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# Capital, credit and the business cycle in Marx

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**Abstract.** The purpose of this paper is to identify two inconsistencies that are found in the third chapter of Marx's *Das Kapital*, dedicated to the study of credit. In the first one Marx states that the distinction between commercial and bank credit is only nominal, but he resorts to it in order to provide an explanation for the nineteenth century crisis in England, thus implying that the distinction was not only nominal, but real. The second inconsistency is noticed between Marx's statement that real and money capital move in opposite directions during the trade cycle (without an explanation of how it is possible), and the second book of *The Capital* where Marx states that capital in the form of money and real capital must move in the same directions during the business cycle.
**Keywords:** Marx; inconsistency; bank credit; money capital.

**JEL classification:** B 14, B 31, B 51

## [en] Capital, crédito y cíclo de negocios en Marx

**Resumen.** El objetivo de este artículo consiste en identificar dos inconsistencias que aparecen en el capítulo 3 de El Capital, de Karl Marx, dedicado al estudio del crédito. En la primera, Marx afirma que la distinción entre banca comercial y de crédito es solo nominal, pero él recurre a esa distinción para dar una explicación a la crisis del siglo XIX en Inglaterra, con lo cual indica que es una distinción real, no nominal. La segunda inconsistencia es la siguiente: Marx anuncia que el efectivo y el capital dinero se mueven en direcciones opuestas durante el ciclo comercial; pero en el segundo libro de El Capital asume que el capital en forma de dinero y de capital efectivo se deben mover en la misma dirección durante el ciclo de negocio.
**Palabras clave:** Marx; inconsistencia; crédito bancario; capital dinero.

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## 1. Introduction

The purpose of this paper is to identify two inconsistencies found in the third chapter of Marx's *Das Kapital* (Book I, chapter 3, section 3), which deals with the study of credit. In the first, Marx states that the distinction between commercial and bank credit is only nominal, but he resorts to it in order to provide an explanation for the nineteenth century crisis in England. However, this implies that the distinction was

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not only nominal, but real. The second inconsistency arises from Marx's statement that real capital and money capital move in opposite directions during the trade cycle (without an explanation of how that is possible), and the second book of *Das Kapital* where Marx states that capital in the form of money and real capital must move in the same directions during the business cycle.

Before analysing these inconsistencies in detail, it is necessary to explain the concept of credit used by Marx. In our opinion, his analysis of this subject is not deep enough, which leads to the emergence of these inconsistencies.

The explanation of the trade cycle and the financial crisis in the nineteenth century in England appears in the fifth part of the third book of *Das Kapital* where Marx analyses capital at interest. In the first chapters he does this, but, afterwards, he comes to speak about the depressions in terms of capital (chapters 30 and following). He provides two explanations of the crisis. The first is in terms of credit, but not explicitly. The second is in terms of capital: real and money capital move in different directions during the cycle, which causes the crisis. Marx does not explain the reasons.

To explain what credit is, we will follow Marx's analysis of interest capital. He elucidates what bank credit is, namely, the loan of money. This seems to be simple but it is the key to solving the problem of the inconsistencies in Marx's work. If the loan of money is the key concept in interest capital, then Marx's statement that interest is a monetary phenomenon is a logical consequence. Through the analysis of what bank credit is we can explain why those inconsistencies appear. In the first place, the lack of differentiation between the two kinds of credit is due to the fact that in the bill of exchange the two are confused. Secondly, with regard to the second inconsistency, the loan of money in the bank system explains the transformation of money into money capital as an independent and relevant concept. Based on an analysis of Marx's explanations about the operations of the banking system, we try to imagine the amount of money capital in the economy. And thus it is possible to assert that there is no contradiction between the movement of different kinds of capital in the second book and the explanations of the trade cycle.

## 2. The first inconsistency

In his account of the financial crisis in nineteenth-century England, Marx understands that the nature of credit consists mainly in commercial credit. The usual form of expressing commercial credit is the bill of exchange. Marx focuses on it in order to show the difference between commercial and bank credit and the different functions that they would have in the explanation of the trade cycle. However, afterwards he does not explain how they can be different because he affirms expressly that their difference is merely nominal[3]. This is because in the bill of exchange the different kinds of credit are confused.

When referring to commercial credit, Marx says that in the recovery phase in the cycle, after the crisis, the commercial operations are carried out by means of bills of exchange without the aid of discounts on them. In good times there is no need for advances of money. With the development of commercial activity, the growing profits have to be reinvested each time in less usual ways. In 1840, a major flow of investments to the joint stock companies that managed the railways in England was observed. The commercial companies decided to perform their operations with bank credit because they had been investing their funds to buy shares in the railway companies. These investments made their funds unavailable, just like the initiation of a new company or like the (presumably impossible) expansion of their usual activities. Thus, they asked the banks for money. Another field of investment similar to railways were foreign trade operations and direct investments in the domains of the kingdom. In this way, the use of bank credit became a general practice and caused a greater dependency of business on it. This move to bank credit is sustained by the confidence of entrepreneurs generating higher profits with additional funds whose origin was the bank system.

