

Mises' Incomplete Theory of the Value of Money

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SUMMARY

Ludwig von Mises introduced the concept of marginal utility into Austrian economics. He presented what he described as a complete theory of the value of money on the basis of the subjective theory of value and its peculiar doctrine of marginal utility. It is shown here that Mises' theory of value is unclear for at least three reasons. Mises states that his theory of money is based on Menger's theory of value, while in fact his theory refers to Jevons' rather than to Menger's. Secondly, the essence of Mises' theory contradicts his earlier assumption on the immeasurability of the use value of money. Thirdly, Mises' concept of continuity in the objective exchange value of money is not grounded in the subjective theory of value.

Keywords: theory of money value, subjective use value of money, objective exchange value of money, marginal utility, Menger, Jevons

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INTRODUCTION

Ludwig von Mises belongs to the so-called Austrian school of economics. His scientific achievements are impressive and go beyond the accomplishments of that school. Although Mises dealt with the general theory of economics, the central focus of his interest was always *money*. Mises proved that resource allocations begin and end in the exchange of commodities – consequently all economic issues are related to the theory of money.

The Theory of Money and Credit (1912) is more than 100 years old, but it nonetheless contains theses that call into question the contemporary approach to money. Mises' theory of money value derives from that of Carl Menger, a founder of the Vienna school of economics. Although Mises' theory is rooted in Menger's, the author departs to a certain extent from its core. Mises introduced, among other things, the concept of the objective exchange value of money, and attributed to it a special significance in the process of money valuation. He showed that the subjective value of money is derived from the objective exchange value. 'While the utility of other goods depends on (...) conditions that do not belong to the category of economics at all but are partly of a technological and partly a psychological nature, the subjective value of money is conditioned by its objective exchange value, that is, by a

characteristic that falls within the scope of economics' (Mises 1981, p. 118).

The primary goal of this article is to determine whether Mises remains a successor to the Mengerian subjective theory of value, or whether his theory of money value relies rather on Jevons' scientific rigor.

ON THE (IM)MEASURABILITY OF THE SUBJECTIVE VALUE OF MONEY

A central element in Mises' theory of money value (1912) is the concept of objective exchange value. Subjective valuation of money is based on the assumption that money has a certain objective exchange value, i.e. the possibility of obtaining a certain quantity of other economic goods in exchange for a given quantity of money. 'If we wish to estimate the significance that a given sum of money has (...) we can do this only on the assumption that money possesses a given objective exchange value' (Mises 1981, p. 119). 'Both the subjective use value of money and its subjective exchange value are derived from its objective exchange value' (Mises 1981, p. 118).

This approach to the value of money may be viewed in certain respects as inconsistent with Menger's subjective theory of value. Let us start from the beginning, however,

namely by explaining the essence of the theory of commodity valuation and its reference to the medium of exchange.

In the second chapter of his book *Theory of Money and Credit* (1912) Mises argues that ‘the notion of money as a measure of value is fallacious’ (Mises 1981, p. 51). This conflicts with the fundamentals of Menger’s theory of value. ‘Every economic activity presupposes a comparison of values’ (Mises 1981, p. 51). The process of valuing means ordering commodities according to their importance to each individual. Each person draws up a list of comparative values for a given point of time (Mises 1981, p. 52). The need for such a comparison is due to the circumstance that the process of valuation itself leads eventually to the exchange of commodities. Instead of stating that ‘this commodity is worth so much’ we can only say that ‘the value of this commodity is greater than the value of that’. ‘The subjective use value of a commodity is immeasurable. It is impracticable to ascribe a quantity (of values) to it’ (Mises 1981, p. 58).

