

CHAPTER ONE

ON PRICE AND VALUE

With other chapters of this book substantially written, it was the opening chapter that presented the greatest difficulties. Though that might seem like completing first the house and then pouring its foundations, it was no accident. Rather, it reflected the condition of both our economy and of economic theory.. Both have lacked a grounding in reality.

At the most fundamental level, the concept of “value “ transcends and provides the benchmarks for assessing the claims of any economic or social system John McMurtry has dealt with the “value” concept at this level and established the benchmark criteria: “does it enhance the life-force and make for the fullest possible realization of human potential, or diminish it? 1 In that perspective any market growth that encroaches on the “civil commons” must be judged carcinogenous, whatever the quotation on any market may be.

The values of economic theory are essentially a bridge construct leading to the realization or evasion of such deeper moral values.. That ambiguity of their function is precisely why the concept of value at the deepest level is so essential to provide the ultimate criteria.

The pioneer economists of the seventeenth and earlier centuries did not suffer from this absence of a nexus with the world of reality. That link was assured by a notion of value distinct from the price of the last market transaction. A relationship between the two certainly existed, but in probing the social implications of trade, economists were not content to stop at market prices. For these could so be distorted by manipulation of supply or demand, quiet apart from abnormal weather and other contingencies.

Moorings to reality of these early enquiries were ensured mostly by one of two competing theories of value, both of which was distinguished from passing market price.1 Of these, the more common was the labour theory of value that explained the terms of exchange between two commodities by the relative amount of “average labour” that went into their production.2

“Average labour”, of course, was a vague concept and was seen by many as a weakness of the labour theory. Increasingly, however, the air-space of indeterminacy that it leaves has become a strength. For it makes possible the injection of other factors as their importance appears..

An example of this is the component of brute power such as the century enclosures that in Britain from the 15th century on, deprived many of a livelihood on the land, and left them at the mercy of the mill-owners. Or when the British conquerors in India stripped the work of the natives of much of its value embodied in their superior textiles, by denying them markets in favour of the conquerors’ inferior products. As the world grows in complexity, these gaps in determinacy of the labour theory of value gain in importance. Thus the chasm between the rewards to bond traders and the wages of highly skilled mechanics has risen wondrously, reflecting the power positions of bond traders in our society.

Globalisation enhances still further the significance of these air-spaces in the “average labour” value concept. The political and military contingencies today are reinforced by the increasing hazard of exchange rates of currencies, which in turn can be referred to the growing

might of speculators.

Today another of the early value theories is assuming increasing importance - the cost-of-production theory as employed, for example, by John Stuart Mill. If we wish to compare the value of the product of a public sector service today with that of a product of the market sector, we are up against a serious difficulty. The bulk of society's output today is marketed and hence priced. But the services of the public sector are not marketed, and lack a price tag. Instead they are distributed by political decision. Being unpriced, they are more often than not regarded as having no value. But that is obviously wrong, if only because without them the private sector itself could not function, nor could society survive. To help us over this difficulty the other of the two historical theories of value can be pressed into service - the cost-of-production theory of value. For the private sector this value model sums up the various costs of production and adds a margin of profit for the producer. For the public sector, the same procedure is followed, except for the absence of the profit component. Sovietologists followed this procedure to arrive at the aggregates of the Soviet economy. Here, too, it was only an approximation, with plenty of room for "air-spaces." Nonetheless, it provided some link with reality - something hard to assert of the "virtual economy" that has blossomed out of established marginal utility theory. Of course, in summing up costs for this value theory we are dealing with money costs and hence with prices. There is then an element of circular reasoning involved. However, one works with what is available. The important thing is to be aware of the insufficiencies of our materials. That in itself provides some insurance against dogma.

It is important to note the hybrid nature of economic theory - in part a would-be science, but also, consciously or otherwise, an essay in advocacy reflecting the interests of the ascendant group in society. Ignore the latter, and you will be at a loss to explain the disappearance from current economic discourse some of the key achievements of economic theory of a couple of generations ago.

