THE VALUE OF MONEY

PRABHAT PATNAIK

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For Utsa, Nishad, and Neelabhra

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Preface

EVEN THOUGH THE IDEAS PRESENTED in this book have been with me for a long time and have been presented through my lectures to generations of students at my university, the writing of this book has not been easy. For one thing, it advances two separate though interlinked propositions, one a critique of monetarism from a point of view I christen "propertyist," of which I take Marx and Keynes as the classic examples and that in my view is the superior one, and the other a critique of "propertyism" itself for its incompleteness, for not having made a sufficiently radical break with orthodox economics. Presenting what in effect are two books rolled into one has raised difficulties. When I first started writing the book in 1995, I thought I would just present a set of essays with an introductory chapter that summed up the argument, leaving it to the readers to make the connections. The result turned out to be so reader-unfriendly that I was advised to write the book in a more conventional format and remove the introductory chapter altogether, since stating an argument at the beginning and then developing it at greater length in the course of the book appeared repetitive. When I had done the latter, I was again advised that the core of the argument might get lost because of the two levels of argument in the book and that therefore an introductory chapter stating the entire argument and some of its contemporary implications was in order. This is finally what I have produced—a conventional book with an introductory chapter stating its main themes and their contemporary meaning.

Three people have stood by me and helped me intellectually during this long journey. Utsa Patnaik reacted to my ideas as they developed over the years and critically read through the second draft. C. P. Chandrasekhar read through the entire first draft and is largely responsible for the book's taking its present form. Jayati Ghosh made numerous suggestions for improving the present version. I express my deep gratitude to all of them. Akeel Bilgrami was a source of great encouragement during my writing the latest version of the book. Indira Chandrasekhar of Tulika Books has provided patient and steadfast support throughout this entire project, as has Peter Dimock of Columbia University Press in its later phase. I have discussed my ideas with several colleagues at the Centre for Economic Studies and Planning of Jawaharlal Nehru University, especially Anjan Mukherji, who have left their influence on my thinking. I wish to express my sincere thanks to all of them.

(June 2008)

Introduction

IT IS AN INTRIGUING ASPECT of our daily life that intrinsically worthless bits of paper, which we call money, appear to possess value and are exchanged against useful objects. The purpose of this book is to examine the social arrangement underlying this fact. While this social arrangement is none other than the entire social arrangement underlying capitalism, there is a point in starting our investigation from the "money end." This is because an important part of the overall social arrangement that may not always be apparent when we start from the concept of "capital" emerges with greater clarity when we take money as the starting point of our analysis; this part relates to the fact that capitalism cannot exist, and never has existed, in isolation as a closed, self-contained system, as has been commonly assumed in much of economic analysis. In other words, a better route for understanding the totality of the social arrangement underlying capitalism is to start with a simple question: What breathes value into these intrinsically worthless bits of paper? This question is in turn part of a more comprehensive question: What determines the value of money, irrespective of whether it consists of intrinsically worthless bits of paper or of precious metals?[1] To this question there have been two basic answers in economics. The first proposition of this book is that one of these answers, the one given by what constitutes "mainstream" economics at present, cannot stand logical scrutiny. I therefore begin with a critique of "mainstream" economics and, in particular, the notion of "equilibrium" central to it.

A Critique of the Mainstream Notion of Equilibrium

Mainstream economic theory takes market clearing as its point of reference. In its perception, the flexibility of prices, which characterizes markets in the ideal type of a capitalist economy, ensures the equalization of demand and supply at a set of equilibrium prices. The endowments an economy has and whose ownership is distributed in a certain manner among the economic agents are fully utilized in producing a set of goods whose supply exactly equals the demand for them at this set of equilibrium prices. It follows that there is no question of any involuntary unemployment in such an economy, in the sense of an excess supply of labor at the prevailing wage rate, in equilibrium. Tastes, technology, the magnitude of endowments and their distribution across the economic agents, and the "thriftiness conditions" (to use Joan Robinson's phrase), or what some would call the "time preference" of the economic agents, determine the equilibrium prices and outputs in this world of "rational" agents, where firms maximize profits and individuals maximize utilities.

