

MARIANA
MAZZUCATO
THE VALUE OF
EVERYTHING

MAKING AND
TAKING IN
THE GLOBAL
ECONOMY

'Forces us to confront long-held
beliefs about how economies work
and who benefits'

MARTIN WOLF, *FINANCIAL TIMES*



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ABOUT THE AUTHOR

Mariana Mazzucato is Professor in the Economics of Innovation and Public Value at University College London (UCL), where she is also Founder and Director of the Institute for Innovation and Public Purpose. Her widely published research focuses on the relationship between public policy, innovation, and economic growth and she advises policymakers around the world on how to steer innovation so that it produces growth that is more inclusive and sustainable. She is author of the highly acclaimed book *The Entrepreneurial State: Debunking Public vs. Private Sector Myths* and co-editor of *Rethinking Capitalism: Economics and Policy for Sustainable and Inclusive Growth*. She is winner of the 2014 *New Statesman* SPERI Prize in Political Economy, the 2015 Hans-Matthöfer-Preis and the 2018 Leontief Prize for Advancing the Frontiers of Economic Thought. She was named as one of the ‘three most important thinkers about innovation’ in *New Republic*.

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For Leon, Micol, Luce and Sofia

Preface: Stories About Wealth Creation

Between 1975 and 2017 real US GDP – the size of the economy adjusted for inflation – roughly tripled, from \$5.49 trillion to \$17.29 trillion.¹ During this period, productivity grew by about 60 per cent. Yet from 1979 onwards, real hourly wages for the great majority of American workers have stagnated or even fallen.² In other words, for almost four decades a tiny elite has captured nearly all the gains from an expanding economy. Is this because they are particularly productive members of society?

The Greek philosopher Plato once argued that storytellers rule the world. His great work *The Republic* was in part a guide to educating the leader of his ideal state, the Guardian. This book questions the stories we are being told about who the wealth creators are in modern-day capitalism, stories about which activities are productive as opposed to unproductive, and thus where value creation comes from. It questions the effect these stories are having on the ability of the few to extract more from the economy in the name of wealth creation.

These stories are everywhere. The contexts may differ – finance, big pharma or big tech – but the self-descriptions are similar: I am a particularly productive member of the economy, my activities create wealth, I take big ‘risks’, and so I deserve a higher income than people who simply benefit from the spillovers of this activity. But what if, in the end,

these descriptions are simply just stories? Narratives created in order to justify inequalities of wealth and income, massively rewarding the few who are able to convince governments and society that they deserve high rewards, while the rest make do with the leftovers. Consider some of these stories, first in the financial sector.

In 2009 Lloyd Blankfein, CEO of Goldman Sachs, claimed that ‘The people of Goldman Sachs are among the most productive in the world.’³ Yet, just the year before, Goldman had been a major contributor to the worst financial and economic crisis since the 1930s. US taxpayers had to stump up \$125 billion to bail it out. In light of the terrible performance of the investment bank just a year before, such a bullish statement by the CEO was extraordinary. The bank laid off 3,000 employees between November 2007 and December 2009, and profits plunged.⁴ The bank and some of its competitors were fined, although the amounts were small relative to later profits: fines of \$550 million for Goldman and \$297 million for J. P. Morgan, for example.⁵ Despite everything, Goldman – along with other banks and hedge funds – proceeded to bet against the very instruments which they had created and which had led to such turmoil.

Although there was much talk about punishing those banks that had contributed to the crisis, no banker was jailed, and the changes hardly dented the banks’ ability to continue making money from speculation: between 2009 and 2016 Goldman achieved net earnings of \$63 billion on net revenues of \$250 billion.⁶ In 2009 alone they had record earnings of \$13.4 billion.⁷ And although the US government saved the banking system with taxpayers’ money, the government did not have the confidence to demand a fee from the banks for

such high-risk activity. It was simply happy, in the end, to get its money back.

