

THE LABOR THEORY OF VALUE

At the heart of economic theory is the concept of value. What gives an article value? Is it something inherent in the object or is it some other factor? Does value derive from human effort or something else? The two major and fundamentally opposite economic systems—capitalism and Marxism—give complete different answers to these questions. To judge the validity of these economic systems it is essential to evaluate their treatment of the concept of value.

The Labor Theory

Karl Marx's labor theory of value asserts that the value of an object is solely a result of the labor expended to produce it. According to this theory, the more labor or labor time that goes into the production of an object, the more it is worth. Marx defined value as "consumed labor time", and stated that "all goods economically considered are only the product of labor and cost nothing except labor".

The labor theory of value is the fundamental premise of Marx's economic reasoning and his analysis of the free market economy. If it is correct, then much of Marx's critique of capitalism must also be judged correct. But if it is false, virtually all of Marx's economic theory is refuted.

Here is an example of how the labor theory of value works: A worker in a factory is given \$30 worth of material and after spending 3 hours labor in production of a good and using \$10 worth of fuel to run the machine he uses, he produces a product which is sold on the market for \$100. According to Marxist theory, the labor and only the labor of the worker increased the value of the natural materials to \$100 and, therefore, the worker is justly entitled to a \$60 payment or \$20 per hour.

Now if the worker is employed by a factory owner who only pays him \$15 per hour, according to Marx the \$5 per hour which the factory owner receives is simply a ripoff. The factory owner has done nothing to earn the money and the \$5 per hour he receives is "surplus value" representing exploitation of the worker. Even the tools which the factory owner provides were, according to Marx, necessarily produced by other workers.

According to the labor theory of value, all profits are the rightful earnings of the workers and when they are kept from the workers by capitalists, workers are simply being robbed. On the basis of this theory, Marx called for the elimination of profits, workers

seizing factories and the overthrow of the tyranny of the capitalists. His call to action has been heeded in many countries throughout the world.

The Origin of Value

There are two fundamentally different answers to the question of where economic value originates. According to *intrinsic theories of value*, value is inherent in objects; remains constant despite changing demand, the passage of time and other factors; and can be "objectively determined" by calculations based upon some fundamental scientific principle. The labor theory of value is clearly an intrinsic value theory.

The other approach to value is that of the *market-exchange value theory*. According to this theory, value is not somehow inherent in objects, but rather is a product of many different consumer judgments, tastes and preferences. According to market-exchange value theories, value is dependent upon people's desires: the more they esteem an object and are willing to trade for it, the more it is worth. This theory is the basis of free market capitalism, which Marx bitterly opposed.

At first glance, both theories seem to make some sense. After all, it is generally true that the more labor invested in an object the more it is worth, but it is also true that the more people want a thing—*regardless of how much or how little labor went into it*—the more it is worth.

Which theory is correct? Both cannot be since they lead to diametrically opposite economic systems. We will argue that it is the labor theory of value which is fundamentally in error and the market theory of value which is correct. The labor theory of value is in fact unsound in principle, leads to false conclusions, and is based upon theoretical, empirical and methodological nonsense.

Flaws in the Labor Theory

The assertion that labor is the sole determinant of value is hard to accept just based upon common sense and experience. To assert that only labor gives an object value is to ignore the fact that many naturally occurring objects in which no labor has been invested—such as scenic views, pure water, gems and minerals, and wild fruits and vegetables—have economic value. Also the labor theory of value cannot by its nature account for the fact that people value some natural objects, such as diamonds, tremendously more than other natural objects such as leaves.

The labor theory of value also fails to take into account changing consumer desires and the *contextual nature* of value. In a horse and buggy culture, horse-shoes are tremendously valuable commodities, but in a society without horses they are virtually worthless. Similarly in a society with much leisure time, games and recreational facilities become important, but in a subsistence economy in which people must work nearly continuously just to stay alive, such things may actually have negative value.

The labor theory also ignores the importance of time and position in determining value. A 20 year old wine and properly aged beef are far more enjoyable than one year old wine and unaged beef. Oil in a desert is a potentially valuable resource, but oil in the local reservoir or in the middle of a farmer's field is a nuisance. Similarly, a house one-third built is far less valuable than one-third of a completed house.

Perhaps the most grievous theoretical fault with the labor theory of value is the fact that it ignores what economists call *time preference*. Time preference simply is the common human experience that people overwhelmingly prefer goods and services here and now rather than later, and that they are willing to pay more for getting things now rather than later. (Time preference largely accounts for such fundamental economic phenomenon as interest rates.) Simply put, present consumption is more valuable than future consumption, and future consumption is less valuable than present consumption.

For example, most workers prefer to be paid when their work is completed rather than when their products are sold, which in some cases may be many months later. For workers to be paid now rather than later, someone must advance their wages, and clearly this service has a value (reflected in the market by interest rates on loanable funds). But proponents of the labor theory would have it both ways: workers are to receive the full *future* value of their product *now*, demonstrating the lack of understanding of the nature of production on the part of proponents of the labor theory.