In the growth phase of the cycle, the recourse to bank credit, that is, to bank advances is more and more frequently used. The new business does not find so quickly

3 "However, in addition to this commercial credit we have actual money credit. The advances of the industrialists and merchants among one another are amalgamated with the money advances made to them by the bankers and money-lenders. In discounting bills of exchange the advance is only nominal". In Karl Marx, Das Kapital, Book Three, p. 347

return than before. Furthermore the entrepreneurs embark on longer scale activities that extend the recuperation time of the capital[4]. Thus, there appears to be need for a constant new credit in order to sustain global activity. When banks reach the reserve limit of theirs funds the situation looks untenable. The banks do not give more advances and then, first the fictional operations and gradually all others, suffer defaults. All merchants look for money, panic ensues and credit disappears. The merchants can no longer put off the debtors.

Marx is explaining how commercial credit grows alongside the development of production; how this kind of credit pushes economic growth, and how credit is progressively replaced by bank credit as entrepreneurs enlarge their profits. In this description of the trade cycle, Marx presents the distinction between the two kinds of credit as key. He knows that this difference is the cause of cycles. Instead of stating this expressly, he points to the different movements of real and money capital as the cause of the trade cycle. However, this question relates to the discussion of the second inconsistency. The problem now is to adapt these arguments about the undeclared causes of crisis to Marx's statement that the difference between the two kinds of credit is only nominal[5].

Both inconsistencies are closely related; in fact, Marx states that the reason for the excess of bank credit is the role of the banks in the entrepreneurs' profits. This is the reason by which banks respond to demands for advances while they can. This account of the banks is rooted in Marx's analysis of capital at interest. For this reason, we must explore the meaning of bank credit in the context of capital at interest.

## 2. Commercial credit

The initial treatment of credit by Marx is already present in the analysis of money in Book One, Chapter Three, of *Das Kapital*, in the explanation of how money is generated from the circulation of commodities. First, money emerges as a means of circulation and subsequently as a means of payment. This second function of money is explained by credit. With the aid of money as a means of payment, it is possible to buy without paying in the same moment. The seller accepts a postponement of the payment. This is explained by the lasting value of exchange present in money: money does not exchange value over time.

Credit is born in the heat of commerce. Confident of future payments from the buyer, the seller gives him the commodity. Credit means precisely confidence. Confidence is guaranteed by the solvency of debtors, by the regularity of payments. This regularity depends on the realization of other sales. Thus, credit is present mainly among producers and dealers, and dealers themselves, because the conditions of credit are better found there: solvency and regularity in redemption of debts.

Marx illustrates it with an example[6]. The manufacturer of thread receives raw material from the importer of cotton and pays him with a bill of exchange. Afterwards, his product is sold to the manufacturer of line, and he is paid with another bill of exchange. The manufacturer of linen sells his produce to the exporter and he is also paid with a bill of exchange. The exporter can also operate as an importer of cotton. In this way, by means of credit alone, it is possible to complete a full cycle of production and final sale wholly with the payment for the final product. Except for the resolution of differences, all debts can be solved by clearing one with the others. With this example Marx shows that commerce is where credit is born. He also notes that the bill of exchange is the main form of credit.

4 At the same time appear fictitious operations. For the only necessity of liquid funds commodities are exported to change with bills of exchange. So the merchants throw the discounts of this bills acquire funds to pay debts created in a before time. The dealers do this instead of their knowing that the external market was full. Is also generalized the money advances against dock warrants of commodities from India. The bill brokers advance money with the guarantee offered over those commodities and issue bills of exchange over those commodities. The banks accept the discount of these bills for the confidence deposited in the bill brokers.

5 Another representation, more clear but less interesting, of the same kind of inconsistency is the observation of the explanation of credit in Book 1, chapter 3. In this part, Marx explains that the function of money like means of payment is based on the credit between merchants. But he says that it is different of the advance of money or *prepayment* (note 50, page 94, chapter 3, I). This is in contradiction with the affirmation in Book 3 about the sole nominal distinction between commercial and bank credit (See before in a reference note).

6 Op cit. Book Three, p. 450.

The same happens in other industries[7]. Capitalists take credit with their right hand and give it with the left hand. The possibility of this trade resides in the capitalist's confidence that he will recover his funds at a sufficient pace. But this confidence needs to be embodied in a bill of exchange, because the bill is a title of value. By law, the bill embodies a value that can be sold at a discount or also realized when the life of the bill concludes. The life period of the bill of exchange determines the moment the money to be recovered. This adds safety to the activity of the capitalists.

The character of "sign of value" of the bill of exchange remains in the bank system. By discount, the bank system gives one form to the realization of the value of the bill. The relation between the bill of exchange and the bank system remains in force for the life-span of the bill. These periods enable the transfer of reserve funds from capitalists to the banks. Idle money is gathered up in banks instead of particular places. This is the explanation of the formation of bank deposits. The possibility of delaying the fulfilment of the obligations favoured by the bill of exchange allows the dealers to make deposits with their reserve funds at the banks.

