

# Good example of behavioural finance essay

[Government](#), [Capitalism](#)



## **Introduction**

Monetary theory focuses on the functions, uses and management of money.

The approaches to money go back as far as Plato and Aristotle. Aristotle focused primarily on money as a medium of exchange but later stated that money needed to be something with intrinsic value. He suggested that money should be something metallic and rare. As a result, Aristotle may be classified as a “metallist.” Plato’s conceptions of money differed from Aristotle’s because he introduced a credit component in the monetary theory. Schumpeter, a monetary historian, classifies Plato as a “Cartalist.” Karl Marx had strong conceptions on theories of money. He considered his theory on money to be a significant accomplishment, and advancement over classical economics, particularly Ricardo’s theory (Nelson, 1999). He believed that classical economics theories had taken money for granted. He believed in tracing the origin of money as an expression of value that comes from the value-relation of commodities. In this regard, Schumpeter classified Marx as a theoretical metallist (Nelson, 1999; O’Hara, 2010). Marx loudly criticized the credit theories of money that existed during his time. He was also openly critical of capitalism because he saw it as a system devised to favor a few, at the detriment of the majority. This essay provides a look into Karl Marx’s idea on the forms and functions of money, his theory of the credit cycle, and his perspective on the concept of “fictitious capital.”

Karl Marx did not present a theory of money that was ideal. He developed concepts that explained capitalist money. Marx prioritized social actions and their implications to develop systemic tendencies described in his labor theory of value. He implicated money in the capitalist exploitation, and greed

to amass personal possessions. There are two main functions of money from a Marxist perspective. The first function of money is the “measure of value.” In his dismissal of capitalism, Marx came up with an unorthodox commodity theory. His theory included some aspects of the existing credit theories into the role of money as a means of circulation (O’Hara, 2010). It is through this theory that Marx located the role of credit money. He stated that capitalism would not be possible without credit money (Marx, 1968). Marx, however, acknowledged “the measure of value” principle as the primary function of money. To this end, he stated that this principle called for the money commodity. Marx explains this commodity component as labor.

The second function of money from a Marxist perspective is as a medium of circulation. According to Marx, circulation refers to the many random purchases and sales that take place simultaneously in different places (Marx, 1907). Purchases and sales are similar in the fact that the seller has the commodity while the buyer has the money. Marx’s theory of money provides some important quantitative perceptions on the price of commodities and the amount of money in circulation. Firstly, he stated that commodity prices (or the ratio between commodities and money) arise from the comparative quantities of socially-necessary labor-time present in the commodity. This relationship is:

$$P_i = (1/L_g)L_i. \text{ (Equation 1)}$$

$P_i$  is the price per commodity;  $L_g$  is the labor-time in a unit of gold (the value of money);  $L_i$  is a socially-necessary labor-time held by each commodity. The inverse of  $L_i$  is the amount of gold produced every hour (Moseley, 2004). This value establishes the quantity of money new-value that is produced in every

hour of socially-necessary labor-time and is referred to as the monetary expression of labor-time (MELT). Algebraically,  
$$\text{MELT} = 1/Lg.. \text{ (Equation 2)}$$

### **Equation 1 may also be expressed as:**

$$P_i = (\text{MELT})L_i. \text{ (Equation 3)}$$

These equations indicate that the price per commodity is proportional to the socially-necessary labor-time contained in it, whereby the MELT is the proportionality factor. Inherent in the function of money as a medium of circulation is Marx's idea that all wealth comes from human labor. This theory is known as the labor theory of value (Marx, 1968; Moseley, 2004). The function of circulation gives rise to another form of money: means of payment (Marx, 1968). Circulation of money leads to conditions whereby there is an interval of time introduced before the realization of the prices of commodities occurs. For example, a landlord sells the right to use a given house for a particular period. The tenant only receives the full use-value of the commodity at the end of the period for which he has paid the rent. In this example, the landlord becomes a creditor, while the tenant becomes a debtor. In this regard, money is simply a means of payment (Marx, 1968).

