

Marx's financial articles

In the critique of political economy which became his life work Marx set out, as he put it in the Preface to the first German edition of *Capital*, to "lay bare the economic law of motion of modern society". One of his conclusions was that the expansion of production under capitalism did not proceed at a smooth, steady pace, but was "a series of periods of moderate activity, prosperity, overproduction, crisis and stagnation" (*Capital Vol I*, Pelican, p.58), in which the long-term trend was nevertheless upwards.

The crisis which marked the end of the period of boom took the form of a financial crash - that is, a collapse of credit and a strong demand to be paid in cash. This gave rise to the illusion that the crisis was simply a monetary question whereas in fact the monetary crisis was a reflection of the real overproduction that had taken place.

Overproduction reflected itself as a monetary crisis, since, in the middle of the 19th century, the main form of credit was the trade bill, or bill of exchange, a promise to pay issued by a manufacturer or merchant which would be honoured when he had sold his product. Such bills could be discounted, that is, cashed below their face-value, the precise deduction depending on the going rate of interest (discount rate). In normal times these bills circulated alongside bank notes as an accepted means of payment.

Clearly, if overproduction has taken place, all the bills are not going to be able to be honoured, so that as soon as people realise - or even suspect, with or without reason - that overproduction has taken place they will no longer be prepared to accept these bills in payment and will insist on cash. Nor will banks be prepared to discount the bills, except at a very high rate of interest. The result is a credit squeeze, high interest rates and a financial crisis.

Marx studied two of these crises in close detail, that of 1847 - when just after arriving in London in 1850 he was investigating the relationship between crises and revolution - and that of 1857. In fact, by co-incidence, 1857, besides being a crisis year, also saw the publication of two British parliamentary reports on financial questions: the secret evidence taken by a House of Lords committee which investigated the 1847 crisis and a House of Commons report on the workings of the 1844 Bank Act. Marx replied on these two documents, together with the House of Lords report itself which had been published, without the evidence, in 1848 and a report on the 1857 crisis published in 1858, to write a considerable number of articles for the *New York Daily Tribune* in 1857 and 1858 as well as to make notes for the section of Volume III of *Capital* to be devoted to interest-bearing capital. Marx had also frequently written on financial subjects before 1857 for the NYDT, especially when a financial or industrial crisis seemed about to break out. He always commented on the British budget when it was presented to the House of Commons and as early as 1853 had written an article explaining the principles and working of the 1844 Bank Act to his American readers.

Since, in the end, Marx never got round to preparing for publication

these notes he made for Capital - they were very scrappy and had to be put into some sort of order by Engels - it is these NYDT articles which must be regarded as expressing in a final form for publication his views on financial crises. Hence these articles are to be regarded as an important complement to Volume III of Capital.

The British banking laws of 1844 and 1845 which Marx analysed in detail were an attempt to put into practice the doctrine of the so-called Currency School. In 1797, at the beginning of the Napoleonic Wars, the convertibility of Bank of England notes into gold had been suspended and was not restored until 1819. As a result of the experience of this period of inconvertibility a controversy arose in the first part of the 19th century over whether or not the number of paper notes issued by banks should be controlled by legislation. The Currency School argued that it ought to be, in order to ensure that the circulation of paper notes conformed to what they believed to be the economic laws governing the circulation of a metallic currency (gold and/or silver). Their opponents, known as the Banking School, denied the need for such control arguing that, as long as the paper notes were ultimately convertible into a fixed amount of gold, the number that would in actual practice circulate would always be governed by the economy's need for currency. It was thus impossible, in their view, for the number of convertible paper notes to be over-issued since if more were issued that the economy needed the surplus notes would eventually find their way back, one way or another, to the bank that had issued them.

The Currency School based their theory on the views expressed by Ricardo on the circulation of a metallic currency like gold. According to Ricardo, there was a direct causal relationship between the amount of gold in a particular country and the general level of prices prevailing there. When a country had a favourable balance of trade, with exports exceeding imports, there would be an inflow of gold to that country; this increased quantity of gold would lead to an increase in the general price level; exports would therefore tend to fall off and imports to increase; as the balance of trade shifted from favourable to unfavourable so gold would flow out of the country, bringing about a fall in prices again. In other words, according to Ricardo, with a metallic currency the amount of money in circulation was automatically regulated by the flow of gold into and out of a country as its trade balance changed one way or the other.