Marx holds that the basis of credit is commercial credit. He sees that the main form of this credit is embodied in the bill of exchange. This view enables him to distinguish commercial from bank credit in the explanation of the trade cycle. Commercial credit is present by the bill of exchange, by advances of commodities against loading documents and dock warrants. Bank credit is realized by discounts of bills and cheques, by the opening of personal credit and by the issuance of bank notes (which the issuance of bills of exchange by the bank against itself payable at some point and which are not nominal). Although this looks like a distinction, in fact it is merely an enumeration of ways to describe each kind of credit; however, Marx does not explain how the distinction is possible. He does not clear up what bank credit is. Moreover, the two kinds of credit are confused in the bill of exchange. This credit instrument serves as much as commercial as it does bank credit. For this reason, Marx states that the distinction is only nominal when he says that the conversion of commercial credit into bank credit in the discount of bills is only a nominal change.

## 4. Capital at interest

Having explained what commercial credit is, Marx tries to define bank credit in the fifth section of Book Three when he analyses capital at interest. Marx states there that this interest is participation in the entrepreneurs' profits. At the same time, the core of the explanation of the trade cycle in terms of credit includes an increase in such profits through the help of bank advances. This goes on until the limit of the reserve level of the banks is neared. They also want to acquire the highest possible profits in the form of interest.

Capital at interest is distinguished by the cession of one value as capital. That is to say, it gives value for that increase. The value is given for nothing in exchange but for the borrower's obligation of returning it with an additional interest. All capital at interest (in the form of a cession of money or of commodities) is reducible to a money loan[8]. If the cession is of commodities, they are considered in terms

7 "Cotton is transferred to the spinner for a bill of exchange, yarn to the manufacturer of cotton goods for a bill of exchange, cotton goods to the merchant for a bill, from whose hands they go to the exporter for a bill, and then, for a bill to some merchant in India, who sells the goods and buys indigo instead, etc. During this transfer from hand to hand the transformation of cotton into cotton goods is effected, and the cotton goods are finally transported to India and exchanged for indigo, which is shipped to Europe and there enters into the reproduction process again. The various phases of the reproduction process are promoted here by credit, without any payment on the part of the spinner for the cotton, the manufacturer of cotton goods for the yarn, the merchant for the cotton goods, etc. In the first stages of the process, the commodity, cotton, goes through its various production phases, and this transition is promoted by credit. But as soon as the cotton has received in production its ultimate form as a commodity, the same commodity-capital passes only through the hands of various merchants who promote its transportation to distant markets, and the last of whom finally sells these commodities to the consumer and buys other commodities in their stead, which either become consumed or go into the reproduction process. It is necessary, then, to differentiate between 2 stages: In the first stage, credit promotes the actual successive phases in the production of the same article; in the second, credit merely promotes the transfer of the article, including its transportation, from one merchant to another, in other words, the process C – M. But here also the commodity is at least in the process of circulation, that is, in a phase of the reproduction process". Op. cit., p. 346.

8 "Money –here taken as the independent expression of a certain amount of value existing either actually as money or as commodities– may be converted into capital on the basis of capitalist production, and may thereby be transformed from a given value to a self-expanding, or increasing, value". Op. cit., p. 230.

of their monetary value. A commodity loan is capital at interest any time that the commodity has the property of being valorised. This is the case of commodities, whose value in use consists usually of raw materials or elements of fixed capital.

Thus, capital at interest is a loan. If the way in which commodity circulation is effected by sale, the way in which the capital at interest circulates is the loan. In all the analysis of the capital at interest Marx never uses the term "credit"; it is clear that the capital at interest must in some sense be credit. It has to be so because capital at interest is a loan, and because the acts that characterize both (credit and capital at interest) are the same in nature. In capital at interest and in credit (commercial and bank) value is advanced in the form of money or commodity in exchange for documented promises of return in several forms.

In the analysis of capital at interest the distinction between kinds of credit is not yet clear. In capital at interest, cession of commodities is reduced by Marx to the lending of money. Thus, in this study the two kinds of credit appear again. Commercial credit would be the cession of commodities to be employed in a valorisation, and bank credit would be the loan of money. In his discussion of capital at interest, Marx presents these two kinds of cessions without any clear difference between them.

The cession of commodities like capital at interest consists of a cession of value with the obligation to obtain surplus value and with the obligation to divide this surplus between the producer and the lender. In this way, it is different from a deferred sale. The important factor in such transfers of commodities is the obligation acquired by the borrower. The producer who gives the commodity has the condition of borrower, not that of buyer.

Nevertheless Marx proposes a solution. He expressly says that all kinds of cessions can be assimilated to capital at interest if they are considered as cessions of money. If capital at interest is the cession of a value for its use as capital, the proper way to do so is in the form of money. It is so because the money may be direct capital. Money has no use value and this feature gives it the possibility of being a means of payment. If money is advanced in exchange for a debt, then its nature as capital at interest becomes clear. Thus, Marx with his emphasis on that assimilation is implying that capital at interest be reduced to the cession or loan of money.

