Was Marx a monetarist?

Margaret Thatcher, and other supporters of the Monetarist doctrine of Professor Milton Friedman, must have been surprised and even alarmed to hear that Marx was a fellow Monetarist. In a recent interview, Friedman said: "Let me inform you that among my fellow Monetarists were Karl Marx and leaders of Communist China" (*Observer*, 26 September). Thatcher need have no fear. There is not a word of truth in the Professor's statement as it affects Marx.

Friedman's reason for his belief about Marx was given in his definition of Monetarism:

> "Monetarism, he explained, was a new name for the Quantity Theory of Money which dealt with the relationships between the quantity of money and economic variables such as price level, interest rates and unemployment."

Friedman is saying that Marx's money theory was the same as the quantity theory of money, and that Monetarism is merely a new name for it. Friedman is wrong on all counts. Marx's money theory was an application of his labour theory of value, which the quantity theorists and the Monetarists both reject. Marx did not share the belief of the Monetarists that unemployment and its rise to peak levels in depressions arises out of an inflationary monetary policy and could be avoided by a different policy.

And Friedman's Monetarism is not a new name for Marx's money theory, or for the quantity theory, but a new name for a quite different theory, the "Bank-deposit Theory of Prices", which holds that the price level is determined by the rise and fall of bank deposits. Both Marx and the quantity theorists were completely opposed to it. The principal thing that Marx and the quantity theorists had in common, and which differentiates them from the Monetarists, is that by "money" they meant only the notes and coins in circulation, the currency.

For Friedman and other Monetarists, as for the bank-deposit theorists, "money" includes, along with the relatively small amount of currency, the much larger amount of bank deposits. Professor Edwin Cannan, in his book *Modern Currency and the Regulation of its Value*, published in 1931, had a chapter entitled "The Bank-deposit Theory of Prices". Cannan's description of that theory showed it to be exactly the same as the theory now advanced by Friedman under the name Monetarism. Cannan was of course opposed to it.

Marx and the quantity theorists made it quite clear that by "money", in connection with prices, they meant only the currency. In *Capital* vol. 1 (Kerr edition, p.143), Marx dealt with inflation in terms of the "'bits of paper", put into circulation by the state, "on which their various denominations, say £1, £2, £5 etc. are printed". Nothing about bank deposits being the factor determining the price level.

The economist, Professor Alfred Marshall, in his *Money, Credit & Commerce* (Macmillan, 1904) stated the quantity theory as "the relation between the volume of currency and the level of prices". Professor Cannan did the same. Cannan is of special interest because not only did he show the fallacy of the bank-deposit theory now advocated by Friedman, but also put in a plea for the retention of the distinctive word "currency" and not allow it to be displaced by the word "money". He warned of the confusion that would be created if his plea went unheeded. Friedman's mistaken belief that Marx was a Monetarist illustrates Cannan's point.

What the Monetarists mean by "money" or "money supply" they obtain from the figures published each month in the official journal *Financial Statistics*, which, however, adds to the confusion by compiling not one figure, but six different figures, ranging at present from £36,124m up to £143,154m. They all consist predominantly of bank deposits except that the top one also includes "shares and deposits with Building Societies". The figures differ because they include different categories of bank deposits. Fifty years ago Cannan foretold what would happen. Once they had started by including bank "sight deposits", withdrawable on demand, they would, he said, be unable to find good reason for excluding the "time deposits" (withdrawable only on giving notice, usually seven days), of the commercial banks and savings banks, and would probably end up by throwing in the Building Societies. too which is what they have done.

The Monetarists disagreed among themselves about which of the six sets of "money" figures is the appropriate one. The only thing the Monetarists are agreed about is a rejection, as the relevant factor, of the currency figures used by Marx and the quantity theorists. (The present currency circulation is £10,741m.) Friedman is not the only one to get into a muddle by confusing "currency" with bank deposits.

The editor of the *Times* (23 September 1976) quoted the economist Jevons as having defined the quantity theory in terms of "an expansion of the currency". Returning to the subject later on (7 April 1977) he again quoted Jevons, but this time he altered the word "currency" to "money supply", by which he, the editor, meant predominantly bank deposits. It was not what Jevons said or intended.

The confusion of the Monetarists extends to giving a new meaning to the simple phrase "printing money". To Marx, Marshall and Cannan it meant "printing notes"; as no doubt it still does to most people. But when Denis Healey, as Chancellor of the Exchequer in the Callaghan Labour Government, said that the government "are not printing money now", and was asked to reconcile it with the fact that the Bank of England was busily engaged in printing and putting into circulation hundreds of millions of pounds of additional notes, the Treasury, on his behalf, explained that "printing money does not mean printing notes . . . but issuing Treasury Bills to the banks" (that is, government borrowing from the banks).

This had its farcical aspect. Two years after Healey made his speech, the Prime Minister, James Callaghan, talking on the same topic, said that the government were not going "to get more bank notes printed". Apparently Callaghan could not believe that "printing money" meant something different from what most people thought it meant. Nobody had told him that his Monetarist advisers had given it a new meaning.

