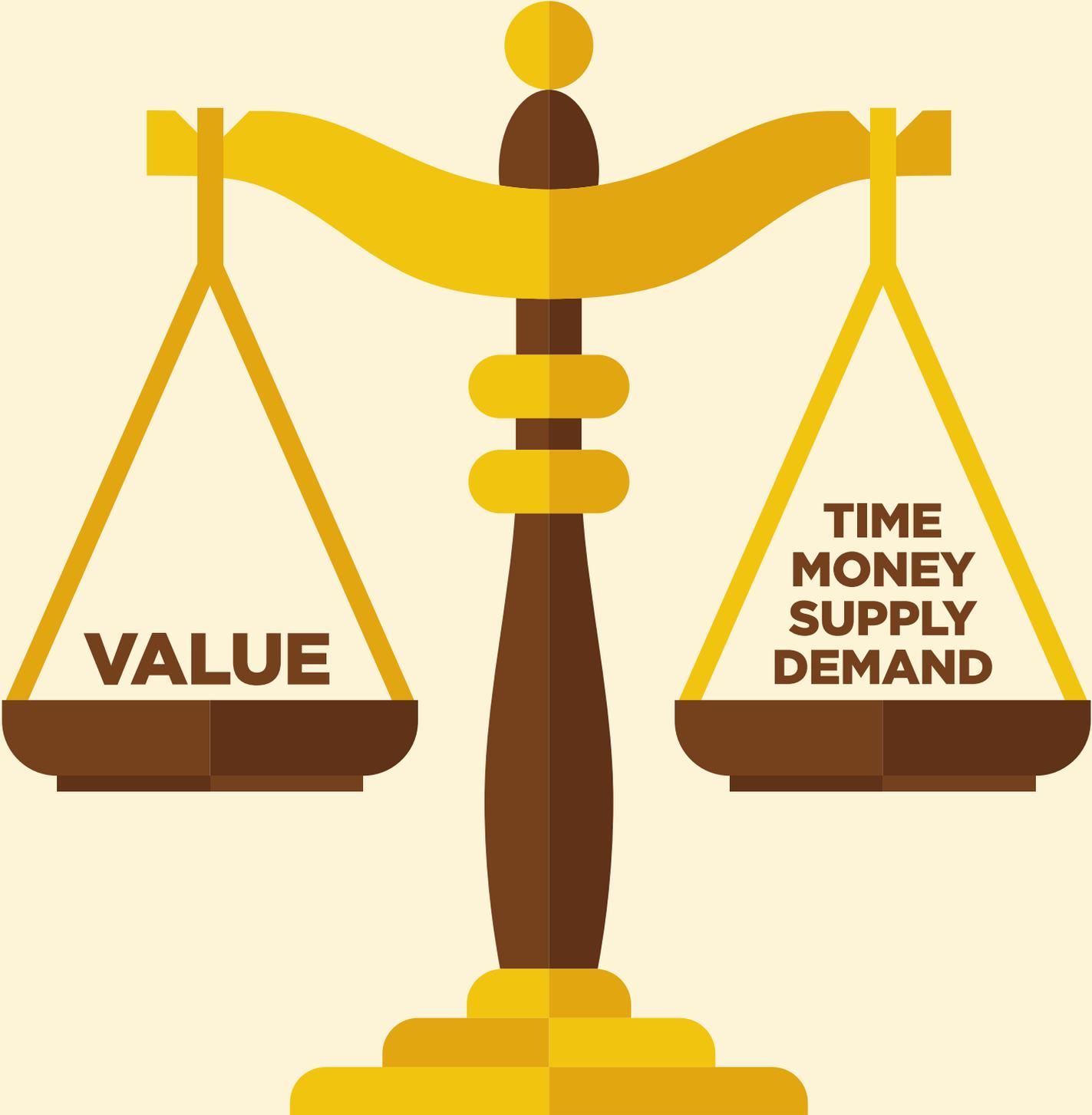




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# VALUE

## CAN IT BE MEASURED?

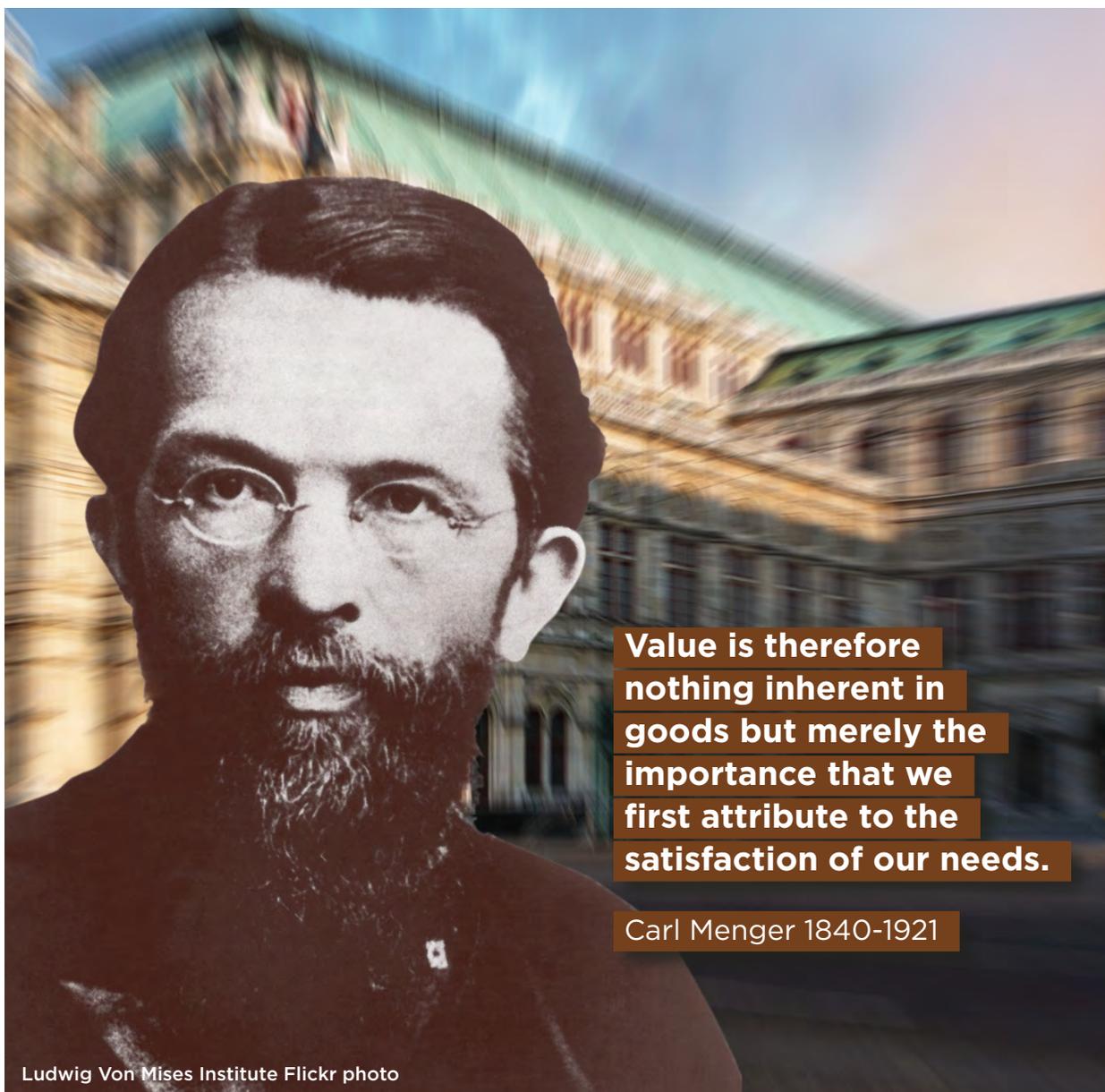
Danny LeRoy

**P**erhaps no other economic concept has spawned and enabled as many intellectual hobgoblins that befuddle clear thinking as that of value. The source of this confusion is the mistaken notion that the value of any good or service is a function of its production cost.

**Classical economists believed that cost determined value and that value was something objective and measurable**

Classical economists, such as Adam Smith, David Ricardo, and John Stuart Mill, were each confounded by the problem of value. They subscribed to the fallacious

idea that value was embodied in products in proportion to the amount of labour that went into their creation. In other words, they believed that cost determined value and that value was something objective and measurable. Inescapable paradoxes immediately arose from the practical application of this theory of value. For example, how could certain raw materials like exotic hardwood or uncut gems fetch higher prices than products that required hundreds of man hours to produce, such as ornate furniture or finely crafted telescopes? How could an essential good, such as water, have a lower price than a luxury product, such as diamonds? In addition to failing to provide satisfactory insight into these



**Value is therefore nothing inherent in goods but merely the importance that we first attribute to the satisfaction of our needs.**

**Carl Menger 1840-1921**

Ludwig Von Mises Institute Flickr photo

and similar questions, the labour theory of value could not explain fluctuating values for different kinds of labour, nor could it account for why found goods could be more valuable than extracted goods.

