Value theory: the link between social philosophy and economic analysis

1 Introduction

Despite the titles of scores of introductory texts and thousands of introductory courses, there are surprisingly few "principles of economics" that would be generally accepted by most followers of the extant schools of economic theory. And perhaps even more surprisingly, given the endless debates and polemics in the field of value theory, the theory of the process of price formation is very nearly one such principle of economics. The reason this realization surprises us is that we have come to regard the words "price theory" and "value theory" as synonyms referring to the same set of ideas. It is the contention of this paper that this view of price and value theories is wrong and generally obscures the extremely important difference between the two. The most common source of the error is the failure to appreciate the role of value theory as the integrating element tying economic theory (in this case, particularly, price theory) into the larger intellectual context of a general social and moral philosophy. In section 2 I shall discuss this integrating role of value theory generally. In sections 3 and 4 I shall show how two nearly identical theories of price formation get integrated into two vastly different social philosophies via the neoclassical utility of value and the Marxian labor theory of value.

2 The Distinction Between Price And Value Theories

Since the time of Adam Smith (if not earlier), economists' interest in prices have taken two very separate (even though not entirely unrelated) forms. First is the interest in describing and understanding the actual, immediate process of price formation in which prices come to assume their general, habitual, customary or normal magnitudes. Second, is the interest in understanding the social and moral meaning or importance of prices, that is, in understanding the role of prices in human development, in social economic and political processes and, most generally, in the quest for a well-ordered good life for the individual and/or for the society.

In the actual writings of nearly all significant economic theorists these two concerns have not been separated — and it is my opinion that they are not completely and entirely separable. Nevertheless, I believe that we can increase our understanding of economic theory by mentally separating the two concerns. The concern with the process of price formation or the quantitative determination of actual price levels I shall call price theory. The concern with the social nature of prices I shall call value theory. (Given the relevant texts in the history of economic doctrines this particular labeling of the two concerns is definitely not arbitrary. With more space I could show that the labeling has definite historical as well as analytical justification.)

When this distinction is made, it is most interesting to note that the two most important intellectual tradition in economics — the neoclassical and the Marxian — yield (at least at a sufficiently high level of generalization) nearly identical price theories despite their profoundly different value theories. Both traditions see capitalist entrepreneurs as the setters of prices. Both see these entrepreneurs as generally endeavoring to maximize profits. Both see market competition as the most significant constraint within which the entrepreneurs' profit-maximizing, price-setting decisions are made. Although the neoclassical conceptions of "pure" or "perfect" competition differ from the conception of competition in the writings of the classical economists and Marx, competition need be neither "pure" nor "perfect" to get the result required by neoclassical price theory (the purity and perfection are needed only for their formulation of welfare economics, about which more will be said later). For the price theory of the neoclassical, classical and Marxian schools alike there must in general be enough competition that the presence of prolonged, abnormally high profit rates will attract new competitors and thus tend to push all (or nearly all, since monopoly is treated as a special case in these approaches) profit rates toward the social average.

Thus, both schools see the process of price formulation as one in which the profit-maximizing entrepreneur sums his/her costs of production and then — in equilibrium at least — adds the socially average rate of profit to these costs to arrive at the price. Any industry that is able to maintain barriers that prevent competition from pushing that industry's rate of profit toward the social average is treated as an exception to this "normal" or usual process and is analyzed on a separate or *ad hoc* basis.

This conception of price formulation is what I believe should be called price theory as distinguished from value theory. Using this terminology the "price theory" just described can be said to come close to being one of the very few genuine "principles of economics" common to nearly all schools of theory. The theories of value of the various schools, however, differ markedly. In order to assess the significance of these differences I shall first discuss the general relation of value theory to price theory and then briefly examine the neoclassical utility theory of value and the Marxian labor theory of value.