Over the past quarter of a century, what had been a bias in the angle of observation, has grown into aggressive mind-control. As the stakes soared, the dominant view of the economy insulated itself against reassessment. It is then necessary to go back to the beginnings of this strange discipline to identify the critical turns in this development.

In the earliest period - say from the seventeenth to the mid nineteenth century, writers on economic theory enjoyed an immense freedom of range, evidenced by the number of competing theories. They could reach back to whatever period of history or prehistory, real or imagined, to help explain the economy of their day.

An outstanding example of this is Adam Smith, unjustly conscripted as regimental philosopher of today's "Leave everything to the market" corps. In fact, Smith's chair at the University of Edinburgh was "Moral Philosophy", and morality continued a principal concern in his great work *An Inquiry into the Nature and Causes of the Wealth of Nations* (1776). A lasting theme in his work was man's ability to form moral judgments on his own behaviour, despite his seemingly engulfing self-interest."Self-seeking men," he wrote, "are often led by an invisible hand..without knowing it, without intending it, to advance the interest of society".

Translated into flesh and blood, the agents of the "invisible hand" consisted of traders, and he spoke out in no uncertain terms against "entrusting government to the mean rapacity, the monopolizing spirit of merchants and manufacturers, who neither are, nor should be the rulers of mankind." 4

Of his fate today at the hands of those who see themselves as his militant followers, Jerry Z. Muller has written, "[Smith's] name is invoked by those who claim that the public good

springs automatically out of the pursuit of self-interest, who regard government as the enemy of liberty, and who cite Smith's principle of 'natural liberty' to defend the legalization of everything from pornography to guns and hard drugs.

"Far from an individualist, Smith believed that the influence of society transforms people into moral beings. He thought that people often misjudge their self-interest. He never used the term '*laissez-faire*' attributed to him, and believed that government expenses were bound to increase as civilization advanced. He regarded the attempt to explain all human behaviour on the basis of self-interest as analytically misguided and morally pernicious. In the society he intended to promote, men and women were freed from the traditional direct controls of political lords and state churches. But that had been made possible by the growth of central government, and it would only be desirable when coupled with a panoply of social institutions which fostered self-control."⁵

Smith wrote before the real beginnings of the Industrial Revolution. The factories around him still depended for its increasing productivity primarily on the division of labour described by him in detail. Mechanization and steam power were still at an rudimentary stage. The Union with Britain (1797) had opened England's colonies to Scottish enterprise. The large landowners were prominent investors in those overseas enterprises, in the improvement of agriculture, and in the conquest and administration of a spreading empire. In Smith's writings there is an intimate link between economic process and society. That is most apparent in his treatment of value which he distinguished from price and saw in the long run as determining the exchange ratios of commodities.

And here we come upon a unique feature of Smith's writing - his almost casual way of switching from one value theory to another. In his great book he explores every conceivable question of policy. That called for changing his angle of observation from the broader appreciations of the philosopher to the tighter reckonings of merchant, manufacturer and tax-collector."When concerned with basic human relations, he reaches back to 'that early and rude state of society that precedes the accumulation of stock and the expropriation of land' to formulate the labour theory of value: 'If it usually costs twice the labour to kill a beaver as it costs to kill a deer, a beaver will usually sell for twice as much as a deer.'

"Elsewhere he draws on two other value theories. One is a cost-of-production theory that sees value as the sum of its components - wages, profit, and rent - an adding up of columns of costs plus markups for profit - essentially the method of our accountants. "Elsewhere he uses as a measure of value, not 'embodied labour', but the amount of labour commanded by a commodity, i.e. the amount of labour that can be purchased with the proceeds of a commodity's sale" ⁶. His value theories call to mind the different focal lengths of the eye-glasses invented by his friend, Benjamin Franklin.

The British economy that Smith knew was still an inchoate affair. But the Napoleonic Wars and the ongoing industrial revolution, led to deeper social divisions. Large landowners profited mightily from the wartime interruption of cheap food imports. After the war, the attempt to prolong the landowners' bonanza with high tariffs on imported wheat led to a sharp conflict between them and the manufacturing class. David Ricardo (1772-1823), son of a Dutch-Sephardic stock-broker and himself apprenticed as a broker at age fourteen, brought that clash into its sharpest focus..