The Currency School wanted to make the circulation of a paper currency (or rather of a currency composed partly of gold and partly of paper notes) conform to this automatic model described by Ricardo. They thus proposed that the number of notes that could be issued should be tied to the amount of gold in the vaults of the bank that issued them. In 1844 led by the banker Samuel Loyd (later Lord Overstone, 1796-1883) they persuaded the then Tory Prime Minister, Sir Robert Peel, to try to put their so-called currency principle into practice. The Act was piloted through the House of Commons by Peel himself and so is often known as the "Peel Bank Act". Marx explained its principle and main features in an article published in the NYDT on 24 September 1853:

It assumes that £14,000,000 of bank notes form the necessary minimum amount of circulation. All notes issued by the Bank of England beyond that amount shall be represented by bullion. Sir Robert Peel imagined he had discovered a self-acting principle for the issue of notes, which would determine with mechanical accuracy the amount of the circulation, and which would increase or diminish it in the precise degree in which the bullion increased or decreased. In order to put this principle into practice, the Bank was divided into two departments, the Issue Department and the Banking Department, the former a mere fabric of notes, the latter the true Bank, receiving the deposits of the State and of the public, paying dividends, discounting bills, advancing loans, and performing in general the business with the public, on the principles of every other banking concern. The Issue Department makes over its notes to the Banking Department to the amount of £14,000,000, plus the amount of bullion in the vaults of the Bank. The Banking Department negotiates those notes with the public. The amount of bullion necessary to cover the notes beyond £14,000,000 remains in the Issue Department, the rest being surrendered to the Banking Department. If the amount of bullion diminish beneath the circulation exceeding £14,000,000, the notes returning to the Banking Department in discharge of its advances, or under the form of deposits, are not reissued nor replaced, but annihilated (Marx-Engels, Collected Works, Vol 12, pp.298-9).

Marx regarded the theory of the Currency School as wholly mistaken and described the attempt to apply it through the 1844 Bank Act as a "fiasco" even in Volume I of Capital (Pelican, p.939). His first objection was to their view, derived from Ricardo, that the quantity of money in circulation governed the general level of prices. In his view the relationship was exactly the reverse: that more or less money was in circulation because prices were high or low, (see Volume I of Capital, Chapter III, 2b). In other words, money was essentially only a secondary factor, the amount circulating depending on the needs of the economy as determined by real economic factors such as the prices of the commodities to be traded (reflecting their value, or amount of socially necessary labour-time spent in producing them from start to finish) and the level of productive activity and trade. His views are summed up rather well at the end of his A Contribution to the Critique of Political Economy, where he says that Thomas Tooke (1774-1858), who had started out as a partisan of Ricardo's theory but who later became a leading opponent of the Currency School, was led to recognise that the direct correlation between prices and the quantity of currency presupposed by this theory is purely imaginary, that increases or decreases in the amount of currency when the value of precious metals remains constant are always the consequence, never the cause, of price variations, that altogether the circulation of money is merely a secondary movement and that, in addition to serving as a medium of circulation, money performs various other functions in the real process of production (Lawrence & Wishart, 1971, p.186).

Marx had the highest regard for Tooke. He was particularly impressed by his History of Prices from 1792 to the Present Time which appeared between 1823 and 1857. When he wrote that detailed confirmation of the economic law that "prices are thus high or low not because more or less money is in circulation, but there is more or less money in circulation because prices are high or low" was "the only achievement of the post-Ricardian English economists" it was clearly the

work of Tooke he mainly had in mind. When Tooke died in 1858 Marx wrote to Engels that the last English economist of any value was dead (letter of 5 March 1858).

Marx's second objection, based on the empirical research of men like Tooke, was that it was not possible in practice to increase the amount of convertible paper money in circulation beyond what the economy required, as he argued and demonstrated with statistics many times in his NYDT financial articles. The needs of the economy determined the amount of currency in circulation just as much when the currency was gold and convertible notes together as when it was gold alone.

This does not mean that Marx is to be regarded as a member of the Banking School; in fact he criticised people like Tooke for not going beyond the currency question to examine the real economic factors at work. Nor should he be seen as an advocate of the reform of the banking legislation in Britain, even though he knew that this aggravated the monetary crisis phase of the industrial cycle:

Ignorant and mistaken bank legislation, such as that of 1844-45, can intensify this money crisis. But no kind of bank legislation can eliminate a crisis (Capital, Volume III, Moscow, p.478).

