A Conceptual Note on the Price–Value Paradox in Economics

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ABSTRACT *Price and economic value are two closely related and yet very different economic concepts. The existence of differences as well as similarities between these two economic categories and, the seeming lack of a universal and a homogenous view on this matter have been termed as the "price-value paradox" in this paper. While modern mainstream economics probably considers prices to be the reflections of the underlying subjective economic values, not all economic schools of thoughts have had similar beliefs in the past and even in the current era. In particular, the Marxist tradition and to some extent classical economics and their modern heterodox extensions consider prices and values to be separate entities and yet inter-connected via the underlying labour content of commodities. The nexus between price and value is probably not fully agreed upon if seen simultaneously from the points of views of multiple competing schools of economic thoughts. The issues briefly touched upon in this paper, to the best of our knowledge, have received limited attention so far and thus, we attempt to survey some of the key and landmark works in this area and also endeavor to build a cursory and elementary conceptual analysis of the ways in which the price-value paradox has been analyzed by various Economists and schools of thoughts into a single short and elementary survey. This paper thereafter also analyzes some of the recent case studies in the Indian and International contexts pertaining to this issue in order to bring out the profundity of this matter for not only the well-being of individuals but also for the well-being of the society as a whole.*

Keywords: *Economics, Microeconomics, Prices, Value.*

1. Introduction

The sum total of knowledge that is generated in a society, its components, and, their inter-connections are disaggregated and diffused across the millions of social agents who continuously interact among themselves and the members of other societies in order to produce various social, cultural, economic, political and other outcomes. Economic knowledge too has a similar nature with the primary difference being that Economists assume this knowledge to be embodied in the complex choice-making processes of individual economic agents. The diffused nature of economic knowledge has been an intensely debated issue in the epistemology of Economics[1]. Following Hayek (1945), Economists have come to appreciate the fact that prices play a critical role in transmitting this diffused and micro-level economic knowledge pertaining to scarcity, value, costs, demand, supply etc. to the various individual members of the economy. In a Hayekian framework, prices reflect incentives for all economic agents. They act as signals to producers, consumers and other economic agents about what the markets and society wants them to do. The complex task of coordinating the millions of consumers, producers, and other economic agents in a market economy is thus undertaken via the "incentive compatibility" Hayek (1973) of prices in such an economy. This occurs essentially by the efficiency with which prices can signal changing conditions of scarcity of resources and commodities to the economic agents. Moreover, it has been argued that prices play such a profound role not only in a market economy, but rather in any kind of economy faced with the problem of scarcity (Mises 1920).

While modern economists have focused particularly on prices as the most successful economic coordination technology till date, classical and Marxist political economists have stressed on the role of values as playing a similar though not exactly the same role. The concept of price was associated with the so-called exchange value of commodities, which were assumed to be related, in certain ways and under certain assumptions, with the underlying labour content of these commodities. Historically, with the shift in political economy brought by the emergence of both the classical political economy led by Smith (1776) and later on by the Marxian political economy, formally beginning with Marx (1887), the issue of value became embedded in the so-called Labour Theory of Value, a theory which most of the modern mainstream economists consider invalid on both logical and empirical grounds[2].

The modern mainstream economics, consisting mainly of neo-classical, Keynesian and related approaches and, the classical-marxist-heterodox traditions in economics throw very different ideas on the

ways in which economic coordination occurs in a market economy facing the problem of scarcity[3]. While the mainstream approaches link economic coordination with prices and values in a subjective marginal-utility theory of value framework, Marxist economists undertake the same within a so-called objective labour theory of value framework. Hence, the role of prices, values and their inter-connections in a market economy turn out to be very different depending upon the theory of value that is utilized. These differences are captured in the ways in which these two traditions, namely the mainstream neoclassical and the Marxist traditions, look at prices and values and their inter-connections. While one side believes that prices and values are conceptually equal, the other side asserts that there are fundamental differences among them and the equalization of both might not produce economically efficient and consistent outcomes. This paper recognizes the fact that price and value, even though might be treated as similar, are essentially two different economic concepts and require very different approaches and theoretical logics for truly appreciating the importance of their interconnections for both economic analysis and economic policies. Treating these two inherently different concepts as one while trying to resolve matters that are a result of the underlying tensions between them and the seeming lack of universal and homogenous view on the inter-connections between prices and values have been termed as the "price-value paradox" in this study. This paper modestly attempts to survey some elementary and conceptually useful insights on this basic, yet profound, theoretical issue, without delving deeper into its historical foundations and theoretical debates.

2. Objectives

This study aims to investigate, at a basic conceptual level, the issue of inter-relationship between two of the most profound economic variables, namely price and economic value. Following are the two major objectives of this study:

I. To analyze the concepts of price and value and their possible inter-connections and differences across the Neoclassical and Marxist schools of thoughts in Economics.