The final theoretical failure of the labor theory of value is its commission of the *value-effort fallacy*. It is the height of folly to assume that all effort produces value. Each of us everyday wastes some time on fruitless efforts or we just simply misuse our limited energies to produce things which no one else wants. To equate labor with the automatic creation of value is to fallaciously imply that all human effort is infallible and constantly productive.

Practical Absurdities of the Labor Theory

As fallacious as the labor theory is in principle, it is even more absurd in practice. If all value is derived from labor and entrepreneurial effort is "parasitic", who would bother to invest the time and money necessary to build factories, plan product development, or organize a production process? If all profits are "exploitation", what incentive does anyone have to risk money on a new and untried product or service? Where will the money come from to finance new investment in tools?

Communist countries have not, of course, abolished profits. They have merely transferred all profits to the state which typically uses them to build a huge military apparatus at the expense of production of consumer goods.

The labor theory of value is, in fact, violently anti-consumer *by its nature*. Under this theory, sellers are compelled to price all goods by the amount of labor that goes into them, rather than how much they are demanded by consumers. Thus stores could charge no more for an aged foreign wine than a local cheap wine (given equal labor input) or more for the work of a skilled carpenter than for that hacked out by a beginner (given equal time). This inevitably implies a surplus of unskilled and shoddy work and a shortage of skilled work—which is, of course, exactly the situation which exists in communist countries.

The labor theory also means the end of all economic freedom. Engels, Marx's disciple, wrote: "For a pure Marxist society to long endure, voluntary exchange between individuals must be abolished." In a communist society you produce what the rulers say should be produced and consume what scraps they allow you. If you don't like it you are of course free to relocate—to a slave labor camp. This is the "abolition of exploitation"?

Methodological Fallacies

The most interesting fallacies of the labor theory of value are methodological. Labor theory arose and can only arise theoretically from two extremely poor methods of economic research. First, it attempts to establish economic laws regarding exchange by examining only the supply half of transactions, ignoring demand entirely.

Even worse, the entire labor theory of value amounts to unproven assertion. In the entire first volume of *Das Capital*, where Marx proposes the labor theory, there is not one "positive proof" Rather Marx offers a fallacious "negative proof" in which he

argues: Premise 1—some factor in the production of a good gives it value; Premise 2—only those goods which man has applied labor to have value [False]; Procedure—list all the factors giving rise to a produced good by examining each one by one, discarding those which did not create equal value in equal quantity, and through the process of elimination, end up with one factor, Labor. [Arbitrary] Therefore, labor must be the source of value. [False]

Marx promised to provide a positive proof in the third volume of *Das Capital*. However, that book published after his death not only does not offer a positive proof of this theory, but in fact implicitly refutes it. In Volume Three, Marx proclaims that two types of capital exist in production, only one of which can produce "surplus value". Thus exchange of items of equal value can have uneven mixtures of these two types of capital—implying that labor alone is not the sole determinant of value.

Does Capitalism Mean Exploitation?

The labor theory of value is nonsense both in theory and practice. It ignores the many non-labor factors which create economic value. is based upon unproven assertions, and leads to economic chaos and political slavery in practice.

Capitalism, in contrast, rests upon voluntary trade between men. If workers choose to contract for employment in factories rather than work their own farms or produce handicrafts, it is because—all things considered—they prefer the wages and conditions in factories to those on farms.

Far from contributing nothing to the production process, the capitalist contributes the great value of his organizational ability, his entrepreneurial foresight, and his management of capital. Because value is *not* solely a product of labor, these abilities are extremely valuable in any society. And profits are the just reward for risking capital in an uncertain world of changing consumer demands and technology.

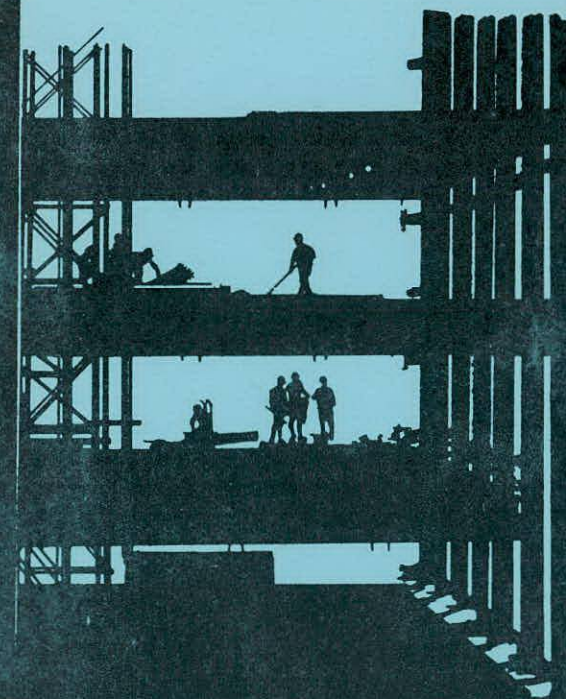
True capitalism, capitalism free of state intervention, prohibitions, subsidies and protectionism, means economic prosperity and freedom for all. Indeed, capitalism is the only economic system which enables the values of consumers to determine what is produced and what things cost, rather than the decrees of economic theoretists who want to run everyone's life for them.

Marx has been in his grave for nearly 100 years. It is time that his theories were buried as well.

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