this factor cannot carry the economic system. Recourse to (iii) has been greatly curtailed in the past year. (iv) and (v) are functions of the forward movement and cease - indeed (v) is reversed - as soon as the position

fails to improve further. The benefit from the momentum of recovery as such is at the same time the most important and the most dangerous factor in the upward movement. It requires for its continuance, not merely the maintenance of recovery, but always further recovery. Thus it always flatters the early stages and steps from under just when support is most needed. It was largely, I think, a failure to allow for this which caused the "error of optimism" last year.

Unless, therefore, the above factors were supplemented by others in due course, the present slump could have been predicted with absolute certainty. It is true that the existing policies will prevent the slump from proceeding to such a disastrous degree as last time. But they will not by themselves - at any rate, not without a large scale recourse to (iii) - maintain prosperity at a reasonable level.

3. Now one had hoped that the needed supplementary factors would be organised in time. It was obvious what these were - namely increased investment in durable goods such as housing, public utilities and transport. One was optimistic about this because in the United States at the present time the opportunities, indeed the necessity, for such developments were unexampled. Can your Administration escape

criticism for the failure of these factors to mature?

Take housing. When I was with you three and a half years ago the necessity for effective new measures was evident. I remember vividly my conversations with Riefler at that time. But what happened? Next to nothing. The handling of the housing problem has been really wicked. I hope that the new measures recently taken will be more successful. I have not the knowledge to say. But they will take time, and I would urge the great importance of expediting and yet further aiding them. Housing is by far the best aid to recovery because of the large and continuing scale of potential demand; because of the wide geographical distribution of this demand; and because the sources of its finance are largely independent of the Stock Exchanges. I should advise putting most of your eggs in this basket, caring about this more than about anything, and making absolutely sure that they are being hatched without delay. In this country we partly depended for many years on direct subsidies. There are few more proper objects for such than working class houses. If a direct subsidy is required to get a move on (we gave our subsidies through the local authorities), it should be given without delay or hesitation.

Next utilities. These seem to be a deadlock. Neither your policy nor anyone else's is able to take effect. I

think that the litigation by the utilities is senseless and ill-advised. But a great deal of what is alleged against the wickedness of holding companies as such is surely wide of the mark. It does not draw the right line of division between what should be kept and what discarded. It arises too much out of what is dead and gone. The real criminals have cleared out long ago. I should doubt if the controls existing to-day are of much personal value to anyone. No-one has suggested a procedure by which the eggs can be unscrambled. Why not tackle the problem by insisting that the voting power should belong to the real owners of the equity, and leave the existing organisations undisturbed, so long as the voting power is so rearranged (e.g. by bringing in preferred stockholders) that it cannot be controlled by the holders of a minority of the equity?

Is it not for you to decide either to make real peace or to be much more drastic the other way? Personally I think there is a great deal to be said for the ownership of all the utilities by publicly owned boards. But if public opinion is not yet ripe for this, what is the object of chasing the utilities round the lot every other week? If I was in your place, I should buy out the utilities at fair prices in every district where the situation was ripe

for doing so, and announce that the ultimate ideal was to make this policy nation-wide. But elsewhere I would make peace on liberal terms, guaranteeing fair earnings on new investments and a fair basis of valuation in the event of the public taking them over hereafter. The process of evolution will take at least a generation. Meanwhile a policy of competing plants with losses all round is a ramshackle notion.

Finally the railroads. The position there seems to be exactly what it was three or four years ago. They remain, as they were then, potential sources of substantial demand for new capital expenditure. Whether hereafter they are publicly owned or remain in private hands, it is a matter of national importance that they should be made solvent. Nationalise them if the time is ripe. If not, take pity on the overwhelming problems of the present managements. And here too let the dead bury their dead. (To an Englishman, you Americans, like the Irish, are so terribly historically minded!)

I am afraid I am going beyond my province. But the upshot is this. A convincing policy, whatever its details may be, for promoting large-scale investment under the above heads is an urgent necessity. These things take time.

Far too much precious time has passed.

4. I must not encumber this letter with technical suggestions for reviving the capital market. This is important. But not so important as the revival of sources of demand. If demand and confidence re-appear, the problems of the capital market will not seem so difficult as they do to-day. Moreover it is a highly technical problem.

5. Business men have a different set of delusions from politicians; and need, therefore, different handling. They are, however, much milder than politicians, at the same time allured and terrified by the glare of publicity, easily persuaded to be 'patriots', perplexed, bemused, indeed terrified, yet only too anxious to take a cheerful view, vain perhaps but very unsure of themselves, pathetically responsive to a kind word. You could do anything you liked with them, if you would treat them (even the big ones), not as wolves and tigers, but as domestic animals by nature, even though they have been badly brought up and not trained as you would wish. It is a mistake to think that they are more immoral than politicians. If you work them into the surly, obstinate, terrified mood, of which domestic animals, wrongly handled, are so capable, the nation's burdens will not get carried to market; and in the end public opinion will veer their way. Perhaps you will rejoin that I have got

quite a wrong idea of what all the back-chat amounts to. Nevertheless I record accurately how it strikes observers here.

5. Forgive the candour of these remarks. They come from an enthusiastic well-wisher of you and your policies. I accept the view that durable investment must come increasingly under state direction. I sympathise with Mr Wallace's agricultural policies. I believe that the S.E.C. is doing splendid work. I regard the growth of collective bargaining as essential. I approve minimum wage and hours regulation. I was altogether on your side the other day, when you deprecated a policy of general wage reductions as useless in present circumstances. But I am terrified lest progressive causes in all the democratic countries should suffer injury, because you have taken too lightly the risk to their prestige which would result from a failure measured in terms of immediate prosperity. There need be no failure. But the maintenance of prosperity in the modern world is extremely difficult; and it is so easy to lose precious time.

I am
Mr President

Yours with great respect and
faithfulness,

JM Keynes

Personal & Private

March 3, 1938

P. P. F.
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Dear Mr. Keynes:

I am in receipt of your letter of February first, which I enjoyed reading. It was very pleasant and encouraging to know that you are in agreement with so much of the Administration's economic program. This confirmation coming from so eminent an economist is indeed welcome.

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Your analysis of the present business situation is very interesting. The emphasis you put upon the need for stimulating housing construction is well placed, and I hope that our efforts will be successful in removing the barriers to the revival of this industry.

The course of democracy and world peace is of deep concern to me. Domestic prosperity, you will agree, is one of the most effective contributions the United States can make to their maintenance. You will likewise appreciate, I am sure, that prosperity in the United States will be more potent in attaining the ends we are all interested in if other democracies strive persistently for similar objectives.

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I remember your previous visit very well and I hope we may have the opportunity to meet again.

Very sincerely yours,

J. M. Keynes, Esq., #
King's College,
Cambridge,
England.

Draft prepared by the Secretary of the
Treasury

mdp