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**Karl Marx on the Foundations of Monetary Theory**

**by**

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**Abstract:** This paper contrasts neoclassical perspectives on the foundations of monetary theory with those of Marx. It is shown that neoclassical value (choice) theory has been inadequate foundation upon which to build a theory of money. Marx's theory of value, when reformulated as an explanation of the coordination of economic activities in capitalist society, directly addresses and provides answers to the questions in the foundations of monetary theory. The labor theory of value provides the basis for an alternative paradigm in monetary theory.

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*If we construct our explanation of the social contrivance of money from the usual building blocks of the theory of individual choice alone, some aspects of the social institution will escape us in a way that can, embarrassingly, only be covered up by resort to brute tautologies--"money is accepted because it is accepted," and so forth (Leijonhufvud, 1981: 220).*

*No self-sustaining theory of money can actually be formulated. The monetary relationships at any given time and the functions ascribed to them can be perceived only as a reflection of ever--changing economic reality. Only an analysis of the latter and the understanding of its processually changing character can give us today the clue to the meaning of money. A theory of money must, therefore, be an aspect of general economic theory, the latter being itself, or an aspect of, a dynamic theory of social organization (Niebyl, 1946: 163-64).*

## **I. Introduction**

There are three fundamental issues in developing the foundations of monetary theory. They include explaining the origins, development, and nature of money; presenting a clear characterization of the fundamental differences between barter and monetary economies; and specifying the connection between a theory of value and a theory of money. The last issue is of crucial significance because the meaning assigned to a theory of value, and the way in which value theory and monetary theory are integrated, provide the conceptual framework within which the first two issues are addressed.<sup>1</sup>

It is now generally accepted that neoclassical economic theory has little of significance to say about the issues in the foundations of monetary theory. In particular, neoclassical value theory cannot accommodate money or provide the foundations for a theory of money.<sup>2</sup> With all of the research that has been done in this field, and it has been considerable, the formal models of monetary economies developed by neoclassical economists have provided explanations for the existence of money that are not "fundamentally different from the traditional verbal explanations" (Barro and Fischer, 1976: 155). In essence, money is nothing more than a technical convenience that human beings have "invented" to overcome the difficulties associated with barter. This, of course, says very little about the issues in the foundations of monetary theory.

What is not generally recognized is that Marx's theory of value directly addressed these issues. This fact has been neglected largely because many writers have seen Marx's theory of value as nothing more than a theory of price determination. The meaning of the labor theory of value has been reduced to two simple and related propositions. The first proposition states that the exchange-value of a commodity is determined by the socially necessary labor-time required for

its production. The second proposition states that commodities will exchange for one another in proportion to the relative amounts of socially necessary labor-time embodied in them. If these two propositions contained the essence of Marx's theory of value, it would be difficult to imagine how Marx could have advanced the theory of value or money beyond the state in which it was left by classical theory. However, if Marx's theory of value is interpreted not simply as a theory of price determination, but as a theory of the coordination and integration of labor processes in a decentralized capitalist economy, a quite different meaning can be given to his theory of value. It is a theory of value in which money plays an indispensable role.

## **II. Marx on the Foundations of Monetary Theory**

Marx explicitly rejected the orthodox notion that barter is a socioeconomic system "well adapted to commodity exchange, suffering merely from certain technical inconveniences, to overcome which money has been cunningly devised" (1970: 51). Marx argued, on the contrary, that the existence of "money is not the result of deliberation or agreement, but has come into being spontaneously in the course of exchange" (1970: 49). One of the central objectives of his labor theory of value was to explain how and why this was the case--how and why money developed as an intrinsic and essential institution of capitalist commodity production and exchange.

