Book Review of The Value of Money, by Prabhat Patnaik. New York: Columbia University Press, 2009

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Abstract

Why does an otherwise worthless bit of paper—money—have a finite and positive value? The author of The Value of Money asserts that understanding capitalism's logic and prolonged existence lies in answering this question. While accepting the superiority of the traditional Marxist/Keynesian argument (namely, that money's value is exogenously determined in any given period) over the mainstream framework, this argument nevertheless fails to identify what ensures money's stability across periods. The real value of money across periods is determined by the rate of inflation, which in turn depends on the class conflict over ex ante shares in total output. Therefore, an isolated capitalist system, as visualized by both Marx and Keynes, cannot have such stability from within unless one of the claimants is a price taker. Only by introducing a semicapitalist periphery as a shock absorber to the capitalist core, both as a price taker and as a market "on tap," can this stability be ensured.

Key Words: Capitalist Dynamics, Class Conflict, Monetarism, Monetary Stability, Prabhat Patnaik

In the opening line of The Value of Money, Prabhat Patnaik clearly states his book's purpose: to explore the social arrangements underlying the value of otherwise worthless bits of paper: money. Through the theory of money (the stability of which is the raison d'être of the capitalist system), he has tried to throw light on the longevity of a system that has survived for periods unimaginable both to its detractors, like Karl Marx, and to its well-wishers, like Joseph Schumpeter.

In Patnaik's view, the basis of a positive and finite value of money has been arrived at from two opposite perspectives: the monetarist tradition, according to which value is derived from within the system (i.e., through the supply and demand of money), and the propertyist tradition, which argued that the value is determined from outside the system.

While accepting the superiority of the latter over the former, Patnaik argues that there is a problem even with the propertyist tradition because for the value of money to be stable requires its determining forces to remain stable, too. But an isolated capitalist system, as visualized in the propertyist tradition, cannot have such stability from within. Only by introducing a semicapitalist periphery as a shock absorber to the capitalist core, both as a price taker and as a market "on tap," can this stability be ensured.

The Infirmity of Monetarism

Monetarism argues that the value of money is decided by its demand and that supply lends support to a laissez faire capitalist system that operates around the full capacity/employment equilibrium. According to Walras's law, in a simplified one-commodity and one-money model with perfect price flexibility, if the money market were to clear, the commodity market would clear on its own. [i]

To establish that laissez faire is the optimum solution, one needs to prove that equilibrium exists in the money market for a positive price of money. For this to happen, there has to be a stable and continuous demand function that is inversely related to its price. Being the inverse of the commodity price, the price of money would require the demand for money to vary positively with the commodity price.

Two arguments have been put forth to establish this relationship. First, since money is used only for transaction purposes, its demand is stable and continuous and moves in tandem with commodity prices. Second, even if money is held as wealth, rational expectations about the future do not adversely affect the stability of the demand for money.

Patnaik explains the internal logical contradictions with both arguments. First, by virtue of being used for transaction purposes, money is held as a "store of wealth," however fleetingly that might be. Second, unless the expectations about prices are inelastic (i.e., not sensitive), money as an asset is never held since there are no returns for holding "cash." But inelastic price expectations require at least some prices to be sticky, which invalidates the perfect price flexibility condition in the first place.

The Superiority of Propertyism

As against the monetarist tradition, the propertyist tradition argues that money is not only held for transaction purposes but is inherently a store of wealth. Hence, not only is the demand for money not necessarily proportional to commodity prices, it is also highly unstable. In such a scenario where there is an ex ante excess demand for money, it is evident that there could be anex ante generalized overproduction in the commodities market. In other words, a capitalist system is inherently plagued with the problem of aggregate demand.

So, unlike the monetarist tradition, in the propertyist tradition the value of money is decided from outside the market system—but where? The answers given to this question are different for Marx and Keynes. Marx proposed that commodities enter the markets with a price and money with a value (i.e., the value of money is decided by the amount of labor power embodied in it, and its exchange ratio with other commodities is determined by the relative quantities of labor power embodied in each one of them). For Keynes, the value of money is decided by fixing its value vis-à-vis one particular commodity: labor. In other words, money wages are fixed from outside in the Keynesian system. It is this anchorage that gives stability to the value of money and, hence, to the capitalist system. Despite the superiority of propertyism over monetarism, Patnaik argues that even the former is incomplete, for the following reasons.

