A Celebration of the Labour Theory of Value

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Introduction

Reflecting on the current state of Marxism prompts both pessimism and optimism. It prompts pessimism because, while there are a number of competitors, there is no obvious single strategy for achieving socialism, and neither is there any consensus on what a socialist economy would actually look like, either in theory or in practice. Theoretically, the emancipatory self-organization of the producers themselves is a phrase whose practicalities have barely begun to be explored, and democratized allocation methods that replace the market are sufficiently demanding of participants as to provoke considerable scepticism as to their feasibility. Empirically, the historical records of both the USSR and the People's Republic of China hardly inspire optimism in their interpretations of the socialization of the relations of production. Indeed, part of the reason for the collapse of the USSR was its inability to replicate (let alone supersede) the technological dynamism of capitalism. So plenty of work remains to be done.

But the current state of Marxian economics also prompts optimism, for Marx was remarkably prescient in his picture of the long run developmental tendencies of capitalism. The alienation of the worker from production process and product, the subordination of the worker to the dictates of technology, the growth of the size of firms, rising labour productivity generated by technical progress that is predominantly labour-saving and means-of-production-using (hence a falling share of variable capital in total capital advanced), the rising rate of surplus-value, the use of unemployment to regulate wages, the importance of credit, the internationalization of commerce, production processes and finance, the anarchy of the market, the alternation of periods of accumulation with periods of crisis – all of these both are parts of the Marxian vision and accurately describe how capitalism has historically developed.

This has long been known, and helps to explain why even in the darkest times Marxism never died. But there is a second set of reasons for optimism, which is concerned with more recent developments in the analytical apparatus of Marxian economics, and it is on these that I want to focus, because they deserve a wider audience. To appreciate their significance, a brief digression into the history of economic thought is helpful.

The Historical Development of the Labour Theory of Value

In 1776, Adam Smith had first proposed a labour theory of value for a primitive economy, with no private ownership of either land or other non-labour inputs. Given perfect labour mobility, the rate at which commodities would exchange would be governed by the relative difficulty of producing them, and an obvious measure of relative difficulty was labour-time. But Smith could not see how to apply this theory to a capitalist economy where rent, interest and profit had to be explained as well as wages. So after proposing what might be called a ‘commodity law of exchange’, he abandoned his labour theory of value for an adding-up theory of price. At the same time, assuming perfect capital mobility, Smith had a clear notion of a long run equilibrium price as the outcome of a competitive arbitraging process producing an equalized rate of profit. This one might call a ‘capitalist law of exchange’.

Some forty years later David Ricardo successfully generalized Smith’s commodity law of exchange by proposing that the labour embodied in a commodity was the sum of both the direct and indirect labour hours required to produce it; the direct hours were the hours worked by employees in the current period, and the indirect hours were the hours embodied in the non-labour inputs (hence hours performed earlier than in the current production period). Colloquially, Ricardian value was the sum of living and dead labour. Yet Ricardo quickly discovered that he could not simultaneously maintain both a commodity law of exchange and a capitalist law of exchange.

The commodity law of exchange says that price ratios are ratios of labour-time. The capitalist law of exchange says that long run equilibrium prices are the costs of all inputs marked up by the equalized rate of profit. These two statements are not in general compatible. For imagine two capitals of identical size producing an identical product but with different technologies, one more and one less labour-intensive, in a situation in which the rate of profit is equalized. The capital with the more labour-intensive technology will produce more value than the capital with the less labour-intensive technology, and hence will have a higher price. But since the commodity produced by each capital is identical, it must sell for a uniform price. So the price ratio as measured by the ratio of direct labour-times cannot be the price ratio as measured by prices that support an equalized rate of profit, because the capitalist whose capital is tied-up for longer will require a higher price. Hence either the arbitraging processes of capitalist competition (the capitalist law of exchange) must be abandoned, or the labour theory of value (the commodity law of exchange) must be abandoned. They cannot both be true, and, in trying to maintain both, Ricardo was reduced to considering the commodity law of exchange as an approximation rather than an exact statement.

Another forty or so years later, Marx resolved Ricardo’s difficulty by transforming the labour theory of value from a microeconomic theory about the determinants of the price of an individual commodity to a macroeconomic theory about the determination of class incomes. He refined Ricardo's notion of labour, regarding it as social rather than private, necessary rather than wasted, and abstract rather than concrete, so that for Marx the measure of labour-time was hours that were 'socially necessary'. (Henceforth hours will always be understood to be so qualified.) But what is important here is precisely what the transition to a macroeconomic theory means, and it is this that is at the heart of recent developments. One way of approaching them is through a consideration of the circuit of capital.