The solution to Marx's inconsistency in relation to credit lies in his assimilation of capital at interest and the cession of money. As capital, the capital at interest can play this role in the form of commodity or in the form of money. However, Marx adds something new when he points out that in order to understand capital at interest it is necessary to consider the cession of a commodity as a money loan. In fact, a cession of a commodity may be capital at interest, but not every cession of commodity is capital at interest. A postponed sale is not always a cession of capital. The commercial credit that consists of postponed sales is not the proper place to analyse capital at interest. Therefore, the analysis of capital at interest reveals that the loan of money is a *new concept* in Marx.

The banks are the ones that mainly perform the loan of money. Banks operate in order to make a profit by interest. Banks are the best place in the economy to look at capital at interest. Thus, if Marx reduces capital at interest to loan of money and the banks operate through capital at interest, bank credit consists mainly of capital at interest. Thus, bank credit is the loan of money as a new concept in Marx. With the development of banks, loans of money are centralized in them every time that a loan of money legitimizes the obtaining of interest. Banks perform the accumulation of funds necessary for the correct application of capital, which in turn usually needs growing volumes of value for its valorisation.

Banks may be the place where bank credit is affected, but the meaning of bank credit lies in the fact of being a loan of money with a view to its valorisation. The characterization of bank credit is not the cession of value for its increase. This is the defining property of capital at interest. In bank credit, the loan of money has a distinctive nature. Although the money given by a bank is not employed for its valorisation, the bank has a right to claim the interest. The activity carried out by the bank transforms the simple loan of money into capital at interest independently of its application as capital.

The means by which bank credit transforms the loan of money into capital at interest directly is accumulation. The bank system is the best place to carry out the accumulation of capital in the form of money. In this accumulation process it is possible to use money-capital.

## 5. Bank Credit and the bill of exchange.

Once we know how Marx characterizes bank credit, it is necessary to explain its relation to the bill of exchange because there the two kinds of credit are said by Marx to be only nominally different. The main way of documenting the cession of money is the bill of exchange through its discount. This discount is the main form of money loan in bank sheets-balances. It is the fundamental element of bank credit. The bill of exchange puts the money directly in the hands of an entrepreneur because the bill is usually issued with a view to a mercantile contract. The entrepreneur will use this money as an element in the circulation of capital.

Regarding the issuance of bills of exchange, the dependence of bank credit on the circulation of commodities is clear. The bill of exchange represents a value (the value of the given commodities) and it will be accepted in discount by a bank.

In the bill of exchange the connection between the two kinds of credit is clear. Commercial credit consists of the postponed sale and the bill of exchange favours it. As Marx shows in the example of the thread manufacturer, the bill replaces money in the commodity circulation. Thus, there is more money to be deposited in banks and to be loaned by them. Moreover, the discount of bills of exchange is the main activity of the banks. It is the main way of lending money or the main act of bank credit. Thus, the use of the bill of exchange may be twofold: first, as a means of circulation (this is the more common form of commercial credit), and, secondly, as an advance of money; in this second usage, the bill of exchange is the main form of bank credit through its discount. The lack of differentiation between these uses of the bill of exchange by Marx led him to state that the difference between the two kinds of credit is only nominal.

From the analysis of capital at interest, Marx explains the monetary nature of the rate of interest. But it is confused with its quality of being a participation in the entrepreneur's profit. Once it is clear what capital at interest is, his clearer account of it as a loan of money, the confusion would be resolved.

In capital at interest the financial capitalist asks for a price for the use of the money he gives to the industrial capitalist. This price is the rate of interest. It comes from a participation in the total gains of the entrepreneur. But to be realized in the form of cession of money, the rate of interest is manifested as the price of the loan of money. Marx says that the interest is not the price of money but the price of the use of money lent as capital. The rate of interest is present in bank credit as the difference in the amount of money given in the discount or given in the maturity of the bill. As in capital at interest, the generalization of the bank activity turns interest into the price of the money loan. If the importance of the loan of money features in capital at interest, the price of this loan emerges in the rate of interest. Thus, the rate of interest is the cause of bank credit, while the cause of the commercial credit is the total profit. In his understanding of the rate of interest, Marx accused Overstone[9], a leading figure at Lloyds Bank, of confusing interest with the value of capital and of identifying interest and profit[10].

There is no interest in commercial credit. This can be obscured by the fact that the postponed price is greater than the price at the time. But the explanation of this lies in the twofold function of the bill of exchange. The difference between the postponed price and the price on the spot is the interest that the bank obtains if it discounts the bill. If there is not discount, the postponed price is the price of the commodity sold. It makes no sense to say that the seller obtains an interest, just as it makes no sense to say that the buyer obtains an interest if he pays on the spot[11]. The source of the confusion is that the same means is employed in the circulation of commodities and in bank credit. The

9 "Overstone, and other Currency prophets, constantly have pricks of conscience since they are striving to make capital out of means of circulation as such through the artificial intervention of legislation and to raise the interest rate". Op. cit, p. 299.

