ISSN 1753-5816

School of Oriental and African Studies University of London

DEPARTMENT OF ECONOMICS Working Papers

No.157

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April 2008

economics@soas.ac.uk

http://www.soas.ac.uk/economics/research/workingpapers/

NIEBYL, MONEY AND DEVELOPMENT

Presented at the Karl H. Niebyl Centenary Symposium

8 December 2006

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Abstract

This paper examines Karl Niebyl's critique of monetary theory against the typology of equilibrium, reflective and critical theories of money. It argues that despite fundamental criticisms of monetary theory, his analysis of money in capitalist development is essentially a reflective one. The paper goes on to show how the development of the capitalist firm in the twentieth century may give a more critical, disequilibrium, role to money and finance. The introduction presents a categorisation of theories of money. The second section shows the reflective nature of Niebyl's theory of money comparing it to more recent disequilibrium or critical theories. As Niebyl's work focuses to the changing function of money with the emergence of industrial capitalism, the next section deals with possible lessons for understanding money in a context of capitalist development. The fourth section reflects on Niebyl's considerations on methodology.

1. Introduction: Equilibrium, Reflective and Critical Theories of Money

In *Theories of Financial Disturbance* a typology of theories of money and finance is put forward (Toporowski, 2005). The author today regrets that he did not re-read Karl Niebyl's *Studies in the Classical Theories of Money* (Niebyl, 1946) more attentively before writing it. If he had, he would have given much closer attention to the way in which equilibrium, reflective and critical theories of money and finance, emerged out of very particular developments in capitalist production and distribution. This paper is in part a step towards remedying this methodological deficiency in Toporowski's book, as well as paying tribute to a great economic philosopher.

Toporowski's book argues that theories of money and finance can be divided up into three categories. In equilibrium theories, money and finance are merely a sub-set of markets in a determinate general equilibrium system that changes in response to a change in any of the parameters or variables of that system. Money and finance are not a systematic source of disturbance in such a system, because *any* factor can cause change.

Among equilibrium theories are general equilibrium theories such as those of Léon Walras, or Don Patinkin. In the system put forward by Walras, a commodity, indeed any commodity, is chosen as the numéraire and allows a determinate solution to emerge from his system of equations. It need hardly be added that this will not do as an analysis of the modern capitalist economy because it postulates a commodity theory of money and one in which money actually has some intrinsic use-value, as opposed to having solely exchange value. Don Patinkin's more recent general equilibrium model has a money commodity supplied by the monetary authorities that is held to satisfy Keynesian motives. But, as systems of general equilibrium, neither of these theories allow for any systematic disturbance from the monetary sector. Their systems will reconfigure around a change in that sector, just as those systems will reconfigure around a change in tastes, individual preferences, technology, and so on.

The most recent kind of macroeconomic models, dynamic stochastic models of general equilibrium, also fall into this category of theory. However, they are even more unspecific about the sources of economic disturbances, which occur randomly in different sectors and, if sustained, are so because of arbitrary restrictions, such as

Calvo pricing, on market equilibrium. The detail of these models does not alter their fundamentally equilibrium character.

The problem with general equilibrium theories is that they exaggerate the stability of economic systems, leaving very little scope for dynamics (economic change over time). In particular they offer no systematic analysis of economic processes that is the feature that distinguishes particular economic systems whereby developments in a particular sector or part of the economy play a leading role in the evolution of the economy. For example, in a state-dominated capitalist system, the public sector budget may play that leading role. One would then expect that budget to determine the dynamics and the character of its economic processes.

For Niebyl, equilibrium is not an illusion but an appearance generated by the automatic way in which, for example, trade payments are settled. He pointed out that once automatic payment for transactions became the norm, it appeared that a stable system of production and exchange had established itself. In Hume's theory, this apparent stability is translated into a view that 'no augmentation or decrease in the volume of money could make any lasting difference to production.' (Niebyl 1946, pp. 52.) In this way static *real* conditions come to be assumed, and the significance of money is limited to price phenomena. More importantly it makes the theorist unaware of the changes in the structure of the economy, underneath a superficial stability, that determine its future evolution.

