Values, Exchange, & Profits:

THE BEDROCK OF ECONOMIC SCIENCE

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THE MOST BASIC questions in economic theory are those concerning *value*. What determines value? What are those factors that make a mere item have a value? A common error is that of speaking about values out of context. For example, if someone were to ask: "Does that rock have a value?," one's immediate reaction should be, "A value to *whom* for what *purpose*?" If that rock cannot be used (a) by someone (b) to achieve some goal, it has no worth.

Thus, the very employment of the term value presupposes the question, "Of value to whom?"; the concept "value" must be used in context. A given individual has a certain hierarchy of values, whether explicitly or implicitly held in his own mind. However, these values are ultimately referable to the purposes set by that person for himself. A fisherman may consider fishhooks and fishing-line as quite valuable, since they have a high degree of importance relevant to his *purpose* of fishing. A writer will not find fishhooks of much use at all; he will want writing instruments; their worth *to him* is derived directly from the goals *he* has chosen. Thus, an individual's hierarchy of values is based on two things: (a) his hierarchy of purposes and (b) the degree of relevance to those purposes of the objects to be valued.

But then what is the relation of *prices* to value? It must be kept in mind that the existence of prices presupposes the existence of ex-

Mr. Jennings, a student at Harvard University, felt impelled by various classroom and campus discussions to try to clarify his principles of economics.

change. Without the latter the former would be unnecessary. Thus, in order to understand exactly how prices relate to exchange, the nature of an exchange relationship must be closely examined. Once again we must ultimately refer to individual values, always remembering that these only reflect that person's goals which he has chosen for himself.

Each Trader Gains

A voluntary exchange, by its own nature, always results in the mutual advantage of both parties, at least in their eyes. In terms of an individual's hierarchy of values, he will not tend to be willing to accept a lower value in exchange for a higher one. He will only be willing to act if he will be better off as a result of that action, i.e., if he will *profit* by it. In a barter economy, exchange will only take place if each party considers himself better off in terms of his value-preferences as a result of the trade. If I have a potato and a friend has a pear, it would only be to our mutual advantage to trade if he wanted the potato more than the pear and I the pear more than the potato. Both of us would consider ourselves to be better off after the trade. When a medium of exchange is introduced, longer-range and more complex exchanges are made possible (thus enabling men to plan long-range and hence to expand their potentialities), but the principle remains the same. Voluntary exchange still works to mutual profit, by its very nature.

A common error is that which views exchange as involving two commodities of equal value, thus dropping the context of what a value is. This notion forms the basis for the conclusion that one man's profit must be at another's expense. However, one man cannot gain at another's expense by free exchange. Only when exchange is coerced may one party to the trade incur a loss.

Note that coercion is only necessary if the exchange wouldn't have taken place otherwise, i.e., if the exchange was *not* to mutual benefit. Thus, coercion is being used to create conflicts of interest rather than to resolve them, by using force to enable one person to profit at the expense of another. If each stands to gain by the trade, it will most likely take place of its own accord.

But how do prices fit into this framework of free exchange? The use of a medium of exchange in the economy facilitates trade relationships between men – this is the source of the value of money; it is good for the purpose of trade. However, money is only of worth to an individual consumer in that it can be exchanged for values; *the degree of its value is only meaningful in the full context of the worth of the many commodities it can be traded for.* But what is the relation of prices to the consumer's values and goals? The price of an item is not its value; they are related but not identical. As previously observed, the item acquires value only in relation to the consumers' goals, and money gains its value from the worth to the purchaser of the things he can buy with it. Then the price only affects the relative gain to each party from the exchange.

Choosing among Alternatives

However, the individual consumer runs into many problems in deciding what specific exchanges to make. One of these is that of *calculating* a value previous to use, i.e., previous to exchanging another value for it. One person may buy a book for 95¢ which changes his life, gives him a whole new approach and outlook, and ultimately shows him the way to achieve happiness. Another may buy the same book and after reading it decide that he was gypped. The first person profited immeasurably from the exchange, and the second person's action resulted in what he considered a loss. However, at the time of purchase both bought the book because they felt that they would be better off from the exchange. This is a difficulty that many socialist planner-theorists seem to overlook. In a market based on free exchange, at least, a consumer occasions a loss only from his own miscalculations, and may even learn from them and apply that knowledge to future choices, so as to avoid repetition of error.

