THE MARXIST THEORY OF MONEY

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INTRODUCTION

Marx had very distinct views on the nature of money, the creation of money and its functioning within the capitalist mode of production. Since these monetary ideas are inseparable from a (related) theory of the economic system we will begin with an overview of his general political economy. This is examined in Part One and Part Two will then investigate his monetary theory in relation to these themes.

PART ONE: MARXIAN POLITICAL ECONOMY

DIALECTICAL MATERIALISM

In contrast to the mainstream thinkers, Marx viewed capitalism (with its private business, free markets and competition) as historically specific and, therefore, subject to change. Marx was also termed a *historical materialist* since he viewed this transformation from one economic system to another as deriving from the 'material relations of production', rather than other determining factors such as the Hegelian notion of a 'synthesis of opposing ideas' that then motivates human behaviour to enact the necessary changes. Marx called this materialism the 'rational kernel within the mystical shell' (Marx 1976). During the capitalist era this directly involves the tensions and contradictions between the *bourgeoisie* (owners of productive resources) and the *proletariat* class who are solely dependent upon selling their 'labour power' (Marx 1848). He contended that these conflicting pressures would eventually give way to a new economic system founded on the common ownership of the means of production and that, since alienation and exploitation would be removed, the state would then soon become obsolete. It could be argued, however, that he viewed capitalism as potentially interminable, given certain countervailing conditions, yet this has been a hotly contested subject of debate for one and a half centuries and is beyond this paper's remit.

MONEY AND CAPITALIST CRISIS

Marx, whilst recognising the wealth-accumulation dynamic inherent in capitalism, in contrast to many of his contemporaries did not posit this prevailing economic order at the pinnacle of human achievement. For Marx a key tension inherent in the market-based system was the nature of endogenous crises/cycles, which he attributed to the falling rate of profit (defined in his own terms) rather than the role of unstable money or policy mistakes (or indeed any other exogenous factors). Profit rates declined in boom periods, as the organic composition of capital (constant to variable ratio) increased, and recessions were caused by capitalists seeking to restore profitability. However Marx did clearly concede that there were various 'tendencies and counter-tendencies' that contribute to the fluctuations of any crisis characteristics. In Marxist political economy therefore, as Potts notes, money has a role within capitalist *crises* in addition to its more expected functioning within capital formation and the circulation of commodities (Potts 2005).

In addition Marx espoused that it was a capitalist imperative to accumulate capital, encapsulated in his famous phrase "accumulate, accumulate! That is Moses and the prophets" (Marx 1976), and this capital takes the form of money that is the "prime mover, giving the first impulse to the whole process (of production)"(Marx 1981). Money capital takes the form of productive capital and then is realised in money form again (M - C - M') and is known as the circuit of capital.

Marx, in the tradition of the classical school, had presented an holistic political economy that was internally consistent. Marx studied the work of the mercantilist and classical schools and his 'labour theory of value' (and hence money) evolved from these positions and understandings. This 'value theory' will therefore be considered at an early stage in order to appreciate his notion of the role of money in the productive capitalist economy. Indeed, his entire economic analysis is predicated on this labour theory of value.

THE LABOUR THEORY OF VALUE (LTV)

The classical economists from William Petty to Ricardo had adopted the labour theory of value, albeit in somewhat crude forms in relation to Marx, which suggested that labour was the *source* of all (exchange) value (Mandel 1969). Consumables that require no human effort to produce, of course, contain a 'use value' but have no exchange value and hence, are free to all. In essence, in order to draw value comparisons between different commodities that contain a 'socially necessary' exchange value, it is imperative to utilise an entity that is common to all as an objective basis for measurement. The use of a monetary numeraire, with its changing value (in labour terms) and the fluctuations of the commodity market prices (driven by subjective notions of utility), is inadequate in this regard. Marx claims, at the beginning of Capital, that it soon becomes apparent that labour is the only entity that can be *objectively* measured in this manner since all commodities that necessitate valuation are the product of human labour (Marx 1976). It is possible, of course, to develop an alternative value theory system based upon the notion of 'utility' although this, as Mises has demonstrated, is also fraught with difficulty (Mises 1912). Historically it is perhaps logical, as Mandel argued, that the more generalised commodity production becomes, the more the exchange value of a certain commodity becomes governed by an accounting system based upon labour production. Market prices may, of course, fluctuate around labour values as axes, according to the vagaries of supply and demand in the short term. In the longer term, however, it is assumed that the underlying 'law of value' will determine price according to work hours (Mandel 1969).

The market prices act as signals to which the producing agents react by reallocating resources. So, for Marx, labour *is* value, residually congealed in commodities.