In *Theory of Money...* Mises refers to Carl Menger’s contributions to the general theory of value. According to Menger, the notion of value belongs to the category of human judgment. A value is the importance we assign to a good because we are aware that the satisfaction of a need depends on command over the good in question¹. The value that we attribute to a good derives from the importance of the need it satisfies². It is the result of a *transfer* of the importance of the need onto the good that satisfies that need³. The magnitude of the value depends on the relative rank of the need satisfied by the good and on the quantity of good being available to a person⁴. The nature of value is subjective. It directs human economic choices, i.e. commodity exchange. Carl Menger showed that the origin of money as a medium of exchange refers to money as an economic good. Each exchange transaction is preceded by an act of valuation. When individuals exchange commodities, they reveal their individual value scales. If commodity *a* is exchanged for commodity *b* it is because the individuals involved assign opposite values to them. If commodity *a* is a loaf of bread, and commodity *b* is half a dozen eggs, then the first party to the transaction values the half-dozen eggs ‘higher’ than the loaf of bread, while the other values the loaf of bread higher than the

half-dozen eggs. In other words, an individual will exchange a good or certain quantity of it as long as the goods acquired are more valuable than the goods given up. The exchange ratio is a result of their different importance to the individuals concerned.

Although Mises argued that the subjective estimates of individuals are the basis for the economic valuation of money, just as for other goods (Mises 1981, p. 117), he unexpectedly introduced into the theory of money value a concept of marginal utility, based on its objective exchange value. Mises assumed that a valuation of money is possible only on the assumption that money has a certain objective exchange value (Mises 1981, p. 130). ‘Since there is no direct connection between money as such and any human want, an individual can obtain an idea of its utility and consequently of its value only by assuming a definite purchasing power’ (Mises 1981, p. 130). As we can see, Mises does not apply universal rules governing the value of goods to the value of money. On the contrary, he states that the theory of money must take account of the fundamental difference between the principles that govern the value of money and those that govern the value of commodities. ‘We need to undertake a different approach in the theoretical approach to the value of money and other commodities’ (Mises 1981, p. 122). ‘It is not the task of economics (...) to explain why corn is useful to man and valued by him. But it is the task of economics alone to explain the utility of money’ (Mises 1981, p. 119). This line of argument leads Mises to conclusions that contradict earlier theses, firstly on the immeasurability of the subjective value of money, and secondly on the nature of value as a category of human judgement. In stating a link between the objective exchange value of money and subjective valuations of the medium of exchange, Mises introduced the concept of marginal utility as a measure of value. ‘The subjective use value of money must be measured by the marginal utility of the goods for which the money can be exchanged’ (Mises 1981, p. 130). All of this shows that Ludwig von Mises did indeed depart from the Mengerian concept of the process of valuation. This would appear to have had many far-reaching consequences.

¹ (...) *Es ist somit der Werth die Bedeutung, welche concrete Güter oder Güterquantitäten für uns dadurch erlangen, dass wer in der Befriedigung unserer Bedürfnisse von der Verfügung über dieselben abhängig zu sein bewusst sind* (Menger 1871/2010, p. 78).

² *Der Güterwerth ist in der Beziehung der Güter zu unseren Bedürfnissen begründet, nicht in den Gütern selbst* (Menger 1871/2010, p. 85).

³ *Die Bedeutung, welche die Güter für uns haben, und welche wir Werth nennen, ist lediglich eine übertragene. Ursprünglich habe nur die Bedürfnisbefriedigungen für uns eine Bedeutung, (...), wir übertragen aber in logischer Consequenz diese Bedeutung auf jene Güter, von deren Verfügung wir in der Befriedigung dieser Bedürfnisse abhängig zu sein uns bewusst sind* (Menger 1871/2010, p. 107).

⁴ *Die Grösse der Bedeutung, welche die verschiedenen concreten Bedürfnisbefriedigungen (die einzelnen Acte derselben, welche eben durch concrete Güter herbeigeführt werden können) für uns haben ist eine ungleiche und das Mass derselben liegt in dem Grade ihrer Wichtigkeit für die Aufrechterhaltung unseres Lebens und unserer Wohlfahrt. (...) Die Grösse der auf die Güter übertragenen Bedeutung unserer Bedürfnisbefriedigungen, das ist die Grösse des Werthes, ist somit gleichfalls eine verschiedene (...)* (Menger 1871/2010, p. 107).