The Circuit of Capital

Capitalism is all about making money. Marx's stylized description of this money-making process is the circuit of money capital, in which capital exists in a variety of forms (stocks) which are transformed one into the other by a succession of processes (flows). Marx described the circuit as $M - C \ldots P \ldots C' - M'$, and there are three phases, $M - C$, $C \ldots P \ldots C'$, and $C' - M'$.

1. *From financial capital to productive capital.* The circuit begins with a stock of financial capital (*M*: money and money-substitutes across a spectrum of liquidity). That stock of financial capital is then transformed in the market - the advance of capital to purchase inputs - into a stock of productive capital (*C*: inputs of means of production and labour-power awaiting the beginning of a production process). This change in the form of capital is just that, a change in form effected by the activities of purchase and sale in market transactions ($M - C$). A transfer of ownership of assets has no effect on the quantitative magnitude of capital, which therefore remains the same in its change of form from financial capital to productive capital.

2. *From productive capital to commercial (commodity) capital.* The stock of productive capital

(C) is in turn transformed via a production process ($C \ldots P \ldots C'$) into a stock of commercial (commodity) capital (C': outputs awaiting sale). This is both a transformation of form and an increase in magnitude. Marx's explanation for this increase in magnitude is that labour-power is a uniquely peculiar commodity in that it is capable of creating more value than it itself possesses. Capital purchases labour-power for a wage; that labour-power is then consumed in a production process, but the labour thereby performed creates a value in excess of the wage that it cost, the excess value being 'surplus-value'.

3. *From commercial (commodity) capital to financial capital.* The sale of outputs for money ($C' – M'$) transforms commercial (commodity) capital (C') into financial capital (M'). As with the market processes that transform financial capital into productive capital, this is only a transformation of form, a transfer of legal title. But because the stock of commercial (commodity) capital is quantitatively greater than the stock of productive capital, the financial capital that completes the circuit is greater than the initial stock of financial capital that began it.

One obvious implication of this specification is that transformations of stocks of capital which do not increase its magnitude are performed by labour which adds no new value. Such labour is 'unproductive' of value and surplus-value. Its function is to circulate already existing value, and since it creates no new value, it is financed out of surplus-value. On the other hand, transformations of stocks of capital that do increase its magnitude are performed by labour which does add new value; that labour is 'productive' of value and surplus-value. Productive and unproductive labour are terms that analytically locate labour in the circuit of money capital.

This does not exhaust the content of these categories. For a complex capitalist-organized division of labour requires both planning and supervision. These are different. The planning of productive labour is a productive activity (part of what Marx called the 'collective worker'), but supervising and disciplining it in authoritarian hierarchies is specific to the capital relation and is unproductive. Yet planning and supervision are inextricably intertwined, and permit no practical empirical separation. For this reason, in empirical work where the data permit, the labour of the management of productive labour – that is, the managerial labour that organizes the transformation of productive capital into commercial (commodity) capital - is generally treated as unproductive.

Equal and Unequal Exchange

A number of features of this theoretical apparatus are of particular importance. First, value and price are inextricably inter-related rather than separable concepts. The activities before production, $M – C$, and after production, $C' – M'$, are market processes of purchase and sale. If price is a form of value, then money is the form value takes when it is separated from the commodity. But this externalization of value immediately poses the issue of possible quantitative difference between value and price.

Yet, so put, this is a meaningless statement because value is denominated in hours, and price in money. Quantitative difference can only mean a difference between 'price' and 'the price that would obtain if prices were proportional to values'. Call these latter 'simple prices'. If exchange takes place at simple prices, exchange is 'equal exchange', meaning equivalents are exchanged, money for commodity by the buyer and commodity for money by the seller. If exchange occurs at any other price, exchange is 'unequal exchange', meaning that one party to the transaction gains money-value and the other loses it. Marx called those long run prices at which the rate of profit was equalized 'prices of production', the same Smithian centres of gravity around which market prices fluctuated.