In his *Essay on the Influence of a Low Price of Corn on the Profit of Stock (1815)* Ricardo argued that a high tariff on grain imports increased the rents of country landowners at the expense of manufacturers. In his hands from the philosophical musings of Adam Smith,

value theory became as pointed and unidirectional as a battle pike. Not only was the labour expended in their production the measure of a commodity's value, but the wages that paid for that labour were determined by the cost of what workers required for surviving and reproducing. What remained went to the manufacturer. Rent - the income of the landowner - was a purely differential affair arising from the greater productivity of more fertile land over the least fertile brought under production to meet the nation's food requirements.. Ricardo was influenced by his friend Thomas Malthus to believe that wages will always remain at strict survival levels, since any improvement over that would merely bring on a higher birthrate among the incontinent poor.

Honed to such a cutting edge, the labour theory of value was pure manna to Karl Marx and other socialists. And this was at a time when the increasing militancy of the growing proletariat had come to people the nightmares of the propertied classes.

That brought on the end of the engaging openness of debates on economics that graced the age of Adam Smith and David Ricardo.

That had been possible because of the prevailing illiteracy of workers in the absence of free compulsory education. The danger had been scant that the frank discussion would reach the wrong eyes. But the spread of mechanics institutes changed that. Before long they were turning out highly educated, talented leaders among the humbler population. Their alumni included such eminences as Michael Faraday, arguably the greatest experimental physicist of all time, or George Boole, the inventor of Boolean logic that underlies not only mathematical logic but our digital revolution.

In his Afterword to the second German edition of *Das Kapital* (1873) Karl Marx noted the effect of the continental revolutions of 1848-9 on economic literature. . "Men who still claimed some scientific standing and aspired to be something more than mere sophists and sycophants of the ruling classes, tried to harmonize the Political Economy of capital with the claims, no longer to be ignored, of the proletariat. Hence a shallow syncretism, of which John Stuart Mill is the best representative. [In Germany] its professors fell into two groups. The one group, practical business folk, flocked to the banner of Bastiat, the most superficial and therefore the most adequate representative of the apologetic of vulgar economy. The other, proud of the dignity of their science, followed John Stuart Mill in his attempt to reconcile irreconcilables."

The social problem climaxed in the Paris Commune after France's defeat by Prussia in 1871. In that bloody context Ricardo's labour theory of value became unacceptable to the ruling classes. An urgent need arose for a value theory that would shift attention from the work-place to the market. Providentially, marginal theory arose to answer that need. Stanley Jevons in Britain and Karl Menger published their works on the subject in the exact year of the Commune and Leon Walras, the most mathematically ambitious of the three, brought out his in 1973.

Two powerful traits commended the new model. Workers were presented as plain traders, assessing the satisfactions they would derive from going to work at the wage offered compared to the delights of leisure in their parlours. Involuntary unemployment was dismissed as impossible. Only because those not working had decided that leisure was more satisfying, were they not at work. And of course Say's Law that supposedly guaranteed that there could be no problem of enough purchasing power if too many workers chose leisure: it held that every commodity by its very production created the market for its sale.

Besides, the use of a particular device of mathematics was mistaken for the ultimate credential of the new model's scientific soundness. In fact, mathematics tells us nothing about any non-mathematical subject. It merely lays bare the implications of what has been fed into the

premisses. If these do not reflect reality, no matter how much you refine them, the result can only be misleading..

To be able to apply the prestigious infinitesimal calculus, Walras and his disciples found it necessary to posit an economy in which all players were of such insignificant size that nothing that they did or left undone individually could affect prices . Their information other than the price of the last transaction was zero. They responded to price changes in a strictly behaviourist way - they went on buying or selling until they just broke even on the last transaction. But these premisses blew the exercise out of the water even then; in the age of Bill Gates they are utter nonsense, and accordingly are kept out of sight.