Reflective theories of money are theories in which money merely reflects activity outside the monetary and financial sector. The characteristic features of these theories are discussed in the next part of this paper. The methodology of Niebyl is further illustrated in the last section.

Finally, critical, or disequilibrium theories of money, are theories that suggest that developments in the monetary sector can cause disturbances or disequilibrium in real economies. It should be pointed out that the disequilibrium referred to is fundamentally different from the kind of disequilibrium postulated in buffer stock theories of money, or the disequilibrium theories that went around during the 1970s. In those theories, the failure to clear of markets for goods and services meant that people were left holding (income) money equivalent to unsold stocks of goods and services. In critical theories of money and finance, disequilibrium in markets for goods and services is caused by developments in the monetary and financial sector, rather than causing some generalised money ‘holding’ by individuals. This is further discussed in the third section of the paper.

2. Karl Niebyl’s reflective view of money

Niebyl’s book *Studies in the Classical Theories of Money* may be somewhat drastically summarised, but without doing violence to its main conclusions, as follows: The nature of money changed with the emergence of industrial capitalism along-side trade capitalism. In particular, industrial capitalism needed prodigious amounts of money to finance production, as opposed to the more modest financing requirements of trade. Niebyl argues that up to the latter part of the eighteenth century “money functioned predominantly as a means of facilitating the exchange of finished products” (p. 4) but “with the division between trade and production, the need for a new source of this capital became increasingly felt” (p. 19). And concludes, “An understanding of the function of money must account for the actual status of the relation of the productive forces as well as for the functional part which its reviewers play in the given economy” (p. 164).

Contemporary economic commentators did not recognise this change in the nature of money, but continued to see the role of money as it was under trade capitalism. The classical school of political economy (from Adam Smith to John Stuart Mill) recognised the use of money in production, but tended, like Henry Thornton, to a partial view dominated by the mercantile interest in the City of London. The classical school was superseded by the neo-classical thinkers who viewed money only in the context of consumption.

The view of money and monetary theory that Niebyl put forward is therefore closer to the analysis of money that Marx put forward in Volume III of *Capital*. Here, it should be noted, modern money emerges from usury and trade credit, rather than, as in Volume I of *Capital*, being a feature of a system of capitalist commodity production as Marx envisaged it, at its fullest stage of development, i.e., abstracted from the history from which it had emerged. Niebyl did not discuss this because, probably in unconscious anticipation of McCarthyism (Niebyl writes in his preface that his studies were written in 1940-1941) his book omits any reference to Marx. Marx only appears in Niebyl's bibliography as the author of one item, *A Contribution to the Critique of Political Economy*, an early and uncompleted draft of Marx's political economy. The absence of any reference to Marx in a work that is so thoroughly Marxian gives Niebyl's book an enigmatic quality that is intellectually irresistible, in part because its author has to rely on reasoning out his argument, rather appealing to textual authority.

In fact Marx's *Contribution to the Critique of Political Economy* has very little in it about money. The book was intended to examine the following topics: capital, landed property, wage labour, the state, foreign trade, and the world market, and little beyond the first chapter was written. But, not long before starting on his *Contribution* Marx had sketched out a much more serious consideration of money in *Grundrisse: Foundations of the Critique of Political Economy* (Marx 1857-8). Niebyl could not have known this book prior to writing his *Studies*: Even in its original German the *Grundrisse* was not widely available outside the Soviet Union until the 1950s and the full English translation did not appear in print until 1973. (The book is also not mentioned in the most important study to have come out in recent decades of Marx's monetary theory, Suzanne de Brunhoff's *Marx on Money*, first published in 1973). Marx's *Grundrisse* consists of two very extensive chapters. By far the longest of them is the one on capital. The shorter one is on money and is of fundamental importance in the Marxian theory of money, perhaps as important as the chapters on money that appeared earlier in Volumes I, and II of *Capital*, and in the various studies that make up *Theories of Surplus Value*.