In price theory, as I have defined it above, it is clear that because of the fact that the outputs of most industries serve as inputs to other industries — and all non-labor inputs in any given industry are outputs of other industries — the cost of production of any commodity (and hence its price) depends on the prices of other commodities. Therefore, price theory leaves us with a set of unknowns (prices) and a set of general functional relations between each price and all other prices. Clearly, by itself price theory is incomplete. In order to break the circularity in which each price simply depends on other prices we must have what Maurice Dobb has called a "value constant." In purely analytical terms, a value constant is some principle or set of principles the knowledge of which enables the theorist to give specific and unique content to the general functional relation between each price and the other prices of the system. With the addition of this value constant price theory yields a specific set of equations, the mathematical solution of which yields prices.

The set of principles from which we derive the value constant is a theory of value. Obviously price theory is analytically incomplete without a value theory and this, in part at least, explains why the two are generally held to be synonymous. The rationale for distinguishing between price and value theory comes from the fact that in addition to providing the value constant that renders price theory analytically complete, value theory plays another extremely important role in economic theory. It anchors price theory securely onto the intellectual foundation that Joseph Schumpeter labeled the theory's "preanalytical vision." It is this "vision" that ultimately dictates our conception of what sort of entity prices are and hence our conception of the social and moral significance of the market allocation of resources. It is this vitally important role of value theory that accounts for the frequently polemical nature of debates on value theory.

Every economic theorist (indeed all theorists) begins theorizing on the basis of an elaborate set of views (which may or may not have been consciously examined) about the ultimate nature of reality. These views include, of course, what philosophers label as principles of ontology or metaphysics. But they also include considerably more. What Aristotelian metaphysics is to physics, the Schumpeterian preanalytical vision is to social theory. It contains the theory's most fundamental conceptions of the nature of human beings and the nature of human society.

Neither metaphysics nor preanalytical visions are amenable to empirical or logical proof or disproof. If they were amenable to proof or disproof they would not be metaphysics or preanalytical visions but rather ordinary physics and social theory. This, of course, accounts for the desire of logical positivists in the 1930s to purge philosophy and science of all metaphysics, and to contemptuously label the elements of the preanalytical vision as either metaphysics, moral philosophy, or meaningless phrases. It is now nearly unanimously agreed by philosophers that the logical positivists' quest was inherently impossible to carry out because all theorizing absolutely requires first principles that are not amenable to empirical or logical proof or disproof. It is all such first principles of a social theory that I refer to as the preanalytical vision of the theory.

Because preanalytical visions are amenable to neither empirical nor logical disproof, Schumpeter explicitly chose to ignore them in his *History of Economic Analysis* (1954) — his assumption being that we have no intelligent means for a normative choice among competing preanalytical visions. I think that this assumption is wrong. Different preanalytical visions predispose us to focus on different social and economic problems and lead to entirely different attitudes toward our social setting and our actions within that setting. Thus, they have enormously important practical consequences in human social action and interaction. Therefore, I would propose that while empirical evidence and logical arguments ought to be important in our normative evaluation of competing propositions in the realm of economic theory proper, the relevant criteria for choosing among competing preanalytical visions are practical and ethical. And since the propositions of analytical economic theory are generally tied to one or another preanalytical vision by a theory of value, a normative assessment of rival theories of value becomes extraordinarily difficult because it must perforce be based upon not only logical and empirical criteria but practical and ethical criteria as well.

Having stated the general principles of my argument, I shall now briefly indicate how this argument applies to the neoclassical and Marxian theories of value.

3 The Neoclassical Utility Theory of Value

The neoclassical preanalytical conception of a human being is that of a single-minded seeker of a maximum of pleasure (or utility, or position on a preference ordering, or whatever other euphemism is used). The specific nature of the individual likes and dislikes (that is, his/her utility function or preference map) is taken as given without any regard whatsoever for the social processes and institutions within which the likes and dislikes were formed. The individual's actions take place in an environment that again is taken as given and not generally investigated. This environment is conceived of as an elaborate set of constraints within the confines of which the individual begins each "period" with an endowment that yields relatively little utility. S/he gives up parts or all of this endowment in a series of exchanges, to arrive temporarily at a constrained optimum. The "optimum" is very brief, however, since the same process continues to recur endlessly.