In order to determine the LTV Marx used the notion of (abstract) socially necessary hours to calculate value. In this sense 'socially necessary' implies that use-values are being produced by commodities that, in turn, contain an exchange value. Clearly some workers are more efficient than others and a unit of socially necessary labour is set at the average productivity during the stated period of production. The value of a commodity becomes the fragment of total (socially necessary) labour, used during a given period of production, that is used for the production of the given commodity, expressed in the form of minutes, hours, days, or weeks. The individual value of a commodity would change, of course, if the productivity of labour changed in some future production period (Marx 1976). In addition in order to account for the existence of skilled labour Marx assumed that the value of a skilled labour hour exceeded that of an unskilled one in proportion to the (labour) hours involved in acquiring the skill.[1]

ALIENATION, EXPLOITATION AND SURPLUS VALUE

In previous economic systems the producer would generally be in possession of his own produce but, in the capitalist era, the worker is not and is forced to experience the subsequent emotional distress of *alienation* from the product. In addition the individual proletariat worker has nothing to sell but his labour power, for which he receives a wage, and is therefore completely dependent upon the capitalist. Yet, there is a difference between the value of the wage and the value (in labour terms) of the final produce that is the source of *surplus value* (or profit) and, of course, is the root of capitalist exploitation.

The classical economists whilst adhering to the LTV had struggled to explain profit and Marx's key contribution to the analysis had been to identify surplus value in labour terms. The breakthrough came by theorising that the value (in labour hours) quantity of the goods and services required in order to *reproduce* labour (food, shelter etc), manifested in the form of wages, is less than the labour value of the produce of labour. The surplus is then expropriated by the capitalist and is realised in money-form. Productive labour is therefore that which produces surplus value – a new value above the wage – that "did not exist in society, even as an equivalent, at the moment when this labour began to be performed"(Marx 1978).

In the economy as a whole, of course, surplus value is split between the productive entrepreneurs, landowners/rentiers, government (in the form of taxation), retailers and the bankers/money capitalists who extract usury. These separate groups could perhaps be seen to be in competition to enhance their relative proportion of surplus value which amount to a 'zero-sum' game.

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[1] Debates that investigate the empirical validity of the calculation of these labour hour sum totals form what is known as the 'reduction problem' Mandel, E. (1987). *Karl Marx*. Marxian Economics. M. M. a. P. N. John Eatwell. Hong Kong, Macmillan.

THE TRANSFORMATION PROBLEM

The LTV has mainly courted controversy in what has been called the 'transformation problem'. The debate centres on the way in which Marx dealt with the transformation of input values into prices of production in volume three of Capital. 'Prices of production' is the term that Marx used to describe the necessary prices that would be required, in order to realise the appropriate amount of surplus value from the market that would lead to an equalisation of profit rates between capitals (Mandel 1987). In such a case some prices will be above value (in labour terms) and some will be below. This, as Brewer noted, is because with varying amounts of constant capital it is not possible for them to be the same (Brewer 1984). Marx himself did not see this as a problem since he believed that normal capitalist competition and development would lead to different branches of production achieving comparable organic compositions of capital in the long term. In time, profit rates send signals to mobile capital owners and the relevant producing agents then reallocate resources, update technology and increase the organic composition of capital in their particular branch of production. However critics have claimed that the relation between Marx's input values and prices of production is dubious because of this.

Several general equilibrium economists have been critical of Marx's LTV, and overall methodology, since they expect input values to match output values in a simultaneous equilibrium. In 1907 Bortkiewicz first advanced this idea, that Marx cannot use his output values to determine input values and then 'reproduce' production – which he assumes he should be able to (Bortkiewicz 1949). Mandel refutes this as an irrelevant suggestion and explains that Marx uses two time-frameworks. In the first period it is assumed that the profit equalisation of different branches of production has already been achieved, for the input data used. In the second period the equalisation is then achieved with the relevant prices of production (Mandel 1987). In this sense Marx is sequential and assumes an accumulation of capital from one period to another, as a result of the extraction of surplus value. In other words for Marx, input values/prices are not expected to equal output ones. It is worth noting that, despite the fuss, the empirical evidence seems to support Marx's general conclusions that labour values will be reflected in prices over time (Desai 2002).

In Marx's overall political economy there are two fundamental equalities. The first is that the sum total of prices of production, during a given period of production, are equal to the sum total of labour values. In the second postulate Marx states that the sum total of surplus value is equal to total profit realised. If Marx's own methodology is utilised then these postulates can be *a priori* seen to be consistent.[2]

[2] The Temporal Single System Interpretation of Marx (TSSI) advanced by Kliman, Freeman and Potts, is such an interpretation and dismisses the Marx critics work as misinterpretation Potts, N. (2005). *The Relevance of Marx to Business Students*. Annual Heterodox Economics Conference, City University, London, Southampton Business School Discussion Paper.

