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# Roots of Capitalist Stability and Instability

ROBERT POLLIN

Prabhat Patnaik is an eminent and prolific economist who has worked creatively for 40 years at the intersection of Marxian and Keynesian theoretical traditions. In addition to his writings on Marxism and Keynesianism per se, he has made important contributions to our understanding of macroeconomics, development economics, and debates around economic justice, capitalism, socialism and imperialism.

*The Value of Money* is his most recent book-length contribution, focusing mainly on technical questions in monetary theory. But Patnaik's mind is too fertile and his interests too wide-ranging for even a technical book on monetary theory to be *only* about monetary theory. In fact, this book is an original, surprising and highly stimulating synthesis of ideas.

He begins with a critique of monetarist monetary theory, which draws on Marx and Keynes in interesting ways. But he also advances a critique of Marx and Keynes themselves, centred on an analysis of colonialism and imperialism in the operations of advanced capitalist economies. In this ladder theme, Patnaik builds from the original contributions of Rosa Luxemburg, where Luxemburg had explained how pre-capitalist economies provide new markets to purchase the excess supply of products produced within the advanced capitalist economies. *The Value of Money* concludes by arguing that the United States (us) needs to control the world's supplies of oil in order for the dollar to maintain its pre-eminence in global financial markets. By this point, Patnaik has connected abstract discussions on the theory of money with the us invasion of Iraq.

In addition to its impressive scope and many insights, there are also many ways in which the main lines of analysis in *The Value of Money* are incomplete and frustrating. For example, his discussion of the theory of

## BOOK REVIEW

**The Value of Money** by Prabhat Patnaik (New Delhi: Tulika Books), 2008; pp x + 253, Rs 500.

money and his critique of monetarists proceeds with almost no references to the operations of financial markets. He also gives almost no attention to the role of the State and economic policy, even though evaluating state policy interventions is crucial to understanding the problems of maintaining adequate levels of overall demand in contemporary capitalism. Correspondingly, his emphasis on the centrality of pre-capitalist societies as being essential to the stability of capitalism provides no clear explanation as to what is distinct about pre-capitalist societies for this purpose. More generally, the book draws upon few references to intellectual or historical developments over the past 50 years, many of which are central to the questions he is pursuing.

### Monetarism and the Theory of Money

The first major section of the book, 73 pages and 8 chapters long, is titled "The Infirmity of Monetarism". It is entirely appropriate that Patnaik devotes such extensive attention to monetarism. Since the late 1970s, monetarism has been the intellectual bedrock for the "age of neoliberalism", the aggressively pro-capitalist policy revolution that has dominated economic policy-making throughout the world. After all, when the 1973 violent coup led by General Augusto Pinochet overthrew the socialist government of President Salvador Allende in Chile, Pinochet almost immediately announced that economic policy under his regime would be guided by monetarism. Similar patterns followed in the United Kingdom after the 1979 election of Prime Minister Margaret Thatcher and in the us after the 1980 election of Ronald Reagan.

In a narrow sense, monetarism is a theory whose fundamental argument is that changes in the economy's inflation rate as well as, more generally, the economy's swings between overheating and recession, are all due to changes in the growth rate of the economy's money supply. Central banks, in turn, control the growth rate of the money supply. As such, monetarism postulates that if an economy is suffering from severe business cycle swings – sharp recessions and excessive inflation – this is due to the central banks' mismanagement of the money supply. Indeed, this is "always and everywhere" the case, as expressed most forcefully by the late Milton Friedman, by far the most influential figure within the modern monetarist tradition.

If the monetarist perspective is correct, the broad take-home message is that capitalist economies would function much more effectively – without mass unemployment, recessions, or hyperinflation – if government policymakers, central bankers in particular, were more capable at performing the one job they need to do well, which is managing the money supply. As such, monetarism is, at once, a narrowly technical but also wide-ranging brief on behalf of free market capitalism.

Patnaik's attack on this intellectual "infirmity" is cogent and persuasive as far as it goes. But it is also too narrowly targeted. Patnaik's critique focuses on the issue of the demand for money, rather than the supply of money, as provided by the central bank. According to monetarists, the main reason people hold money is to have it in their pockets or bank account to be available whenever they need to pay bills or make new purchases. As such, the demand for money should rise along with people's income – the higher the level of people's income, the more they are able to buy, thus the more money they need to pay bills and make new purchases.

The problem with this theory is that, in fact, people do not hold money only to buy things. They also hold money as one form of savings – as what economists call a "store of wealth", among other possible stores of wealth, including stocks, bonds, real estate, and savings accounts. This is a simple point, and it has been widely

recognised by economists within all theoretical camps, including the monetarists. Friedman himself could not have been more clear in recognising that people demand money as one of many stores of wealth. The issue is not whether this wealth-based demand for money exists, but rather how much it actually matters for understanding the operations of capitalism.

The monetarists say that this is not a major issue, since the demand for money as a store of wealth is reasonably stable over time. If it is indeed true that the demand for money as a store of wealth does not fluctuate significantly over time, it then follows that this could not be a major force in causing capitalist economies to become unstable.