This mainstream notion of equilibrium, however, is logically tenable only in a world without money, which is why it cannot be a logically valid description for a capitalist economy. This is because in a world with money, according to this conception, the market for money must "clear" at a certain price of money in terms of the nonmoney goods. This can happen only if the excess demand curve for money is downward sloping with respect to the "price of money." For a given supply of money, in other words, the demand for money must vary inversely with the price of money. The price of money being the reciprocal of the price level of commodities in terms of money, this implies that the demand for money must vary directly with the price level of commodities. Mainstream economics took this for granted, because it saw money only as a medium of circulation, so that the higher the value of the goods that have to be circulated, the greater is the demand for money. Since, with output at the full employment level, the value of the goods (and hence the value of the goods to be circulated) depends on their price level, the demand for money has to be positively related to the price level.

The role of money as a medium of circulation ensured this. The problem, however, is that money is a form of wealth, too. It cannot be a medium of circulation without also being a form of wealth, since even the former role requires that money be held, however fleetingly, as wealth. And as the form-of-wealth role of money is recognized, it becomes clear that the demand for money must also depend upon the *expected* returns from other forms of wealth holding. If the demand for money depends upon *expectations* about the future, then there is no necessary reason why the demand curve for money should be upward-sloping with respect to the price level, as required by "mainstream" theory, since any change in the price level cannot leave expectations unchanged.

To get out of this quagmire, mainstream theory has taken two alternative routes. One is to refuse, quite stubbornly, the form-of-wealth role of money and to see money only as a medium of circulation. The other is to recognize the form-of-wealth role of money but to assume that expectations are always of a kind that does not create any trouble for the theory, at least with regard to the existence and stability of equilibrium. The first is the orthodox route of the Cambridge constant, *k*, or, what effectively comes to the same thing, a constant income velocity of circulation of money (subject to long-run autonomous changes), which is much used even today in bread-and-butter empirical work belonging to the monetarist genre. The second is the route of the "real balance" effect, whose validity depends, among other things, on the assumption of inelastic price expectations.

Both these routes, however, are blocked by logical contradictions. The Cambridge-constant route is blocked by the obvious contradiction that money cannot logically be assumed to be a medium of circulation unless it can also function as a form of wealth.

And if it can, then there is no reason why it should not actually do so. And if it does, then we cannot assume a Cambridge constant *k*. The second route is blocked by the contradiction that inelastic price expectations presuppose some anchorage to prices, the existence, that is, of some prices that are sticky, and in a world of flexible prices there is no reason why this should be the case. It follows that there is simply no logically tenable way of erecting a theoretical structure in conformity with the "mainstream" perception in a world with money, and hence for a capitalist economy.[2]

Because of this there has been an alternative tradition in economics, which I call the "propertyist" tradition, that has always seen the value of money as being fixed outside the realm of demand and supply. At this value, fixed from outside the realm of demand and supply, individuals habitually hold money balances in excess of what is required for the purpose of circulation: Money constitutes both a medium of circulation and a form of wealth holding. In such a case, Say's law cannot possibly hold. If wealth can be held in the form of money, then the possibility of *ex ante* overproduction of the nonmoney commodities arises. And this *ex ante* overproduction gives rise to actual output contraction, not just of the nonmoney commodities but of money and nonmoney commodities taken together, precisely because the price of money in terms of commodities is fixed from outside the realm of demand and supply, so that price flexibility cannot be assumed to eliminate this *ex ante* overproduction.[3]

It follows, then, that the recognition of the role of money as a form of wealth holding, the recognition of the fact that its value cannot be determined within the realm of demand and supply but must be fixed from outside this realm, and the recognition of the possibility of generalized overproduction or—what comes to the same thing—of involuntary unemployment in the Keynesian sense, are logically interlinked and constitute the propertyist tradition. By contrast, the denial of each of these phenomena, is also logically interlinked, and constitutes the Walrasian-monetarist tradition that remains the mainstream.

Within the propertyist tradition, there are two main contributions. One is of Marx, who had not only explicitly noted the untenability of explaining the value of money in terms of demand and supply, but had also provided an alternative explanation for it through his labor theory of value. He had underscored both the existence of a "hoard" of money at all times as a form of wealth holding in a capitalist society, and had recognized, against Ricardo, who had been a believer in Say's law, the possibility of *ex ante* generalized overproduction as a consequence of this fact. But neither Marx himself nor his followers pursued this fundamental contribution of Marx any farther; they preferred instead to follow exclusively the other major theoretical discovery of Marx, namely the one relating to his theory of surplus value. This is why another three-quarters of a century had to elapse before the same themes had to resurface during the Keynesian revolution through the writings of Kalecki and Keynes, among others, who constituted the second main group of contributors within the propertyist tradition.