As was already mentioned, the preoccupation with Marx's theory of value as a theory of price determination over the past one hundred years has obscured the fact that his theory of value was concerned with other, more fundamental issues than the problem of price determination. He made this clear in a letter to Ludwig Kugelmann dated July 11, 1868 (Marx, 1934: 73-75). Marx suggests to Kugelmann that all societies must have some social mechanism for allocating their labor force between the various forms of productive activity that constitute their economies. This is a universal requirement common to all modes of social production. The numerous kinds of productive activities present in a society must be coordinated and unified into a coherent system if the life of the society is to be maintained. Of crucial significance, however, is that the form this coordinating mechanism takes varies widely over historical time. Marx tells Kugelmann that his theory of value is aimed at explaining how this social mechanism for integrating and coordinating

production processes operates in capitalist society. He then suggests that the economic interrelationships between independent producers, in capitalist society “is manifested in the private exchange of the individual products of labor, [in] the exchange value of these products” (1934: 74). In other words, the integration and coordination of independent labor processes takes place through the exchange of commodities. Thus, the first problem the theory of value must confront, according to Marx, is to explain what renders qualitatively heterogeneous commodities, themselves representing qualitatively different forms of human labor, exchangeable in definite quantitative proportions. In offering an explanation of this problem Marx’s theory of value not only elucidates how independent labor processes are coordinated in capitalist society, it also lays the foundations for monetary theory, because money is absolute crucial to the coordination process.<sup>3</sup>

Marx argues that the exchange of commodities in determinate quantitative proportions presupposes the existence of some qualitative attribute that commodities share with one another that permits them to be treated as equivalents for one another in the process of exchange (Marx, 1967a: 37, 49). Marx poses the question in the following way:

What is this unity of objects exchanged against each other? This exchange is not a relation which exists between them as natural things. It is likewise not a relation which they bear as natural things to human needs, for it is not the degree of their utility that determines the quantities in which they exchange. What therefore is their identity, which enables them to be exchanged in certain proportions for one another? As what do they become exchangeable? (1971: 144).

As is well known to historians of economic thought, after contending that utility cannot be the foundation for the qualitative equivalence and quantitative commensurability of heterogeneous commodities, Marx says that commodities “have only one common property left, that of being products of human labor” (1967a: 38). More specifically, in the process of exchange, if “along with the useful qualities of the products themselves, we put out of sight both the useful character of the various kinds of labor embodied in them, and the concrete forms of that labor, [then] there is nothing left but what is common to them all; all are reduced to the same sort of labor, human labor in the abstract” (1967a: 38). In other words, commodities share only one common social attribute: they are all what Marx calls “values” (1967a: 38; 1973: 141-42), meaning that they are

all material embodiments of abstract, “homogeneous human labor” (1967a: 74). Abstract labor is the foundation for the qualitative equivalence between, and general exchangeability of commodities. This relationship of equivalence between heterogeneous commodities, and consequently between the various forms of human labor spent in their production, is what Marx calls the “value-relation” (1967a: 60; 1978: 136), or more precisely--value (Marx, 1967a: 74).

In a commodity producing economy, value expresses the qualitative relationship of equivalence between commodities as products of human labor in the abstract and, therefore, between the specific forms of concrete labor expended in the production of those commodities. Value is an expression, in objects, of the socioeconomic interdependencies between formally autonomous producers in a society based on generalized commodity production and exchange. As Marx puts it, “Value...is only a representation in objects, an objective expression, of a relationship between men, a social relation, the relationship of men to their reciprocal productive activity” (1971: 147). Or, as Marx explains elsewhere, “the ‘value’ of a commodity only expresses in a historically developed form, what exists in all other historical forms of society as well, ...namely, the social character of labor, so far as it exists as the expenditure of social labor-power” (1975: 207). In this context, value can be thought of as abstract human labor that assumes the social form of a commodity generally exchangeable for any other commodity. Since value can manifest itself only indirectly “in the social relation of commodity to commodity” (1967a: 47), rather than directly as socioeconomic relations between human beings, the process of coordinating the labor of independent producers with the labor of the entire society is established only through commodity exchange. This implies that, for any given commodity, its value must have an independent social form of expression because no commodity can express its value, or general exchangeability, in terms of itself. This is tantamount to suggesting that abstract labor must have some concrete social form of appearance.

