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Need the Depression Last Forever

BY R. F. KAHN, M.A.

PROFESSOR GILBERT JACKSON, as Chairman:—Gentlemen, it is a two-fold pleasure to introduce to you this morning Mr. R. F. Kahn of King's College, Cambridge. For myself, it is a personal pleasure, as our visiting speaker comes from my old university in England. For all members of the Canadian Club, it is a very great pleasure, because Mr. Kahn is a distinguished member of a very small group or organization, of which Mr. T. Maynard Keynes perhaps forms the centre, which has done so much in recent years to make clearer our understanding of boom and depression and, incidentally, to re-write a good deal of accepted economic theory. I describe these men as a group and not as a school because it is not orthodoxy that they preach. They have not made the mistake in these very difficult times of trying to shape an orthodoxy which everyone is going to be called upon to believe but rather attempt to broaden our knowledge of economics, unfortunately so narrow, and to make it possible for a larger number of us to understand what are really the forces controlling our financial destiny. Mr. Kahn has pointed out to me that he still possesses the youth which so many of us are trying to keep by means of various devices. He is, I think, one of the youngest speakers who have visited us this year, and I think I may say, that it is a tribute to Cambridge that she fearlessly comes out and does not hold back very young men who are capable of carrying the banner of truth forward. In connection with the same fact, Mr. Kahn has expressed a certain trepidation at meeting the Canadian Club of Toronto which, I am sure, your reception of him, will soon remove. But

it should be said to his credit, that he has fortified himself before coming to this gathering. Not in the manner which should have been possible by your chairman for, I am frank to confess, that I forgot such means of fortification. He fortified himself by spending three weeks in the City of Chicago. Any man who does that before coming to Toronto should be well qualified to face us. Mr. Kahn.

MR. KAHN:—Mr. Chairman, ladies and gentlemen, I think it would be the simplest way if I began, at the very outset, by giving an answer, for what it is worth, to the question which I have chosen as the title of my address, "Need the Depression Last Forever?" My answer—for what it is worth, I repeat and emphasize—is that in actual fact, given the right policy, and given the right men to carry that policy out, there is no reason on earth why the depression should not be brought to an end within quite a short time—a question, perhaps, merely of months. But, taking things as they are and governments as they are, it is hard to see why the depression should ever come to an end. When I say that there is no reason why the depression should not be brought to an end, what I have in mind is, there is nothing intrinsic in the present organization of society to prevent depressions being brought to an end, or indeed to cause depressions. It is all a question of leadership on the part of bankers and of governments. Given a certain condition, which I shall try to explain in a few minutes, the present system, it seems to me, is capable of running on even keel. I hasten to point out that I hold no brief for the present system but I think there is considerable danger, when one is thinking of remedies for the depression, of criticizing one thing for something that it is not responsible for. What I have in mind is this constant reference to over-production. What I should like to suggest is that to talk of over-production is really impossible. The impossible is often achieved! Of course, you can have over-production in particular commodities. But, to talk of over-production of commodities in general—that, I suggest, is a contradiction in terms, so long as people have not so much of everything that they would not take

any more even if you gave it to them for nothing. People earn exactly the amount their output costs to produce. If you add to the total amount, wages, rent, profits and the like, you get a sum of money which, if everything is proceeding normally, is exactly equal to the cost of production and if that sum is spent on purchasing goods then everything will go normally.

Again, in passing, one may notice that substitution of machinery for labor cannot be put forward as a reason for unemployment. If a man and one machine can do the work previously done by two men there is twice the output there was before. We are twice as wealthy as we were before. If money earned increases that is just what we want to pay for the extra goods produced. But, obviously, I have tried to prove far too much. I have tried to show that over-production is impossible. If you look at the world to-day you clearly have got over-production. Goods are being sold in quantities that cannot be sold at a price that covers the cost of production. Well, I prefer to look at it as under-consumption. You see what I have done is to demonstrate that everything would be running beautifully provided all wages and profits were spent on buying goods. But all wages and profits are not spent in buying goods. Part of people's earnings are saved. They may be devoted to buying paper securities on the stock exchange; they may be put into banks but not directly devoted to buying goods. Only that part of the people's earnings that is not saved goes directly in purchasing goods.