THE MARXIST THEORY OF RENT

Marx's theory of rent deals with a different aspect of value theory and concerns the 'rentier' who receives a proportion of the 'price of production' and, in particular, part of the surplus value. Marx then engages in a consideration of different producers of the same given commodity without a completed productivity equalization process. During one production period there will be a simultaneous existence of firms with different 'individual' commodity values, since the competitive process has not yet led to an 'average efficiency' being established. To illustrate his idea of rent Marx then uses his concept of 'market value' (MV) to describe an underlying value around which market prices will fluctuate. He then suggests that this MV will be determined in the short term by the least, average or most efficient firm depending on whether the market is growing, stable or saturated respectively (Mandel 1987). In this (short-term) sense the market forces of demand and supply will be contributory factors to this MV. In addition this means, of course, that more efficient firms gain surplus profits. Capitalist competition should eliminate these advantages in the longer term and the MV will be based upon an average social productivity. However if this is hindered, as a result of scarcity or institutional blockages for instance, surplus profits can be sustained for some time. Marx discusses agriculture and mining as examples and suggested that when the less productive firms determine the market value, efficient firms and mines enjoy surplus profit which Marx called 'differential rent' (Mandel 1987).

There are also differences between branches of production. For instance, as long as the productivity of labour in agriculture is less than the average in the economy (and there is no ability for mobile capital to enter/leave the branch for profit equalisation) all surplus value will accrue to capitalist farmers and landowners and will therefore not enter the (re) distribution process of surplus value that is to be expected in the whole economy (Mandel 1987). In other words 'prices of production' are not established. The redistribution process, of course, will occur if 'prices of production' are established in order to equalize profit rates but this assumes capital mobility. Marx called this extra bonus, through capital mobility restrictions, 'absolute land rent'. Different branches of production that are not subject to the profit equalisation process, due to institutional blockages or private property, are then able to obtain this absolute rent. It is worth noting that Marx predicted that within agriculture there would eventually be a profit equalisation process as well as a productivity equalisation process as a result of normal capitalist development (Mandel 1987). The productivity equalisation process comes after the different organic compositions, in each branch of production (that necessarily equalizes profit), are adjusted by producing agents who wish to not just equalize profit but gain a return on capital employed that is commensurate with the labour hours extended. This, of course, is the real cost of production. However, as bourgeois economists argue, it might be that the return on capital employed (ROCE) is the overriding factor?

With these aspects of Marx's political economy defined we now turn to a consideration of his monetary ideas.

PART TWO: THE MARXIAN THEORY OF MONEY

INTRODUCTION

Surplus value is realised in the market in the form of money and Marx was fully aware of the subsequent central role that money performed in the economy. Capital accumulation is, of course, manifested in monetary nominal terms. Also money is the instigator of economic activity and is therefore indispensable to production. In essence Marx's monetary ideas are essentially an extension of the LTV. It is worth noting, however, as Itoh notes, that when Marx theorised on the history of money and further suggested that the emergence of money was based on an objective labour value for the exchange of commodities, it relies on the existence of exchange itself which is unlikely to have existed in early tribal communities (Itoh 1999).

THE NATURE OF MONEY

For Marx the function of money follows from its nature as a commodity. In other words it is able to perform the functions of money because it *is* a commodity. In Marx's time this, of course, referred to gold – mined using human labour – that contained use-value (as money) and hence an exchange value. There is the inference that in order to possess the social acceptability that money requires the entity needs to possess this commodity status. It is irrelevant whether or not the commodity money has commodity value other than its use value as money and that, therefore, accounting prices could be set in value-less units of currency in an abstract sense (Itoh 1999). However, whilst Marx appreciated the existence of abstract money that transfers (labour) value into price and *real* money that transfers price in to a 'concrete equivalent' that contains the 'qualities of money' (Itoh 1999) it is generally assumed that Marx did not conceive of anything other than a commodity money containing such qualities. In the modern era, conversely, we have a complete fiat/credit money system that is not convertible to any other commodity and is fully legitimised and sustained by the modern state and it would be reasonably fair to suggest that Marx assumed this would not happen.

For Marx gold was money and its value was determined by the labour content that was embodied in it. Yet, in contrast to the quantity theorists, he felt that it was the value of money determining the quantity in circulation rather than the quantity of money determining its value (Brewer 1984). If the value of gold falls, more gold will be required to represent the same value and so more circulating currency is needed. Gold production is cheaper, and is initially more profitable, and then more gold is produced and exchanged. The extra demand pushes up prices through the system until a new equilibrium is reached with a new amount of circulating currency. In these cases the value of gold and the volume of exchanges determine the amount of money in circulation. Marx demonstrates that the quantity theorists have causality the wrong way around (Brewer 1984).

