

✓ About

✓ THEORY

of

✓ VALUE

CLASSICAL LABOUR THEORY OF VALUE:

Smith:	Ricardo:	Marx:
<p>1) Labour theory of value in a primitive society:</p> <ul style="list-style-type: none"> In a society in which labour was the only resource, the relative value of a good would be determined by the amount of labour necessary to produce it Labour is the real measure of the exchangeable value of all commodities <u>Labour</u> is both the source and the measure of <u>exchange value</u> <p>2) Labour theory of value in an advanced economy:</p> <ul style="list-style-type: none"> Growth of capital would invalidate a simple labour cost theory of value Society where capital investments and land resources become important, goods will normally be exchanged for other goods, for money or for labour at a figure high enough to cover wages, rent and profits Profits will depend on the whole value of the capital advanced by the employer. <u>Real value</u> of commodities can be measured by the quantity of labour which they can, each of them, purchase or command The quantity of labour that a commodity can buy exceeds the quantity of labour embodied in its production by the total profits and rents 	<ul style="list-style-type: none"> Was concerned with relative values Discover the ratio of exchange between commodities Processing utility or use value, commodities derive their <u>exchange value</u> from <u>2 sources</u>: 1) Scarcity 2) Quantity of labour required to obtain them Commodities that are reproducible – produced without restraint under conditions of competition Reproducible goods to which Ricardo applied his labour theory of value Ricardo applied his labour theory of value to an advanced economy Felt Smith's distinction between the 2 types of economies was artificial The exchange value of a commodity depends on the labour time necessary to produce it Labour time includes not only work done 	<ul style="list-style-type: none"> Started with analysis of commodities in capitalist society Commodity: something produced for profit and capable of satisfying human wants Commodity can satisfy wants directly (subsistence) or indirectly (production) Use values constitute the substance of all wealth Commodity has exchange value or value Socially necessary labour time embodied in the commodity, considering normal conditions of production and the average skill and intensity of labour at the time determines the value of a commodity Socially necessary <u>labour time</u> includes <u>direct labour</u> in producing the commodity, <u>labour embodied in machinery</u> and <u>raw materials</u> used up during the process of production and the <u>value transferred to the commodity</u> during the process Marx: Temporary fluctuations of supply and demand cause prices to deviate from the values sometimes rising above or falling below values Continual oscillation of prices reduces themselves to average prices that reflect

labour = only resource → value = necessary to produce.

↑K

Q. of L

labour time = work done in making
 commodity + work in
 raw materials + capital goods

<ul style="list-style-type: none"> • Demand does not influence the value of commodities; the cost of production (wages, rent and profits) are the only determinants of value in the long run <p>MR value = costs of production (wages, rent, profits) determine value.</p>	<p>in making the commodity itself but also used in work embodied in raw materials and capital goods used up in the process of production</p> <ul style="list-style-type: none"> • Advantage is that it could be used to determine the causes of changes in exchange values over time • Problems with simple theory of value is that it does not seemingly account for such factors as: <ol style="list-style-type: none"> 1) Differences in K-L ratios among industries 2) Differences in labour quality 3) Variations in wages, profits and rents 	<p>the values of commodities Marx differed from Ricardo's: Marx: labour time determines the absolute value of goods and services</p> <ul style="list-style-type: none"> • Ricardo: believed that relative values of different commodities are proportional to labour time embodied within each • Marx believed that his labour theory of value stripped away the illusion that <u>owners of land and capital contribute to a commodities value</u> • His theory opened the door to a <u>theory of exploitation of labour</u>
<ul style="list-style-type: none"> • Any increase in demand will not increase value because the costs of producing each unit of the commodity remain unchanged 		

SAY'S

LAW →

Write an essay on Say's Law (supply creates its own demand) in which you pay attention to:

- Why, according to Say, the law holds:

Underdeveloped economies are characterised by low output and low income payments to people. As an economy grows, it simultaneously generates an increase supply of goods and increase payments to the factors of production, which generate an increase demand for goods.

$\uparrow \text{economy} \rightarrow \uparrow S \rightarrow \uparrow \text{payments to FOP} \rightarrow \uparrow D$

International trade: as a country produces more; it can export more, and therefore can afford to import more (domestic and foreign trade), 'supply creates its own demand' in the long run. Does not hold true in the short run in market-based economies.

Payments to FOP would be enough to buy all goods produced, there is no guarantee that the recipients of these income payments will spend them on existing output.