Financial crises, of course, are not new. Yet Blankfein's exuberant confidence in his bank would have been less common half a century ago. Until the 1960s, finance was not widely considered a 'productive' part of the economy. It was viewed as important for transferring existing wealth, not creating new wealth. Indeed, economists were so convinced about the purely facilitating role of finance that they did not even include most of the services that banks performed, such as taking in deposits and giving out loans, in their calculations of how many goods and services are produced by the economy. Finance sneaked into their measurements of Gross Domestic Product (GDP) only as an 'intermediate input' – a service contributing to the functioning of other industries that were the real value creators.

In around 1970, however, things started to change. The national accounts – which provide a statistical picture of the size, composition and direction of an economy – began to include the financial sector in their calculations of GDP, the total value of the goods and services produced by the economy in question.⁸ This change in accounting coincided with the deregulation of the financial sector which, among other things, relaxed controls on how much banks could lend, the interest rates they could charge and the products they could sell. Together, these changes fundamentally altered how the financial sector behaved, and increased its influence on the 'real' economy. No longer was finance seen as a staid career. Instead, it became a fast track for smart people to make a great deal of money. Indeed, after the Berlin Wall fell in 1989, some of the cleverest scientists in Eastern Europe

ended up going to work for Wall Street. The industry expanded, grew more confident. It openly lobbied to advance its interests, claiming that finance was critical for wealth creation.

Today the issue is not just the size of the financial sector, and how it has outpaced the growth of the non-financial economy (e.g. industry), but its effect on the behaviour of the rest of the economy, large parts of which have been 'financialized'. Financial operations and the mentality they breed pervade industry, as can be seen when managers choose to spend a greater proportion of profits on share buy-backs – which in turn boost stock prices, stock options and the pay of top executives – than on investing in the long-term future of the business. They call it value creation but, as in the financial sector itself, the reality is often the opposite: value extraction.

But these stories of value creation are not limited to finance. In 2014 the pharmaceutical giant Gilead priced its new treatment for the life-threatening hepatitis C virus, Harvoni, at \$94,500 for a three-month course. Gilead justified charging this price by insisting that it represented 'value' to health systems. John LaMattina, former President of R&D at the drugs company Pfizer, argued that the high price of speciality drugs is justified by how beneficial they are for patients and for society in general. In practice, this means relating the price of a drug to the costs that the disease would cause to society if not treated, or if treated with the second-best therapy available. The industry calls this 'value-based pricing'. It's an argument refuted by critics, who cite case studies that show no correlation between the price of cancer drugs and the benefits they provide.⁹ One interactive

calculator (www.drugabacus.org), which enables you to establish the 'correct' price of a cancer drug on the basis of its valuable characteristics (the increase in life expectancy it provides to patients, its side effects, and so on), shows that for most drugs this value-based price is lower than the current market price.¹⁰

Yet drug prices are not falling. It seems that the industry's value creation arguments have successfully neutralized criticism. Indeed, a high proportion of health care costs in the Western world has nothing to do with health care: these costs are simply the value the pharmaceutical industry extracts.

Or consider the stories in the tech industry. In the name of favouring entrepreneurship and innovation, companies in the IT industry have often lobbied for less regulation and advantageous tax treatments. With 'innovation' as the new force in modern capitalism, Silicon Valley has successfully projected itself as the entrepreneurial force behind wealth creation – unleashing the 'creative destruction' from which the jobs of the future come.

This seductive story of value creation has led to lower rates of capital gains tax for the venture capitalists funding the tech companies, and questionable tax policies like the 'patent box', which reduces tax on profits from the sale of products whose inputs are patented, supposedly to incentivize innovation by rewarding the generation of intellectual property. It's a policy that makes little sense, as patents are already instruments that allow monopoly profits for twenty years, thus earning high returns. Policymakers' objectives should not be to increase the profits from monopolies, but to favour the reinvestment of those profits in areas like research.

Many of the so-called wealth creators in the tech industry, like the co-founder of Pay Pal, Peter Thiel, often lambast government as a pure impediment to wealth creation.¹¹ Thiel went so far as to set up a 'secessionist movement' in California so that the wealth creators could be as independent as possible from the heavy hand of government. And Eric Schmidt, CEO of Google, has repeatedly claimed that citizens' data is safer with Google than with government. This stance feeds a modern-day banality: entrepreneurs good, government bad – or inept.