First, while propertyism establishes that the value of money is anchored within a period, how is it maintained across periods? In other words, what ensures long-term stability of demand for money? Instability of the value of money becomes a critical problem in a system where commodity prices are determined through negotiations on ex ante nominal wages and profit margins based on the bargaining power of workers and capitalists, respectively. In such a system, there would be a tendency toward accelerating inflation beyond a "ceiling" of activity. But in reality, the value of money has remained stable across periods except in conditions of extreme crisis. But neither Marx's nor Keynes's theory ensures this.

Second, in a system where there are debt commitments carried over from previous periods, the level of activity has to be above a certain "floor" below which they cannot be honored. But as Kalecki (1962) demonstrated, the only stable "steady state" under capitalism is when the growth rate is zero, which is by definition below the floor level. How has the system avoided this?

Patnaik thus poses two basic questions: What ensures that there exists a viable set of activities lying between the two levels of floor and ceiling? And even if this set does exist, does the system stabilize within that set instead of sliding down into stagnation as Kalecki argued?

The Incompleteness of Propertyism

Patnaik argues that the incompleteness of propertyism follows from the assumption made by both Marx and Keynes: namely, that the capitalist system functions in isolation. The capitalist core neither has existed historically without a noncapitalist periphery[ii] nor can it theoretically exist in such a manner. The rest of Patnaik's book attempts to show the roleof the periphery in solving the problems with traditional propertyism. It also establishes that there can never be a "diffusion of capital" to the periphery as a whole because in that case the two problems of maintaining the value of money across periods and meeting debt commitments would erupt again with no shock absorbers to depend on. But the existence of a periphery ensures stability through two different routes.

First, the periphery acting as a market on tap ensures that the capitalist core functions at levels of activity higher than the floor. In case of any decline in domestic demand, the core can easily access these markets to sell its surplus production.

Second, because of the existence of a broadly unorganized reserve army of labor in the periphery, the prices of peripheral goods—which are used as raw materials as well as wage goods for the working class in the core—can be kept under check through an unfavorable change in the terms of trade against peripheral economies. This acts as a shock absorber for price instabilities arising out of class conflicts in the core, thereby pushing the ceiling of activity beyond what would otherwise have been possible.

Existence of the periphery creates a viable set of activity because of the second reason while ensuring that the system settles down within that viable set for the first reason.

Some Points for Further Debate

I believe there are certain issues that have not been explored but that might have interesting effects on the arguments extended in Patnaik's book.

First, even in the absence of peripheral markets on tap, there is the possibility of a capitalist state in the core pushing the level of activity above the floor. That this played an important role during the so-called golden age of capitalism is something that should be kept in mind. Although discussed briefly in Patnaik's book, it has not been given its due.

Second, it is quite possible that, just as there are peripheral goods markets on tap, the labor markets in the periphery can act as reserve markets on tap. The very existence of such huge reserve armies of labor in the periphery, which are potential destinations for outsourcing, can act as a motive for the working class in the core to tame their wage demands, thereby striking at the source of price instability without directly depending on the periphery. I am referring to what Greenspan famously called the "traumatized workers" of the north.

While placing emphasis on the capitalist state as an output stabilizer and as a suppressor of the working class in the capitalist core during the era of globalization, I am not claiming that peripheral markets are not required or that a genuine diffusion of capital can take place in these areas. I am merely trying to show other ways in which these peripheral countries could play a role without being directly involved in the process.

To wind up, Patnaik's is a refreshingly original contribution in the heterodox tradition; it attempts to bring together three fields of research—monetary theory, macroeconomics, and development economics—and hence breaks the straightjacketed compartments that exist in the discipline today.

References

Kalecki, M. 1962. Observations on the theory of growth. The Economic Journal 72 (March): 134–53.

[i] The argument would not change even if there were an array of "n" commodities. Then the logic would be that, if the money market were to clear, not *all* the commodity markets would simultaneously have excess capacity (i.e., there would not be *generalized* overproduction).

[ii] It seems that Patnaik is treating the core and the periphery strictly as spatial categories, but it needs to be clarified that he considers the distantly located periphery to be *semi*-capitalist. So, while the peripheral manufacturing sector is capitalist, its primary goods-producing sector is noncapitalist. The former acts as a market "on tap" and the latter as a price stabilizer for the core. Even for the core one could assume, though Patnaik does not, that there are noncapitalist modes of production coexisting with a dominant capitalist sector. But it would not alter his argument if we were to consider, realistically, that for social stability to be maintained in the core even the noncapitalist sector's ex ante share in the output has to be ensured, in which case, far from stabilizing the system, this periphery from within adds to the instability. Moreover, Patnaik's spatial categorization of core-periphery emanates from his argument that capitalism has historically been, and continues to be, imperialist.

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