One might imagine that I have described only "consumption theory" and not "production theory." This is not the case. The more perceptive undergraduate economics student soon notices that there is a striking analytical symmetry between "consumption theory" and "production theory" in neoclassical economics. In fact, in the words of a leading neoclassical text, the individual begins with an "initial endowment," that is, "a combination of goods that provides a starting point for optimizing choice" (Hirshleifer 1970: 2). The individual then exchanges with other isolated exchangers or s/he produces. But the analytical symmetry between utility functions and production functions is by no means accidental. The same text concludes that all economic theory is exchange theory because "consumption theory" deals with exchange among individuals while "production theory" reduces to the fact that "production is 'exchange' with nature" (ibid.: 12).

In fact, the preanalytical vision of neoclassical economics is so extremely individualistic that the only way in which human sociality appears at all is in the individual's need for other entities with whom to exchange. The theory applies different labels according to whether these entities are human or nonhuman. But a rose is a rose, and the asocial nature of the theory is strikingly clear when one sees that it does not matter either analytically or substantially whether these entities are human or not. The isolated Robinson Crusoe is, in this theory, absolutely no different from the participant in a social process. Indeed, differing social or cultural contexts make no difference whatsoever. Another widely used neoclassical text asserts that this theory is “applicable to all economic systems and countries” (Alchian and Allen 1964: 5).

This, then, is the core of the value theory that emerges from the utility theorists’ preanalytical vision of human beings. It furnishes the context within which entrepreneurs set prices by summing costs and adding the socially average return on their capital. Clearly this context is very important because the only response these theorists have made to the innumerable devastating critiques of their concepts of utility functions and production functions has been to devise more abstract and esoteric formulations that still retain the necessary analytical characteristics. Necessary for what? The answer to this question is utterly unequivocal: necessary in order to intellectually derive all of the conditions of Pareto optimality from the analysis of pricing within a competitive capitalist society.

It is the aim of nearly all neoclassical value theory to culminate in a demonstration of how the competitive capitalist economy automatically attains Pareto optimality. Typical of nearly all orthodox microeconomic texts is the revised edition of *Microeconomic Theory* by C.E. Ferguson (1969), which consists of 16 chapters. The last chapter is entitled “Theory of Welfare Economics,” and it is obvious that most of the first 15 chapters are designed to lay the analytical foundations for the last chapter on neoclassical welfare economics, which is the climax and denouement of the entire book.

Early in the final chapter Ferguson wrote:

> We now wish to show ... that a perfectly competitive, free enterprise system guarantees the attainment of maximum social welfare. The proof rests upon the maximizing behavior of producers and consumers. To recall the dictum of Adam Smith, each individual, in pursuing his own self interest, is led as if by an “invisible hand” to a course of action that promotes the general welfare of all. (Ferguson 1969: 444-5)

There follow nine pages of summary explanation outlining the deductive argument that culminates in the demonstration of attainment of Pareto optimality. The most important aspect of these nine pages is this: Ferguson is able to tie together his demonstration of neoclassical welfare economics and the attainment of bliss in a coherent and brief manner, because with each point he makes, he is able to refer his readers to earlier chapters of sections of his book. His standard explanation of orthodox microeconomic theory has developed the ideas and analytical tools *that inevitably lead to the conclusions of neoclassical welfare economics.* Indeed, in examining the previous 15 chapters, we can see very little else to which they do lead. The nine-page demonstration of welfare economics ties the entire book together and then concludes: “This unique equilibrium ... is called the point of ‘constrained bliss’ because it represents the unique organization of production, exchange and distribution that leads to the maximum attainable social welfare” (ibid.: 454).

Of course it is demonstrated to the student that a free-market, competitive capitalist system inevitably allocates resources, distributes income, and apportions consumer goods among consumers so that no reallocation of resources through changes in consumption, exchange, or production could *unambiguously* augment the value of the commodities being produced and exchanged. This is Pareto optimality: the fundamental norm of neoclassical economics.