According to Marx, value has an independent social form of expression in the exchange-values of commodities, i.e., in the quantitative proportions in which commodities actually exchange for one another. Exchange-value is the social form of expression of value and its substance, abstract labor (Marx, 1967a: 38; 1978: 130-50). Indeed, it is the necessary form of expression of value. As Marx suggests, “since no commodity can relate to itself as equivalent and

therefore cannot make its own hide an expression of its own value, it must relate itself to other commodities as equivalent or make the hide of the body of another commodity” express its value (Marx, 1978: 138-39). It is precisely the necessity for value (or abstract labor) to have an independent social form of appearance in exchange-value that stimulates the development of money (Marx, 1967a: 86-87; 1970: 50-51). Unlike orthodox monetary theorists, Marx wants to demonstrate “that commodity circulation is bound to evolve money” (1971: 130).

Marx traces the genesis of money in the rather enigmatic third section of the first chapter of Capital, entitled “The Form of Value or Exchange-Value” (1967a: 47-70). While the argument is rather abstrusely expressed, it can be summarized in the following way. In a society based on generalized commodity production and exchange, it is possible for the value of any one commodity to be expressed in an interminable number of other commodities acting as equivalents. The only limit placed on the number of possible value-expressions for any one commodity is the number of other commodities in circulation. In a situation where no commodity acts as the exclusive equivalent, each commodity would have  $(n-1)$  different expressions of its value, or  $(n-1)$  exchange-values. In an economy with  $n$  commodities in circulation there would be  $[n(n-1)]/2$  possible value-relations. For example, with 200 commodities in circulation, there would be 19,900 different value-expressions. Obviously, such a system would have no unity. It would be nothing more than “a motley mosaic of different expressions of value” (1978: 145).<sup>4</sup> In a system in which there is no money-commodity, every commodity is money from the perspective of its owner. The development of generalized commodity production and exchange, therefore, demands that one commodity be “excluded from the rest, and made to play the part of ...the universal equivalent” (1967a: 66). The one commodity that serves as the universal equivalent, or the exclusive representative of the value of all commodities, “becomes the money-commodity, or serves as money” (1967a: 69). The commodity that functions as money becomes the objective embodiment of value (or of human labor in the abstract). Money becomes the sole social form of expression for exchange-value (or price) and is equivalent to, and immediately exchangeable for any other commodity or any other form of human labor (Marx, 1967a: 66-67; 1967c: 607; 1971: 136-37). It is the concrete social form of appearance of abstract labor, or the objective embodiment of value.

Historically, the development of money proceeds pari passu with the development of commodity production and exchange. Marx suggests that the “money-form” initially attaches itself to commodities that constitute the major forms of local alienable wealth. Gradually, “as exchange bursts its local bonds, and the value of commodities more and more expands into an embodiment of human labor in the abstract,...the character of money attaches itself to commodities that are, by nature, fitted to perform the social function of a universal equivalent. Those are the precious metals” (1967a: 89). Eventually, even “useless scraps of paper” (1970: 119) given an “objective social validity” through “compulsory action” by the state can function as money (1967a: 129). In tracing the evolution of money, Marx is attempting to demonstrate this fundamental point:

Money is a crystal formed of necessity in the course of the exchanges, whereby different products of labour are practically equated to one another and thus by practice converted into commodities. The historical progress and extension of exchange develops the contrast, latent in commodities, between use-value and value. The necessity for a giving external expression to this contrast for the purposes of commercial intercourse, urges on the establishment of an independent form of value, and finds no rest until it is once and for all satisfied by the differentiation of commodities into commodities and money. At the same rate, then, as the conversion of products into commodities is being accomplished, so also is the conversion of one special commodity into money (1967a: 86-87).