10 Lord Overstone (Parliamentary Reports, 1848-1849) understands that the lent capital, that for him is equal to the banking capital, is the capital of the economy. So he also identifies the value of the capital with interest. The interest is higher before the crack because the demand for capital is higher. Marx thinks that the value of capital is the quota of profit. The problem in bank credit is the confusion of money and capital. So the Currency School only sees bank credit as capital. But other authors (Fullarton, Tooke) do not accept this confusion and distinguish incorrectly, as Marx says, between all circulation and capital. They do not see that the money in the circulation of sales is the same as the money in the loan of money (in the capital at interest).

11 Marx says: "In commercial credit, the interest –as the difference between credit price and cash price– enters into the price of commodities only in so far as the bills of exchange have a longer than ordinary running time. Otherwise it does not. And this is explained by the fact that everyone takes credit with one hand and gives it with the other". Op. cit., p. 371.

bill of exchange and money perform the function of the means of circulation and the function of ways of enabling the cession of capital. However, Marx is very clear on this point and he understands that there is no interest without an advance of money.

## 6. Conclusions regarding the first inconsistency

1) Marx's treatment of credit is not consistent. He explains the nineteenth-century English financial crisis in terms of an excessive increase in bank credit and, at the same time, says that bank and commercial credit are only different in name. Marx does not explain what bank credit is as a distinct concept from commercial credit.

Commercial credit is the circulation of commodities by means of bills of exchange. It is a cession of a commodity with a postponed payment. Someone gives value without obtaining another. A delay in the recovery in the money permits it. Certainly, there is an act of confidence or trust, aptly called credit, but it is only a postponement in payment.

Bank credit mainly consists of the loan of money and the discount of bills. For this advance an interest rate is received. Its explanation arises from Marx's analysis of the capital at interest. So the commercial credit consists of an advance of a commodity and receiving a credit and bank credit consists of an advance of money and receiving a credit. Both are a cession of value without receiving anything; this is explained by confidence in their future repayment. The distinction is in the ways that these values are given and in the different functions they play in the explanation of the trade cycle.

2) This is our answer**,** to the problem of what bank credit is. The money cession in a loan is a significant concept in the economy. The bank system as a whole depends on this operation. Bank credit consists of the loan of money for its valorisation, its use as capital. By the generalization of this operation in banks, money loans become a form of capital at interest. Money that is not in circulation is converted into new capital. At the same time, new forms of circulation such as the bill of exchange allows to continue the process.

The bank system is the best way of accumulating money and this is the best way of accumulating capital, on a larger scale than other forms of accumulation. Moreover, the bank system facilitates new means of circulation that extends such accumulation. So the bill of exchange and the banks effect this twofold function: to substitute money as a means of circulation and to increase the capacity of money to be lent as capital at interest. For these reasons, the loan of money appears as a significant concept mainly in the explanation of the business cycle.

3) The business cycle corresponds in Marx with a repeated situation of overproduction and a surplus of industrial capital. Dramatic differences between commercial and bank credit accompany this. The excessive growth of capitalist operations is possible because of the increase in bank credit over and above commercial credit. If the bank system obtains money to be lent for its use as capital at a rhythm which is greater than that of the production of real activity, then the excess of industrial capital may be explained.

Clarifying what Marx means by bank credit sheds light on his explanation of the business cycle. This is so because the increase in commercial credit is always proportional to the increase in activity, and thus it is necessary to provide an explanation for the excessive increase in bank credit. This cannot be found in Marx because he does not expressly admit that the separation of bank credit was the cause of the crisis and he is more interested in the analysis of the cycle in terms of a distinction between real capital and money capital. But it is true that Marx's account of the kinds of credit amounts to a causal explanation of the cycle irrespective of his purpose.

Thus, independently of the inconsistency entailed by Marx's statement that the distinction between bank and commercial credit is nominal, the inconsistency is more clearly reflected in the unfinished explanation of the crisis. Marx explains the crisis in terms of a differentiation that he does not explain. Afterwards he expressly states that the differentiation is only nominal.

4) The interest rate consists of a participation in the gains. Gains are divided into entrepreneur profit and interest rate. Interest rate is a monetary concept. The loan of money for its valorisation grounds the right to recover an interest.

Marx is clear about this matter. Nevertheless, he introduces a slight element of doubt by his analysis of capital at interest as a kind of capital. He does not overstate the significance of his statement that the correct way to explain capital at interest is in the form of a cession of money.

Another consideration of the nature of the interest rate lies in the explanation of bank credit. The obtaining of interest is the cause that moves bankers to act and to lend money whenever they can. This desire to participate in gains is just like the unlimited desire ascribed by Marx to capitalists.

## 7. The second inconsistency

In the explanation of the trade cycle offered by Marx in the fifth section of the Book Three of *Das Kapital*, the main cause of the cycle consists of the inversion of the exchanges of money capital and of real capital. This is clearly inconsistent with Marx's understanding of the capital cycle in Book Two. In this case, the movements of the two kinds of capital must go in the same direction. Either one explanation is possible and the other impossible or vice-versa, but the two relations cannot possible be congruent with one another.