- Malthus's advocacy of the Corn Laws:

Defended the corn laws and unproductive consumption, served the interest of landlords.

- Why according to Marx, the law does not hold

Refer to Marx's schematic $M \rightarrow C \rightarrow M'$ in this context:

Marx attacked Say's law, stating that at best it applied only to simple commodity production.

[Self-employed small artisans] seeking to acquire use values, produce commodities in order to exchange them for others they wish to consume.

Example:

The weaver of linen sells it and uses the money to buy food. $C \rightarrow M \rightarrow C$, C represents commodities
linen and food. Linen Food

Money is the medium of exchange

[Large-scale capitalist production:]

The process of exchange becomes $M \rightarrow C \rightarrow M$, where people buy in order to sell. Money is changed into commodities such as labour power, raw materials, and machinery. Products are then sold for money. This does not make sense if the 2 M's are equal.

The correct representation of the capitalist process is $M \rightarrow C \rightarrow M'$, where $M' > M$ by the amount of surplus value squeezed out of the productive workers:

- 1) Process of expanding investment
- 2) Rapid investment in K and L temporarily increases D for labour and increases wages capitalists must pay
- 3) Higher wages, decrease rates of surplus value and profit, ending expansion – sending the economy in the opposite direction

$\uparrow I$
 $\uparrow K+L \rightarrow$
 $\uparrow \text{labour} \rightarrow$
 $\uparrow \text{wages}$
 $\text{wages} \rightarrow \downarrow \text{rates of surplus value}$
 $\downarrow \text{profit}$

- **Why, according to Keynes, the law does not hold.**

Refer to Keynes's different treatment of consumption and investment spending:

Consumption:

Keynes pointed to a 'fundamental psychological law' concerning the relationship between consumption and income.

There is a positive functional relationship between consumption (C) and income (Y):

- $C = f(Y)$
- $MPC = \text{Change in } C / \text{Change in } Y$ (positive and less than one)

Savings is also a positive function of income:

- $S = f(Y)$
- $MPS = \text{Change in } S / \text{Change in } Y$ (positive and less than one)

Investment:

Keynes defined economic investment as the purchase of capital goods. Unintended investment occurs when sales decrease and inventories of unsold goods increase.

↓ sales → ↑ inventories goods

Economic investment vs financial investment: purchase of bonds, stocks and other financial instruments.

Financial investment is not investment in the Keynesian sense because it does not directly represent purchases of capital goods.

Business undertake investment on the expectation that the new capital will add to profits.

Keynes's investment decision = supply price or replacement cost of the asset

The supply price of the piece of capital is the price that would be just sufficient to cause the manufacturer of the capital to produce one additional unit.

Marginal efficiency of capital: equal to that rate of discount that makes the present value of the series of expected returns just equal to the supply price of the capital asset.

Keynes said:

Increase investment in any type of capital, decreases marginal efficiency of that capital.

Reasons: 1) profits decrease as increase amounts of investment compete with one another

2) marginal efficiency of capital – construct an investment demand curve

$I = f(i)$: inverse relationship between rate of interest (i) and investment (I)

*I →
marginal
efficiency
of capital*

- **According to Chicago School, How Say's law can be made to hold in a modern economy:**

Tenets:

- 1) Optimising behaviour: people attempt to maximise their well-being; engage in optimising behaviour at the time of their decisions
- 2) Observed prices and wages tend to be good approximations of their long-run competitive ones
- 3) Mathematical orientation: relies heavily on mathematical theorising (partial equilibrium method and general equilibrium approach)
- 4) Rejection of Keynesianism: Economy is self-adjusting and regulating. Recessions result from inappropriate monetary policy, not from changes in spending
- 5) Limited government: Government is inherently inefficient as an agent for achieving objectives that can be satisfied through private exchange

Benefit:

Market system, left free of government interference, produces maximum economic freedom.

Yields maximum individual and collective well-being (Chicago view benefits society)

- **How was Chicago School valid, useful, or correct in its time:**

- 1) Maintained and strengthened the marginalist tradition
- 2) Kept alive monetary views of Fisher during a period when they could have been buried by Keynesian ideas

- **Tenets became lasting contributions:**

Chicago theories of human capital, household production, job search, and discrimination discussed in textbooks on labour economics.