There were major differences, of course, between Marx and Keynes in the specifics of their theories. While Marx invoked the labor theory of value to explain the determination of the value of money, Keynes believed that the value of money vis-à-vis the world of commodities was fixed through the fixing of the value of money vis-à-vis one particular commodity, namely labor power (to use Marx's term). The fact that the money wage rate was fixed in the single period, which was Keynes's focus of analysis, is what gave money a finite and positive value vis-à-vis the entire world of commodities. And the fixity of money wages was not a cause for market failure, as has been generally supposed, but the modus operandi of the market system itself in a capitalist economy that necessarily uses money. The superiority of the propertyist tradition in analyzing the functioning of the capitalist economy over the Walrasian-monetarist tradition arises therefore not only from its greater "realism" (for example, the fact that capitalism does witness overproduction crises) but also from its being free of the logical infirmities that afflict Walrasian monetarism.

A Critique of the Notion of Capitalism as an Isolated System

This book advances a second proposition as well. Propertyism, notwithstanding its superiority over monetarism, still remains incomplete. It adduces no convincing mechanism for ensuring that the activity level of a capitalist economy remains within the range that keeps it viable. The proneness of a capitalist economy to generalized overproduction makes it essentially a demand-constrained system (with the supply constraint becoming relevant only in exceptional periods of extremely high demand). But if capitalism is a demand-constrained system, then what ensures the fact that it remains viable, generally earning a rate of profit that the capitalists consider adequate? The spontaneous operations of a demand-constrained system will not ensure that it functions generally above a certain degree of capacity utilization, which constitutes the threshold for its viability. As the Harrodian growth discussion has shown, left to its own devices a capitalist economy does not have the wherewithal to reverse tracks if it starts on a downswing. And as Kalecki has shown in the context of a demand-constrained system, of which the Harrodian universe was one specific example, the long-run trend in such a system in the absence of exogenous stimuli is zero, which would certainly undermine the viability of such an economy.

Now, an isolated capitalist economy operating spontaneously does not have any exogenous stimuli. Innovation, the main exogenous stimulus emphasized by authors as diverse as Schumpeter and Kalecki, is really not an exogenous stimulus, since the pace of introduction of innovations is itself not independent of the expected growth of demand. And state expenditure, the other main exogenous stimulus that can arise in an isolated capitalist economy, is really not a part of the *spontaneous* functioning of capitalism (apart from being a phenomenon that has acquired particular prominence only in more recent years). Hence, even propertyism remains incomplete. Having correctly recognized the capitalist system as being prone to a deficiency of aggregate demand, it offers no explanation of how, despite this, the system has managed to survive and prosper for so long.

There is a second and related issue here. To highlight it, let us assume away for a moment the first issue. Let us accept that exogenous stimulus in the form of innovations always succeeds in keeping up the level of demand and hence the level of activity in the capitalist economy that constitutes our universe. Now, even if the value of money in terms of nonmoney commodities is given from outside the realm of demand and supply in any period, if this value itself keeps moving in an unbounded manner across periods, through, for instance, accelerating inflation, then again the continued existence of a normal monetary economy becomes inexplicable. And if the level of activity has to adjust to keep the "across-period" price movements within bounds, then this level itself may well drop below the threshold that makes the economy viable, in spite of the presence of the exogenous stimulus. It follows that a monetary economy must have not only "outside" determination of the value of money in any period, but also some mechanism, other than through adjustments in the level of activity, to keep price movements across periods within strict bounds. An obvious mechanism is the fixity of some price not only within the period but also across periods. Or, putting it differently, the price that is given from "outside" in any period should also be slowly changing across periods. Propertyism remains incomplete because it adduces no reason why this should happen. Hence, notwithstanding its superiority over monetarism and Walrasianism, propertyism too, as it stands, is not free of logical problems.

The only way that all these problems can be overcome is by conceiving of capitalism as a mode of production that never exists in isolation, that is necessarily linked with the surrounding precapitalist modes, and that continuously keeps itself viable by encroaching on precapitalist markets. The limitation of propertyism is that even though it rejected monetarism for perfectly valid reasons, it remained trapped within the same assumption, of an isolated and closed capitalist economy, that had characterized monetarism. Its rejection of the mainstream view, in short, was not sufficiently radical and thoroughgoing.