To resolve this, it is necessary to indicate what money capital is because his explanation in section five is not clear. In this context we can attempt to clarify it with the help of the solution obtained in the previous inconsistency. With the help of the understanding of what credit is, it is possible to analyse money capital. This explains the title of this article. Credit is the key to accounting for the general question of the trade cycle.

In Book Two of *Das Kapital*, Marx explains the capital cycle. It can be represented in the form: M-C…P…C'-M'. The first movement is the change between money and productive commodity: labour force and the means of production. The need that the labour-force exists as a commodity for the manifestation of capital is already evident. This labour force is the wage-earning labour. The following movement is the time of the suspended circulation during production. It is represented by…P… and expresses the necessary unavailability of the invested value. This lack of availability or exclusive application to production actually affects all the phases of this process. The acquisition of plus value features in the third movement of the sequence. Nevertheless, here lays the illusion that capital cycle itself recovers the entire value invested in only one cycle. Marx recognizes his failure to undertake the capital cycle explanation. He says that it must be taken as a non-linear but repeated process, where eventually the capitalist obtains M', which is M plus m (where M is the money initially invested and m the plus value in terms of money obtained).

This illusion is logically connected with Marx's affirmation that the best way to represent the capital cycle is by starting at M, money. Marx says that because the cycle must be repeated, in order to solve this illusion, the best technique to circulate and repeat the cycles is to have capital in the form of money. This is clear because money is the medium of circulation of commodities. Thus, in the next section, we will explain what capital is in the form of money.

The logical conclusion of Marx's explanation of the capital cycle is the impossibility of an inverted position between capital in the form of money and the form of commodity. Capital could increase more in one form than in the other, although neither can one increase when the other decreases.

## 8. Capital in the form of money

Capital in the form of money is the best means by which to begin an act of circulation of new capital because capital is the value that is revealed. This definition of capital emphasizes capital as a process. Capital is a value in movement. This is the circulatory movement of commodities that aims for increased value by the medium of production. Only if the value circulates adequately, is it reproduced and increased. The term capital is used to mean "value in movement". Capital in the form of money reveals the capacity of money to introduce itself into the process of value reproduction. In order to do so, money has to go through the phases of the capital cycle which, expressed with a beginning and end in terms of money, is the cycle of money capital.

It is important to realize that capital may be expressed in different forms: mainly money and commodities. Much of the growth capacity that a value has is found in its capacity to change form: its capacity to circulate. For this reason, capital must not be identified with a kind of commodity, but rather with the typical commodities used in production. Capital seems to be an aspect of things in different circumstances. Sometimes capital appears to be anything, and this is a possible fault in the concept of capital by Marx.

Given this understanding of capital, the function of money is clear as a medium of circulation in order to facilitate the circulation of capital. For this reason, capital in the form of money is the best way to express the capital cycle as a valorisation process. Marx calls this the "money capital cycle". In the second book, the equivalent of capital in the form of money is money capital. He uses the former expression because he is interested in explaining what capital is and how it cycles. He concludes that the best way to define the capital cycle is as the money capital cycle. This is the cycle already formulated above: M-C-…P…-C'-M'. The character of money as an independent value of change allows it to initiate several investment operations.

## 9. Capital in the trade cycle

In Book Two of *Das Kapital*, Marx hols that money capital is authentic capital and the best way to use new value like capital in production. In Book Three, section five, money capital is the main component in the explanation of the trade cycle.

Throughout the cycle, Marx explains how real capital and money capital are substituted by each other. The surplus of one corresponds to the scarcity of the other[12]. In the recovery phase after a crisis, there is a surplus of money capital and a scarcity of real capital. In the middle phase, the two kinds of capital more or less coincide and then the growing demand for money capital raises the interest rate. In the high phase of the cycle, the scarcity of money capital explains the high interest rate. This coincides with a surplus of real capital. Thus, a marked separation in the movements of the two kinds of capital may be observed. This explanation of the cycle is impossible because the capital movements must be in the same direction as the components of the capital cycle: money and real capital. The inconsistency in Marx's argument is clear here[13]. In the trade cycle, one kind of capital increases by substitution of the other. Conversely, in the capital cycle, one kind of capital only increases if the other also increases. Marx does not explain how this change in the nature of the capital could ever be possible.

The only way to accept the trade cycle explanation is to consider that real and money capital are not simple forms of capital as in the explanation of the capital cycle. Nevertheless, this is not articulated in Marx's thought. He uses the terms real capital and money capital without differentiating them from the other forms of capital. Marx does not define the nature of money capital.