II. To rudimentarily survey some of the mainstream and heterodox approaches on the price-value paradox.

3. The Price-Value Paradox: Conceptual Evolution and Survey

This section develops the survey thematically rather than chronologically in order to express the organizing theme of this paper in a more structured manner. The first trace of price-value paradox can be located in Smith (1776), who laid down the theoretical foundations for the neoclassical project which was to follow later, and, who discussed the so-called Diamond-Water paradox expressed in the fact that despite the low use-value of diamonds versus that of water, they still commanded a very high exchange-value compared to water. Even though the traces of this issue can be located in Smith's work, he was far from having a coherent theory of value that could explain the price-value nexus beyond a rough approximation of the so-called "adding-up account" Wolff (1981). It was Ricardo (1821) who developed a more coherent Labour Theory of Value by including both "the quantities of direct and indirect labour" Wolff (1981) in the concept of value of a commodity. Then the classical tradition in Political economy saw a major shift with Marx (1887) who developed, using the basic theoretical apparatus developed by Ricardo and others, the Law of Value wherein exchange value (the counterpart of monetary price in a barter economy) was tightly anchored to the underlying socially necessary labour-time embodied in a commodity. Subsequent to the Marxist revolution, dissenting ideas and frameworks also emerged that attempted to refute the monopoly of labour as the ultimate source of value, with Bohm-Bawerk (1896)[4] allegedly concluding the fall of the Labour Theory of Value on grounds of internal logical inconsistency within the Marxian system. However, the price-value relationship was renewed later on, within the Marxist framework, by the emergence of the so-called "Temporal Single-System Interpretation" (TSSI), initiated among others by Kliman (1955), Freeman and Carchedi (1996), among others, of Marx's theory of value and the transformation problem as discovered and elaborated in the works of Bohm-Bawerk (1896).

The Marxist framework of value theory and hence the issue of price-value relationship was further affected by the debates on Ricardian elements in Marx's Labour Theory of Value with some arguing Marx to be a "minor post-Ricardian economist" (Samuelson 1962), while others arguing the originality in Marx's system compared to the Ricardian framework (Tsoulfidis 1999). The marginalist revolution and the subsequent neoclassical tradition, initiated among others by Menger (1871), discarded altogether the labour theory of value and instead, introduced a marginal utility theory of value that understood prices as reflections of the subjective values expressed by individual economic agents via their demand-supply behavior in the market. With this shift, a new approach to the price-value paradox emerged which also provided a logically consistent solution to the Diamond-Water paradox by allowing economists to look at,

not total use-values, but rather the marginal use-values[5]. Such a framework also established a tight association between price movements and the changes in the underlying values of commodities and services in a modern capitalist market-based economy. The current Economics education focuses primarily on the marginal utility apparatus to introduce students to the economic way of thinking and several Economists believe it to be a theoretically monist way of teaching Economics, while arguing for a more Pluralistic pedagogy[6]. Prices are thus explained as reflections of the underlying subjective values. One can gain a flavor of these observations by looking at the contents and primary arguments of introductory Economics texts such as Samuelson and Nordhaus (2010), Mankiw (2017), Lipsey and Chirstal (2015), etc.

4. Some Case studies and further comments on the price-value paradox

The notes in Section 3 examined the nature of the debates on the price-value paradox. This section fills in the discussion with more issues and elementary insights. While price and value were established as having a strong association after the emergence and dominance of neoclassical approach, the earlier traditions as contained in the landmark works of Classical economists and Marxists, as well as some of the modern Heterodox paradigms, look at this issue quite differently. Prices, in these non-neoclassical frameworks, are not direct representatives of values. The distinction made between use-value and exchange-value in Classical, Marxists and some heterodox schools in economics, exemplifies this issue further. As per this distinction, Economic values are represented, at least in the Marxist framework, by the underlying labour content of commodities which is generally measured as the Socially Necessary Labour Time that is expended in the production of a commodity, while their prices are assumed to be represented by the exchange values as established in the market. In the modern economic approaches, such a distinction does not play much of a role probably due to the equalization of price with the underlying use-value of a commodity itself, while use-values do not play much of a role in the determination of prices in a Marxist framework. In such a scenario, use-value and exchange value of a commodity are tightly linked and probably can be considered as equal under certain conditions and assumptions. Thus prices and values appear as strongly connected due to the derivation of the price of a commodity (including service) solely from its use-value. It might be proposed here that the ways in which Economists look at price-value inter-connections determine not only their theoretical conclusions, but probably also their policy prescriptions. A recent event in the Indian context where the price-value paradox came to the fore was the strike by the workers of Bajaj company plant in Chakan, Maharashtra, in the year 2013. The labour union applied a labour theory of value framework to assert that the workers were being underpaid. Hence, they asserted that the price of labour (i.e. the wage rate) was sub-optimal as the entire value being generated by workers was not being reflected in the price that they were paid in the form of wages. On the other hand, the management did not make its pricing theory clear but asserted that their wages were very-well as per the prevailing market rates and that the workers were being paid the full value that they were adding in the firm. Despite not making it clear, it is quite evident that the management was roughly thinking in terms of the marginal productivity theory and hence had quite different conclusions compared to those of the union of workers. Such events dramatically bring out the profound impact that price-value paradox can have on even the day-to-day functioning of economic units.