His concern was to show that capitalism was a system that worked according to economic laws which arose from deeper causes than mere monetary reform. A surprisingly large part of Marx's writings on economics - not just these articles in the NYDT but also his *A Contribution to the Critique of Political Economy* and the notebooks known as the *Grundrisse* - was devoted to exposing incorrect theories about money. For Marx, the only way to end recurring economic crises was a social revolution as a result of which money would be abolished.

The exact way in which the 1844 Bank Act proved to be a "fiasco" is well described by Engels in an explanatory passage he added to the chapter on "The currency principle and the Bank legislation of 1844" (chapter XXXIV) of Volume III of *Capital* which he edited after Marx's death and which was published in 1894:

the separation of the Bank into two independent departments deprived its management of the possibility of freely utilising its entire available means at critical times, so that situations could arise in which the banking department might be on the verge of bankruptcy while the issue department still had intact several millions in gold and, in addition, its entire 14 million in securities. And this could take place so much more easily since there is a period in almost every crisis when heavy exports of gold take place which must be covered in the main by the metal reserve of the bank. But for every five pounds in gold which then go abroad, the domestic circulation is deprived of a five-pound note, so that the quantity of circulating medium is reduced precisely at a time when the largest quantity is most needed. The Bank Act of 1844 thus directly induces the entire commercial world forthwith to hoard a reserve fund of bank-notes at the outbreak of a crisis; in other words, to accelerate and intensify the crisis. By

such artificial intensification of demand for money accommodation, that is, for means of payment, at the decisive moment, and the simultaneous restriction of the supply the Bank Act drives the rate of interest to a hitherto unknown height during a crisis. Hence, instead of eliminating crises, the Act, on the contrary, intensifies them to a point where either the entire industrial world must go to pieces, or else the Bank Act. Both on October 25, 1847, and on November 12, 1857, the crisis reached such a point; the government then lifted the restriction for the Bank in issuing notes by suspending the Act of 1844, and this sufficed in both cases to overcome the crisis. In 1847, the assurance that bank-notes would again be issued for first-class securities sufficed to bring to light the £4 to £5 million of hoarded notes and put them back into circulation; in 1857, the issue of notes exceeding the legal amount reached almost one million, but this lasted only for a very short time (Moscow, pp.542-3).

The Act was suspended for a third time on 11 May 1866 during the crisis of that year by the then Chancellor of the Exchequer, Gladstone. Marx did not analyse this crisis in as much detail as he did those of 1847 and 1857, though he does refer to it in passing in Volume I of Capital (Pelican, pp.822-3) and he did discuss the 1866 suspension in a letter he sent to Collet in 1868 and which the latter published in the Urquhartite journal he edited, the Diplomatic Review (as the Free Press became) under the somewhat misleading title "How Mr Gladstone's Bank Letter Procured a Loan for Russia" (Gladstone had in the meantime become the Prime Minister).

In Volume III of Capital Marx also argued that the 1844 Act had been deliberately designed to keep interest rates artificially high, so benefiting the financial section of the capitalist class at the expense of the industrial section. He thus regarded the bankers like Lord Overstone and George Norman (1783-1882), who both came in for his harsh comments, as being motivated by self-interest as well as being ignorant of monetary economics. In fact as early as 1850, in their notes for the Revue of Neue Rheinische Zeitung, Marx and Engels had spoken of "the Bank Acts of 1818 and 1844, which strengthened the financial aristocracy" (The Revolutions of 1848, Pelican, pp.305-6).

In case it should be thought that Marx's remarks can be simply transposed to the modern discussion on money and inflation, we should bear in mind that he was talking about the circulation of a paper currency convertible on demand into a fixed amount of gold. This situation no longer obtains today. All modern currencies are now inconvertible paper money, the laws governing which are quite different - the opposite, in fact, insofar as the quantity issued does directly affect the level of prices rather than vice versa - to those governing the circulation of a metallic currency and a mixed metallic/convertible paper currency. Marx did have something to say on this also in his A Contribution to the Critique of Political Economy and in Capital (chapter III, 2c) where his comments still provide a basis for an analysis of modern inflation as resulting from the over issue of an inconvertible paper currency. ALB