To say that the capitalist economy needs to encroach upon precapitalist markets is not to say, as Rosa Luxemburg did, that it needs to "realize" its entire surplus value in every period through sales to the precapitalist sector. Indeed the role of the precapitalist markets does not even have to be quantitatively significant. Much of the time the capitalist economy can grow on its own steam, as long as it can use precapitalist markets as a means of turning itself around whenever it is on a downward movement. And even for this turning around, the quantitative magnitude of sales to the precapitalist markets does not have to be significant. Indeed, strictly speaking, as long as the very availability of precapitalist markets "on tap" can instill among the capitalists sufficient confidence to undertake investment, any downturn can be arrested and even thwarted, without any notable actual encroachment on the precapitalist markets. What is required logically, in other words, is the existence of precapitalist markets that can be encroached upon, not any actual significant encroachment upon such markets. They constitute in short, "reserve markets" on a par with the reserve army of labor. And they do so because goods from the capitalist sector can always displace local production in the precapitalist economy, causing deindustrialization[4] and unemployment there.

Such periodic displacement leaves behind a pauperized mass in the precapitalist economy, which constitutes for the capitalist sector a second, and distantly located reserve army, in addition to what exists within the capitalist sector itself. This distantly located reserve army ensures that the money wage rate of the workers situated in the midst of this reserve army changes only slowly over time.[5] These workers, in short, are price-takers—or, more accurately, their *ex ante* real-wage claims are compressible precisely because they are located in the midst of vast labor reserves. Since the products they produce enter into the wage and raw material bills of the capitalist sector at the core, they play the role of "shock absorbers" of the capitalist system. Because of them, the capitalist economy remains viable both in the sense of always having a level of activity that exceeds the threshold level that provides it with the minimum acceptable rate of profit, and in the sense that its monetary system can be sustained without any fears of accelerating inflation.

The capitalist mode of production, in short, always needs to exist surrounded by precapitalist modes that are not left in their pristine purity but are modified and altered in a manner that makes them serve the needs of capitalism better. The incompleteness of propertyism can be overcome through a cognizance of capitalism as being ensconced always within such a setting.

This perception, though it has some affinity with that of Rosa Luxemburg, differs from hers in crucial ways. First, as already mentioned, it emphasizes the qualitative role of the precapitalist markets more than their quantitative role, and it certainly does not see them as the location for the realization of the entire surplus value of the capitalist sector in every period. Second, it does not see the precapitalist sector as getting assimilated into the capitalist sector and hence vanishing as a distinct species over time; rather, it remains as a ravaged and a degraded economy, the location of a vast pauperized mass of displaced petty producers, a distant labor reserve, which serves the needs of capitalism by ensuring the stability of its monetary system.

Social Relations Underlying Money

Underlying a modern monetary economy, therefore, is a set of social relations that are necessarily unequal and oppressive. The stability of the value of money is based on the persistence of these relations. This does not of course mean that each and every money-using capitalist economy actually has to impose such unequal and oppressive relations upon some particular segment of its precapitalist environment. Typically such capitalist economies are bound together within an overall international monetary system, and the leading capitalist power of the time undertakes the task of imposing the requisite unequal relations upon the "outside" world of precapitalist and semicapitalist economies. The stability of the value of money then gets linked to the stability of the international monetary system, taking the form above all of the persistence of the confidence of the capitalist world's wealth holders in the leading economy's currency as a stable medium for holding wealth.

It is not always obvious that this role of the leading country's currency arises from its ability to sustain a set of unequal and oppressive global relationships. It is sometimes thought that this role arises from the leading currency's being linked to precious metals. But this is erroneous. The link to precious metals itself cannot be sustained in the absence of such relationships. The stability of the international monetary system during the years of the gold standard arose not because of the gold backing of the currencies, including especially of the pound sterling, which was the leading currency of the time; it arose because Britain could impose a set of oppressive and unequal relationships over the large tracts of the globe that constituted her formal and informal empire. The maintenance of the gold link was a signal to wealth holders that these relationships continued. And when these relationships were undermined in the interwar period, even though the pound sterling was formally linked to gold again, this link could not be sustained.

It follows from this that even in the absence of any formal link to precious metals, as long as the leading capitalist power can establish such global relationships, its currency will still be considered "as good as gold"; that is, even a pure dollar standard can constitute the international monetary system as long as the United States can establish the global hegemony required to instill confidence among the capitalist world's wealth holders that its currency is "as good as gold." A precondition for that, however, is that the value of its labor power in terms of its currency must be relatively stable (which rules out significant inflation, let alone accelerating inflation within its own territory); and, related to that, the value of crucial imported inputs that go into the wage bill and materials bill, should also be relatively stable. In fact, as long as this latter condition holds and domestic labor reserves are large enough to prevent any autonomous wage push,[6] inflation can be ruled out as a source of destabilizing its currency's role as a stable wealth-holding medium. The most significant imported input being oil, a dollar standard can work as long as the dollar price of oil is relatively stable. What appears at first sight as a pure dollar standard, on a closer look must therefore be an oil-dollar standard. The post–Bretton Woods monetary system can be characterized not as a dollar standard but more accurately as an oil-dollar standard. The world may have, to all appearances, done away with commodity money with the delinking of dollar from gold. But the crux of the argument of this book is that it can never do so. The value of money, even paper/credit money, arises because of its link to the world of commodities.