Marx’s theory of value, therefore, is capable of accomplishing a task that orthodox economic analysis has been incapable of doing; namely, “the task of tracing the genesis of...money..., of developing the expression of value implied in the value-relation of commodities, from its simplest, almost imperceptible outline to the dazzling money-form” (Marx, 1967a: 48). The origin of money is to be found in the division of the product of labor, the commodity, into a use-value and an exchange value. The development of money progresses simultaneously with the evolution of commodity production and exchange. Over time, money becomes the bond that ties the entire system of human productive relationships together in capitalist society. As Marx puts it, a monetary economy is one in which the “individual carries his social power, as well as his bond with society in his pocket” (Marx, 1973: 157).

### **III. The Social Nature and Functions of Money**

In every one of its functions, money mediates some social relation of production. As a standard of value, it permits individuals to equate their products to one another as manifestations of abstract social labor, or of their own socioeconomic interdependence. It allows qualitatively different forms of human labor to be rendered quantitatively commensurable with one another and to be expressed in a quantitative language that everyone understands--price. In its function as a medium of circulation it allows individuals to socially validate the products of their labor through sales, and allows them to appropriate the labor of others through purchases. As a store of value, money allows individuals to accumulate wealth and power in its most pure form and therefore, provides them with the means to appropriate the labor of others whenever and for whatever reasons they might desire. It becomes a claim upon some portion of the labor and wealth of society. When money functions as a means of deferred payment, it mediates the relationship between creditors and debtors. Contracts specify the obligations between them in terms of money. As world or universal money, it mediates the economic relationships between various nation states and reflects the economic interdependence between those nations (Marx, 1967a: 94-145).

When money is transformed into capital, it mediates the most fundamental social relationship of capitalism; and that is the relationship of wage labor to capital. Money-capital expresses the capitalists' domination of the process of production and their power to organize and control labor-power. The emergence of money as capital reflects the transformation of a simple exchange economy into a capitalist monetary economy and a reorientation of the end and aim of social production; i.e., the accumulation of money in the form of capital. Furthermore, the transformation of money into capital lays the foundation for the modern system of financial markets and institutions (Marx, 1967a: 156-76; 579-712). I call this the "missing function of money," since it is never discussed in orthodox monetary theory.

Marx also points out that while money functions as this special kind of social bond, its very existence as the mediator of productive relationships implies the possibility of economic crises. The extensive division of labor in capitalist society, and especially the division of the process of exchange into purchase and sale, implies the possibility of disruptions in the process of production and circulation. Individuals can always hoard money and, most importantly, capitalists

may not advance money-capital to purchase new means of production and labor-power. People can hold fast to money as a store of value and refuse to employ it as a medium of exchange or as capital. A monetary economy is therefore contradictory and implies the ever present possibility of systemic instability and crises. Money is both the instrument through which coordination must occur and through which crises become generalized to the entire economy. Money cannot be reduced to a neutral medium of exchange. As long as the coordination of productive activity is indirectly social, taking place only through money, monetary economies are inherently prone to instability and crises (Marx, 1967a: 94-145; 1968: 470-546). While the neoclassical economists focus only on the benefits of monetary exchange, Marx is almost alone in emphasizing its limitations and contradictions.

Unlike neoclassical value theory, Marx's theory of value can answer the central questions in the foundations of monetary theory. Marx can explain the origin, development and nature of money. He can also offer a coherent characterization of a capitalist monetary economy. This is because his theory of money is fully unified with his theory of value. There is no need to impose frictions--such as transaction costs, random payments or asymmetric information--on frictionless models. Marx's theory of money is built into his general theory of the laws of motion of a capitalist economy. This distinguishes Marx from contemporary neoclassical economists who try to artificially introduce money into general equilibrium models that exclude money by design.

#### **IV. Conclusion**

The principal point of this study has been to suggest that, while neoclassical economic theory cannot provide satisfactory answers to the central questions in the foundations of monetary theory, Marxian economic theory can. More specifically, the argument here is that neoclassical value theory cannot generate a meaningful theory of money, while Marx's theory of value generates a theory of money that directly addresses the issues in the foundation of monetary theory. The vision of the economic process embodied in Marx's value theory has room for money; the vision of the economic process implicit in neoclassical value theory does not.