K
EYNES



The Keynesian school → Keynes

- 1) Macroeconomic emphasis =
 - determinants of total aggregate amounts of consumption, saving, income
- 2) Demand orientation =
 - importance of effective demand as a determinant of national income and output
- 3) Instability in the economy =
 - economy is given to recurring booms and busts
- 4) Wage and price rigidity =
 - wages tend to be inflexible downward because of institutional factors such as union contracts
- 5) Active fiscal and monetary policies =
 - Government should intervene in monetary and fiscal policies to promote full employment, price stability and economic growth

Whom did the Keynesian school benefit or seek to benefit?

- addressed depression and unemployment
- tax cuts stimulated demand and economic growth

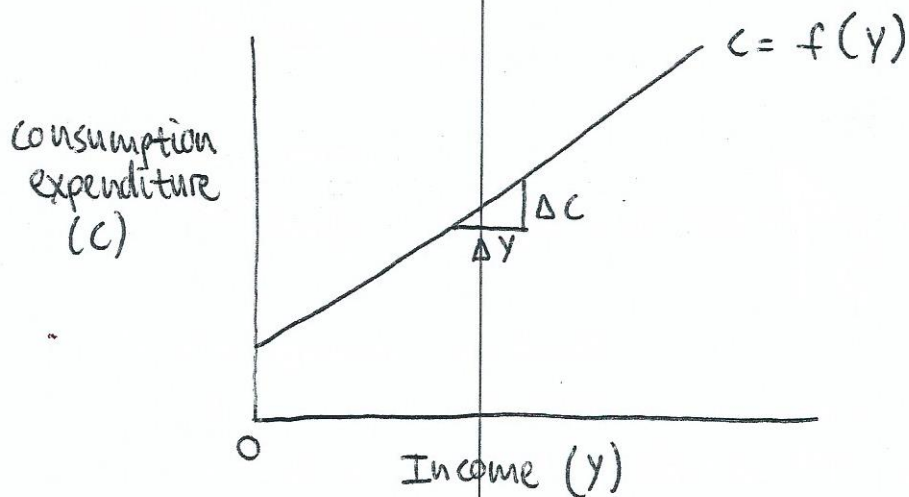
How was the Keynesian School valid, useful or correct in its time?

- geared economic theory to policy making
- Explained business fluctuations
- role of economists in shaping government policy
- general reduction of nominal wages is bad economic policy

lasting contributions =

- consumption function	- M + F policy	- IS-LM analysis
- multiplier	- MP/	

Figure 21-1 = The consumption function



National income \uparrow , consumption also \uparrow but not as much as the \uparrow in income

Slope ($\Delta C / \Delta Y$) of the consumption function $C = f(Y)$ measures the marginal propensity to consume

$$MPC = \frac{\Delta C}{\Delta Y}$$

MARGINALIST
SCHOOL



Marginalist School =

Focus on margin =

The marginal principle that Ricardo developed to all economic theory

Rational economic behaviour =

Assumed people act rationally in balancing pleasures and pains and in measuring marginal utilities of different goods

Microeconomic emphasis =

Individual and firm take centre stage

The use of abstract, deductive method =

Marginalists rejected the historical method in favour of the analytical method.

Pure competition emphasis =

Based their analysis on pure competition

Demand-oriented price theory =

Demand was the primary force in price determination

Emphasis on subjective utility =

Demand depends on marginal utility

Equilibrium approach =

Economic forces generally tend toward equilibrium - a balancing of opposing forces

Write an essay on institutionalist economics in which you pay attention to the following:

- **Reaction against marginalist-neoclassical economics:**

Veblen's theory of the leisure class constituted an attack on neoclassical economic, which assumed that consumers are sovereign.

Veblen: in making economic man into social man upset the (laissez-faire) policy implications of neoclassical consumption theory

Veblen attacked neoclassical thought directly:

- Veblen also accused the neoclassicist's of supporting the present scheme of the distribution of wealth and income
- Veblen was concerned with social economic instead of the business economics of the business of price, profit, and ownership
- Veblen attacked the notion of perfect competition, which then dominated standard economic theory. He recognised that most businessmen had some monopolistic control over the prices they charged and that they used advertising to strengthen their market positions
- **Meaning of institutions and their role:**

Focus on institutions:

- The school emphasised the role of institutions in economic life
- An institution is not merely an organisation or establishment for the promotion of a particular objective, like a school, a prison, a union, or a bank
- It is an organised pattern of group behaviour well established and accepted as a fundamental part of the culture → customs, laws, habits, ways of living
- Institutionalists were especially interested in analysing and reforming the institutions of credit and distribution of income

- **Veblen's concept of 'the leisure class:'**

1) Conspicuous consumption:

- Leisure class is engaged in the predatory seizure of goods without working them for them
- Consume in a way that display their wealth; a show of wealth indicates power and success

2) Propensity to avoid useful work:

- Members of the leisure class must avoid useful, productive work
- Must indulge only in wasteful and useless tasks if they are to remain reputable

3) Conservatism:

- Veblen asserted that the evolution of social structure has been a process of natural selection of institutions
- Progress can be attributed to the survival of the fittest habits of thought and the enforced adaptation of individuals to a changing environment

- **Veblen's views on the credit system:**

Credit plays a special role in modern business

Borrowing money can increase profits as long as the current rate of business

earnings > rate of interest

Competitive use of credit in extending business operations gives an enterprise an

advantage against other competitors. Credit expansion has no aggregate effect on

earnings or on output

Workers benefit during prosperity through fuller employment

Increase in price level, increases cost of living, decreasing real wages

$\uparrow P \rightarrow \uparrow \text{cost of living} \rightarrow \downarrow \text{real wages}$

- **Galbraith's views on the 'technostructure' and its purpose control over the operation of the corporation is exercised by the technostructure:**

The technostructure is a professional elite consisting of executives, managers, engineers and scientists.

Galbraith said: it is naïve to assume that the technostructure has an incentive to maximise the return anonymous shareholders

The technostructure purposes:

1) Protective purpose:

- Survival of the firm

- Need to earn a profit sufficient to keep most stockholders happy and to provide sufficient retained earnings for investment and growth

2) Affirmative purpose:

- Corporate growth

- Growth of output, sales, and revenue produces greater employment security and financial rewards to the members of the technostructure

Earn a profit \rightarrow
stockholders happy

retained earnings = I + growth

\uparrow sales \rightarrow employment
security/financial rewards

Tenets: 1) Holistic, broad perspective = • Examined the economy as a whole instead of small sectors isolated from the whole.

2) Focus on institutions = • Emphasis on the role of institutions in economic life.

• not an establishment for the promotion of a particular objective \rightarrow school

3) Evolutionary approach = • organised pattern of group behaviour, accepted as a fundamental part of the society and institutions are constantly changing culture, customs, laws, habits, ways of living

4) Rejection of the idea of normal equilibrium = • principle of circular causation that may salutary or harmful in achieving economic and social goals

5) Clashes of interest = recognised major differences and clashes of interests. Eg: big businesses v/s small businesses

6) liberal, democratic reform = • political economy espoused reforms in order to bring about a proper distribution of wealth

7) Rejection of pleasure-pain psychology = • reached ~~out~~ out instead for a better psychology

Write an essay on the law of motion of capitalist society according to Marx:

- The theory of exploitation:

Marx assumed that all commodities sell at their value. How does the capitalist receive profit then. According to Marx, the answer is by purchasing the one commodity that can create a value greater than its own. This commodity is labour power.

Marx's concepts of labour power and labour time:

1) Labour power:

- Refers to a person's ability to work and produce commodities.
- Is itself a commodity that is bought and sold in the market; it is what the capitalist needs to make profits.

2) Labour time = actual process and duration of work

What determines the value of labour power?

- The socially necessary labour time required to produce the cultural necessities of life consumed by the labourers and their families.
- If these necessities could be produced in 4 hours per day, the value of the commodity labour power would be 4 hours of labour time per day.
- If the productivity of labour doubled, so that the commodities could be produced at 2 hours per day, the value of labour power would fall 50%
- Important points:
 - 1) Employers pay wages to workers equivalent to the workers' labour power, that is they pay the going market wage
 - 2) This market wage is sufficient only to purchase the cultural subsistence required for survival and perpetuation of the labour force
- For Marx – the reason for this subsistence wage is not excessive population growth (he rejected Malthus's law of population)
- Marx felt that capitalism produces a large reserve army of the unemployed, and this excess supply of labour means that in the long run the average wage will remain near the cultural level of subsistence

- Surplus value:

The exploitation of workers (extraction of surplus value by capitalists) cannot occur when the productivity of labour is so low that the workers have to consume goods equivalent in value to their own output in order to survive.

- If that were the case – the value of a day's labour power would be a day's labour time
- Marx said – exploitation of labour arises only when workers can produce more in a day than they must consume in order to maintain themselves and their families
- The employers must pay the workers the full market value of their labour power (but the daily pay equals only part of the value the labourers create)

- Employers ownership of capital thus possess that which workers need to gain subsistence: jobs that pay wages
- Capitalists can set the length of the workday and in a sense say, 'work the number of hours that we set or choose not to work at all)
- Necessity forces ~~to~~ workers to work
- The labour time they spend during the workday creates a larger sum of values than the value of their own labour power, the costs of subsistence
- The owners of the means of production garner a surplus value

- The rate of surplus value:

constant capital = machinery and raw materials.

