Value (economics)

In economics, **economic value** is a measure of the benefit provided by a good or service to an economic agent, and **value for money** represents an assessment of whether financial or other resources are being used effectively in order to secure such benefit. Economic value is generally measured through units of currency, and the interpretation is therefore "what is the maximum amount of money a person is willing and able to pay for a good or service?" Value for money is often expressed in comparative terms, such as "better", or "best value for money",[1] but may also be expressed in absolute terms, such as where a deal does, or does not, offer value for money.[2]

Among the competing schools of economic theory there are differing theories of value.

Economic value is *not* the same as market price, nor is economic value the same thing as market value. If a consumer is willing to buy a good, it implies that the customer places a higher value on the good than the market price. The difference between the value to the consumer and the market price is called "consumer surplus".[3] It is easy to see situations where the actual value is considerably larger than the market price: purchase of drinking water is one example.

Overview

The economic value of a good or service has puzzled economists since the beginning of the discipline. First, economists tried to estimate the value of a good to an individual alone, and extend that definition to goods that can be exchanged. From this analysis came the concepts *value in use* and *value in exchange*.

Value is linked to price through the mechanism of exchange. When an economist observes an exchange, two important value functions are revealed: those of the buyer and seller. Just as the buyer reveals what he is willing to pay for a certain amount of a good, so too does the seller reveal what it costs him to give up the good.

Additional information about market value is obtained by the rate at which transactions occur, telling observers the extent to which the purchase of the good has value over time.

Said another way, value is how much a desired object or condition is worth relative to other objects or conditions. Economic values are expressed as "how much" of one desirable condition or product will, or would be *given up* in exchange for some other desired condition or product. Among the competing schools of economic theory there are differing metrics for value assessment and the metrics are the subject of a theory of value. Value theories are a large part of the differences and disagreements between the various schools of economic theory.

Explanations

In neoclassical economics, the value of an object or service is often seen as nothing but the price it would bring in an open and competitive market. This is determined primarily by the demand for the object relative to supply in a perfectly competitive market. Many neoclassical economic theories equate the value of a commodity with its price, whether the market is competitive or not. As such, everything is seen as a commodity and if there is no market to set a price then there is no economic value.

In classical economics, the value of an object or condition is the amount of discomfort/labor saved through the consumption or use of an object or condition (Labor Theory of Value). Though exchange value is recognized, *economic value* is not, in theory, dependent on the existence of a market and price and value are not seen as equal. This is complicated, however, by the efforts of classical economists to connect price and labor value. Karl Marx, for one, saw exchange value as the "form of appearance" (This interpretation of Marx is along the lines of the Marxist thinker Michael Heinrich) [*Erscheinungsform*] of value, in his critique of political economy which implies that, although value is separate from exchange value, it is meaningless without the act of exchange.

In this tradition, Steve Keen makes the claim that "value" refers to "the innate worth of a commodity, which determines the normal ('equilibrium') ratio at which two commodities exchange."[4] To Keen and the tradition of David Ricardo, this corresponds to the classical concept of long-run cost-determined prices, what Adam Smith called "natural prices" and Marx called "prices of production". It is part of a cost-of-production theory of value and price. Ricardo, but not Keen, used a "labor theory of price" in which a commodity's "innate worth" was the amount of labor needed to produce it.

"The value of a thing in any given time and place", according to Henry George, "is the largest amount of exertion that anyone will render in exchange for it. But as men always seek to gratify their desires with the least exertion this is the lowest amount for which a similar thing can otherwise be obtained."[5]

In another classical tradition, Marx distinguished between the "value in use" (use-value, what a commodity provides to its buyer), labor cost which he calls "value" (the socially-necessary labour time it embodies), and "exchange value" (how much labor-time the sale of the commodity can claim, Smith's "labor commanded" value). By most interpretations of his labor theory of value, Marx, like Ricardo, developed a "labor theory of price" where the point of analyzing value was to allow the calculation of relative prices. Others see values as part of his sociopolitical interpretation and critique of capitalism and other societies, and deny that it was intended to serve as a category of economics. According to a third interpretation, Marx aimed for a theory of the dynamics of price formation but did not complete it.