In Marx’s terminology, Ricardo had discovered that price of production is in general different from simple price. Specifically, capitals with more labour-intensive technology must ‘lose’ value to capitals with less labour-intensive technology. However, this in turn is not compatible with the statements above that the market processes $M – C$ (the purchase of inputs) and $C´ – M´$ (the sale of outputs) are transformations only of the form of value, its magnitude remaining constant. These transformations cannot simultaneously be processes of both equal and unequal exchange. But value transfers in unequal exchange must sum to zero, for the gain of one capital is the loss of the other. This suggests that the circuit of money capital for an individual capital and that for all capitals taken together is *different*. Transformations of stocks of capital that are value-preserving are properties only of an aggregate perspective on the circuit. Consequently, the labour theory of value is a theory of aggregate value, and, since only living labour creates value, it is a theory of aggregate new value, or value-added. From an aggregate perspective, this is a specification of a fundamental *conservation principle*: *value-added in the aggregate is conserved across market exchange.*

The Value of Money

Another way to express this conservation principle is to say that value-added in the aggregate is ontologically the same whether it is expressed in hours of socially necessary labour-time or in terms of money. It is the same substance of abstract labour, whether expressed as money-value-added or labour-value-added. But in order to equate units of time with units of money, a conversion coefficient is required. So we can write that, in the aggregate, money-value-added is equal to labour-value-added divided by the ‘value of money’, where the value of money is precisely that conversion coefficient, expressed as socially necessary hours per unit of money. Indeed, this expression of the fundamental conservation principle serves to define the value of money as the ratio of aggregate labour-value-added to aggregate money-value-added.

The value of money is the answer to the question ‘how many units of money are equivalent to an hour of abstract labour?’ But a coefficient expressed in terms of socially necessary hours per unit of money is not particularly intuitive. For that reason, it is sometimes easier to work with its inverse, the ratio of aggregate money-value-added to aggregate labour-value-added, whose units are units of money per hour of socially necessary labour-time. It is the answer to the question ‘how many hours of abstract labour are equivalent to a unit of money?’ This inverse of the value of money is called the ‘monetary equivalent of labour-time’. Then, in the aggregate, money-value-added is equal to labour-value-added multiplied by the monetary equivalent of labour-time. Whether one works with the value of money or its inverse, the monetary equivalent of labour-time, is purely a matter of convenience.

The conservation of aggregate value-added through the circuit of money capital lies at the heart of Marxian political economy. It is Marx’s most developed expression of the labour theory of value, resolving Ricardo’s difficulty by transforming the labour theory of value from a microeconomic theory about the determinants of the price of an individual commodity to a macroeconomic theory about the consequences of the conservation of aggregate value-added across exchange. Prices remain forms of value. They describe how value is distributed, but that distribution is effected through unequal exchange at the individual commodity level; it could not be otherwise if competition is tendentially to equalize the rate of profit.

The Value of Labour-Power

Individual commodities do not in general exchange at prices proportional to labour-values because of the different proportions of non-labour to labour inputs in their production processes, in a market environment in which competition (tendentially) equalizes the rate of profit that each capital earns. So two related features are crucial for this result to hold for any commodity. First, production of the commodity is a capitalist production process, requiring the investment of capital. Second, a rate of profit has to be earned on that capital, via the sale of the commodity. Were there to be a commodity that did not conform to these features, then there would be nothing to force the divergence from proportionality between money-value and labour-value.

There is indeed one such commodity. Consider the commodity labour-power, the capacity to work. As an attribute of human beings, with no existence independently of them, it is not produced under capitalist relations of production. The only societies in which human beings are bought and sold are slave societies, and, despite the socialist rhetoric of capitalist ‘wage slavery’, capitalist relations of production are not slave relations. Further, if human beings are not produced under capitalist relations of production, then there is no rate of profit to be earned on their production. Hence the conditions that in general force divergence from proportionality between money-value and labour-value do not exist for the commodity labour-power, and labour-power must sell at a price proportional to its value. Thus the price of labour-power per hour (the wage rate) must equal the value of labour-power per hour of labour hired, divided by the value of money.