While the above example illustrates the profundity of this paradox for microeconomic decision-making, the recent debates on the inequalities and other inefficiencies of capitalism as a mode of organizing economic life exemplify the importance of this issue for macroeconomic growth and sustainability of modern market-oriented economies. An important case study on this account was Mazzucato (2018) who analyzed the macroeconomic consequences of confusing price with value by capitalist economies and their policy-makers and asserted that socially and economically meaningful outcomes could be produced only by taking into account the fundamental differences between price of economic goods and services, and their social value. This, the author suggested, was critical in paving the way for a more equitable, just and sustainable future. This case study also brought to the fore the fact that environmentally sustainable economic outcomes also needed to take into consideration the costs and benefits associated with non-economic variables and factors. One can find many such illustrations and case studies throughout the history on this issue.

5. Limitations and Conclusions

This study does not delve deeper into the theoretical foundations of the price-value debate in the history of economic thought. The history and theoretical analyses on this issue are vast and require much more intense surveys of evidences to account for the wide heterogeneities of opinions, ideas and ideologies across the major schools of thoughts in Economics. Given the scope and objectives of this paper, such concerns

have not been dealt with in this study. The very labeling of the core issue briefly investigated here as a "paradox" might not be acceptable to some Economists and we have only employed this term more as a metaphorical device rather than as a logically and empirically correct economic category.

It can thus be argued that price and value can be, and have been, analyzed in at least two different frameworks. Firstly, they can be conceptualized as two different economic categories that may or may not be related to each other. The classical tradition in Economics and the subsequent Marxist shift in this area, along with some modern-day Marxist analyses, can be included here. Classical economists, and, even Marx and Marxists, clearly differentiated between price and value via their use value-exchange value differentiation of the total composite value of a commodity. While classical economists such as Adam Smith, David Ricardo, etc. did not focus much upon the possible inter-connections and economic implications of the price-value paradox, Marx developed his theoretical arguments by examining the economic linkages between prices and values in a Labour Theory of Value framework. The marginalist, and subsequently the neo-classical, shifts in the economic thought paved way for the establishment of homogeneity between prices and values of commodities via the application of the concept of marginal utility. This presumably solved the price-value paradox only to emerge later as evident in the heterodox paradigms and the many real world events, some of which were noted earlier in this paper.

Notes

1. The literature on epistemology of economics and the nature of economic knowledge is vast. Many dimensions of the nature of economic knowledge, the ways in which it is produced and exchanged, the kind of knowledge that economists utilise, etc. have been the major areas of debate and research. However the scope of the present study prevents us from venturing deeper into these directions. Some basic insights on such issues can be obtained by referring Irizarry (2013) and Hayek (1945), among others. A focus on the epistemological foundations associated with the Austrian School and particularly with their epistemological approach called "Praxeology", was Hill and Uselton (1976). This study touches upon some of the most fundamental issues pertaining to economic knowledge. A more generalized and detailed analysis on these dimensions can be found in Sagal (1977).
2. Even though modern mainstream economists have discarded the Labour Theory of Value, similar beliefs are not shared by various heterodox schools such as Marxists, Institutionalists, etc. Particularly, the modern Marxist economists have been refining the Labour Theory of Value so as to suit it to their theoretical ambitions and empirical analysis of the modern capitalist society. The emergence of the TSSI approach to Marxian theory of value is an illustration of the same.
3. Economics as is practiced and taught today is based on the fundamental economic problem of scarcity. Under the environment of universal scarcity, the role of price and economic value in coordinating the various economic decisions and behaviours of the members of society has been a well-debated area, while this issue might not be relevant for economies that happen to be immune to the problem of scarcity. Theoretically, this can happen if an economy is able to increase the quantity and productivity of its resources infinitely. Here, prices and values might not play the same role as they do under the existence of scarcity of means.
4. Although Eugene-von-Bohm-Bawerk provided an important criticism of the Marxist theoretical system in the form of the so-called "Internal Inconsistency Problem", there were important responses to his criticisms during the same period, particularly by Hilferding (1904).
5. The term "Marginal Use-Value" has only been used only as a rhetoric tool and the term "Marginal utility" is the more appropriate and correct representation of what is being discussed in this section.
6. There is a vast literature on Pluralism in Economics and among many others, Baria and Mehta (2018), provides an elementary and brief survey, and some basic applications, of the same with reference to the Undergraduate education scenario in India. However, for more intense analysis on this issue, readers can refer to Colander (2017), Jackson (2017) and Shakoori (2014), among others.

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