The question has to be considered whether the Monetarist bank-deposit theory is valid. Does the price level rise and fall with the total of bank deposits? Many examples could be given to show that it is not valid. Between 1878 (the first year for which figures of total bank deposits are available) and 1914, bank deposits increased by 119 per cent. Prices did not rise at all, but fell by seven per cent. And in 1931, Cannan in his book *Modern Currency* pointed out that at that time "prices continued to wax and wane with currencies and to exhibit towards the variation of bank deposits complete indifference" (p.95).

Another question concerns the relationship between the total currency in circulation and the total of bank deposits. If the two kept in line, rising and falling together and by the same percentage, it might be argued that it does not matter whether guidance is looked for in changes in the volume of currency or in changes in the amount of bank deposits. But there is not such co-relationship. Between 1970 and 1975 Sterling deposits in the banks in- creased by 120 per cent but the currency in circulation increased by only 80 per cent. (If bank deposits in currencies other than Sterling are included the discrepancy was wider still).

Since the Callaghan government, six years ago, adopted the Monetarist policy continued by Thatcher they have operated in the belief that "by controlling the money supply", that is bank deposits, they could control the rise of prices. But which of the several different sets of figures should they use? If all the six moved together, and by the same percentage, any one would be as good as any other. But they do not keep in line with each other. They change by different percentages and at times some are rising while others are falling. The one generally favoured by British governments has been Sterling M3 which consists predominantly of bank deposits in Sterling (excluding deposits in British banks in other currencies). But in practice the governments found that they could not control it. Repeatedly they would announce the limits within which they planned to keep the "money supply", only to find their planned limits exceeded. The American government had the same experience.

The Chancellor of the Exchequer, Geoffrey Howe, admitted this at the Lord Mayor's dinner. He spoke of the Government's anxiety "when it focused on Sterling M3 which promptly nearly went out of control" (*Financial Times*, 22 October). So he said he had favoured not concentrating on only one of the six but looking at all of them. But he also admitted that "occasionally all the money measures together did not give a clear message of what was happening" (*Times* 22 October).

The truth is that the monetarists cannot make up their minds what exactly they mean by "money supply", and they cannot control it. And even if they could, that would not give them control of the price level. Underlying Monetarist doctrine there is still another fundamental conflict between Monetarism and Marx's money theory and Cannan's quantity theory. For Marx and Cannan bank deposits are sums of money lent to banks by depositors. They held the same view as that of the banker Walter Leaf in his book *Banking* (1926, p.102):

> "The banks can lend no more than they can borrow—in fact not nearly so much. If anyone in the deposit banking system can be called a 'creator of credit' it is the depositor: for the banks are strictly limited in their lending operations by the amount which the depositor thinks fit to leave with them."

Opposed to this is a theory described by Cannon as "the mystical school of banking theorists", which holds that the bulk of bank deposits are "created" by the banks themselves. One of the believers in the "mystical" theory was Major Douglas, founder of the Social Credit Movement, with his statement that the banks can "create unfold wealth by the stroke of a pen".

Another "mystic" is Professor Friedman. In the book *Free to Choose*, written jointly with his wife, dealing with inflation, they considered who are and who are not "the culprits".

> "None of the alleged culprits possess a printing press on which it can turn out those piece of paper we carry in our pockets; none can legally authorise a book-keeper to make entries in ledgers that are the equivalent of those pieces of paper."

In view of the belief of the Keynesians and the Monetarists that they are in opposite camps it is relevant to recall that Keynes also was a "mystic". Like the Monetarists he urged abandonment of the policy of directly controlling the amount of money, and was responsible for drafting the statement in the 1931 Report of the Committee on Finance and Industry that "the bulk of deposits arise out of the action of the banks themselves."

The Monetarist policy of the governments in the past six years has been based on the idea that, through money market operations, the government can control the amount of bank deposits alleged to be "created" by making "entries in ledgers". If this is a fallacy, as it is, how is it that the Thatcher government can claim some success in reducing the rate at which prices are rising?

In the first place comparison should be made with the performance of the Lloyd George government in the twenties. They not only halted inflation but, within months, there was an actual fall of prices. The government's advisers at the time were not Monetarists, and the government halted inflation by curtailing the note issue. The present government, like the Callaghan government, has maintained an excess note issue, vainly hoping to reduce inflation by the impossible idea of "controlling" bank deposits.

That prices are now rising less rapidly is due to the depression. As Marx showed, prices rise in a boom and fall in a depression quite apart from the currency factor. The difference between the twenties and now is that, at that time, two factors (curtailment of the note issue, and the depression) were both affecting the price level in the same direction, downwards. This time they are working in opposite directions. Government policy is pushing prices up while the depression is operating to make the rise of prices less than it would otherwise be.

One last word. Marx, unlike the Monetarists and unlike at least some of the quantity theorists, never supposed that getting rid of inflation would solve workers' problems.

(January 1983)