Yet in presenting themselves as modern-day heroes, and justifying their record profits and cash mountains, Apple and other companies conveniently ignore the pioneering role of government in new technologies. Apple has unashamedly declared that its contribution to society should not be sought through tax but through recognition of its great gizmos. But where did the smart tech behind those gizmos come from? Public funds. The Internet, GPS, touchscreen, SIRI and the algorithm behind Google – all were funded by public institutions. Shouldn't the taxpayer thus get something back, beyond a series of undoubtedly brilliant gadgets? Simply to pose this question, however, underlines how we need a radically different type of narrative as to who created the wealth in the first place – and who has subsequently extracted it.

And yet – where does government fit into these stories of wealth creation? If there are so many wealth creators in industry, the inevitable conclusion is that at the opposite side of the spectrum featuring fleet-footed bankers, science-based pharmaceuticals and entrepreneurial geeks are the inert, value-extracting civil servants and bureaucrats in

government. In this view, if private enterprise is the fast cheetah bringing innovation to the world, government is a plodding tortoise impeding progress – or, to invoke a different metaphor, a Kafkaesque bureaucrat, buried under papers, cumbersome and inefficient. Government is depicted as a drain on society, funded by obligatory taxes on long-suffering citizens. In this story, there is always only one conclusion: that we need more market and less state. The slimmer, trimmer and more efficient the state machine the better.

In all these cases, from finance to pharmaceuticals and IT, governments bend over backwards to attract these supposedly value-creating individuals and companies, dangling before them tax reductions and exemptions from the red tape that is believed to constrict their wealth-creating energies. The media heap wealth creators with praise, politicians court them, and for many people they are high-status figures to be admired and emulated. But who decided that they are creating value? What definition of value is used to distinguish value creation from value extraction, or even from value destruction?

Why have we so readily believed this narrative of good versus bad? How is the value produced by the public sector measured, and why is it more often than not treated simply as a more inefficient version of the private sector? What if there was actually no evidence for this story at all? What if it stemmed purely from a set of deeply ingrained ideas? What new stories might we tell?

Plato recognized that stories form character, culture and behaviour: ‘Our first business is to supervise the production of stories, and choose only those we think suitable, and reject

the rest. We shall persuade mothers and nurses to tell our chosen stories to their children, and by means of them to mould their minds and characters rather than their bodies. The greater part of the stories current today we shall have to reject.¹²

Plato disliked myths about ill-behaved gods. This book looks at a more modern myth, about value creation in the economy. Such myth-making, I argue, has allowed an immense amount of value extraction, enabling some individuals to become very rich and draining societal wealth in the process.

The purpose of this book is to change this state of things, and to do so by reinvigorating the debate about value that used to be – and, I argue, should still be – at the core of economic thinking. If value is defined by price – set by the supposed forces of supply and demand – then as long as an activity fetches a price, it is seen as creating value. So if you earn a lot you must be a value creator. I will argue that the way the word ‘value’ is used in modern economics has made it easier for value-extracting activities to masquerade as value-creating activities. And in the process rents (unearned income) get confused with profits (earned income); inequality rises, and investment in the real economy falls. What’s more, if we cannot differentiate value creation from value extraction, it becomes nearly impossible to reward the former over the latter. If the goal is to produce growth that is more innovation-led (smart growth), more inclusive and more sustainable, we need a better understanding of value to steer us.

In other words, this is not an abstract debate but one with far-reaching consequences – social and political as well as

economic – for everyone. How we discuss value affects the way all of us, from giant corporations to the most modest shopper, behave as actors in the economy and in turn feeds back into the economy, and how we measure its performance. This is what philosophers call ‘performativity’: how we talk about things affects behaviour, and in turn how we theorize things. In other words, it is a self-fulfilling prophecy.

Oscar Wilde famously captured the value problem when he said that a cynic is one who knows the price of everything but the *value of nothing*. He was right – and indeed economics is known as the cynical science. But it is exactly for this reason that change in our economic system must be underpinned by bringing value back to the centre of our thinking – we need a revived ability to contest the way the word value is used, keeping alive the debate, and not allowing simple stories to affect who we think is productive and who is unproductive. Where do those stories come from – in whose interests are they told? If we cannot define what we mean by value, we cannot be sure to produce it, nor to share it fairly, nor to sustain economic growth. The understanding of value, then, is critical to all the other conversations we need to have about where our economy is going and how to change its course. And only then can economics go from being a cynical science to a hopeful one.