The fundamental rule of Pareto optimality states that the economic situation is optimal when no change can improve the position of one individual (as judged by that individual) without harming or worsening the position of another individual (as judged by that other individual). A Pareto improvement is a change that moves society from a non-optimal position closer to an optimal position. Only a change which harms no one and which makes some people better off (in their own estimation) can be considered to be unambiguously an improvement.

The most significant point to note in the Pareto rule is its conservative consensual character. Defined away are all situations of conflict. In a world of class conflicts, imperialism, exploitation, alienation, racism, sexism, and scores of other human conflicts, where are the changes that might make some better off without making others worse off? *Improve the plight of the oppressed and you worsen the situation of the oppressor* (as perceived by the oppressor, of course!). Any important social, political, and economic situations where improving the lot of one social unit is not opposed by naturally antagonistic social units are indeed rare. The domain of this theory would, indeed, seem to be so restrictive as hardly to warrant serious investigation, were it not for the fact that the theory is considered important by the overwhelming majority of neoclassical economists.

Thus, a conservative social-economic philosophy rests on the foundation of the preanalytical vision of the utility theorists and it is precisely the utility theory of value that anchors the concept of price determination which is common to both neoclassicism and Marxism to this conservative philosophy.

From the preanalytical vision underlying the utility theory the value constants are derived primarily from (a) the supposed mathematical properties of preference maps or utility functions and (b) the supposed mathematical properties of "well behaved" neoclassical production functions. With these, the set of price equations becomes determinate and the price theory is complete and logically consistent. Moreover, in addition to the necessary value constants the preanalytical vision supports a social philosophy some of the deductive implications of which are: (a) the market harmonized all interests so that social harmony and not conflict is the normal state of human affairs; (b) since human beings are by nature maximizing exchangers the present capitalist economic system is not essentially different from (only an improved or even perfected version of) earlier economic systems; (c) the market tends automatically to create the most efficient allocation of resources (indeed, it automatically creates "constrained bliss") such that no outside interference or reform could unambiguously augment human welfare; and (d) there is a certain ethical logic in the income distribution that obtains in a market capitalist system since it is assumed that each factor of production will earn a reward that is determined by its marginal productivity.

4 The Marxian Labor Theory of Value

The preanalytical vision that underlies the labor theory of value seems to be almost the very antithesis of that underlying the utility theory. Whereas the latter sees humans as essentially exchangers, the former sees them as producers. The labor theory rests on a preanalytical vision that focuses on the fact that the "crust" of the earth is an environment that is not immediately suitable for the sustenance of human life. The natural environment must be transformed if it is to support human life. Production *is* this transformation. And production has only one universally necessary ingredient: human labor. To be sure, the natural environment must exist in order to be transformed — something cannot be made from nothing. But to say that "land" (or natural resources) is a factor contribution to production in a manner analogous to the contribution of labor is seen as a form of fetishism. A tree cannot be chopped down if no tree exists, but no one says that a tree is chopped down partly by a lumberjack and partly by itself simply because it exists. The sun is as essential to human productive activity as is the crust of the earth. But no one speaks of the sun being a factor of production on the same footing as labor. On examination, of course, this is because we cannot be coercively excluded from making use of the sun while we can be so excluded from making use of natural resources. But coercive exclusion is not an essential element of production and it is therefore difficult to see how it should be the defining feature of what constitutes a "factor of production." Within the labor theory tradition coercion does not play this role and labor is the only universal factor of production (though labor theorists certainly accept the less than profound stipulation that human life and production cannot be sustained in an absolute void).

The second major difference between the two preanalytical visions is that whereas the utility theorists see humans in starkly individualistic terms (remembering that in neoclassical theory there is no important difference between exchanging with nature and exchanging with another human being), the labor theorists see humans as essentially and fundamentally social creatures (the historical roots of the word "socialism" can be found in precisely this distinction between the two views). Production is seen as always being a social process of interdependent social beings transforming a given, preexisting natural environment.