But this is not the whole picture. Just as a portion of a people's earnings is not devoted to expenditure on consumption, so a portion of a country's output of goods, from the production of which much of a country's earnings is derived, does not consist of consumption goods. People earn money not only by producing consumption goods but also by producing what we call investment goods—the part of a country's output that Mr. Keynes called investment. By investment, we mean, broadly speaking, constructional activity, the building of roads, railways, houses, machines, factories, in fact anything

that is produced and is not consumed forthwith. Now, I come to the gist of Mr. Keynes' theory. It is easy to see that if investment in this sense is called savings, then the goods that are produced will sell at a price that covers their cost of production. In other words, if that part of a country's output that does not consist of consumption goods is equivalent to that part of a people's earnings that is not devoted to consumption goods, then the system will run on even keel. But, if investment falls off, if constructional activity declines, then the demand for goods falls off and depression ensues and that is precisely what has happened to-day. There has been an enormous falling off all over the world in constructional activity.

I should like, if I may, just to give you one series of figures from the January number of *The Monthly Review* of the Bank of Nova Scotia. If we take the average of employment in Canada provided by building construction as representative of the years 1925 to 1929 by one hundred, then it went up during 1929 to one hundred and sixty. By December 1931, it was down to seventy-eight and, last December, it was as low as thirty-four. One could give the average for the years 1925 to 1929 and obtain similar figures for the United States and much the same would be true of every country in the world. These figures are capable of telling you most of what is necessary to know. When constructional activity declines, there are more out of work and the less you can spend on consumption goods. The people engaged in producing consumption goods in their turn have less to spend. They are also less inclined because production is unprofitable, so you get a vicious double circle spreading out and you have the situation we know to-day.

If this analysis is correct, the remedy is obvious. We are suffering from a lack of demand for goods. There is only one way to raise the demand for goods and that is to increase the rate of constructional activity or investment or to diminish the rate of saving. Now, from time to time, slumps have come to an end as a result of recovery in the rate of constructional activity. Rates of interest fall at a

time of depression and credit becomes easy. It is very easy to see how a fall in the rate of interest tends to promote constructional activity. Consider the case of a man who is contemplating embarking on some capital enterprise. He will make an estimate of the yield he may expect to get if he invests money in that enterprise and he will compare his estimate to the rate of interest that he would have to pay if he borrows money or if he borrowed his money he will estimate the rate of interest he could have obtained by investing the money in ordinary securities. A fall in the rate of interest will make capital enterprise profitable if it were not profitable before. It will increase the rate of constructional activity and it is a fall in the rates of interest that we want to-day. I shall be told, probably, that interest rates are already phenomenally low which is not true. Short term of interest discount rate is very low. Long term rate of interest on government securities is low, but it can be very much lower and has, in the past, been very much lower. The rate of interest banks charge on advances is far too high. I thought you would like that bit. And the rate of interest on industrial bonds is also high.

But, when all is said and done, I think it must be agreed that the depression has become so acute and production has become so unprofitable that the response of the private investor, the response of the person who might, under other conditions, be indulging in constructional activity—his response to a lower rate of interest, is going to be very small. The most, I think, we can hope for, is that a further easing of the credit situation will prevent things from getting worse than they are.

I have dealt now with the ordinary, normal channels by which one can hope increased expenditure on goods is to emerge. If we want a significant upward movement, then I really want to suggest we must look for State action. When the State undertakes public works which it finances by borrowing, it is increasing the rate of investment in Mr. Keynes' sense. When the State cuts down taxation without, at the same time, cutting down expenditure—more important, if the State increases expenditure without in-

creasing taxation, it is diminishing the nation's savings. In either case, whether there are public works or a budget deficit, expenditure on goods has decreased, the demand for goods is raised and employment activity will go up.

I think I am now treading on dangerous ground. I have no axe to grind in this matter. I am a professional economist who incidentally benefits because I have a fixed income. All I can do is to follow up a line of argument and draw certain conclusions. I am well aware that most people in this room will share the prevalent belief that it is the duty of governments at a time like the present to cut down public works, reduce expenditure and increase taxation. All I can do as an economist is not to try to comfort but to draw my own conclusions.

My conclusion is that so long as people continue to think in this way and so long as governments act in accordance with the way people think, then it is likely to be a very long time before the depression comes to an end. So long as you persist in cutting down expenditure whether it is the expenditure of the government itself or the expenditure of the taxpayer, you can only make matters worse. Take the case of Britain. Most of the benefit we might have hoped for as a result of lowering the rate of exchange has been offset by this fetish of economy. What are the arguments that are advanced against a policy of increased government expenditure—a policy, after all, when reduced to the last analysis of ordinary common sense, if you want more people employed then spend more money to employ them? What are the arguments against it? First of all, there is that terrible thing called confidence. I know as a result of sad experience how easy it is to upset any conclusion at which an economist arrives by the bogey called confidence. It is my belief that thing is exaggerated. It is too often called in by people who know they should try to do a certain thing but find it more comfortable not to do it lest they upset confidence. When the National Government was formed we were told how awful it would be if Britain left the Gold Standard. There was an economist speaking on the radio who must, one would have thought, have made his listeners'

blood curdle when he related to them the disasters that would ensue if Britain left the Gold Standard. Two days after that economist was speaking, Britain left the Gold Standard. There was no panic buying, no lack of confidence. The government in its anxiety had hastily distributed notices which it put all over, begging the people to carry on business as usual. People laughed at these notices. Why not carry on business as usual? As a matter of fact, business was going to be better than ever. There was a boom on the Stock Exchange, the moment Britain left the Gold Standard.

