

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 completely different answers.

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 an object, the more it is worth. Marx defined value as "consumed labor time", and stated that "all goods, considered economically, are only the product of labor and cost nothing except labor".

The labor theory of value is the fundamental premise of Marx's economics and the basis of his analysis of the free market. If it is correct, then much of Marx's critique of capitalism is also correct. But if it is false, virtually all of Marx's economic theory is wrong.

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 working 3 hours producing a good, and using \$10 worth of fuel to run a machine, he creates a product which is sold for \$100. According to Marx, the labor and only the labor of the worker increased the value of the natural materials to \$100. The worker is thus justly entitled to a \$60 payment, or \$20 per hour.

If the worker is employed by a factory owner who pays him only \$15 per hour, according to Marx the \$5 per hour 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 provided 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, for workers to seize factories and for the overthrow of the "tyranny" of capitalism. 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 is the *market-exchange theory*. According to this theory, value is not inherent in objects, but is a product of many different consumer judgments. According to market-exchange theories, value depends 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 sense. 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 something -- *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 the labor theory of value is fundamentally wrong and the market theory of value is correct.

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. The assertion that only labor gives an object value is ignores the fact that many natural 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 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 useless. Similarly in a society with much leisure time, games and recreational faci-

lities 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. 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 hazard.

Perhaps the most grievous theoretical fault with the labor theory is that it ignores what economists call *time preference*. Time preference is the common strong preference for goods and services here and now, rather than later. Present consumption is more valuable than future consumption.

For example, most workers prefer to be paid when their work is completed rather than when their products are sold -- which may be months later. For workers to be paid now, rather than later, someone must advance their wages, and clearly this service has a value. But proponents of the labor theory would have it both ways: workers are to receive the full *future* value of their product *now*.

The final theoretical failure of the labor theory of value is the *value-effort* fallacy. It is folly to assume that all effort produces value. Every day each of us wastes time on fruitless efforts. To equate labor with the automatic creation of value is to fallaciously imply that all human effort is infallible and constantly productive.

Absurdities of the Labor Theory

The labor theory 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 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 consumer production.

The labor theory of value is 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 work hacked out by a beginner. This inevitably produces a surplus of unskilled and shoddy work, and a shortage of skilled work -- which is exactly the situation that 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 tell you 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.

Methodological Fallacies

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

Even worse, the entire labor theory is unproven. 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 [true];

Premise 2 -- only those goods to which man has applied labor have value [false];

Procedure -- Examine all the factors producing a good by discarding those which did not create equal value in equal quantity, and end up with one factor-- Labor. [Arbitrary].

Conclusion: Labor must be the source of value. [False]

Marx promised to provide a positive proof in the Vol. 3 of *DAS CAPITAL*. However, that book does not offer a positive proof, and implicitly refutes one. 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.

The free market, in contrast, rests upon voluntary trade. If workers choose to contract for employment in factories rather than work their own farms or produce handicrafts, it is because they prefer the wages and conditions in factories.

An entrepreneur contributes the great value of his organizational ability, foresight, and management skills. Because value is *not* solely a product of labor, these abilities are extremely valuable. Profits are his just reward for risking capital in an uncertain and changing world.

True free market capitalism, capitalism free of state intervention, prohibitions, subsidies and protectionism, means economic prosperity and freedom for all. Indeed, the free market is the only economic system which enables consumers rather than bureaucrats to determine what is produced and at what price.

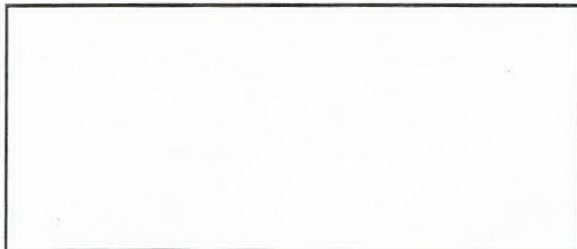
Marx has been in his grave for over 100 years. It is time that his theories were buried as well.

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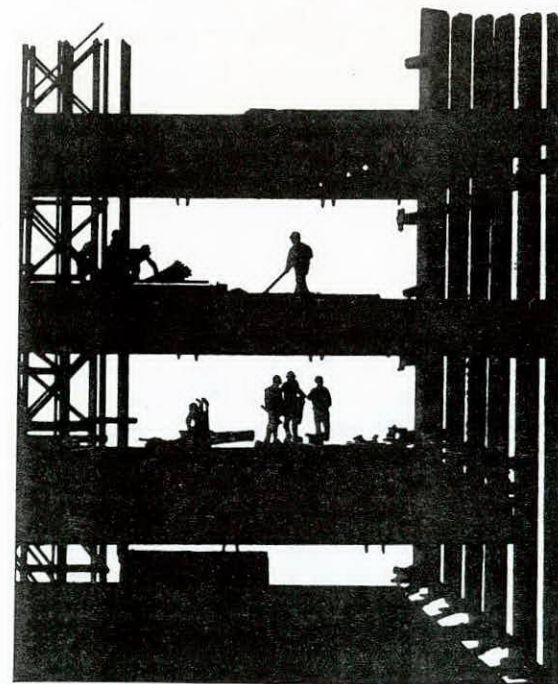


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