In 1860, John Ruskin published a critique of the economic concept of value from a moral point of view. He entitled the volume *Unto This Last*, and his central point was this: "It is impossible to conclude, of any given mass of acquired wealth, merely by the fact of its existence, whether it signifies good or evil to the nation in the midst of which it exists. Its real value depends on the moral sign attached to it, just as strictly as that of a mathematical quantity depends on the algebraic sign attached to it. Any given accumulation of commercial wealth may be indicative, on the one hand, of faithful industries, progressive energies, and productive ingenuities: or, on the other, it may be indicative of mortal luxury, merciless tyranny, ruinous chicanery." Gandhi was greatly inspired by Ruskin's book and published a paraphrase of it in 1908.

Economists such as Ludwig von Mises asserted that "value" is a subjective judgment. Prices can only be determined by taking these subjective judgments into account, and that this is done through the price mechanism in the market. Thus, it was false to say that the economic value of a good was equal to what it cost to produce or to its current replacement cost.

Silvio Gesell denied value theory in economics. He thought that value theory is useless and prevents economics from becoming science and that a currency administration guided by value theory is doomed to sterility and inactivity.[6]

Connected concepts

The theory of value is closely related to that of allocative efficiency, the quality by which firms produce those goods and services most valued by society. The market value of a machine part, for example, will depend upon a variety of objective facts involving its efficiency versus the efficiency of other types of part or other types of machine to make the kind of products that consumers will value in turn. In such a case, market value has both objective and subjective components.

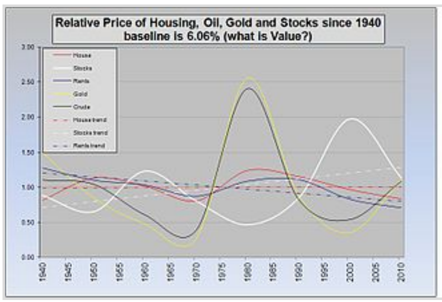
Economy, efficiency and effectiveness, often referred to as the "Three Es", may be used as complementary factors contributing to an assessment of the value for money provided by a purchase, project or activity. The UK National Audit Office uses the following summaries to explain the meaning of each term:

- Economy: minimising the cost of resources used or required (inputs) – *spending less*;
- Efficiency: the relationship between the output from goods or services and the resources to produce them – *spending well*; and
- Effectiveness: the relationship between the intended and actual results of public spending (outcomes) – *spending wisely*.[7]

Sometimes a fourth 'E', equity, is also added.[7][8]

In philosophy, economic value is a subcategory of a more general philosophical value, as defined in goodness and value theory or in the science of value.

Theories



Value or price

Adam Smith agreed with certain aspects of labor theory of value, but believed it did not fully explain price and profit. Instead, he proposed a cost-of-production theory of value (to later develop into exchange value theory) that explained value was determined by several different factors, including wages and rents. This theory of value, according to Smith, best explained the natural prices in the market. While an underdeveloped theory at the time, it did offer an alternative to another popular value theory of the time.

The utility theory of value was the belief that price and value were solely based on how much "use" an individual received from a commodity. However, this theory is rejected in Smith's work

The Wealth of Nations. The famous diamond–water paradox questions this by examining the use in comparison to price of these goods. Water, while necessary for life, is far less expensive than diamonds, which have basically no use. Which value theory holds true divides economic thinkers, and is the base for many socioeconomic and political beliefs.[9]

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Labor theory of value

In classical economics, the labor theory of value asserts that the economic value of a commodity is determined by the total amount of socially necessary labor required to produce it. When speaking in terms of a labor theory of value, value without any qualifying adjective theoretically refers to the amount of labor necessary for the production of a marketable commodity, including the labor necessary for the development of any capital used in the production process. Both David Ricardo and Karl Marx attempted to quantify and embody all labor components in order to develop a theory of the real, or natural, price of a commodity.[11]

In either case, what is being addressed are general prices—i.e., prices in the aggregate, not a specific price of a particular good or service in a given circumstance. Theories in either class allow for deviations when a particular price is struck in a real-world market transaction, or when a price is set in some price fixing regime.