Please do not misunderstand me. I am not denying the importance of this thing called confidence. I say it is perhaps rather exaggerated. When people argue that government borrowing upsets confidence, they are assuming the expenditure of money the government borrows is going to have no effect. It is quite true, if the government borrows a large sum of money and hands it over to millionaires who have no need for it and do not spend it, that will upset confidence. If money is spent, you offset depressing effects, and an increase in output and employment and the rise of prices and profits will come about as a result of the expenditure of that money.

In the same way, when people argue that balancing of the budget will promote confidence, they forget that a decline in trade physically brought about by an attempt to balance the budget will do far more to upset confidence than balancing the budget will do to promote it. Even if balancing the budget were successful in promoting confidence, which I deny, it would only do so if the budget were successfully balanced. The whole trouble is that contraction in trade, that comes about as a result of the diminished expenditure of the government, means lower taxable income and the harder the government tries to balance the budget the harder the budget is to balance. Now, the spectacle of a dog chasing his own tail is not particularly ennobling. Whatever view one may take on this question of confidence, it must be agreed that an unsuccessful attempt to balance the budget will have a more disas-

trous effect on confidence. It is better not to have tried at all than to have tried and failed.

There is one aspect of this question of confidence that it is unwise to disparage—that is an aspect that must have a particular appeal to a Canadian audience. It might very well be that the Canadian authorities would be perfectly sensible in their efforts about affecting an increase in government expenditure, but if the people who hold liquid assets in Canada are not so sensible and think that Canada is embarking upon a perilous course and withdraw their funds to other financial centres, then Canada will be prevented from pursuing a sensible course owing to the fear of the effect of her actions in causing withdrawals and so a fall in her rate of interest. That is a serious problem, but I think it is usually exaggerated although it certainly does exist. It is very difficult for a country like Canada or for a country like Britain to act alone. But if the whole world were acting together then the whole problem would cease to exist at all. In this sphere more than any other sphere international co-operation can play a large part. If every country in the world were, at one and the same moment, conducting public works on an equally grand scale, if every country were running an equally large budget deficit then this problem would not arise. No country could be afraid of financiers withdrawing funds because by comparison there would be no better country to withdraw funds to.

The other grave problems of international indebtedness could be settled by suitable modification of this policy that I am putting before you. It would only be necessary for government expenditure on public works, on the ordinary purpose of government, it would be only necessary for government expenditure to proceed rather in the creditor countries with a necessary excess of imports over exports in the creditor countries and an excess of exports over imports within debtor countries. Thus the necessary payment of debts would be automatically brought about. A large program of government expenditure conducted simultaneously in all countries of the world as a result of international co-operation, it seems to me, is the only thing that is likely

to restore world prosperity if we are thinking in terms of the next few years.

But, I see very little hope of such a policy being put into operation. Members of the International Labor Bureau have long been advocating public works on an international scale. But their suggestions were frowned on by their more doctrinaire and more authoritative colleagues in the economic secretariat in the League of Nations. As for the World Economic Conference—well, you have only got to look at the summary recently published in the press and the report of the preparatory commission to realize that what is likely to happen is, this Conference will advocate that every government in the world shall put its finances in order, raise the level of taxation and reduce expenditure and cause more unemployment than ever.

Now, the next question you will be interested in is, where this money is going to come from that the governments are going to borrow and spend? I must confess that I have not been able to see where the problem lay. In the first place, failing all else, it is always possible for governments to borrow from the banks. Even in Canada, the Government has borrowed from banks. I can see no reason why, in the future, the Canadian Government cannot borrow from the banks and on a very large scale. As a matter of fact, by spending the money the governments would actually be supplying the private investor with the very amount required to lend back to the governments. The money will be passed from hand to hand in the purchasing of commodities and so in providing employment until finally, it reaches the hands of somebody who does not want to spend that money and wants to save it and, therefore, is willing to lend it back to the government from whom it originally came.