In addition, Marx notes that paper money can be created by the banking system which he refers to as a 'money sign' (Mandel 1987). In this instance the paper money represents the money commodity nominally. This implies, therefore, that if any production of paper notes occurs that is in excess of the quantity of commodity money that it represents, *ceteris paribus*, there will be inflation. This appears, for paper money, at first sight to be an expression of the quantity theory of money although Marx's views were different. During the nineteenth century Marx was sympathetic to the views of the *banking school* who felt that any excesses of paper money, above the necessary quantity of commodity money backing (that was not used for economic activity), would return to the banking system according to what has been called in monetary theory the 'law of the reflux' (Itoh 1999). The banking school tended to emphasise the hoarding and paying functions of money that tend to mitigate any inflationary impact of money.

Marx had also considered the activity of discounting bills of exchange by the banking sector, which is what he had meant by the credit system. He thought that this activity economised on the use of money (Brewer 1984). It is interesting to note that he did not foresee the growth of the cheque clearing system, which utilises bank deposits as money, and also economises on paper money in circulation. In the modern era switch payments and direct debits use bank deposits in the same way. Modern economists view bank deposits as money but Marx never did. He was only interested in that which fulfilled the functions listed below (Brewer 1984).

THE CREATION OF MONEY

Marx appears to underplay the role of the state in money creation and, in this sense, has much in common with Carl Menger of the Austrian school who had suggested that the development of money had been market driven (Menger 1871). In essence Marx believed that money was created by productive capitalists who, in the normal manner, combine constant and variable capital in order to produce the commodity money.

THE MARXIAN THEORY OF THE FUNCTIONING OF MONEY

For Marxist analysis there is an ordering of the functions of money in the capitalist economic order and these are respectively; the measure of value, the means of exchange (purchase) and money as money (for hoarding, payment and world money) (Itoh 1999). For Marx the function of measure of value was dependent on the oscillations in the value of commodity money in labour terms as mentioned above. Yet, Marx also talked about the 'standard of price' which referred to the actions of the state in setting rates of exchange between the commodity money and the official currency. In Marx's time an ounce of gold was set at £3 17s 10 &1/2d (Brewer 1984). What is significant is that the accounting system of prices is abstract (as mentioned above) but has a social foundation in terms of their commodity values and is independent of the standard of price (Itoh 1999). The second function is the means of exchange. Here Marx is mindful of the velocity of circulation and is characterised by constant movement. He recognised, in line with Ricardo, that the *necessary* quantity and velocity varied according to commodity values. Yet, Ricardo had thought that money was exogenously created whereas Marx felt that meeting monetary requirements depended on the commodity money output and the existing hoards of money (Itoh 1999). Drawing money from hoards to meet any productive requirements is, of course, endogenous. Marx had partly accepted the Ricardian notion of money as a 'veil' since he felt that it was the circulating commodities, rather than the functioning of the money system, that determine prices and subsequent money quantity. However, as Itoh notes, Marx also felt that money functioned outside of circulation and, in this sense, is not a 'veil' (Itoh 1999).

For Marx the hoarding of money was an essential part of his overall political economy since the capitalist, through hoarding, was able to instigate new production or choose not to whereas the proletariat was forced to sell his labour power. So Marx sees precautionary hoards as enabling capitalists to deal with market price fluctuations (of raw materials etc) in order to maintain the continuity of capitalist production. Itoh points out that Marx was here drawing on the mercantilist thinking that recognised the social power of money hoards (Itoh 1999, p.46).

Another function of money (as money) in Marxian economics is the function of payment. During the course of production and commercial transactions money is used to 'settle' any promises to pay. Commercial debt is subject to clearing, the exchange of one debt for another, but any balancing items can be settled during a given period of production. This economises on the function of money as a means of purchase. Marx felt that the efficiency of the credit system (bills of exchange in his day) would determine the quantity of credit extended and he adhered to the idea of the 'cyclical' nature of credit money in terms of the law of the reflux. It is worth mentioning, as Itoh notes, that Marx also saw credit money as contributing to the expansion of capitalist accumulation and, therefore, as non-neutral and endogenous (Itoh 1999, p.49).

Finally, Marx had viewed (commodity) money as serving the function of *world* money, for purposes of 'payment' for all sorts of things, in contrast to Ricardo who viewed bullion as a *pure* means of exchange. For this purpose Marx felt that gold was most appropriate. It could be argued, of course, that Marx's ideas have stood the test of time when we look at the development of the international financial system from the gold standard to gold-exchange standard and then on to the financial liberalisation of today. Financial crises seem to be a recurring symptom of a global system without gold.

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