Marx designated the part of capital invested in machinery and raw materials as constant capital (c).

variable capital = wages, labour power

- The value of this capital is transferred to the final product without any increase
- The capital that goes for wages, for the purchase of labour power – is variable capital (v)
- It produces a value greater than its own
- The extra value it produces, which the capitalists takes without compensating the workers who produce it, is surplus value (s) *K = Extra value → capitalists take → surplus value*
- The rate of the surplus, or the rate of exploitation is given as $s' = s/v = \frac{\text{Surplus value}}{\text{variable capital}}$

- The rate of profit:

Marx's formulation: is the ratio of surplus value to the total capital invested

$$p' = s/(c + v) = \frac{\text{Surplus value}}{(\text{constant } K + \text{variable } K)}$$

- The transformation problem:

1) Marx assumed that all commodities are sold at their values

2) Labour, v, is the sole source of value

3) Industries that employ a large amount of machinery and raw materials, c, and a small amount of labour, v, will have a lower surplus value, s, and profit rate on their capital, p', than industries that employ a small amount of constant capital, c, and a large amount of labour, v.

This is the case because labour is the only commodity that can be exploited for profit

4) Following from 3). It contradicts what Marx knew from his own observation: Mechanised industries, using much capital and little labour, have at least as high a rate of profit as industries using little capital and much labour. *used of more K than L = high rate of profit*

Like the classical economics, Marx knew that profit rates tend to equalise among industries

5) If profit rates are uniform and capital-to-labour ratios vary among industries, then commodities will not sell at their values as Marx assumed. This appears to be a significant contradiction in Marx's analysis

Marx concluded that the selling prices of commodities produced in constant-cost, capital intensive industries will sell above their values.

K-intensive industries = commodities sell ↑ values.

L-intensive industries = commodities sell ↓ values

Where as, labour-intensive commodities will sell at prices below their true values.

- According to Marx, the labour theory of value still holds, but only for the capitalist system as a whole
- Individual commodities will sell at prices above or below their values in order to equalise rates of profit for the whole economy
- There is much debate whether Marx successfully handled this transformation problem
- There is also a debate over the consequences of a faulty labour theory for his overall theory of capitalist development

- The falling rate of profit:

L/R = Rate of profit $\rightarrow \downarrow$
1) \uparrow efficiency (mechanisation)

According to Marx, the rate of profit (p') will tend to fall over the long run

The reason is the drive toward increasing efficiency through mechanisation and labour-saving inventions. This raises what Marxists call the organic composition of capital

This is the ratio of constant capital (c), to total capital (c + v)

$$Q = c/(c + v)$$

$$\text{organic composition of capital} = \frac{\text{constant } K}{\text{Total } K}$$

Profit rate equation:

$$p' = s' (1 - Q)$$

This equation indicates that the rate of profit (p') varies directly with the rate of surplus (s'), and inversely with the organic composition of capital (Q)

invest in machinery
 $Q \uparrow \rightarrow p' \downarrow$

- As capitalists invest relatively more in machinery and less in labour power, Q rises and p' falls (very important to Marx)
- The drive toward the use of more capital reduces the rate of profit; labourers are the source of all value, including surplus value, and as relatively fewer workers are used, the profit rate falls
 $K \rightarrow \downarrow \text{profit} + \downarrow \text{labourers} \rightarrow \downarrow \text{profit}$
- But if value and profit are produced only by labour, won't capitalists have an incentive to use more labour and less capital?

The answer is NO for Marx.

He believed that the dynamics of capitalism inevitably lead to an increased organic composition of capital

2 Reasons:

- 1) The enterprise that leads in promoting efficient production through the use of more and better constant capital will temporarily receive extra profits by lowering its costs of production

profits $\rightarrow \downarrow$ production costs

Eventually, product prices will fall to reflect the lower costs, and the employer who lags behind the trend toward mechanisation in a particular industry will not survive

$p \downarrow \rightarrow \downarrow$ costs

↑ efficiency of production → ↓ labour power

- 2) The greater the efficiency of production, the lower the value of labour power – the number of hours required to produce the subsistence – and the greater the total amount of profit produced per working day.