In 1871, Carl Menger brilliantly and completely resolved the conundrum over value by combining the novel concepts of marginalism and

subjectivism. Marginalism refers to the way individuals evaluate certain things depending upon the quantity available and the quantity consumed. If you were thirsty, you would, for example, pay more for your first glass of lemonade than for the second, third, or tenth glass. After the tenth glass, there may be absolutely no marginal value to lemonade at all (at least as far as

you are concerned). The marginal value of the lemonade decreases with each glass consumed. Subjectivism refers to the fact that things are inescapably appreciated (and valued) according to a private set of priorities, tastes, and preferences. Some people pay vast sums for old comic books whereas others could not be convinced to pay a nickel for even one comic book. This largely comes down to individual—hence subjective—preferences.

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While the medieval scholars and French economists of the 18th and 19th century implicitly used a marginalist and subjective theory of value, Menger formalized this combination (together, but independently with Stanley Jevons and Léon Walras) and in doing so contributed to one of the greatest discoveries in economic science. Menger revealed the precise nature of economic value and rooted economics firmly in the real-world actions of individual human beings.

Menger's penetrating insight was that value is not inherent in goods or services. Instead, goods or services take on significance for individuals, either as a way to directly satisfy a need or as a means to satisfy a need through exchange. It is for this reason that a good can

have great value to one individual, little value to another, and no value at all to a third, depending on each individual's requirements and the good's availability. Thus, both the nature and the measure of value are entirely subjective. Goods or services always have some kind of value to individuals—at least to economizing individuals who are sensitive to scarcity and prices—and their marginal value can only be determined by those individuals. In other words, value is in the eye of the beholder.

Since value is completely subjective, it cannot be quantified or measured. There are no cardinal units of value that enable it to be added, subtracted, multiplied, or divided across individuals. Furthermore, individual valuations are not constant; they are always changing. Value is something that each individual weighs on a purely private set of scales. When determining value, an individual takes into account a vast range of considerations, many of which are peculiar to him alone and may be so deeply subjective that they could not be described to another person.

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The expression of subjective valuations is most clearly seen through interpersonal exchange. Every time a person decides to

buy something, he or she gives up something they value less (a specific amount of money) in exchange for something they value more (a specific quantity of a specific good or service). The same is true for the counterparty to the transaction, the seller. He or she gives up something they value less (a specific quantity of a specific good or service) in exchange for something they value more (a specific amount of money). The resulting price may be public knowledge, but the value to each individual is known only to them and can be known only by them.

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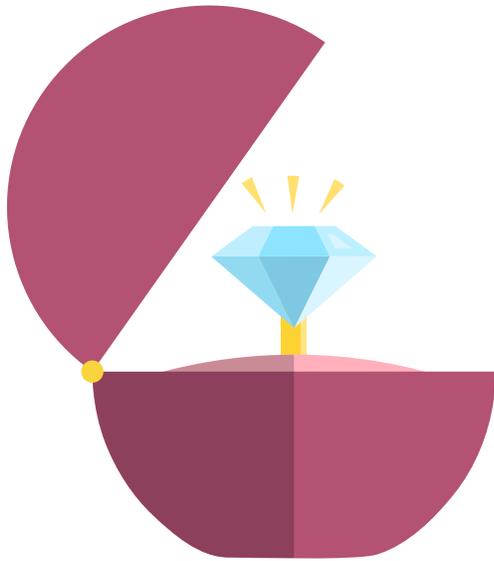
Thus, when I pay \$1.64 in exchange for one large coffee at a particular place and time, the value of my newly acquired coffee is known



only by me. By virtue of Menger's contribution, it is first and foremost evident that in this and in every other unhampered interpersonal exchange, value never equals price. Second, my personal (and marginal) valuation of a cup of coffee changes over time with each mouthful, as the coffee cools, and in concert with my perception of the external world which influences my enjoyment of that beverage. For instance, my valuation of a cup of coffee on a given day is certainly much higher after a poor sleep the night before.

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The subjective valuation of consumer goods and services ultimately determines the valuation of all factors of production, including the inputs required to produce goods and services. Each unit of each input at every stage of production is valued by entrepreneurs according to the estimated value of the consumer goods they might produce. It is true that many goods or services requiring high-priced inputs will themselves command a high price. But that is because entrepreneurs will not use expensive inputs in the creation of these goods or services unless consumers are willing to pay high prices. It is not because diamonds are expensive that diamond rings are expensive; it is



because people value diamond rings highly that diamonds are expensive.

Although Menger provided a correct theory of value in 1871, ancient errors clearly die very hard. Fallacious and erroneous conceptions of value inevitably misdirect contemporary discussions of economic issues. The resulting problems would be far less widespread if valuation was not so central to economic decision making. 

## SUGGESTIONS FOR FURTHER READING

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