The worldwide quest for oil and natural gas that is currently on, led by the United States, is fed not just by the desire to acquire these resources for use. It is fed even more strongly by the need to preserve the oil-dollar standard. Even Alan Greenspan has openly admitted that the invasion of Iraq was for acquiring control over its immense oil reserves; doubtless similar motives underlie the threatened action against Iran. A common perception is that such acquisition of control is needed by the United States and other advanced countries because they are the main consumers of this resource, which is currently under alien ownership. This may be so. But an extremely significant motive that is almost invariably missed is that control over oil is essential for the preservation of the present international monetary system.

This may appear strange at first sight because the very attempt at such control has been accompanied by a massive increase in the dollar price of oil. But that is because the Iraq invasion has not gone according to plan. And in any case a rise in the oil price per se is not destabilizing if it does not trigger persistently higher inflation and if it does not give rise to expectations of persistent increases in the oil price itself or in the general price level in the leading country. Obituaries to the prevailing international monetary system, entailing dollar hegemony, are premature. But while this may be so, there is an important sense in which the capitalist world is more and more beset with difficulties.

Capitalism in Its Maturity

Rosa Luxemburg drew from her analysis the conclusion that the capitalist system was faced with the inevitability of "collapse," when the entire precapitalist sector would be assimilated into the capitalist sector. No such conclusion follows from the argument advanced in this book; and no such conclusion can be validly drawn about capitalism. Contemporary capitalism, however, is faced with serious difficulties, many of which spring from the advance of capitalism itself.

Two consequences of maturity are obvious. First, the weight of the precapitalist sector, and hence of the precapitalist market, declines over time relative to the size of the capitalist sector, so that it is no longer able to play the same role in providing an exogenous stimulus to the capitalist sector as it did earlier. Second, the decline in the share of primary commodity inputs (other than oil) in the gross value of output of the capitalist metropolis, itself a legacy of past squeezes on primary producers, implies that any further squeeze on them becomes increasingly unfruitful. Compression of the *ex ante* claims of such producers, ceases to be a potent weapon for preventing accelerating inflation at the prevailing level of activity.

The first of these problems can be overcome through "demand management" by the state. But with the globalization of finance, not all states can do so, since such state activism will frighten speculators. The government of the leading capitalist country, the United States (whose currency is considered "as good as gold"), can still afford to run a fiscal deficit to stimulate world demand, and a current deficit vis-à-vis its rival capitalist powers to offer them a larger market. It can, in short, act as a surrogate world-state, expanding the level of activity in the world capitalist economy.

There are two obvious obstacles to this. First, the U.S. government, which *can* act as a surrogate world-state, is nonetheless a nation-state. It can scarcely be expected to be altruistic enough to stimulate the level of activity in the capitalist world as a whole, not just within its own borders, while increasing the external indebtedness of its own economy (which such expansionary intervention will entail). Secondly, even at a relatively low level of activity in the capitalist world, the U.S. economy is already becoming more and more indebted. It can scarcely be expected to compound this problem any further for altruistic ends, which implies that the demand stimulus in the capitalist world, and hence the trend rate of growth, will continue to remain low.

The growing U.S. debt, even at the current level of activity, represents a potential threat to its hegemony, and indeed a unique development. The idea of the leading capitalist power also being the most indebted one represents an unprecedented situation in the history of capitalism. To be sure, the leading capitalist power, in order to preserve its leadership role by accommodating the ambitions of its newly industrializing rival powers, has, at a certain stage of its career, necessarily got to run a current account deficit with respect to them. Britain, the leading capitalist power of the time, had to do the same in the late nineteenth and early twentieth centuries, a period of significant diffusion of capitalism. But Britain did not become indebted in the process; on the contrary, it became the most important creditor nation of the world exactly during this very period. The case with the United States today is the exact opposite.

