CHAPTER 5

MONEY, PROFITS, AND PRICES
UNDER FULL EMPLOYMENT

Difficult years followed Britain’s decision to return to gold. After the brief boom of 1924 unemployment increased persistently. The government, by devaluing sterling, had forced itself into a deflation corner; the monetary policy of the Bank of England, fully coherent with the government line, was to darken the situation. In the spring of 1926 came the crisis in the coal industry, which with its low profit margins had been the unsheltered industry most exposed to revaluation. Bearing in mind the competition of German and Polish coal on the European market, no other exporting industry was in more dire need of a cut in production costs. Unfortunately, any hope of greater productivity, at least in the short term, was considered illusory. The mine owners and the Conservative government insisted on slashing money wages, and the miners proclaimed an all-out strike with the other unions joined in solidarity. Thus, the first General Strike in the history of British trade unionism shook the country to its roots.

The Lancashire cotton industry was also in distress, its exports having fallen to a level insufficient to absorb production. As mentioned earlier, the employers’ solution was a cut in working hours, with spreading underemployment rather than unemployment proper. The crisis was becoming unrestrained. Before the General Elections in the spring of 1929 Keynes estimated that unemployment hovered at one million.¹ The pending collapse of Wall Street aggravated the crisis enormously, pushing back the potential date for concrete recovery.

This, in outline, was the gravity of the British situation in the stormy period between 1926 and 1930 when Keynes wrote *A Treatise on Money*, published in two volumes in October 1930. This work was the fruit of Keynes's most ambitious undertaking in the field of monetary theory, being a theoretical synthesis derived from his concrete personal experience with capitalism up to that time. Although I do not wish to detract from the importance of *A Tract of Monetary Reform*, it is nevertheless the *Treatise* which represents Keynes's original flowering contribution to the understanding of the role of money. Keynes's aim, in fact, was to resolve problems previously left dangling. The theoretical significance of the *Treatise* is that it is a juncture in the process whereby Keynes sought a rational, analytical description, at a high level of abstraction, of the capitalist reality which he had encountered so long at the empirical level.

The main argument of *A Tract on Monetary Reform* revolved about the non-neutral nature of fluctuations in the purchasing power of money on real economic magnitudes. Accordingly, the proper aim of monetary policy was to manipulate the money supply so as to maintain a stable price level. It followed that the "healthy rules" of conduct inspired by the gold standard and the faith in the "invisible hand" were misplaced and ought to be revised. Under downward rigidity in wages, or in a situation in which different sectors of the economy showed discrepancies in their ability to resist domestic and foreign competition, rational conduct made it incumbent on the central bank to manipulate the availability of credit so as to create unemployment: job deflation was the only way to align money wages with prices.

In order for Keynes's propositions to achieve analytical coherence it was first necessary to demolish the quantity theory of money, in either the Cambridge or the Irving Fisher equational versions. If Keynes could show that there existed independent nonmonetary


3. In our day the strongest supporter, in the tradition of Keynes, of inducing the alignment through incomes policy, has been Sidney Weintraub. See, e.g., his *Capitalism, Inflation and Unemployment Crisis: Beyond Monetarism and Keynesianism* (Reading, Pa.: Addison-Wesley, 1978), chaps. 3–9.