Chapter 34: The Currency Principle and the English Bank Legislation of 1844

Marx begins by summarising Ricardo's theory of the value of metal money (also dealt with by Marx in the 1859 *Contribution*), which formed the theoretical basis for the 1844-5 Bank Acts. According to Ricardo:

> [T]he value of (metal) money is determined by the labour-time objectified in it, but only as long as the quantity of money stands in the right proportion to the quantity and price of the commodities to be exchanged. If the quantity of money rises above this proportion, its value falls and commodity prices rise; if it falls below the right proportion, its value rises and commodity prices fall – as long as other factors remain the same. In the first case, the country which has this surplus of gold will export the gold that has fallen below its value and import commodities; in the second case gold will flow into the countries where it is priced above its value, while the under-valued commodities from there will flow to other markets, where they can obtain normal prices. Since on these assumptions 'even gold in the form of coin or bullion can become a value-token representing a larger or smaller value than its own, it is obvious that any convertible banknotes that are in circulation must share the same fate. Although banknotes are convertible and their real value accordingly corresponds to their nominal value, "the aggregate currency consisting of metal and of convertible notes" may appreciate or depreciate if, for reasons described earlier, the total quantity either rises above or falls below the level which is determined by the exchange-value of the commodities in circulation and the metallic value of gold.'[1]

This understanding of the relation between the value of money and commodity prices forms the basis of the banking legislation operative in Marx's day in this way. If the remedy with regard to metallic currency and falling or rising prices is to import or export precious metals, then, in the case of paper money, banks have now to effect a similar influence on prices by adjusting the quantity of banknotes (convertible into gold) in circulation in function of the flow of gold into or out of the country.

> If gold is flowing in from abroad, it is a proof that there is an insufficient amount of currency, that the value of money is too high and commodity prices too low, and banknotes must therefore be thrown into circulation in accordance with the newly imported gold. On the other hand, banknotes must be taken out of circulation in accordance with an outflow of gold from the country. In other words the issue of banknotes must be regulated according to the import and export of the precious metals, or according to the rate of exchange. Ricardo's wrong assumption that gold is simply specie and that consequently the whole of the imported gold is used to augment the money in circulation thus causing prices to rise, and that the whole of the gold exported represents a decrease in the amount of specie and thus causes prices to fall – this theoretical assumption is now turned *into a practical experiment by making the amount of specie in circulation correspond always to the quantity of gold in the country*.[2]

The school of thought associated with these theories confuses, first, the demand for money capital and the demand for 'capital' in general (i.e. commodities); two, the relationship between commodity prices and the presence of money, and, hence, three, the relationship between international flow of bullion and commodity prices; and, finally and therefore, what determines the prevailing rate(s) of interest.

Marx presents evidence (submitted by a former Governor of the bank of England to the 1857 Select Committee) which shows clearly a close correlation between interest rates and the quantity of bullion held by the Bank, but no relation whatsoever between the *flow* of bullion and the prices of commodities. Says the former Governor:

> The effect of the export of bullion ... has no reference whatever to the prices of commodities. It has an effect, and a very important one, upon the price of interest-bearing securities, because, as the rate of interest varies, the value of commodities which embodied that interest is necessarily powerfully affected. [...] As in the years 1834-43, so in the period 1844-53, the upward and downward movements in the bullion of the Bank have invariably been accompanied with a decrease or increase in the loanable value of money advanced on discount; and, as in the earlier period, so in this, the variations in the prices of commodities in this country

[1] Karl Marx, *Capital* volume 3 (Harmondsworth, 1981) [hereafter C3], p. 680.

[2] C3, pp. 682-3.

> exhibit an entire independence of the amount of circulation as shown in the fluctuations in bullion of the Bank of England'.[3]

Marx comments:

> Since the demand and supply of commodities regulates their market price, it is evident here how false is [...] [the] identification of the demand for loanable money capital (or rather the gap between its demand and supply), as expressed in the discount rate, with the demand for real 'capital'. The contention that commodity prices are governed by fluctuations in the total amount of 'currency' is now concealed beneath the phrase that the fluctuations in the discount rate express fluctuations in the demand for actual material capital, as distinct from money capital.[4]

We have already seen how the Bank legislation of 1844-5 – introduced after the crises of 1837 and 1842 – functions. Under its terms the Bank of England is divided into an Issue Department and a Banking Department. The former holds government stock to the value of £14 million, plus the metal reserve, and issues a sum of notes corresponding to this total. This issue of notes are divided between the public and the Banking Department, in the case of the latter forming its reserve. (The private banks entitled in 1844 to issue their own notes retain the right to issue notes, but their note issue is fixed; if one of these ceases to issue its own notes, the Bank of England can increase its own issue by two-thirds of the quota made available.) For every £1 that leaves the Issue Department in metal, £1 in the form of banknotes comes back and is destroyed; for every £1 in metal that enters the reserve, £1 is put into circulation. In this way, paper circulation functions as if were governed by the laws of metal circulation.

Marx reiterates that the banking legislation allows the financial interest to artificially manipulate the rate of interest to its own interest, at the expense of that of manufacturing capitalists.

[3] C3, pp. 682, 685 (unbracketed ellipses in original cited text).

[4] C3, p. 685.