The main reason for the difference is that Britain used her tropical colonies and semicolonies to find markets for its goods, which were increasingly unwanted within the metropolis; and since the primary commodities produced by these colonies and semicolonies were demanded by its newly industrializing rivals, they were made to earn an export surplus vis-à-vis the latter, which not only balanced Britain's current account deficit with them but even provided an extra amount for capital exports to these newly industrializing economies. Britain did not have to pay for this extra amount, since it simply appropriated gratis a part of the surplus value produced in these colonies and semicolonies that financed these capital exports. The United States today lacks such colonies; and as already mentioned, the relative importance in value terms of primary commodity exports to the metropolis has declined so greatly that such an arrangement will no longer work. Political control over oil-rich countries does offer some prospects of successfully resurrecting the old British-style colonial arrangement for settling current accounts without getting indebted. And this, as we have already seen, is exactly what the United States is tempted to acquire.

Thus what lies ahead are a prolonged period of slow growth for the capitalist metropolis, growing indebtedness for the leading capitalist power, and looming uncertainty over the continuation of the oil-dollar standard and the general health of the international monetary system. All this is occurring in the midst of an "opening up" of the third world to the unfettered movement of globalized finance and the unrestricted operations of multinational corporations, and attempts by the leading capitalist power at the political recapture of the oil-rich third-world countries. In the absence of a conscious effort to transcend this situation, it will trap humankind in the vicious grip of a dialectic of imperialist aggrandizement, both engendering and deriving legitimacy from a destructive terrorism as its counterpart. Nobody can seriously believe that this is the final destiny of humankind. To overcome this conjuncture, however, we have to free ourselves first from the blinkers of mainstream economics.

The Value of Money

1

The Great Divide in Economics

The circumstances of its birth have left an indelible imprint on the development of economics as a subject. When Adam Smith wrote *The Wealth of Nations*, his objective was, among other things, to provide the theoretical basis for the removal of the fetters imposed on the emergence of the bourgeois mode of production by the feudal-mercantilist policies of the state. To this end, he showed that a bourgeois civil society, taken as a "complete system" in itself—that is, in isolation both from the state and from its specific surroundings—constituted in its spontaneous operation a "benevolent" and self-acting economic order.[1]

Three elements of this demonstration deserve emphasis. The first is the unit of analysis, namely a bourgeois civil society in isolation. This civil society, to be sure, was not visualized as existing in isolation, that is, without a state, but the state provided only certain minimum prerequisites for the functioning of the civil society, such as law and order; it did not intrude into this functioning, which was seen in its spontaneity. Second, this spontaneous functioning was seen as resulting in the establishment of not only an overall order out of the chaos of myriad individual decisions, but also an order independent of the will and consciousness of the individual participants. This perception echoed the dictum of Hegelian philosophy, which represented a parallel intellectual development to classical political economy,[2] that the "whole" is not merely the sum of the "parts." Third, the "whole," that is, the overall functioning of the system, was seen to be in some sense beneficent, even though the motives underlying the myriad individual actions that went into the fashioning of this "whole" were by no means noble. Smith might have explicitly rejected Mandeville's notion of "private vice, public virtue," but his own perception was not free of its shadow (Dobb 1973, 38).

Liberal economic thought has never really outgrown these basic Smithian birthmarks, no matter how varied in terms of detailed content the alternative theoretical traditions that subsequently made their appearance may have been. Even Marx, the most trenchant critic of bourgeois economic theory in both its classical and its vulgar incarnations,[3] conducted his analysis within these broadly Smithian parameters, with of course one major qualification. He saw the spontaneity of the "self-acting economic order" as productive not of unmitigated beneficence but of class exploitation and class antagonism, which, notwithstanding the enormous development of productive forces it unleashed to start with, would eventually yield stagnation, decay, and social breakdown, necessitating its own historical superseding.

We will discuss Marx later. But this Smithian imprint is most clearly visible in what is today the dominant strand of liberal economics, namely Walrasianism, whose raison d'être is to show how a bourgeois civil society considered in isolation reaches an economic equilibrium that is beneficial in some sense for all participants. Indeed, this strand is often explicitly claimed to be the direct descendant of Smithianism.