The individualism of the utility tradition causes this productive interdependence among human beings to be seen by utility theorists as a dependence of the isolated individual on a non-human material thing: capital. Thus, for example, if we see a carpenter building a house, the utility theorist sees three factors of production at work: first, the carpenter; second the wood, land and other natural resources; and third, the saw, the hammer, and the other tools. Each of these three factors is doing its separate part in building a house. Each factor produces and each receives a return determined by its productivity. The labor theorist sees this as a social process of transforming nature to make it habitable for human life. The process (which, of course, could not occur in the void of outer space) requires a large number of socially interdependent human beings working. Some humans are extracting natural resources, some are fashioning them into lumber, hammers, saws and other tools, and the carpenter is providing the last of these interdependent social exertions. Thus, when the utility theorists say that the lone carpenter depends on capital and that capital (in the forms of the hammer, saw, and other tools) produces just as the carpenter produces, the labor theorists insist that this is again a form of fetishism in which a purely human form of interdependent productive activity is seen as the productive "contribution" of a non-human, material thing.

From this preanalytical vision the labor theorist derives the value constants with which his/her set of simultaneous equations for prices become determinate. Again, as in the utility theory, there are two general sources for these constants: first, the quantitative magnitudes of the various portions of the labor force socially assigned to the various interdependent tasks; and second, the division of the product between those who produce and those who own. With this information the price equations become solvable.

The differences with the utility tradition are inevitable and are clearly derivable from the contrasting preanalytical visions: first, unlike the utility tradition, the labor theory tradition sees capitalism as a historically unique mode of production. It is a mode in which an individual's labor appears to be private rather than social (and this gives rise to the illusion that land and tools produce in the same way that people produce). This appearance is caused by the fact that in a capitalist system individual producers produce in isolation and in ignorance of their social and technological interdependence. The social nature of the individual's labor appears only as a price in an exchange. Thus, neoclassical economics as a social science deals elaborately with prices, interest rates, wage rates, profit rates, and so on, and only very sparingly with human beings — and then only with humans as that rarified abstraction "rational maximizing exchangers." Labor theorists, on the contrary, attempt to show that human behavior, including exchange behavior, is the outgrowth of sociality and is strikingly and importantly different from one socioeconomic system to another.

Second, since only labor produces, it follows that in a society in which laborers receive only a portion of what they produce and non-producers (usually through some system of ownership) receive the surplus, there is a fundamental, antagonistic conflict between these social classes. Therefore, whereas harmony is the normal state of affairs in utility theory, conflict is seen as the normal state of affairs by the labor theory — normal, that is, until that historical point at which non-producers cease having social, political, and economic control over producers.

Third, since the labor theory does not view individuals as asocial entities with metaphysically given desires, but rather sees desires as coming into being within the process of social interaction, it follows that labor theorists reject the ethical foundations of neoclassical efficiency analysis. The labor theorists generally deny the "well-behaved" utility and production functions as well. Thus, neoclassical efficiency analysis is seen as virtually entirely ideological and non-scientific.

Fourth, the rejection of the "well-behaved" production function is sufficient grounds to reject both the neoclassical income distribution theory and the ethical conclusions to which it leads. More importantly, however, the view that labor alone produces conduces to the view that under capitalism property income is derived from parasitic exploitation and ought ethically to be abolished. Indeed, the marginal productivity theory of distribution was developed because of this implication of the labor theory perspective. The most important originator of the marginal productivity theory of distribution, John Bates Clark, wrote:

> The welfare of the laboring classes depends on whether they get much or little; but their attitude of the social state — depends chiefly on the question, whether the amount that they get, be it large or small, is what they produce. If they create a small amount of wealth and get the whole of it, they may not seek to revolutionize society; but if it were to appear that they produce an ample amount and get only a part of it, many of them would become revolutionists, and all would have the right to do so. The indictment that hangs over society is that of "exploiting labor." "Workmen," it is said, "are regularly robbed of what they produce. This is done within the forms of law, and by the natural working of competition." If this charge were proved, every right-minded man should become a socialist; and his zeal in transforming the industrial system would then measure and express his sense of justice. (Clark 1965: 101)

It is clear that these contrasting preanalytical visions have most drastically conflicting practical and political implications. It is also clear that practical and ethical criteria are at least as important as empirical and logical criteria in choosing between the two theories of value.

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