In the chapter on money, Marx explicitly rejected, as he did not do in his other works, a monetary theory of capitalism, the business cycle, or of capitalist crisis:

'We have now reached the fundamental question… can the existing relations of production and the relations of distribution which correspond to them be revolutionised by a change in the instruments of circulation? …Various forms of money may correspond better to social production in various stages: one form may remedy evils against which another is powerless; but none of them, as long as they remain forms of money and as long as money remains an essential relation of production, is capable of overcoming the contradictions inherent in the money relation (of expressing value but being unable to create it - JT), and can only hope instead to reproduce these contradictions in one or another form.' (Marx 1857-'8, pp. 132-3).

Later in the same chapter (ibid. pp. 233), Marx argued that money has become a generalised form of wealth through exchange. His statement then leads into the chapter on money which starts with the first appearance of (productive) capital as money. This is precisely the shift that Niebyl examined in his book from money reflecting the value of trade capital because it is used by merchant proto-capitalists, to money used to buy commodity means of production. At this point, money relations come to reflect the relations of production, rather than determining them:

'No self-sustaining theory of money can actually be formulated. The monetary relations at any given time and the functions ascribed to them can be perceived only as a *reflection* of ever-changing reality. Only the analysis of the latter and the understanding of its processually changing character can give us today the clue to the meaning of money.' (Niebyl 1946, pp. 163-4, italics added)

This is perhaps the most generalised expression of Niebyl and Marx's 'reflective' view of money. This rejects the possibility that monetary variables may cause crises, for example, in the monetary business cycle of Ralph Hawtrey, or that monetary reform may stabilise capitalism, as argued by Keynes and most Post-Keynesians.

Indeed, it excludes theories like those of Veblen, whose *Theory of Business Enterprise* Niebyl cited with implicit approval or, in our time, the analysis of Victoria Chick or H.P. Minsky. These authors argued that the functioning of capitalism is changed by developments in monetary and credit relations, rather than merely reflecting underlying developments in capitalist production. Using an evolutionary approach that recognises different stages in the development of banking, it is argued that "because deposits are now means of payment they represent all income whether destined for consumption or saving. It becomes appropriate to argue that investment can precede saving, because bank loans, based as much on consumption flows as on savings lodged with them, play a significant role in the finance of investment" (Chick 1992, pp. 196). Focusing on the nature of debt in investment, Minsky states that "The normal functioning of an economy with a robust financial situation is both tranquil and, on the whole, successful. Tranquillity and success are not self-sustaining states; they induce increases in capital assets prices relative to current output prices and a rise in (1) acceptable debts for any prospective income flow, (2) investment and (3) profits. These concurrent increases lead to a transformation over time of an initially robust financial structure into a fragile structure" (Minsky 1978, p. 20)".

In fact, the industrial capitalism that Marx and Niebyl saw as the summit of capitalist development turned out to be the prelude to a further capitalist evolution. Minsky, although from a different perspective, recognised this change. To illustrate this point, Minsky described how the relationship between commerce and finance evolved in the United States in a shift from big business to big finance: in colonial times, the use of bank credit was essentially for commercial transactions; in today's era of money-manager capitalism, institutional investors play an increasingly influential role in corporate decision making. This evolution brought money even further into the heart of the productive process, and arguably has changed again the nature and functions of that money. This is considered in the next section of this paper.

3. Money and capitalist development

In a book on the classical theories of money, it is not really surprising that Niebyl does not discuss the problems of money and banking in developing countries. In fact there is only one brief comment when discussing the dependence of Hume's quantity theory of money on 'the habits and manners which prevail in country.' Niebyl added:

'The habits and manners are determined by the specific stage to which the mode of production has developed, and the concrete institutions of that stage will to some extent depend on facilities that may have been created elsewhere at an earlier date. This especially is relevant to the development of the so-called "late" countries or of colonial countries. Both of the latter find to a certain extent the institution of credit ready-made for them by previously developed industrial countries, and to them the scarcity of money or capital (in relation to productive need – JT) must have a different meaning.' (Niebyl 1946, p.48).

Thus the development of money and credit as required by the productive needs of industrial capital, detailed by Niebyl in chapters 3 and 4 of his book, is only possible in its pure, reflective form in the first industrial countries. Subsequent countries entering the capitalist world market find themselves provided with a financial system that has been developed for the industrial capital purposes of the first industrial countries. This view had appeared earlier in Rosa Luxemburg's *Accumulation of Capital* and Rudolf Hilferding's *Finance Capital*, neither of which are mentioned by Niebyl. Luxemburg and Hilferding both saw the credit systems emerging in the developing countries as means of facilitating the accumulation of capital in the advanced capitalist countries, through the export of capital to pre-capitalist countries.