However, their unquestioned acceptance today gives us the measure of the trouble that we are in. .

Walras himself disposed of this difficulty by drawing a line between Applied and Pure Theory. (“Clearly, it would be necessary to prove that free competition leads to maximum utility.

Pure political economy is, after all, set up to abstract wholly from the matter of justice as well as from that of interest.”).⁷

. It is this “pure and perfect market” that underlies the mathematics supposed to establish the validity of all the policies of the past quarter of a century that have led the world into its present impasse - “zero inflation”, “the natural rate of unemployment”, deregulation and globalisation.

Even after the Paris Commune Walras encountered difficulties in obtaining acceptance for his model - particularly in his native France. For several reasons. . At the age of fourteen he had been an enthusiastic witness to the 1848 revolution, and throughout his life he used much socialist rhetoric to assuage his conscience having turned his back on his early ideals. But the very word “socialism” was anathema after the accession of Napoleon III, and even more so after the Paris Commune. Though Walras made amends by watering down his socialist verbiage to a mere advocacy of buying back the expropriated lands that had been auctioned off during the Revolution, the very word grated on the ears of those in the saddle.

Having been refused entry into the prestigious Polytechnic, and repeatedly failed his examinations at the Ecole des Mines, he even tried his luck as a novelist. But his father, Auguste Walras, had been a fervent student of economics with a leaning towards the utopian socialism of St. Simon and influenced his son to restructure economic theory. Hence the anomaly of the creator of the mathematical model of the self-balancing market considering himself a socialist.

There were other barriers to Walras’s mathematical model being accepted. Since 1877 the chairs of political economy in France were attached to the faculties of law, and lawyers were mostly innocent of any mathematics beyond grocery arithmetic.

What had positive results was less the general equilibrium aspect of his model, than its tabulation of the input-output relationships of production that he employed to set up its differential equations. Essentially it was the tableaux of Walras that some decades later inspired the input-output inter-industry analysis of Wassily Leontief.

All this did little to help Walras find academic employment. He obtained a position with the Northern Railway through a childhood friend, Leon Say, the grandson of J.B. Say, immortalized for “Say’s Law”. Together with Say he tried organizing cooperatives which were to replace social reform. Only when he had been reduced to accepting a job as bookkeeper of a small bank was he saved by an offer of a chair at the Academy of Lausanne.

Oddly enough, many socialists - including George Bernard Shaw - contributed to the

victory of his system in the early 20th century. Undoubtedly, it was in part his profession of socialism and his reverence for what seemed high technology of the day - the differential calculus - that helped his cause with them.

The most important contribution of the Walras system was its replacement of the real economy with a derivative of that economy - its rate of growth. That rate of growth, moreover, was assumed self-balancing. This was a giant step towards the “virtual” economy that lit up our skies until its recent collapse.

There is no way of coming to terms with that “virtual” economy without revisiting marginal utility theory that took over the world a century ago. Without this, no bridge exists to lead us back to the real economy that deals with the essential conditions for human survival. Marginal utility confuses scarcity with wealth. It validates the speculative increase of demand on the stock market as the most prolific multiplier of “value”. That makes it obligatory to rethink economic theory from the bottom up. There is no other way of recapturing space for humanity and the biosphere.

In the sixties the French economist Francois Perroux (1903 -1987) made a brilliant beginning at that task: “It is impossible to speak of a ‘psychology’ of maximization: one can only talk of a *rule* of maximization deduced from the algebraic properties of maxima and minima. The theory of general equilibrium is not the simplification of economic life as we are able to observe it; rather it is the polar opposite. At no time in the history of the Western people has it been possible to discern a trend towards the equality and homogeneity of units that one could express through stylization as units of equal dimension. Nor has there been a tendency to eliminate or reduce the elements of private power in merchant economy; nor a tendency toward the sovereignty on all markets of prices determined by anonymous forces arising in equal measure from the contributions of all participants. General equilibrium is a gymnastic exercise of the mind that reduces the action of people to mechanically organized forces, which under the set conditions will inevitably yield the expected results. It is the product of a combination of simple mathematics, distorted observations, and - unconsciously without doubt - an apologetic attitude”