However, Patnaik argues – following Marx, Keynes and many others, including many mainstream Keynesian economists – that the demand for money tied to wealth-holding is not, in fact, stable. Indeed, it is actually highly unstable. This is because people will choose to hold money as a store of wealth – rather than, say, stocks or bonds – depending on their expectations about the future of the economy. If, for example, they think that stock prices are about to rise quickly, they will want to hold less money in the bank and put more into the stock market. The demand for money as a store of wealth thereby falls. If they think inflation is about to rise, they will also want to get rid of their money, since, with all prices rising in an inflation, the buying power of a given amount of money depreciates. People would rather hold their wealth in some form that retains its value during bouts of high inflation. A bond whose interest rate rises in step with inflation would be one example of this.

These may seem like less than earth-shattering observations. But as Patnaik emphasises, once we take account of the influence of people's expectations in establishing the demand for money at any given time – and thus for the possibility of sharp fluctuations in the wealth-based demand for money – then the benign characterisation of free market capitalism as advanced by the monetarists logically collapses. In fact, to recognise that the demand for money can be highly unstable is one first step towards understanding how free-market capitalism as a whole can

also be unstable – that recessions and depressions are due to the normal functioning of the capitalism, not, as the monetarists would have it, to the malfeasance or stupidity of central bankers.

Patnaik's discussion on this is logically strong, but, as mentioned above, very narrow in scope. This becomes clear once we acknowledge the 800-pound gorilla in the room that is neglected altogether from Patnaik's story – this being the operations of financial markets.

As should be evident from the above, what makes the demand for money highly unstable is what is also the heart and soul of advanced capitalism – that is, the global financial casino. If investors think they can make a killing speculating on an expanding financial market bubble, they will pull their money out of the bank, where it is earning minimum interest rates, and move it into the casino. But if investors think the bubble is about to collapse, they will then rush to cash out – i.e., increase their demand for money and reduce their demand for speculative assets.

Hence, the central arguments advanced by Patnaik about market expectations and the demand for money are actually considerations on the day to day functioning of casino capitalism. Keynes certainly stressed such matters in his writings on monetary theory. Marx also devoted lots of attention

to these issues, although, it is true, separately from his discussion of the pure theory of money in Volume I of *Capital*. The fact that Patnaik refers only obliquely to the operations of financial markets in *The Value of Money* certainly weakens the level of empirical, historical, and institutional richness in the book. But even in terms of purely logical discussions, there really is no basis for assuming that the demand for money should be unstable, and that this instability is important enough to bring down the entire theoretical apparatus of monetarism, unless the issue is understood as a front-and-centre feature of casino capitalism.

### Marx, Keynes, and Propertyism

Patnaik joins the writings on monetary theory of Marx and Keynes, along with the work of Keynes' contemporary, the great Polish Marxist Michal Kalecki, into a unified analytic tradition that he terms "Propertyism". What is Patnaik getting at with this term? As he writes:

A crucial difference, indeed one might even say *the* crucial difference, between Monetarism and the Marx-Keynes-Kalecki tradition, which I designate as the "Propertyist" tradition, is the latter's recognition of money as a wealth-form, and hence of the fact that it always exists as someone's property; the amount if it held, it follows, is always subject to the wealth-holder's choice between different wealth forms (p 21).

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The fact that Patnaik joins Marx and Keynes, along with Kalecki, via their respective ideas about the wealth-motive for holding money underscores just how fundamental he thinks this issue is for advancing a theoretically coherent analysis of capitalism. For Patnaik, once we recognise that people hold money as a form of property or wealth, it then follows that they might choose, at any time, to save their money rather than spend all of it purchasing goods and services. This, in turn, means that some significant portion of all the goods and services that get produced at a given point in time could end up unsold, if people choose to hold cash hoards as a form of property rather than spending all the money they have received at this point in time.

Here, then, is the next link in understanding capitalism as an inherently unstable economic system. When people choose to hold money as property rather than use it to buy things, this leaves goods and services unsold. The profits of businesses that produced these unsold goods and services then fall. The businesses will then cut back their operations in the next time period and, as part of this downsizing, lay off some of their workers or at least refrain from hiring new employees. Businesses also start experiencing increasing difficulties paying back their outstanding debts, which, in turn, cuts into the profits of their bankers. When workers lose their jobs or are unsuccessful in getting newly hired, they also then cut back on their spending and stop paying back their debts. Both the businesses trying to sell goods to workers as well as the banks waiting for loan repayments thus take further hits to their bottom lines. In simplified terms, this is precisely the vicious cycle that pushes capitalist economies into recessions or depressions.

The analysis of these dynamics advanced by Keynes in his 1936 masterpiece, *The General Theory of Employment, Interest and Money* was the intellectual foundation to the construction of big government capitalism in the aftermath of the 1930s Depression and the second world war. The most basic tasks for post-war big government capitalism, as established by mainstream Keynesianism, were to stabilise the overall level of spending and counteract the fluctuations in private spending (and correspondingly, private-sector demand for money). In particular, if

private expectations turn negative and private sector spending collapses as a result, the private sector needs to step in. Government deficit spending is a crucial tool. Central bank intervention to expand the supply of money and credit is the other tool.