So another way to express the problem, or a second aspect of the inconsistency, has to do with the clarification of what money capital is in the trade cycle explanation[14]. Marx's use of this term in this part seems to give it a new significance. He seems to say that money capital is now capable of separating itself from real capital. Moreover, when Marx speaks about interest capital, he reduces it to a cession of money for its valorisation, i.e. capital in the form of money. It would therefore be money capital which, in connection with banking activity, explains a new nature of capital in the form of money. In order to solve the inconsistency problem, it is necessary to reduce the analysis expressly to Marx's affirmations about money

12 Marx says: "An expansion of money-capital, which arises out of the fact that, in view of the expansion of banking (…), what was formerly a private hoard or coin reserve is always converted into loanable capital for a definite time, (…) As long as the scale of production remains the same, this expansion leads only to an abundance of loanable money-capital as compared with the productive. Hence the low rate of interest".
"After the reproduction process has again reached that state of prosperity which precedes that of over-exertion, commercial credit becomes very much extended; this forms, indeed, the "sound" basis again for a ready flow of returns and extended production. In this state the rate of interest is still low, although it rises above its minimum. This is, in fact, the *only* time that it can be said a low rate of interest, and consequently a relative abundance of loanable capital, coincides with a real expansion of industrial capital".
"The interest now rises to its average level. It reaches its maximum again as soon as the new crisis sets in. Credit suddenly stops then, payments are suspended, the reproduction process is paralyzed, and with the previously mentioned exceptions, a superabundance of idle industrial capital appears side by side with an almost absolute absence of loan capital".
"Consequently, the movement of loan capital, as is reflected in the interest rate, goes completely in the opposite direction from that of industrial capital." Op cit., p. 351.

13 He seems to recognize this contradiction when he says: "The accumulation of money capital susceptible to loans does not express more than the fact that all money, in which the industrial capital is converted in its cyclical process, takes the form, not of money invested by the producers, but of the money loaned by them. In reality, the investment of money that necessarily must be affected in the production process appears to be an investment of borrowed money". Op cit., p. 474.

14 Here the real capital can be understood in an intuitive manner. There is no reason to specify real capital in any other way. It is capital in commodity form.

capital. In any case, this is the problem: the determination of the nature of money capital.

## 10. Money Capital

Marx says that the *offer* of loan capital is the supply of money capital to be loaned. He also says that the *mass* of loan capital is composed of securities, commodity loans, money capital and commerce credit. Nevertheless, he does not clarify more than this. In light of these statements, the mass of loan capital is qualitatively more than the offer of loan capital. This is logically explained because the latter is present in money capital and afterwards is materialized in other forms: securities, commodity loans, money capital and commercial credit.

By the description of the mass of capital to loan it is clear that money capital is neither commercial credit, nor securities, nor commodity loans. Moreover, the solution of what money capital is, according to Marx, must satisfy the double condition of mass of loan capital and offer of loan capital. So money capital must be the money loaned because this is the only way to satisfy the double condition. This is our way**,** of accounting for the actions that make up money capital.

The money loaned is money capital. This solution corresponds to what we mentioned before when we denote in Marx the money loaned as a new concept to explain interest capital. The money loaned is money capital which Marx calls *the conversion of money into loaned capital*. The process of accumulation of funds that is realized in the economy by the bank system produces this. When money begins to accumulate as bank deposits, an economy of means of circulation and private reserve funds is obtained. The circulation of commodities is facilitated and expanded in new ways: the clearing of debts. At the same time, the reserve fund of the economy is increased, that is to say, there is accumulation. In summary: money economy and accumulation on a larger scale.

The average volume of deposits in banks is the quantity of money accumulated. In average terms, the deposits are independent of the current operations. So the money accumulated and the money in circulation are separated. If all the deposits of the banks and of the Bank of England[15] are taken together we have the mass of money capital in the economy[16]. Banks make their money in this business. So, in this way, the quantity of the money capital is determined[17].

Marx explains how money is transformed into capital according to the explanation of the conversion of money into loan capital. As the public becomes accustomed to depositing their money in banks, the larger the volume of money loaned will be. So the banks represent the principal means of increasing the disposable quantity of capital, which exists in the form of money capital. As the quantity of deposits increases the concept of money loaned acquires new importance. By increasing the scale of accumulation the banks convert money loaned into money capital. This transforms the money loaned into money capital independently of its application in a capitalist process.

In nineteenth-century England, when the credit system was developing[18], the accumulation of money was increasing in scale. This was so in spite of recurring crises. The transformation of money loaned into capital was aided by the fact that capital accumulation was faster than ever. All advances of money are converted into money capital.

## 11. The alternative trade cycle explanation

If this is indeed money capital (observed as a result of money loaned, and determined by the volume of deposits in the bank system), what becomes of the movements of money capital and real capital in opposite directions?

15 The deposits in the Bank of England consist of the reserves of private banks. Of these the Bank only takes enough reserves to secure the demands of the depositors and of the Treasury. "Marx (1894) says that the excessive responsibilities that fall on the reserves of the banks along with the restriction of the 1844 Act make financial crises sharper". Op. cit., p. 388.

16 Marx says: "In the study of countries which are developing systems of credit, we can admit that the all loan money capital disposable exists in the form of bank deposits or in the domain of the lenders of money", Op cit., page 469.

17 Here we obtain an identification of money capital. So the concept of money capital is manifested in superficial aspects of reality. This is easier in the case of money capital than in other forms of capital because money is the measure of value and so it is a homogeneous unit.

18 The number of banks increased significantly in the early 1850s. This was when the use of generalized deposit balances developed. The example noted by Marx is that of the agricultural county of Ipswich. In this county the deposits of tenant farmers multiplied by four in just a few years.