8 And then to explain the massive resistance to so complete a refutation of the general equilibrium model, Perroux arrives at his momentous conclusion: “Distribution is the end product of a record of struggles that always reflect the relationship of forces. Power asserts itself through information and constraint.” Against the providential equilibria of marginal theory, he sets up the reality of macro-decisions. These are taken by structured macro-units - firms and governments - through conscious, informed intention rather than as behaviourist responses to the stimuli of price. “When such a unit has made a structured decision, it is always possible for an observer to *reconstruct* the decision along marginal lines. The observer thus *assumes* that the unit has proceeded by adding and subtracting tiny dosages until it has attained the new structure and volume”.

The notion of changing structure is closely linked to that of a ‘dominant revenue’.

“The European Occident has passed through successive periods of development, each characterized by a typical morphology of distribution and by a dominant revenue..

“In turn the dominant revenue has been that of the landowners, then industrial profit, then financial and industrial profits in a mixed economy, in which the rate and masse of profit are functions of a complex combination of public and private, of market and extra-market actions.

“During a specific period of development, the dominant revenue is the one to which the

others adapt themselves. In an apologetic doctrine it is represented as the revenue that, by the rate and mass which it achieves, determines whether the given economy functions properly. In the institutional framework corresponding to the given dominant revenue, that in fact is the case; but in another context it would be otherwise".⁹

Since Perroux wrote those lines the dominant revenue has shifted first to money-lenders and bankers, then to speculative finance with banks assuming a prominent participation.

Considering the means of dealing with this threatening situation is the purpose of the present book.

1. *Unequal Freedoms - The global market as an ethical system*, Garamond Press, Toronto 1998,
2. Joan Robinson, in *Economic Philosophy*, Aldine Press, Chicago, 1962, pp. 7-9, dismisses value theories as "metaphysical". But let us not deceive ourselves. Doing so would leave us captive of the value theory that we were brought up in - in her case marginal utility. Implicitly identifying value with the last market price holds special perils in the era of globalisation and deregulation when money creation is entrusted increasingly to stock markets and derivative boutiques..
3. Thus Karl Marx (*CAPITAL, A Critical Analysis of Capitalist Production, Translated from the third German edition, by Samuel Moore and Edward Aveling and edited by Friedrich Engels, Vol. 1, Progress Publishers, Moscow 1965, Vol. 1, p. 51*) wrote: "The celebrated [Benjamin] Franklin, one of the first economists, after Wm. Petty, who saw through the nature of value, says: 'Trade in general being nothing else but the exchange of labour for labour, the value of all things is...most justly measured by labour'.
4. Adam Smith, *The Wealth of Nations*, Dent, London, Everyman's Library, 1910, Vol. 1, p.436.
5. Jerry Z. Muller, *Adam Smith in his Time and Ours - Designing the Decent Society*, The Free Press, New York, 1993. "The search for knowledge of the passionate, egoistic origins of virtuous behaviour spread [from the Jansenist sect in Catholicism] to French, British and Dutch analysts who sought to improve man's worldly behaviour through harnessing this knowledge rather than warning of inadequacy as a means to salvation." p. 51
6. William Krehm *Price in a Mixed Economy - Our Record of Disaster*, Toronto 1975, p. 123. *Elements d'economie politique pure*, Oeuvres économiques complètes d'August et Leon Walras, Paris, *Economica*, ed. Claude Hebert et Jean-Pierre Potier, 1987 quoted in Pierre Dockes, *La Société n'est pas un pique-nique*, Leon Walras et l'Economie Sociale, *Economica*, Paris, 1996, p. 11. Translation by W.K.
8. Francois Perroux, *Economie et Société - contrainte - échange - don* (Paris, Presses Universitaires de France, 1960, p. 7)
9. Francois Perroux, *L'Entreprise et l'économie du Xxe siècle* (Paris, Presses Universitaires de France, 1966) p. 958.