UTILITY AS A MEASURE OF MONEY VALUE

In *Theory of Money and Credit* (1912) Mises argued that 'the revolution in economics since 1870 had not provided a satisfactory solution to the theory of value problem' (Mises 1981, p. 137). Although Menger, as Mises argues, had initiated a deeper understanding of the nature and value of money, nobody had yet succeeded in solving 'the fundamental problem of the value of money'.

Mises assumed that the essence of money's utility derives from its objective exchange value. If an individual values money, he needs to assume that it has some purchasing power. The value of money is derived from the objective factor, namely money's purchasing power. We need to search for, as Mises writes, 'objective determinants of its subjective value' (Mises 1981, p. 119). Any investigation of subjective value demands prior investigation of this objective exchange value. 'There is no subjective value of money without objective exchange value' (Mises 1981, p. 119). 'The theory of the value of money leads us back through subjective exchange value to objective exchange value' (Mises 1981, p. 122). How does Mises eventually trace the objective determinants of the subjective exchange value of money? Mises assumes that the objective exchange value of money contains a historically continuous component. 'The past value of money is taken over by the present and transformed by it (...)' (Mises 1981, p. 133). 'Once an exchange ratio between money and commodities has been established in the market, it continues to exercise an influence beyond the period during which it was maintained; it provides the basis for the further valuation of money' (Mises 1981, p. 130). The money prices of today are linked to those of yesterday, and with those of tomorrow and beyond. In other words, the past objective exchange value of money has a certain significance for its present and future valuation. When searching for the objective determinants of subjective values of money, we will eventually reach a point in time where the object derives its exchange value from a value other than money. At this stage of his analysis, Mises is undoubtedly turning towards the approach proposed by Friedrich von Wieser, who attributed a special social and economic significance to the

'*objective innere Tauchwert des Geldes*' (Taylor 1958). Although Wieser, as Mises noted, did not manage to develop a complete theory of money, '(...) it was Wieser who, by revealing the historical element in the purchasing power of money, laid the foundation for the further development of the subjective theory of the value of money' (Mises 1981, p. 139).

Let us pause at this point to analyse the essence of Mises' theory of value. Mises himself claimed that he had managed to present a complete theory of the value of money on the basis of the subjective theory of value and its peculiar doctrine of marginal utility (Mises 1981, p. 136). By introducing the concept of utility into the theory of money value, i.e. by assuming that the starting point of money valuations is its objective exchange value, Mises aligned himself with the school that associated the term utility with value. He followed the concept of utility within the subjective theory of value introduced by Jevons and Walras. Jevons referred the economic question of a commodity's value to its utility. 'Value depends on the utility' – he wrote in *Theory of Political Economy* (1871). Utility is an abstract quality of a commodity which serves human purposes. It is, as Jevons put it, the intensity of the effect produced upon the consumer⁵. Utility must be considered as measured by, or even as actually identical with, the addition made to a person's happiness (Jevons 1931, p. 45). A similar understanding of utility can be found in earlier works, including those of J.S. Mill (1806–1873), J.B. Say (1767–1832) and E.B. de Condillac (1715–1780)⁶. Ludwig von Mises followed the approach to value understood as the benefit that a good provides – that is, as a property of the good. 'If we wish to estimate the significance that a given sum of money has, in view of the known dependence upon it of a certain satisfaction, we do this only on the assumption that money possesses a given objective exchange value' (Mises 1981, p. 119). Mises attributed to money, as a medium of exchange, the concept of utility.

It needs to be pointed out that the concept of utility as a measure of value seems inconsistent with Menger's theory of value. In the latter theory there is a significant difference between the notions of utility and value. The value of a good is related to its economic character (its relative scarcity) and the importance of the good in the process of satisfaction of a person's need. For Menger the concept of utility ends in the *commodity attribute*.