↑ unemployment

- The substitution of capital for labour has another effect:
The size of the industrial reserve army of the unemployed rises
Workers are thrown out of work by machinery (technologically unemployed)
The larger capital investments for each individual establishment lead to a growing concentration of capital

Marx perceived certain offsetting forces to the falling rate of profit:

- 1) Intensity of exploitation (s') – can be raised by forcing the workers to increase their pace of work or by lengthening their working day
- 2) Wages temporarily may be cut below their value
- 3) The constant capital may be cheapened. The ratio of constant capital to labour is a value relationship, and as machinery and raw materials become cheaper, the rise in the organic composition of capital and the fall in the rate of profit both become slower
- 4) Growing population in relation to jobs and increasing technological unemployment are conducive to setting up new industries that use much labour and little capital
The high rates of profit in such industries enter into the average rate of profit for the system as a whole
- 5) Foreign trade raises the rate of profit by cheapening the elements of both constant capital and the necessities of life
Capital invested in colonies yields higher rates of profit because the ratio of constant to variable capital is lower and because the exploitation of workers is more intense than the exploitation of wage labour at home
- 6) The rate of exploitation is increased by reducing the value of labour power through increased efficiency of production

Several of these factors that partially offset the falling rate of profit increase the rate of exploitation and further 'immiserise' the proletariat. Class consciousness is heightened, and the probability of revolution is increased

- The centralisation of capital and concentration of wealth:

*→ dynamics of capital accumulation
→ recurring business crises*

The dynamics of capital accumulation and the tendency for recurring business crises centralise the ownership of capital and concentrate wealth in fewer hands.

- Capital grows in one place to a huge mass because it has in another place been lost by many. The battle of competition is fought by cheapening of commodities. The cheapness of commodities depends, on the productiveness of labour, and on the scale of production. Therefore the larger capitalists beat the smaller
Development of the capitalist mode of production, there is an increase in the minimum amount of individual capital necessary to carry on business under its normal conditions

*heapiness of commodities →
) Productiveness of labour
) scale of production*

① concentration of wealth in hands of fewer capitalists v/s impoverishment of workers.

- Class conflict:

The concentration of wealth in the hands of fewer and fewer capitalists and the absolute and relative impoverishment of the workers together set the stage for class conflict

The relations of production under capitalism come in conflict with the forces of production

The workers overthrow the capitalists and establish a dictatorship of the proletariat. State ownership of the means of production replaces private ownership, the rate of capital expansion is stabilised, and the exploitation of workers is eliminated. The workers in a sense become owners of the capital.

- Assessment of Marx's contributions:

He contributed to economic analysis in several ways:

- Theory of value
 - 1) Marx was an important participant in the struggle to establish a suitable theory of value in economics (problems associated with the labour theory of value provided an incentive for economists to explore other routes for understanding exchange values)
 - 2) Marx was one of the first economists to note that business cycles are a normal occurrence in capitalist economies (Malthus did not develop the idea of business cycles) (Marx, addressed cyclical upswings and downswings in the market economy)
 - 3) Marx accurately predicted the growth of large-scale enterprise and monopoly power
 - 4) Marx highlighted the substitution effect as it applies to labour-saving-capital. In some circumstances, new capital can replace labour (also discussed the idea of labour-saving innovation) Marx contributed to economics through his emphasis on dynamic, rather than static analysis. The dynamic approach was stressed later by the institutional economists

Business cycles are normal occurrences
upswings + downswings
growth of large scale enterprise
emphasis on dynamic analysis

• Analytical Flaws:

- 1) Defects in the labour theory of value – contemporary economists dispute that workers are the source of all exchange value. Land and capital resources also are productive, independently and beyond the value of labour required readying them for production
 - 2) Problems with Marx's theory of exploitation – the wages paid to workers tend toward the cultural subsistence because of the presence of a large reserve army of the unemployed, Marx said
 - 3) Shortcomings in Marx's analysis of capital accumulation – Marx believed that capital accumulation causes a falling rate of profit, worsening business crises, and technological unemployment
 - 4) Problems with the idea of class conflict – Marx's prediction of the inevitability of class conflict rests on his theories of exploitation and capital accumulation, with capital accumulation causing a falling rate of profit, worsening crises, and technological unemployment
- Marxian revolutions did not occur in the advanced capitalist nations (England, Germany) where Marx expected them

- It occurred in nations such as Russia and China, that had a woeful lack of capital accumulation at the time
- The historical evidence simply does not support Marx's theory of class conflict