The chances are, however, that the consumer will gain from exchanges, unless he is completely irrational in his choices, because of the way the market operates on producers' profits. We saw that both parties gain from a voluntary exchange; the price merely determines the relative degree that each profits. But in a competitive economy producers' profit-rates tend toward an average minimum. From this observation it could be argued that the largest profits in the free market are those that accrue to people as consumers!

Thus, it is my contention that the conventional view of profits as only accruing to the businessman's end of the exchange relationship is too narrow; that it gives a false picture of the true nature of voluntary trade. There is no conflict of interests inherent in trade relationships. Mutual profit provides the incentive for people to produce and trade; it is the all-important fuel which keeps the economic engine progressing through human action toward the betterment of everyone.

Satisfy the Customer

In the light of my approach to values and demand, then, what is the source of producers' profits? If the use of coercive measures is not open to him (i.e., if the government acts to protect free exchange between individuals rather than to inhibit it, and does not engage in policies of protectionism, etc.), he has only one means by which he is able to *make money*. He must seek out and identify unsatisfied demand and attempt to fulfill it. This he can do by creating a new product which people will value in that it aids them in achieving their goals (thus making them better off); or he can raise his own efficiency in producing commodities already being produced and undersell the other producers, thus giving the consumer a better deal in the trade than his competitors have; or he can devise a new invention which will raise the efficiency of others' production and lower their costs and thus their prices and thus ultimately helping the consumer in that way.

There are many ways of making profits as a producer in a free-exchange economy, but all of them have one thing in common. *They all ultimately must aim at improving the well-being of the consumer.* Through the legal protection of property and of uncoerced exchange, producers are rewarded by the free market commensurate with their ability to and success in satisfying consumer preferences.

However, I have been very careful about qualifying my conclusions relative to *free* exchange: what happens if these voluntary exchange relationships are inhibited by governmental coercion? What happens in a socialist or even a mixed economy in the light of my conclusions? It would appear that, at least in the consumers' own eyes, they would be not better but worse off than under a free-enterprise system, because if an exchange is to be mutually profitable it must be uncoerced. And goods must be produced to be consumed, so producers' profits are as important economically as consumers' profits.

Who Is to Judge?

But here we run into the moral question: are individual consumers competent to decide what is in their own best interests, i.e., what will improve their conditions of existence? Are they competent to decide their own purposes for their own lives? Or, will the planning of production by someone else more nearly reflect the best interests of "society," i.e., of all individual members?

This question has been argued and will continue to be; it remains one of the more basic issues in the conflict between free enterprise and socialism. But if economics as a science is concerned with setting up conditions under which everyone will be better off, in their own estimations, then we can examine the effects of governmental inhibition of free exchange, whether it take the form of interventionism, fascism, socialism, communism, or any of the many variants of each.

Exactly how is this harm done? For example, what are the effects on business decisions of government price-fixing?

Consequences of Price-Fixing

One consequence is that the price is no longer a direct indicator of the dynamic balance between changing consumer value-preferences and evolving production conditions. The price thus is no longer meaningful in the context of market conditions. Thus, the scope of business decisions is considerably narrowed. Business managers no longer must view the price as an indicator of a great many other changing factors; they need only focus on the price itself, relative to their own production costs. Whereas beforehand they based their decisions ultimately on varying consumers' preferences and attempted to anticipate new wants and fulfill them (thus producing directly *for* the consumer), once prices are planned, the scope of the factors upon which decisions are based is constricted and altered.

As for a mixed economy, the degree of interference will determine the extent of the change. Business decisions weigh heavily on price predictions, which in turn under socialism depend on the vagaries of economic planners with near-arbitrary control. Thus, as a result of this redirection in emphasis, in order to better his position the businessman may aim more at gaining political influence so the price can be adjusted to his advantage (at consumers' expense) rather than aiming solely at improving the lot of the consumer by more efficient production of values. Granted, price controls are a means of directing economic production, but let us not rationalize it by saying that it is "in the best interests of the consumer."

Once again we get back to the same basic question. If values are ultimately referable to individuals' purposes, then they cannot be quantified, calculated, and planned by anyone except that individual, and especially not by any central body. Production of *values* is best done by letting producers aim solely at satisfying consumer demand, in an uninhibited market economy. The final issue remains one of whether a central planner can better decide what is in people's interests than they themselves can; i.e., whether businessmen should act according to the dictates of the consumer or of the planner.