### **Pre-Capitalist Societies and the Critique of Propertyism**

Of course, a wide range of debates emerged over the past 60 years around this approach to maintaining stability in the overall level of demand through big government interventions. The debates have been both highly technical as well as highly political, with contributions by analysts of all stripes across the ideological spectrum. Curiously, Patnaik chooses to neglect this literature. This is the other 800-pound gorilla ignored in *The Value of Money*. Instead of engaging with these questions, Patnaik argues that even before Keynesian big government policies were developed to stabilise capitalism, a more basic stabiliser was already in operation. This was the way in which advanced capitalist economies relied on pre-capitalist societies as a safety value, the place where the excess supplies of goods produced within the capitalist economies could be unloaded rather than having them remain unsold.

Patnaik's argument originates with Luxemburg, but he also firmly stakes out his own position. Luxemburg held that the pre-capitalist societies would be responsible for purchasing the *entire* surplus product generated within capitalism. Patnaik rather holds that the size of the market purchases by the pre-capitalist sectors does not have to be as large as suggested by Luxemburg. It needs to be only large enough to absorb a relatively small share of the capitalist economy's total of surplus products – just enough to keep the capitalist economies afloat while they undertake additional adjustments to dig out of recessions. But even in this diminished role, according to Patnaik, the pre-capitalist economies make a crucial contribution to the ongoing functioning of capitalism. In emphasising this point, Patnaik is also arguing that the Propertyist tradition of Marx and Keynes has always been incomplete. Luxemburg, in his view, pointed the way towards establishing a fully developed theory of the operations of a capitalist economy, because she developed an

analytic understanding of colonialism and imperialism that even Marx himself had neglected to appreciate.

But Patnaik's discussion here, while highly stimulating, is itself incomplete in significant ways. The first and most obvious gap, as mentioned before, is that he does not give serious consideration to the role of the modern capitalist state as an alternative safety value to absorb excess supply of goods produced by private capitalist businesses. For example, in the us today, government spending at all levels accounts for about 35% of all spending in the economy, amounting to a total of about \$5 trillion per year. The proportions of government spending in other advanced capitalist economies are higher still. Why should we expect that government spending proportions of such formidable magnitudes are inherently incapable of serving to stabilise overall demand within capitalist economies? In addition, the pre-capitalist societies that Patnaik is describing are poor. As such, the amount of money they have to purchase goods and services produced within the advanced capitalist economies is highly limited. On what basis could we, therefore, expect the businesses and consumers in pre-capitalist societies to provide a more significant boost to demand within the advanced capitalist economies than government spending within the advanced economies themselves?

More generally, Patnaik is not clear in establishing what are the unique features that, in his view, define pre-capitalist societies. Assuming he is basically describing poor countries whose economies are dominated by rich capitalist countries, why is it necessary for the poor countries to be "pre-capitalist" as opposed to capitalist? The businesses in the rich countries – to say nothing of the military – could still dominate the markets of poor countries, if they exerted the necessary effort to do so. Rich-country businesses could still hire workers from poor countries and pay them destitution-level wages. They could still steal the natural resources of poor countries, at gunpoint if necessary.

Indeed, as Patnaik's own discussion acknowledges but does not dwell on, the role of poor countries within an overall global capitalist system is not merely to provide a boost to overall demand for the businesses

of rich capitalist countries, but also to provide raw materials and cheap labour. These other aspects of the situation are distinct from the role they can play in boosting overall demand. But Patnaik, like Luxemburg, does not sort through these distinctions carefully.

For example, if the role of poor countries is to supply cheap labour for capitalist production, this then will serve to push wages down for workers in the rich countries as well. This is because an expanding pool of cheap and available workers – a global “reserve army of labour” in Marx’s famous phrase – increases the bargaining power of businesses against workers, enabling them to play one set of workers off against others. This should increase the profit margins for businesses, assuming these businesses can

still sell their products to somebody. But in this case, the challenge of selling their goods has now become more difficult, not less. This is because workers in the rich countries now are paid lower wages, and thereby have less money to spend. Meanwhile, workers in the poor countries are paid far less still, hardly enough to boost overall demand throughout the rich capitalist countries. Patnaik is certainly aware of such issues, and he is almost uniquely well-qualified to address them in illuminating ways. But this is not a theme he takes up in *The Value of Money*.

Overall then, *The Value of Money* raises a range of fundamental issues, and grapples through them with originality and force. One would expect no less from Prabhat Patnaik. At the same time, Patnaik

has left a good number of crucial questions unanswered. Other authors have explored these additional questions, and there is a great deal to learn from them in conjunction with the contributions of Patnaik. Understanding capitalism as a foundation for advancing beyond capitalism – in order to build more egalitarian and democratic societies – has always presented intellectual and political challenges of the first order. *The Value of Money* stands as an important new source of intellectual and political sustenance in facing these ongoing challenges.

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