### **Marx's theory of the credit cycle.**

Money, finance, and credit were at the heart of Marx's criticism of capitalism. The collapse of the gold standard proved to be the catalyst needed for Marxist perspectives on credit to come to the fore. Marx believed that money must be a commodity known as the money commodity. Its value was inherently recognized in circulation. The value of this money was neither

symbolic nor imaginary. On the other hand, credit views interpreted money as a vacant space of a black hole (Nelson, 1999). Marx did not agree with these views. He discredited credit theories, stating that money functioned to develop a specific version of labor-time, as a measure of value. He regarded credit money as merely a commercial instrument such as a bill of exchange (Marx, 1968). Legal tender and state currency were distinct from credit money because they were tokens of value. State currency had to be backed up in metallic currency or by circulation (Marx, 1968). He believed that money, in its exchange value, can have an existence that is separate from its substance/ material. This notion implies that paper money could exist as a measure of value with reference to its substance of value, which is labor. These Marxist ideas oppose the theory of credit. Credit/ nominalist theories claim that money is valueless in itself. They also hold that its value only depends on its purchasing power as formed in and by the minds of buyers and vendors (Nelson, 1999; Marx, 1968). Marx asserted that credit theories ignored or distorted the notion of socially-necessary labor-time changed as the material of the value-form.

Marx not only criticized the credit practices of capitalism in theory but also highlighted their shortcomings in practice (Marx, 1968). He studied the withdrawal of capital from the processes of production for the purposes of making more money in speculation, stating that these activities were responsible for financial crises. He highlights the lies of capital markets that dwell on speculation and rational expectations- practices he believes lead to dishonesty, deceit and systemic corruption on government and other institutions (Marx, 1968).

Marx notes that there are imbalances between consumption and investment, the inclination of the profit rate to decline, as well as other explanations of the method of production. He states that it is possible for a big firm's failure to produce a wider collapse via knock-on impacts on the creditors as well as interdependencies in supplier and credit markets (Marx, 1968).

## **Fictitious Capital**

Another failing of the credit cycle of capitalism, according to Karl Marx, is the emergence of "fictitious capital." He states that the increasing creation of fictitious capital results inevitably in crisis (Tabb, 2010). Fictitious capital may be explained as a value in the form of shares, credit, debt, speculation and some versions of paper money that are above and beyond the value that is realizable in commodities. Marx (1968) writes that when the chain of payments and the system of setting them up become too long, the credit system is bound to fail. To explain the idea of fictitious capital, Marx provides the example of banks. Banks act as an intermediary between savers and borrowers who want to make productive use of the borrowed money at a cost of interest. Banks are important to the economy (Nelson, 1999).

However, they continually fall to the temptation of over-extending themselves by over-lending to increase their income. This action places the savers' money into great risk. Banks best illustrate the idea of fictitious capital and frailties of the credit system. By over-lending, banks make use of fictitious capital to produce interest. The negative aspect of this strategy reveals itself in times of the financial crisis. This strategy is a form of pyramid scheme that relies on speculation. In times of expansion, it is easy to borrow because banks make money available at low-interest rates.

However, during contraction, credit crunches drastically reduce loan capital, stifling recovery.

## **Conclusion**

Monetary theory focuses on function, management and uses of money. The first monetary theories emerged as early as the first exchanges of barter trade. Money developed from its function as a medium of exchange into other functions such as medium of circulation, medium of value and store of value (Marx, 1968). Karl Marx had strong opinions about monetary theories, especially the credit theories. His criticisms on capitalism emerge from his perceptions on the function of money. First, Marx saw money as a measure of value. This idea was evident in his commodity theory which was based on the money-commodity of social labor. Secondly, Marx held that money acted as a medium of circulation. He highlighted this function by providing scenarios of buyers and sellers and how money facilitated them. The circulation function of money also extends to the “ means of payment” function of money because it introduces the aspect of time in transactions involving money. One of the most significant areas of Marx’s criticism on capitalism is the credit cycle. He cited the withdrawal of capital from production processes as one of the failings of capitalism (Moseley, 2004). The concept of fictitious capital, as practiced among capitalist banks, is central to these criticisms. Overall, Marx’s views on capitalism are significant today, especially in the wake of the 2008 global financial crisis.

## References

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