The More Complex the Society, the More Need for Freedom

If values are ultimately referable to individual purposes, they are not calculable or quantifiable in a developed economy. Possibly in an undeveloped, subsistence-level economy, values are to some degree predictable in that, by the very nature of life, survival requires certain actions of men. But when choices and alternatives become more complex, and men are not living a hand-to-mouth existence, men develop longer-range, more diversified purposes. Thus their value-hierarchies become more complicated and varied, and unless one aims at directing the very purposes of people's lives, it is best to leave it all to them. Since we are living in a highly integrated, complex society, we must direct our focus onto the problems of socialist planning in that context, in order to cover two final points. First, since attempts at "planning" do get so complicated, and require so much gathering of information, many man-hours must be dedicated to this task. Would not these planners do more good for consumer well-being if they, too, directed their efforts toward the production of values?

Furthermore, a highly-developed and specialized economy is one in which many lives are crucially and intricately dependent upon exchange relationships and their fluidity. Men's professional purposes are so specialized that the fruits of their work may only be of value to a small number of others. The fluidity and sensitivity of a market economy enables these men to seek each other out — thus, men are free (to a certain extent) to specialize and exchange their productive work for other values, always to the mutual benefit of both parties. But it might be quite difficult to convince a "disinterested" planner that this highly specialized work was useful (he might not see things in the same light as the person to whose purposes this man's work had value). In such an instance, who is blocking "progress"? This problem might be intensified all the more in that socialism is partly based on the idea of intrinsic values, which, in the planner's eyes, this work might lack.

The practical problems of socialist planning seem to be without limit in their number and complexity. My purpose in this essay has not been primarily to enumerate those difficulties, however, but rather to present my own claim that much socialist and interventionist theory is ultimately based (a) on an erroneous theory of the nature of *value* and (b) on a subsequent misunderstanding of the nature of *exchange* and *profit*. My analysis of the nature of prices and the value of money merely follows from my other conclusions, as well as my espousal of a free exchange economy as the most efficient creator and protector of "social welfare." ◈

IDEAS ON LIBERTY

Profit-Seeking Business

THE ENTREPRENEURIAL FUNCTION, the striving of entrepreneurs after profits, is the driving power in the market economy. Profit and loss are the devices by means of which the consumers exercise their supremacy on the market. The behavior of the consumers makes profits and losses appear and thereby shifts ownership of the means of production from the hands of the less efficient into those of the more efficient. It makes a man the more influential in the direction of business activities the better he succeeds in serving the consumers. In the absence of profit and loss the entrepreneurs would not know what the most urgent needs of the consumers are. If some entrepreneurs were to guess it, they would lack the means to adjust production accordingly.

Profit-seeking business is subject to the sovereignty of the consumers, while nonprofit institutions are sovereign unto themselves and not responsible to the public. Production for profit is necessarily production for use, as profits can only be earned by providing the consumers with those things they most urgently want to use.

LUDWIG VON MISES, *Human Action*

TOO MUCH

DONALD ROGERS, who used to be the financial editor of the *New York Herald-Tribune*, would like to be the leader of a crusade. But unfortunately only a few straggling platoons have formed behind him. There is a promise in the air of a bigger army, but it is only a promise, and we should not delude ourselves into thinking the crusade is about to burst into full swing.

In a fighting book, *The End of Free Enterprise* (Doubleday, $3.95), Mr. Rogers explains the nature of his crusade. It is to persuade American business to take a vastly augmented responsibility for re-creating a climate of opinion in the United States that will be favorable to the retention and expansion of a voluntaristic enterprise system. Having stated his desires and his hopes, Mr. Rogers then turns to and lets American capitalists have it right in the solar plexus for what he considers is their failure to understand the philosophical bases of the system which they profess to support.

Mr. Rogers' troubles began when he made a supposedly off-the-record speech to a group of business executives at a Washington, D.C., "round table." Part of his speech was devoted to criticizing those executives for failure to throw at least some of their advertising to publishing media that still continued to fight socialistic and Big Government trends. As he tried to tell the executives, business has a responsibility to maintain a healthy competitive social climate as well as a responsibility to its sales departments and its dividend-hungry stockholders.

He wasn't asking the businessmen to boycott "liberal" newspapers and magazines of large circulation which are admittedly the best advertising media when it comes to marketing widgets,