But even in the first capitalist countries, Niebyl regarded the industrial capitalism that spawned the classical theories of money as a transitional form, and not just to the socialism that was supposed to emerge from capitalism but, even before that, to a different kind of capitalism. He made the astonishing claim that the economic institutions of the mid-twentieth century developed and reached their most appropriate forms by the middle of the nineteenth century. By that time, he argued, those institutions were no longer struggling to establish themselves, 'nor are they as yet forced to take on warped forms because of the difficulties and rigidities which develop organically in later phases of their life-span (Niebyl 1946, pp. 1-2). Thus, according to Niebyl, capitalism in its classic form appeared just before the 1860s. In one of his many suggestive asides, he wrote that the industrial capitalist firm of Ricardo's time was organised in a way that was very conducive to profitable production:

'…no general rigidities had yet developed in the industrial structure of England. The still relatively small degree of fixity of capital and the relatively low status of concentration and combination left ample space for further expansion and provided equally well for the possibility of actual change from one type of production to another if and when the opportunity arose. We may add also that the financial structure of industry, for example, the initial stage of joint-stock enterprise with its hardly existing absentee ownership still made for an easy transfer of capital…the responsibility still rested with the owner-manager, who was willing and able to take the risk for himself.' (p. 119).

Niebyl seems to suggest that this use of money in production is the final stage in the development of capitalist money. But in fact the rise of credit, and its most significant effects on capitalist production, was largely still to come. Another curious omission from Niebyl's bibliography is Wicksell, who first put forward the idea of a 'pure credit economy', perhaps because Wicksell had also pointed out the incompatibility of credit money with Marx's labour theory of value. (Educated in Germany in the 1920s, and tutored by Hayek, Niebyl could not have been unaware of Swedish monetary theory.) Niebyl's account of post-1860s capitalism is all too sketchy. He noted the rise of 'manager nonowners as well as the correspondingly growing number of absentee owners' (pp. 129 + 161-2). These feature in Veblen's critique of early twentieth-century capitalism in his *Theory of Business Enterprise*. But there is no mention in Niebyl of the effects of credit financing on capitalist production, which lie at the heart of Veblen's critique.

In fact Veblen reversed Niebyl's insistence that money reflects capitalist production needs, and had argued that financing determines production. This is then the precursor to Minsky's theory of the capitalist firm an institution engaged in balance sheet financing, with productive activity being incidental to such financing, rather than being its purpose. Niebyl dismissed the Banking School rather too readily as advocates of laissez-faire banking (pp. 148-9). This is strange in view of the influence of that School on Marx himself. The importance that the Banking School's attached to credit issued directly by businesses, in the form of bills and commercial paper, highlighted the importance for production of the liquidity of markets for corporate liabilities. So money was not just a liability of the central bank, or the banking system, and it is not so today.

4. Niebyl and methodology

Methodological notes left by Niebyl are by no means exclusively related to the study of money. The first chapter of his book is, in fact, dedicated to methodology. Something just more than two pages in which he presents his unequivocal position with respect to methodology in economics in general.

Niebyl recognised and warned against the growing use of positivist methodology and detachment from reality in economics, "The continuity of received doctrine, therefore, is not safeguarded in the way in which some of the economists of the past have tried to safe guard it, by removing and separating the doctrine from economic reality; but it may be safeguarded by *carefully anchoring it in the continuity of reality*" (italics pp. 3)

In a later paper he also notes "It was the profitability of British and American imperialism that made it possible for Anglo-American scientists to stop their inquiry into the world in which they live at the point of describing it without being forced, by the reality of emerging social contradictions, to analyze the nature of that reality (Niebyl, year unknown).