Monetary theory of value

Critics of traditional Marxian economics, especially those associated with the Neue Marx-Lektüre (New Readings of Marx) such as Michael Heinrich, emphasize a **monetary theory of value**, where "Money is the necessary form of appearance of value (and of capital) in the sense that prices constitute the only form of appearance of the value of commodities."[12] Similarly to the exchange theory, this theory emphasizes value as being socially determined, rather than having a physical substance.

According to this analysis, when money incorporates production into its M-C-M' circulation, it functions as capital implementing the capitalist relation and the exploitation of labor power constitutes the actual presupposition for this incorporation.[13]

Power theory of value

Radical institutional economists Jonathan Nitzan and Shimshon Bichler (2009) argue that it was never possible to separate economics from politics.[14] This separation is required to allow for neoclassical economics to base their theory on utility value and for Marxists to base the labour theory of value on quantified abstract labour. Instead of a utility theory of value (like neoclassical economics) or a labour theory of value (as found in Marxian economics), Nitzan and Bichler propose a **power theory of value**. The structure of prices has little to do with the so-called "material" sphere of production and consumption. The quantification of power in prices is not the consequence of external laws—whether natural or historical—but entirely internal to society.

In capitalism, power is the governing principle as rooted in the centrality of private ownership. Private ownership is wholly and only an act of institutionalized exclusion, and institutionalized exclusion is a matter of organized power.[15][16] And since the power behind private ownership is denominated in prices, Nitzan and Bichler argue, there is a need for a power theory of value. There is, however, a causality dilemma to their argument that has drawn criticism: power is based on the ability of firms to set monopoly prices yet the ability to set prices is based on firms possessing a degree of power in the market.

Capitalization, in their theory, is a measure of power, as illuminated through the present discounted value of future earnings (while also taking into account hype and risk). This formula is basic to finance which is the overarching logic of capitalism. The logic is also inherently differential as every capitalist strives to accumulate greater earnings than their competitors (but not profit maximization). Nitzan and Bichler label this process differential accumulation. In order to have a power theory of value there needs to be differential accumulation where some owners' rate of growth of capitalization is faster than the average pace of capitalization.

Subjective theory of value and marginalism

The subjective theory of value emphasizes the role of consumer preferences[17] in influencing price. According to this theory, the consumer places a value on a commodity by determining the marginal utility, or additional satisfaction of one additional unit.[18][19] Marginalism employs concepts such as marginal utility, marginal rate of substitution, and opportunity costs[20] to explain consumer preferences and price.

Subjectivist or marginalist theories of value were created by William Stanley Jevons, Léon Walras, and Carl Menger in the late 19th century.[21] These theories contradicted earlier labour theories of values proposed by classical economists which emphasize the role of socially necessary labour in producing value.[22] The subjective theory of value helped answer the "diamond–water paradox," which many believed to be unsolvable. The diamond–water paradox questions why diamonds are so much more valuable than water when water is necessary for life. This paradox was answered by the subjective theory of value by realizing that water, in total, is more valuable than diamonds because the first few units are necessary for life. The key difference between water and diamonds is that water is more plentiful and diamonds are rare. Because of the availability, one additional unit of diamonds exceeds the value of one additional unit of water.[22] The subjective theory emphasizes the role of supply and demand in determining price. A more recent view, incorporating quantum and information theories, using the granular interactions thinking mechanism, proposes the informational entropy-based notion of value. [23]

See also

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- Asset pricing
- Labour theory of value
- Law of value
- Marginal theory of value
- Market price
- Non-extractive economic value
- Objective theory of value
- Paradox of value

- Real versus nominal value (economics)
- Store of value
- Subjective theory of value
- Theory of value (economics)
- Use value
- Utility
- Value (marketing)
- Value form
- Value network

Further reading

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