⁵ Utility may be treated as a quantity of two dimensions, one dimension consisting in the quantity of the commodity, and the other in the intensity of the effect produced upon the consumer (Jevons 1871/1931, p. 47).

⁶ Mill (1848) argued that utility is an inherent property of a good which serves the satisfaction of human need (Zawadzki 1949). In Say's treatise (1814) utility is a quality of a good that makes it desirable for each person (Zawadzki 1949). Condillac (1776) demonstrated that value is based on utility, on the need that is satisfied by a commodity or on the benefit ("behoof") that a good provides (Zawadzki 1949).

A good is useful if it satisfies human needs⁷. A non-economic good is useful, i.e. able to satisfy human needs, but does not have value. Utility is in fact a non-economic term. It does not refer to the theory of value, but belongs to the theory of good. Since we face scarcity, we rank goods according to their importance in the satisfaction of needs; that is to say, we attach *value* to the commodities exchanged in the marketplace. We exchange goods directly or indirectly, always giving up goods that are less valued than those accepted. Money as a medium of exchange follows these rules just like other goods.

As we can see, Mises employed a notion of utility not in Menger's but in Jevons' sense. By introducing the objective exchange value of money, Mises turned to marginal utility as a measure of value⁸. Mises assumed that, since money does not meet human needs (as other goods do), we cannot assign value to it as we do to other goods. 'When explaining the value of commodities, the economist can and must be content to take subjective use value for granted and leave investigation of its origins to the psychologist (...)' (Mises 1981, p. 118). It is immaterial whether or not the commodity also has exchange value, but for money to have use value, the existence of exchange value is essential.

DISCUSSION

As we have shown, money as a means of exchange was considered by Mises not to be subject to the rules of valuation introduced by Menger. In making this exception, Mises introduced at least three unsolvable problems.

Firstly, he did not explain how the subjective value of money is derived from its objective exchange value. Mises stated that the past objective value of money is linked to its present and future valuations. The subjective value of money is conditioned by its given objective exchange value. Both theses fail to explain the nature of the subjective exchange value of money. When searching for 'objective determinants of money's subjective value' we do not recognise any factor or process which results in the magnitude of its utility.

Secondly, by introducing into Austrian economics the concept of marginal utility, Mises was essentially following a blind alley. He assumed that the subjective use value of money is measured by the marginal utility of the

goods for which the money can be exchanged. This contradicts his earlier statement on the immeasurability of the subjective exchange value of money. 'So long as the subjective value of money is accepted, this question of measurement cannot arise' (Mises 1981, p. 51). 'Acts of valuation are not susceptible to any kind of measurement' (Mises 1981, p. 52).

The process of measuring requires the use of an objective means of measurement, namely a unit 'fixed in time and space' – a tool which is constant and material; for example we measure lengths of fabric in metres or body weight in kilogrammes. In valuing goods we do not measure the value of goods by money – neither do we measure the value of money by goods. Value – as Menger was the first to note – belongs to the category of human judgment. It cannot be measured or quantified. It is of qualitative character. Neither Commodity *a* nor Commodity *b* is a measure of the value of the good exchanged. 'In a market, exchange will continue until it is no longer possible for the reciprocal surrender of commodities by any individuals to result in their each acquiring commodities that stand higher on their value scales than those surrendered' (Mises 1981, p. 53).

Thirdly, the concept of the marginal utility of money assumes the existence of price. According to Mises, it is subjective valuations that are the basis for money prices. So prices are on the one hand a result of the valuation process, and on the other its cause. Although the prices in question are not the same ones, the category of price cannot be explained in terms of itself. In this context, the historical element of continuity in the objective exchange value of money, employed by Mises as proof of the commodity origin of money, also becomes unclear. It appears to depict a functional dependency, which is a category of descriptive rather than causal character.