But there is another respect in which labour-power is a peculiar commodity. The value of a loaf of bread, for example, is the sum of the direct and indirect labour-time required for its production, so that its value might be called ‘intrinsic’. But because of its peculiarity, labour-power has no such intrinsic value. Perhaps the value of labour-power could be measured by the value of the commodities that the worker requires to consume in order to renew her capacity to work after each production period of labour. But this cannot in general be true. For labour-power is sold for a wage, and that wage is used to purchase required consumer goods. Those consumer goods will be purchased at prices that are not proportional to their labour-values, for the now familiar reasons common to all commodities except labour-power. Hence because labour-power is sold at a price proportional to its value, and because the wage then purchases commodities at prices that are *not* proportional to their labour-values, it logically cannot be the case that the value of labour-power can be measured by the values of the commodities the wage purchases.

If labour-power is sold for a price (wage) proportional to its value, then, for any given value of money, the hourly wage rate directly measures the value of labour-power per hour of labour hired. So the question of the determination of the value of labour-power (for any value of money) is the question of the determination of the wage rate. And in general the wage rate is determined by the interaction of social norms about what constitutes a reasonable standard of living at any point of time, with often intense class struggle over the shaping and direction of those norms.

Some Implications

Since the hourly wage rate is proportional to the value of labour-power per hour of labour hired, then total wages paid are proportional to the total value of the labour-hours hired; hence variable capital as a sum of money is proportional to total variable capital measured in hours. Since by the fundamental conservation principle, the sum of total wages and total profits is proportional to total variable capital and total surplus-value both measured in hours (total value-added in money is proportional to total value-added in hours), it immediately follows that total profits as a sum of money is proportional to total surplus-value in terms of hours. That is, in the aggregate and for any value of money, profits are unpaid labour-time. Thus, contrary to conventional wisdom and received opinion as it has developed since Marx's death, there is no logical incompatibility between the Marxian theory of exploitation (the commodity law of exchange) and the theory of competition (the capitalist law of exchange).

There are two further important implications. First, there is nothing in the previous paragraph, or indeed in the previous section, that restricts attention to any particular system of prices. Whatever prices are (simple, price of production, market), the commodity law of exchange holds both for total value-added (the fundamental conservation principle) and for labour-power. That is as it should be; that capitalism is an exploitative society is independent of what prices happen to be.

Second, by the same token, this is an approach that can be used empirically. For the wage rate is empirically measurable; total hours worked is a known datum (even if some adjustment is required to distinguish hours of productive from hours of unproductive labour); and total value-added in money terms is Net Domestic Product (possibly with some adjustments to more closely align the National Accounts category with its theoretical counterpart). Consequently, it is not difficult in principle to calculate the value of money (and its inverse, the monetary equivalent of value), the value of labour-power and the rate of surplus-value.

One further implication should be noted. Consider aggregate constant capital in price terms (which typically will not be at simple prices), and convert it into labour-value terms at the prevailing value of money. These imputed hours of labour will bear no relation either to the hours which historically were required to produce these means of production or to those that are currently required to produce them. The labour theory of value therefore says nothing about constant capital, for the price of each individual item is not proportional to its labour-value, and the price of all such items aggregated together is not proportional to their aggregate labour-value. It is value-added that is central to this interpretation, not total value.

Directions for Future Research

If Marx's labour theory of value is a macroeconomic theory, then more work is required on both wages and profits. On wages, more work is required on how social norms about an acceptable standard of living are determined, and how class struggle shapes the evolution of those norms and their change over time. On profits, each firm (however large) only employs a tiny fraction of the world's labour force, and so its own workforce contributes a correspondingly tiny fraction of the world's unpaid labour; each firm (via the price system) draws on this pool of surplus-value to determine its profits according to its total investment in all inputs. How successfully each firm can participate in this parable of redistribution depends upon its competitive strategy in the marketplace. Thus it is competitive strategy that determines a firm's profits, and the exploitation of its own labour force is just a part of its control over costs. This suggests a reorientation of much contemporary Marxist work about the firm's profits.

Finally, a core concept in this approach to Marx's theory is the value of money (or monetary equivalent of labour-time). But to measure the value of money is not thereby to explain it, and more work is required on the causal relations that determine it, and how it is situated in the historical evolution of the international system of money, created by banks, and near-money, created by shadow banks.

Conclusion

This paper has argued for an interpretation of Marxian political economy that depends upon a fundamental conservation principle of total value-added, and upon a recognition of the peculiarities of the commodity labour-power. It thereby encompasses a theory of exploitation and a theory of competition that are compatible with one another, and it holds out the prospect of serious empirical work. On this basis, it can constitute Marxian political economy as a progressive research agenda for the 21st century.