This claim is questionable. The differences between the Smithian and the Walrasian conceptions are enormous; they relate to basic methodological constructs, to categories of analysis, and even to perceptions about the meaning of the term *beneficence of the market*. At the methodological level, the Smithian notion of equilibrium (where "natural prices" prevail) as a center of gravity toward which market prices gravitate, is far removed from the Walrasian notion of equilibrium, which is exclusively short-run and concerned with market prices alone. Likewise, the difference in the categories of analysis in the two systems is obvious: Smith conducted his analysis in class categories, to which the numerous individual agents belonged, while in the Walrasian system it is individuals as individuals who reign supreme. Above all, however, the Smithian and the Walrasian systems differ on the very criteria for defining the beneficence of the market. Smith sees the beneficence of the market as consisting in its ability to usher in "progress," defined in terms of material production, or "the wealth of nations." (It is for this reason that his emphasis on "increasing returns" is so crucial an ingredient of Smith's thought.) Smith's notion of "progress," in other words, is close to what Marx was later to call "the development of the productive forces." By contrast the beneficence of the market in the Walrasian system is seen to consist in the fact that a competitive equilibrium yields an optimum outcome in Pareto's sense (namely, at this equilibrium no one can become better off without some one else becoming worse off).

This proposition, which is the centerpiece of modern general equilibrium theory, is really not much of an advertisement for the beneficence of the free market. In fact, notwithstanding its mathematical elegance, it is almost a tautology. As long as it is individuals as individuals, always mindful of their self-interest and differentiated from one another only by differences in endowments and tastes, who participate in the market, and that entirely voluntarily, with complete freedom to withdraw from it if they so desire, without any threat to their survival, it stands to reason that they must be better off through market participation than otherwise. And as long as "competition" ensures that nobody has any control over prices and everybody acts as price taker, it stands to reason that spontaneous price movements, assumed to occur precisely for this very purpose, would eliminate any slack in the system in the sense of unrealized benefits of commerce, thus ensuring that no person in equilibrium can be made better off without someone else becoming worse off. This proposition therefore is not only a rather shallow demonstration of the beneficence of the market, deriving conclusions that are almost assumed, but it can also scarcely stand on a par with Smith's Hegelian proposition that "the whole is not the sum of the parts": the "whole" here is taken to consist almost exclusively of the sum of "parts." (This is even truer, as we will see, of more recent advances such as rational-expectations equilibria.)

Nonetheless, the common strands between Smithianism and Walrasianism, notwithstanding differences in the perception of beneficence, should not be overlooked. An essential characteristic of an equilibrium with beneficent properties must be that it is not demand-constrained, for if it is demand-constrained then the system can be accused of possessing inherent "irrationality" that prevents the full utilization of the productive potential of society, defined not in any absolute sense but even within the given context. In such a case, to call the equilibrium beneficent, no matter how we define the term, would scarcely carry any conviction. Thus, from Smith to modern general equilibrium theory, the beneficent equilibrium that bourgeois civil society, taken in isolation, has been assumed to achieve spontaneously, has been an equilibrium where demand plays no constraining role.

Moreover, the theoretical objective of modern general equilibrium theory is reminiscent of Smithianism: to demonstrate the essential coherence inherent in the economic functioning of the bourgeois civil society. Its universe therefore is the same as that of Smith, namely, the bourgeois civil society taken in isolation, where it shows the spontaneous achievement of an equilibrium imbued with beneficent properties arising inter alia from its being unaffected by demand constraints.

The purpose of this book is to show that any theoretical system that is built around the bourgeois civil society in isolation is fundamentally incomplete. Among such systems, however, which virtually cover the entire corpus of economic theory, a distinction has to be drawn between two strands. The theoretical analysis of one of these strands is fundamentally logically flawed. The other strand overcomes this logical flaw, but it suffers from the contradictions of an incomplete break, in the sense of remaining trapped within the assumption of a closed capitalist system, because of which it, too, remains incomplete. The distinction between these two strands is of great intrinsic importance and should not be lost sight of in the process of developing a general critique of economic theory on account of its looking at capitalism in isolation.

The distinction between these two strands comes out most clearly in their respective theories of the value of money, which accordingly is the central concern of this book. The two strands on the theory of money, and hence by implication on economic theory as a whole, are christened in this book the "monetarist" and the "propertyist" strands.

The Schism in Economics

Economics as a discipline is characterized by several "great divides." The one most commonly identified is the divide between what are, paradoxically, called the classical and the neoclassical traditions, which can, with less ambiguity, be described as the "Ricardo-Marx" and the "Menger-Jevons-Walras" traditions. Among the many and obvious differences between these two traditions, the one that stands out most sharply for a contemporary economist—especially after the labors of Piero Sraffa (1960)—is that income distribution among the two main classes in the former is independently (socially) determined, and the price system is erected on the basis of it. The relative prices between commodities in equilibrium, according to this tradition, is independent of demand, and dependent, solely instead, on the conditions of production and this separately determined distributional parameter. In the Menger-Jevons-Walras—or, more simply, the "marginalist"— tradition, by contrast, all prices, including factor prices (and hence the distribution of income between the two main classes) are determined by demand and supply.