Finally, we have the question of the increase in the national debt that comes about when governments borrow money in order to spend it. Well, if the world is satisfied with the condition in which it finds itself then there is no clear reason why it should do anything at all. But I should have thought that most people would agree that it

is worth while incurring a small cost to get out of this terrible despondency, and the cost need not be very great for several reasons which I have only time to indicate. In the first place, you have to include the saving on the cost of supporting the unemployed which results from the reduction of the amount of unemployment. I have calculated that if the British Government spends a certain sum of money, say on public works, half that sum of money goes back to the British Treasury in the shape of a reduction in the cost of unemployment relief. As a matter of fact, about an equal amount of employment is provided as a result of the stimulus to the ordinary industries in the increased demand for commodities. That conclusion is based on the assumption that Britain acts alone but, if the whole world is acting together, then the saving in respect of unemployment relief is really going to be very much more than half, because each country will be getting the benefit from the actions of the other countries. On the top of that you must include the increased yield of taxation that comes about when trade revives. I should like to point out that the whole object of this kind of policy is to make capital enterprise on the part of the private investor once again profitable, so that easy credit shall have its normal effect in promoting constructional activity. It is not necessary to go on with this policy very long. What is necessary is to go at a very high intensity. It is no use tinkering with a problem of this magnitude. Something in the nature of shock tactics is what is required to get the wheels revolving again. Once the wheels start revolving again this system could be allowed to carry on under its own momentum. Then government excess of expenditure over income could be cut down. It is not really necessary to spend an enormous sum of money in the aggregate. What is necessary is to spend rapidly in a short time at a very high rate.

In the third place, it is all very well to talk about an increase in the national debts that will come about as a result of this kind of government activity but, as Professor Jackson pointed out to me a few days ago, the real burden of the national debts of every country in the world is con-

stantly increasing as a result of the fall in prices now going on. If the policy of government expenditure I am advocating were successful it would result in higher prices as well as increased output and employment and, as a consequence, the burden of national debts, measured not in money but in real things, may actually diminish.

To sum what I have been saying, things will not be normal until constructional activity revives. There are all sorts of policies which enable one country to gain an advantage at the expense of another country. You have, if you will, a fixed stock of misery, and one country, by means of a tariff can push part of that misery on other countries and, by some way, lower the rate of interest of one country and cause competition within all other countries. But if every country were to do the same thing then every country would be worse off than before. A fashionable policy is to reduce wages. Readjusting rental to costs and level of prices is a more polite way of putting it. Another fashionable policy is raising prices by reducing outputs and exports. Wheat producers may gain by a reduction in output but, so far as the world as a whole is concerned, obviously, if you are reducing the quantity you are doing exactly the opposite to what you want to do. The only thing, as I see it, is a recovery in the level of constructional activity. But the depression has become so acute that the ordinary remedies are no longer efficacious. Constructional activity will not revive except as a result of a remedy that many people will contemptuously refer to as artificial. I mean government expenditures financed by borrowing.

I know that I have only really been irritating most of my audience. I know that I have not been particularly encouraging. In fact, the more irritating you have found the purport of my remarks the more irritating they should have sounded. Most people believe it is the duty of governments, at the present time, to reduce expenditures with a corresponding reduction in taxation. As long as that represents the people's belief, as long as governments act accordingly, I can see no hope of recovery until something

happens that forces governments to spend money, whether that be something catastrophic in the nature of a war or an earthquake.

CHAIRMAN JACKSON:—The silence and attention with which you have listened to Mr. Kahn and your applause is evidence of our interest in what he has said. These are times, in the fourth year of the depression, when we have learned to push to one side all catch-words which once did a certain amount of work for us and to listen to every sincere idea which is put before us by any intelligent person. We have, I must say, had a good deal of luck in the English economists whom we were able to secure to address the Canadian Club. By luck I mean that we were able to secure Professor Gregory and Mr. Kahn on appropriate occasions. You may recall that when Professor Gregory came here for the first time Britain left the gold standard on the morning he was to address us. In the case of Mr. Kahn, a large body interested in the construction business begin a three-day convention in this hotel on questions of what is going to be done in constructional industries. A large number of them are present in this room. They have now heard their answer. We have heard Professor Gregory more than once and we hope we may make him something like an annual visitor to the Canadian Club. Mr. Kahn visits us for the first time. May I say on your behalf, I hope it may only be the first of many. Mr. Kahn belongs to the ranks of the unemployed. He is unemployed because, as he tells me, he holds for this year the Garden Foundation Travelling Studentship which is a result of the munificence of Sir Richard Garden, who has made it possible for economists to get a much more intimate knowledge of international conditions than they would otherwise possess. It is on his travels, during the tenure of his studentship, that Mr. Kahn comes by way of Chicago to visit us. I only hope that some similar undertaking will bring him again very soon.