And last but not least, if we take Mises' view that 'the subjective use-value of money (...) is nothing but the anticipated use-value of things that are to be bought with it' (Mises 1981, p. 130), then we will inevitably accept the assumption of the *objective theory of value* on the *reciprocal surrender of equivalent goods*. Its primary implication is that exchange transactions are preceded by measurements of the quantity of value contained in each of the objects that are to be exchanged. And money as a medium of exchange is a measure of value (!).

⁷ *Nützlichkeit ist die Tauglichkeit eines Dinges, der Befriedigung menschlicher Bedürfnisse zu dienen und demnach (und zwar die erkannte Nützlichkeit) eine allgemeine Vorraussetzung der Güterqualität. Auch nicht ökonomische Güter sind nützlich, indem dieselben zur Befriedigung unserer Bedürfnisse ebenso wohl tauglich sind, als die ökonomischen, und diese Tauglichkeit muss auch bei ihnen eine von den Menschen erkannte sein, sonst könnten sie überhaupt nicht die Güterqualität erlangen. Was aber nicht ökonomisches Gut von einem solchen unterscheidet, welches in dem den ökonomischen Charakter begründenden Quantitätenverhältnisse steht, das ist der Umstand, dass nicht von der Verfügung über concrete Quantitäten des erstern, wohl aber von einer solchen über concrete Quantitäten des letztern die Befriedigung menschlicher Bedürfnisse abhängig ist, und somit die ersteren wohl Nützlichkeit, nur die letzteren aber neben ihrer Nützlichkeit auch jene Bedeutung für uns haben, die wir Werth nennen (Menger 1871/2010, p. 84).*

⁸ 'Money utility is the possibility of obtaining a certain quantity of other economic goods in exchange for a given quantity of money. (...) money has no utility other than that arising from the possibility of obtaining other goods in exchange for it' (Mises 1912/1981, p. 118).

In his later book *Human Action: A Treatise on Economics* (1949) Ludwig von Mises basically sustains the theses introduced in *Theory of Money and Credit* (1912). However, the theory of the value of money was presented there slightly differently⁹.

The numerous references to *the quantity theory of money* appearing in Chapter XVII, titled *Indirect Exchange*, indicate that as far as money theory is concerned, the 1949 work may be regarded as a supplementation of the analysis first put forward by Mises in 1912. Mises argued, referring among others to the ideas of Menger, that 'the theory of money was and is always the theory of indirect exchange and of the media of exchange' (Mises 1949, p. 395). From that assumption he derived two important premises. First, money as a medium of exchange is an economic good – it is rare and there is a demand for it. Second, the subject matter of the theory of indirect exchange is the study of exchange ratios between the medium of exchange on the one hand and goods and services on the other hand.

In *Human Action ...* (1949) Mises used the so-called praxeological method, which, in Mises' words, 'traces all

phenomena back to actions of the individuals' (Mises 1949, p. 403). He argued that when analysing monetary phenomena we need to take as a point of departure the value judgments of the people concerned. The method applied by Mises led him to two important conclusions. First, '(...) the appraisal of money is to be explained in the same way as the appraisal of all other goods: by the demand on the part of those who are eager to acquire a definite quantity of it' (Mises 1949, p. 400). Second, '(...) it would still be faulty to explain the purchasing power – the price – of the monetary unit on the basis of its services' (Mises 1949, p. 396). (...) It is always demand that influences the price structure, not the objective value in use (Mises 1949, p. 397). Having in mind Mises' theory from 1912, one can see that these statements contradict the theses presented there. In spite of this, Mises does not revise his theory. Instead, he returns to his *regression theorem*, arguing that 'the demand for a medium of exchange (...) depends on its value in exchange' (Mises 1949, p. 405).

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⁹ A great part of the theory of the value of money in *Human Action: A Treatise on Economics* (1949) was first presented by L. von Mises in *Nationalökonomie: Theorie des Handelns und Wirtschaftens* (1940).