This, to be sure, is a divide of enormous significance. And yet it is quite unsatisfactory to take this as *the* divide, owing to the fact that on both sides of this divide there is a common belief that capitalism, through its internal devices, functions, on average, in the neighborhood of full capacity. Barring Marx, who rejected Say's law explicitly (even though he subscribed to this view of near-full capacity production *on average*), all the other protagonists on either side of this divide were believers in Say's law, that is, in the proposition that aggregate demand cannot be a constraint on output (or, in Say's words, "supply creates its own demand").

This division, in other words, implicitly deprecates the significance of the Keynes-Kalecki revolution, and hence the *theoretical* significance of the demand constraint under capitalism. To be sure, capitalism has not *empirically* been a system that is forever bogged down in a demand constraint of any severity, but then capitalism has never existed in isolation from other surrounding precapitalist and noncapitalist economies, such as is assumed in the theoretical universe constructed by authors on both sides of the divide. This empirical fact cannot justify a deprecation of the theoretical significance of the demand constraint. The legitimacy of this particular "great divide" therefore becomes questionable.

This divide, however, is in conformity with the basic Marxist distinction between the spheres of production and of circulation, and hence between classical political economy, which takes the sphere of production as its point of departure, and so-called vulgar economy, which remains confined to the sphere of circulation. Marx of course subsumed under the latter concept a whole range of relatively minor post-Ricardian writers, and not the authors of the marginalist revolution, among whom Engels referred to Jevons and Menger without, curiously, explicitly labeling them as proponents of vulgar economy.[4] But, strictly speaking, notwithstanding the novelty and the technical sophistication of the marginalists, they would fall under that Marxian rubric.

Likewise, since the whole question of demand and of "realization" of surplus value (and of social output in general) is a matter pertaining to the sphere of circulation, deprecating the centrality of issues of aggregate demand, as is implied in this particular identification of the "great divide," is a natural part of this basic Marxist position.

Not only is the issue of demand central to capitalism, though it bursts into blinding visibility only sporadically, but this orthodox Marxist interpretation of Marx also does not do justice to Marx himself. Classical capitalism, as Janos Kornai (1979) once remarked, is a "demand-constrained system," while classical socialism (as it then existed) was a "resource-constrained system." The reason why classical capitalism was demand-constrained was discussed with great clarity by none other than Marx himself, who could be considered the pioneer of the Keynes-Kalecki revolution, though he did not carry his ideas in this sphere to their natural, logical conclusion. Putting it differently, Marx authored two great ideas in economics, one concerned with the origin of surplus value, for which he relied very much on Ricardo, and the other concerned with the problem of aggregate demand or the "possibility of generalized overproduction," where he broke sharply with Ricardo. Of the two, he pushed the latter into the background, where it awaited rediscovery by Keynes, Kalecki, and others in the context of the Great Depression; he concentrated instead almost exclusively on the former. He did so, in our view, for reasons having to do with his perception of an imminent proletarian revolution in Europe, for which laying bare the process of exploitation of workers under capitalism was a task of great theoretical urgency, and almost everything else became secondary. But it had the unfortunate effect of submerging a powerful tradition, namely the one that took cognizance of aggregate demand, making it appear to later generations as if it were a preoccupation exclusively of the Keynesians, and preventing an understanding of it in its theoretical totality.

But the effects were even deeper. It is not just that some ideas of Marx were pushed into the background while others got the limelight; since underlying both sets of ideas was a certain unified theoretical system, the pushing into obscurity of one set of ideas meant that this unified theoretical system could never be properly comprehended. The prime example of this is Marx's labor theory of value, which has for long been considered, entirely illegitimately, as being identical with Ricardo's labor theory of value. In short, the pushing into obscurity of one important set of Marx's ideas has meant a lack of understanding of the Marxian system (including its logical problems) in its totality, and hence a misinterpretation of even those components of it which have been in the limelight.

It follows that while the use of the phrase "Ricardo-Marx tradition" is justified to an extent by Marx's own contingent theoretical preoccupations, it prevents a recovery of the other major strand of Marx's thought, which is necessary not merely out of intellectual curiosity or for reasons of hagiography, but for a better understanding, both of the totality of the Marxian system, and of the very real problem of aggregate demand itself. In short, we can identify an alternative "great divide" that exists in economics and has escaped attention till now, a "great divide" between what I would call