Moreover, Niebyl felt very strongly about the necessity to contextualise any study on actual institutions, including money. His book is, in fact, an analysis of the role of money in an historical perspective. The function of money is not derived *in vacuo*. It is rather seen as dependent on the relations of the particular factors of the economic process for which it serves. This is the only way, for Niebyl, to avoid the colossal methodological mistake of using only "the received doctrine" which may have been theorised under previous different circumstances.

He highlights the example of "the classical theory of inflation". There, "the received doctrine" about money had been formulated during a time of mercantile conditions, based on a manufactural, not an industrial, mode of production" (pp. 78).

The important insight of this approach is to consider "economic theory as indeed every theory that attempts to make intelligible the problems confronting society at a given time has to be recognised as part of that specific economic setting from which it has evolved" (pp. 160). This point is considered so relevant for Niebyl, that he quotes Keynes in his methodological chapter "the postulates of the classical theory are applicable to a special case only…the characteristics of the special case assumed by the classical theory happen not to be those of the economic society in which we actually live" (pp. 2).

This methodological consideration is repeated in many instances. In the only reference he makes to the developing countries, Niebyl warns that a meaningful analysis cannot overlook the fact that the process of "bridging the gap" is substantially different from that of creating a new mode of production. This notion is extremely significant in terms of modern development theory. Developing countries see the availability of ready-to-use credit institutions incubated in the developed world. However, actual economic conditions in developing countries are very different. As a consequence, the content of terms like scarcity, money or capital is altered, because these contents are determined historically and therefore specifically. The risk, for Niebyl, is to confuse, as Hume did, "the historical contents of the term "money" with its "form", in the early manufacturing period with its function during the late manufacturing period and early industrial period because of the merely formal identity of the terms". The consequences are devastating as by doing so it is constructed "an imaginary history of economic development, just as the different nations today construct their political histories" (pp. 49).

Conclusion

The classic capitalism, of which Niebyl wrote, and its money, was not the end of capitalism or the end of money. Nor is that classic capitalism available to developing countries. Credit has come to dominate capitalist production, not to facilitate production but as financial rent-seeking. New credit solutions are therefore needed inside and outside the de-industrialising financially-advanced economies to provide support for industrial expansion and maintain a balance of economic activities consistent with financial and economic stability.

The relation between finance and productive necessities has become a very complex one and, paradoxically, has attracted relatively little attention. The present paper attempts to contribute to this analysis by commenting the work of Niebyl within a wider panorama on theories of money. In particular, Niebyl's theory is shown to be a reflective one: money is a reflection of reality and the understanding of it can only be pursued by understanding the economic reality itself. This conception highlights a deep difference with both types of equilibrium theories, General Equilibrium one or stochastic ones. The former ones are essentially unable to explain any disturbance, let alone its origin, as the economy immediately re-adjusts to an equilibrium position. The latter ones have a dynamic character derived not from the dynamics of the reality they analyse, but from a disturbance which is made arbitrarily random and assumed to be unsystematic. Niebyl's idea of money is also different from disequilibrium or critical notions of money, in which credit and monetary relations are not a reflection of the economic reality but have managed, throughout history, to shape the evolution of capitalism.

The present paper considers the reflective nature of Niebyl's idea of explaining the evolution of money along the transformations occurred from trade capitalism to industrial capitalism, as equally insightful in attempting to shed light on the problems of capitalism development today. The institutions that developed in the dominant capitalist countries after the Second World War matured within historically a very distinctive capitalist order. Today's capitalist development cannot be understood by using analytical categories incubated in capitalist development under very different circumstances in a very different time. Both analytical categories and relations had a very different content then. Hence, the analysis of earlier periods of capitalist development cannot be applied to understanding the economic structure and progress of emerging markets and the poorest countries today.

In particular, the last section explains even further this point in bringing to light Niebyl's considerations about methodology. The process of development today is essentially different from the historical phenomenon of the emergence of capitalism. This is so not only in the trivial (although, surprisingly still controversial for many economists) sense that each process is historically and country specifically determined, but also, according to Niebyl, because today's developing countries face the qualitative different process of "bridging the gap" rather creating a new mode of production.

Acknowledgement

We are grateful to Victoria Chick for introducing the principal author to the work of Karl Niebyl some years ago, and to Geert Reuten for advising on the publishing history of Marx's *Grundrisse*.

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