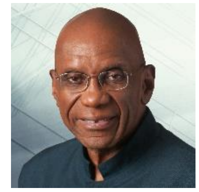

Book Review

Can We Know the Value of Everything?

A Review of The Value of Everything*, by Mariana Mazzucato, New York: PublicAffairs, 2018*

Mariana Mazzucato has written a book which goes to the failing heart of economics: the theory of value. The discipline of economics purports to explain how value is exchanged in society. If I choose to sell my property, I expect to receive its fair value in exchange. If I go to work as a barista, a teacher, or an office manager, I expect to be paid wages in exchange for the value of the work I do. If I am a nail technician, an attorney or an economic consultant, I charge fees in exchange for the services I provide. Economics is about what motivates these exchanges and what value results. *The Value of Everything*, the title of Professor Mazzucato's book, therefore lies at the heart of all economics.

Unlike meteorology, where there are independent, invariable measures of temperature, or mathematics, where there are invariable measures of length, economics has no independent, invariant measure of value. Instead, economics derives value from prices. The value of the land I sell is the price at which I sell it; the value of the services the barista, teacher or office manager provides is their wages; and the value of the services of the nail technician, attorney or economic consultant is the fee charged for their services.

This is clearly problematic. What price I obtain for my property depends on the conditions of the sale: am I in urgent need of funds, or can I wait for the best offer? Is the property market in a boom or slump? Is the property in a desirable neighbourhood? Similarly, economic and non-economic factors will decide what wages I can expect for my services or what fees I may charge for them. There are other problems: how are we to compare the services of the barista with the services of the teacher or the economic consultant? How do we take into account the varying quality of goods and services offered for sale? Why are the prices of identical goods and services so different in different countries, and in different regions of the same country?

Using price as the measure of value has an even more consequential defect: it implies that anything which does not have a price is of no value. That cannot be true, because it would mean that many things we value highly, such literacy, essential health services, security of person and property, garbage collection, law and order and all unpaid household work, are of no value. This is by no means the extent of the problem. We have not yet taken account of new technologies, new products and services, the impact of marketing, monopoly powers, and many other factors that result in prices that do not seem fair.

Professor Mazzucato challenges the economics profession to rethink what has become the accepted theory of value. In the early days of economics, the founders of the discipline sought to derive value from labour, inputs and organisation. The time taken in production and the quality of labour were taken into consideration. This approach was replaced in the mid-nineteenth century with a theory which essentially says that value is in the eye of the beholder. We are reminded that Adam Smith, whose *Wealth of Nations* is a classic of economics, proposed a theory where value depends on time spent by workers in production. Following Smith, free trade proponents of that period argued that value was created in production, and wealth was accumulated value. For Karl Marx, exchange was the activity that crystallises the value inherent commodities. That value is created by labour power, defined as the capacity to work. However, because of power disparities, capitalist societies do not reward workers with the full value that their labour power creates. They should resort to class struggle to recover their fair share.

Adam Smith was Professor of Moral Philosophy; the emergence of economics as a distinct discipline only becomes apparent with the contributions of Alfred Marshall, whose *Principles of Economics* was published in 1890. This marks the introduction of the theory that price determines value, rather than vice versa. This school of thought, still taught in economics departments, is labelled "marginal utility theory". According to this theory, the price of any commodity is determined at the point where the cost of producing one extra unit (the marginal unit) of that commodity exactly matches how useful it is (its utility) to the most "recent" customer (the marginal customer). "Prices, then, reflect the utility that buyers get from things. The scarcer they are - the higher their marginal utility - the more consumers will be willing to pay for them (Page 64)."

Marginal utility theory was appealing because it seems to explain "how prices were arrived at and how much of a particular thing was produced (Page 65)." The value of every commodity is determined by this price. However, in practice there is no independent way of knowing what the utility of any commodity is to everyone who might think of buying it, and the same item will usually appeal more to one individual than to another. Moreover, how are we to identify the "marginal" customer, and how does it happen that everyone who is shopping gets to know when the bargain is struck between the producer of the marginal unit and the marginal consumer. There is a long list of other unresolved questions in translating this marginal utility theory of prices into something that can be used in practice to set actual prices.

Professor Mazzucato gives examples of the practical difficulties which arise from the fact that we cannot in practice identify the marginal price. They include pervasive pollution problems, when producers are not made to account for pollutants that they dump as waste, and do not pay the cost of cleaning up the environment. Very powerful companies which achieve domination of the market can also force consumers to pay more than an item is really worth to them, if they need to have it. In these circumstances profit is no longer a reward for the investment the producers have made; instead they extract extra value, in excess of "normal" profit, by virtue of their monopoly.

The marginal utility approach also ignores the social context: whether an individual lends out capital or works for wages depends on their inherited wealth, whether they live in a rich country, their access to advanced education, whether they live in a city, their parents' social and economic circumstances, and a large number of other factors. The marginal utility approach is also applied to the determination of wages: workers are supposed to work as many hours as they need to balance their need for income with their desire to relax and entertain themselves. Obviously, this theory does not resemble actual practice in any way.

These difficulties are consequential. For one, they mean that the GDP, the common measure of the wealth of nations, provides a highly distorted view. The value attributed to Government services, research and development, and other services that are not priced is problematic, and compromises the rigour of the national accounts. Other problems include the treatment of very high incomes, accounting for informal market activities and valuing home ownership. In 2008 the US GDP was enlarged by 2.5 percent by including the annual cost of R&D, and Nigeria briefly became Africa's largest economy when revised data on the informal economy was included. The imputed rents from home ownership contribute 6 percent of US GDP.

The measurement of value added by financial services is also problematic, where the value is based on fees and interest margins which may respond to influences and circumstances which do not reflect any change in the volume and quality of these services. Because of this disconnect, financial instability may appear as an increase or decline in GDP, when in fact there is no change in the services offered.

A chapter of the book is devoted to the disconnect between financial markets and the funding of investment projects, which has been a defining feature of the last 50 years. It used to be that the prices of equities reflected the returns that were expected on the underlying investment, and price to equity ratios stabilised around a market norm. The values of financial instruments were a fair measure of the value created by the investment. However, with the burgeoning of financial markets in New York and London, and more recently in the Far East, financial market values no longer reflect real investment returns. This disconnect is at the root of controversies over executive pay and under-investment in long-term projects.

Professor Mazzucato shows how price-determined value, in circumstances where there is strong patent protection, inhibits innovation and encourages unproductive rent-seeking (i.e capturing a share of the value created by others, to which you have contributed nothing). "[T]he most modern form of rent-seeking in the twenty-first-century knowledge economy is through these way in which risks in the innovation economy are socialized, while the rewards are privatized (Page 191)." This chapter concludes with recommendations for "confident and capable government" with the ability to "explore, experiment and strategically deliberate inside the public sector (Pages 226, 227)." Also needed are new types of contracts between private and public actors.

The final chapter, "The Economics of Hope", offers some suggestions for the direction in which economists should seek a new, adequate measure of value. Professor Mazzucato favours a mutualistic eco-system, involving different actors in the economy, including government. They should together "fashion markets in ways that produce desirable outcomes such as 'green growth' or a more 'caring' society (Page 275)." Within such markets there would be systems of arriving at agreed measures of value which reflect an acceptable social consensus. The prices of things that are bought and sold would be accepted as fair if they accorded by and large with the mutually agreed consensus on their value. However, any price that appeared to be seriously out of line with accepted values would trigger agreed market mechanisms to bring it back into line. This is a seminal work which will hopefully ignite a thoughtful debate on a practical way forward, in arriving at an acceptable measure of value.

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