

*Not general expansion  
but specific measures.* 3 August 1981

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PRIME MINISTER

KEYNES, UNEMPLOYMENT AND PUBLIC EXPENDITURE

In 1937, when unemployment was around 12%, Keynes wrote three articles in The Times. The main purpose of these articles was to point out that the public authorities should postpone capital expenditure as much as possible. He was concerned at that time, even though the price level was virtually constant and unemployment was at 12%, that additional expenditure would simply generate inflation. Some quotations will give you the flavour of his advice.

"We are in more need today of a rightly distributed demand than of greater aggregate demand."

"Three years ago it was important to use public policy to increase investment, it may soon be equally important to retard certain types of investment so as to keep our most easily available ammunition in hand for when it is more required. Just as it was advisable for the Government to incur debt during the slump, so for the same reasons it is now advisable that they should incline to the opposite policy... Just as it was advisable for local authorities to press on with capital expenditure during the slump, so it is now advisable that they should postpone whatever new enterprise can reasonably be held back."

"I believe that we are approaching or have reached the point where there is not much advantage in applying a further general stimulus at the centre. So long as surplus resources were widely diffused between industries and localities it was not great matter at which point in the economic structure the impulse of an increased demand was applied. But the evidence grows that - for several reasons into which there is no space to enter here - the economic structure is unfortunately rigid, and that (for

/example)

example) building activity in the home counties is less effective than one might have hoped in decreasing unemployment in the distressed areas. It follows that the latter stages of recovery require a different technique ....

"We are in more need today of a rightly distributed demand than of a greater aggregate demand; and the Treasury will be entitled to economise elsewhere to compensate for the cost of special assistance to the distressed areas."

In an article headed "Borrowing for Defence" in The Times of 11 March, Keynes maintained: "The Chancellor's loan expenditure need not be inflationary but it may be rather near the limit ..... In two years time or less rearmament loans may be positively helpful in warding off a depression. On the other hand the War Department may not succeed .... in spending up to their timetable." He went on: "The number of insured persons who are still unemployed is indeed as high as 12½%.... but though the new demand will be widely spread .... we cannot safely regard even half of these unemployed insured persons as being available to satisfy home demand for we would have to subtract the unemployables, those seasonally unemployed, etc, and those who cannot readily be employed except in producing for export."

Keynes's concern throughout 1937 was trying to avoid a slump as he made perfectly clear in a letter to The Times of 28 December when he made clear that he supported proposals for preparing schemes of public works against the next downturn when unemployment would be liable to rise again from the 11%-12% level at which it then stood. Yet he conceded that "public loan expenditure is not .... the only way and not necessarily the best way to increase employment". "It is very generally held today that there is a good deal of advantage in retarding expenditure by such bodies when other sources of demand are strong .... This is probably a reason for not pushing such expenditure at present."

/It is clear

It is clear that in 1937 Keynes was mainly concerned with the possible dangers of inflation when unemployment was still round about 12%, and from that level downwards Keynes clearly insisted that unemployment must be dealt with not by general expansion of aggregate demand by Government, but by "a different technique", that is by specific measures in the depressed areas. Keynes was urging the damping down of extra public borrowing and deficits.

This does not imply that Keynes did not think that unemployment could not be brought below 11% or 12%. From other evidence we know that he believed there was much to be done to remove what he called the structural rigidities in Britain. But he clearly regarded it as inappropriate and indeed inflationary to use aggregate demand measures in these circumstances.

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cc Mr. Wolfson  
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