The problems that neoclassical economic analysis has had in attempting to address the issues in the foundations of monetary theory stem from the reduction of the theory of value to

nothing more than a theory of relative price determination. In constricting the scope of a theory of value, the neoclassical economists have left themselves without a foundation upon which to build a general theory of money. Quite simply, the pure theory of choice, which is the core of neoclassical value (price) theory, cannot be a foundation for monetary theory. No connection can be made between the neoclassical value principle, utility, and money. This is reflected in the fact that neoclassical theory cannot explain the use or role of money without recourse to arbitrary constraints imposed on individual behavior or arbitrary frictions imposed on the process of exchange (e.g., in temporary equilibrium and overlapping generations models).<sup>5</sup> Individuals must be forced to use money. As Fischer has pointed out, the main trend of neoclassical monetary theory “has been to impose the use of money on the model, rather than allow it to emerge from within the model” (1988: 300). This violates Schumpeter’s important dictum that “the analysis of money should be built into the system of general theory instead of being developed independently and then plastered upon it” (Schumpeter, 1954: 1082). Given the scope of neoclassical value theory, it would be impossible for money to emerge from within general equilibrium models. Since the pure theory of choice is not a general theory of the socioeconomic organization and functioning of modern capitalism, it has not been able to explain money as an essential aspect of capitalist commodity production and exchange. If one wants to explain why “an egg costs more than a cup of tea” (Robinson, 1953: 22), the level of analysis at which neoclassical price theory is conducted is appropriate for resolving the problem. However, if one wants to address the questions in the foundations of monetary theory, price theory does not proceed at a level of analysis or “degree of generality that is consistent with the phenomena which one seeks to handle” (Dobb, 1945: 8).

Marx, on the other hand, can explain the emergence, development and nature of money as well as the nature of a monetary economy. Marx’s theory of money is developed simultaneously with his theory of value. There is a direct connection between his value principle, abstract labor, and money; money is the objective embodiment of abstract labor. This is why money is given a central and indispensable role in Marx’s analysis of the general character of economic life in capitalist society. In Marx’s analytical framework, it would be impossible to explain the systematic regularities that govern the determination of output, employment, the rate of growth

and the distribution of income without reference to money. Ultimately, for Marx, a theory of the nature and mode of functioning of a capitalist market economy would be impossible without a theory of money because the development of capitalism implies the development of money. This explains why Marx places money at the core rather than the periphery of his theory of value.

In conclusion, a Marxian framework for monetary analysis can definitely offer an entirely different method of posing and resolving some important questions in monetary theory and policy. If economic theory is ultimately away of thinking about the problems of social life, an alternative mode of thinking about these problems should be welcomed. The debates between the monetarists and Keynesians have defined the acceptable range of discussion in monetary economics for far too long.<sup>6</sup> This study is offered as a modest contribution to expanding that range of discussion by freeing the debate from its orthodox integuments.

## Notes

1. While this perspective is usually credited to Hicks (1935) and Patinkin (1965), it was originally suggested much earlier by Canaan (1921), Mises (1924), and Pigou (1917).
2. See Barro and Fischer (1976), Clower (1970), Davidson (1977), Fischer (1988), Foley (1989), Hahn (1973) Hayek (1935), Leijonhufvud (1981), MacDonald and Milbourne (1996), Myrdal (1939), and Niebyl (1946). An excellent overview of the history of the debate on the foundations of monetary theory can be found in Rogers (1989).
3. Thus Marx anticipates by more than 140 years Leijonhufvud's argument that money is a social mechanism for transmitting information and coordinating economic activities.
4. While an explanation of this problem is commonplace in today's Money and Banking texts, such was not the case when Marx was writing.
5. I refer here to such devices as "random payment periods," "cash-in-advance constraints," "transactions costs," or the imposition of the use of fiat money as the sole mechanism for transferring consumption goods between generations.
6. Of course, there have been the Post-Keynesian intruders into the discussion, but heterodox economists are often pushed to the margins of the debate by orthodoxy. In an open society, this ought to cease.

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