The answer suggested here is that these contrary movements in the trade cycle do not exist. Just before a “crash”, the surplus of real capital coincides with the surplus of bank deposits. If there is a lot of real capital it is because there is also a lot of money capital. The fact that in a time of panic, the demand for money in circulation increases by the progressive destruction of credit, especially commercial credit, the basis of all credit, is a separate issue. So the demand for money, not the demand for money capital, although both coincide, increases in time of crisis because other forms of circulation such as debt clearing disappear. So the demand for money is greater than the also large supply of average deposits. So the interest rate also increases because of the relative scarcity of money but not of money capital. The key question is that when public confidence disappears, commercial credit disappears and so the conversion of money into capital diminishes. The new means of circulation no longer exists; money capital and average deposits are employed in the circulation.

When the crisis is generalized, average deposits are diminished while real capital is destroyed because of paralyzed activity. Finally, in the beginning of the recovery of activity the volume of deposits are as diminished as real capital. So the interest rate is low because the demand for money, to be employed in its valorisation (demand for money capital) or to be employed in the diminished circulation of commodities, is very low.

This explanation resolves the inconsistency problem. There is no opposition between the movements of money capital and real capital. The different kinds of capital must move in the same direction. The correct explanation of the capital cycle is the one Marx sets out in Book Two. The trade cycle is equal to the capital cycle. The existence of the inconsistency is based on the confusion between money and money capital. Certainly, in the trade cycle what is happening is that the expansion of capital in the form of money is greater than the expansion of capital in the form of commodity. This is possible by means of the conversion process explained above. The capacity of the bank system to expand and create new money to be used as capital is like the capacity of bank credit to be separate from the commercial credit. However, the key solution relates to inconsistency outlined above. The question of the trade cycle is clearly demonstrated but it will not be given detailed discussion here.

The confusion that we perceive in Marx consists of identifying money with money capital in the trade cycle explanation. In fact, this confusion is present in real life, because more and more the bank system appears to be the recipient of all money. But the proximity that exists between money and money capital disappears when deposits decrease. Until the maximum limit of credit is reached money and money capital enjoy high proximity. But when credit disappears, money is required for repayments, but not for the increased use of money as capital. Without credit, the conversion of money into money capital is impossible. In a time of crisis, commerce credit does not exist, so the real confusion between money and capital disappears.

Thus, the confusion present in Marx disappears and there is no contradiction in the movements of the two kinds of capital. The two kinds of capital are capital and expressions of different phases of the capital cycle. Considering the capital cycle[19] of the whole national economy there is no reason to think that the two forms of capital have opposite movements in reality.

## 12. Conclusions regarding the second inconsistency

1) Money capital is the form of capital that is most appropriate for the initiation of the capital cycle. Moreover, the ease of money accumulation enhances the process of capital accumulation. The increased form of accumulation is present in the economy in the funds deposited in the bank system. Indeed, the bank business consists of promoting the accumulation and the management of money for its use as capital.

2) There is a kind of indeterminacy in Marx with regard to the concept of money capital. This explains the inconsistency discussed here. Some indeterminacy is acceptable in relation to real capital, but this is not the case with money capital. This is because the homogeneity of money causes confusion between circula-

19 Explained by Marx in Book Two and now projected onto the trade cycle.

tion and capital[20]. So it is necessary to specify where the money capital in the economy is and what activities produce money capital.

Given what Marx has to say about the offer of loan capital and of the mass of capital to be loaned it is possible to say what the activities that create money capital according to Marx may be. The activities that create money capital are money loans. The mass of money capital in the economy is determined by average deposits.

3) The inconsistency discussed here arises from the contrast between the explanation of the capital cycle in Book Two of *Das Kapital* and the explanation of the trade cycle. The movements declared in the capital cycle between capital in the form of money and in the form of commodity must be in same direction. However, in his analysis of the causes of the trade cycle, Marx says that that movement is in the opposite direction. This is not possible. But the confusion in Marx has a real cause which is the fact that money has two functions: the circulation of commodities and its ability to be loaned as capital. This confusion is based on credit. In fact, when this disappears the real confusion disappears. So the confusion stems from the similar nature of commerce credit and bank credit.

4) There are similar extensions and reductions of money capital and of real capital in the trade cycle. The cause of the crisis is the excessive expansion of money capital over real capital and the inability of banks to maintain this expansion because the reserve limit is reached. This reserve limit is a legal amount known by the public and instils public confidence. But in spite of the crisis the point of recovery is higher than before. The accumulation of money by banks enhances the scale of accumulation in the economy because the deposit of money is the best and the easiest form of capital accumulation. At the same time the bank system itself is interested in capital accumulation in order to conduct its business.

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20 In Marx this is the error in the Currency School, also recognized by Tooke and Fullarton. Marx also declared that Tooke and Fullarton distinguish excessively between circulation and capital. But Marx does not clarify the reason for this last affirmation because he does not make a distinction between money and money capital. That is to say, Marx does not attempt a development of the consequences of his declared process of conversion. He does not project these consequences to the determination of the money capital.