Introduction: Making versus Taking

The barbarous gold barons – they did not find the gold, they did not mine the gold, they did not mill the gold, but by some weird alchemy all the gold belonged to them.

Big Bill Haywood, founder of the United States' first industrial union, 1929¹

Bill Haywood expressed his puzzlement eloquently. He represented men and women in the US mining industry at the start of the twentieth century and during the Great Depression of the 1930s. He was steeped in the industry. But even Haywood could not answer the question: why did the owners of capital, who did little but buy and sell gold on the market, make so much money, while workers who expended their mental and physical energy to find it, mine it and mill it, make so little? Why were the *takers* making so much money at the expense of the *makers*?

Similar questions are still being asked today. In 2016 the British high-street retailer BHS collapsed. It had been founded in 1928 and in 2004 was bought by Sir Philip Green, a well-known retail entrepreneur, for £200 million. In 2015 Sir Philip sold the business for £1 to a group of investors headed by the British businessman Dominic Chappell. While it was under his control, Sir Philip and his family extracted from BHS an estimated £580 million in dividends, rental payments and interest on loans they had made to the company. The collapse of BHS threw 11,000 people out of work and left its

pension fund with a £571 million deficit, even though the fund had been in surplus when Sir Philip acquired it.² A report on the BHS disaster by the House of Commons Work and Pensions Select Committee accused Sir Philip, Mr Chappell and their ‘hangers-on’ of ‘systematic plunder’. For BHS workers and pensioners who depended on the company for a decent living for their families, this was value extraction – the appropriation of gains vastly out of proportion to economic contribution – on an epic scale. For Sir Philip and others who controlled the business, it was value creation.

While Sir Philip’s activities could be viewed as an aberration, the excesses of an individual, his way of thinking is hardly unusual: today, many giant corporations are also guilty of confusing value creation with value extraction. In August 2016, for instance, the European Commission, the European Union’s (EU) executive arm, sparked an international row between the EU and the US when it ordered Apple to pay €13 billion in back taxes to Ireland.³

Apple is the world’s biggest company by stock market value. In 2015 it held a mountain of cash and securities outside the US worth \$187 billion⁴ – about the same size as the Czech Republic’s economy that year⁵ – to avoid paying the US taxes that would be due on the profits if they were repatriated. Under a deal with Ireland dating back to 1991, two Irish subsidiaries of Apple received very generous tax treatment. The subsidiaries were Apple Sales International (ASI), which recorded all the profits earned on sales of iPhones and other Apple devices in Europe, the Middle East, Africa and India; and Apple Operations Europe, which made computers. Apple transferred development rights of its products to ASI for a nominal amount, thereby depriving the

US taxpayer of revenues from technologies, embodied in Apple products, whose early development the taxpayer had funded. The European Commission alleged that the maximum rate payable on those profits booked through Ireland which were liable for tax was 1 per cent, but that in 2014 Apple paid tax at 0.005 per cent. The usual rate of corporation tax in Ireland is 12.5 per cent.

What is more, these ‘Irish’ subsidiaries of Apple are in fact not resident for tax purposes anywhere. This is because they have exploited discrepancies between the Irish and US definitions of residence. Almost all the profits earned by the subsidiaries were allocated to their ‘head offices’, which existed only on paper. The Commission ordered Apple to pay the back taxes on the grounds that Ireland’s deal with Apple constituted illegal state aid (government support that gives a company an advantage over its competitors); Ireland had not offered other companies similar terms. Ireland, the Commission alleged, had offered Apple ultra-low taxes in return for the creation of jobs in other Apple businesses there. Apple and Ireland rejected the Commission’s demand – and of course Apple is not the only major corporation to have constructed exotic tax structures.

But Apple’s value extraction cycle is not limited to its international tax operations – it is also much closer to home. Not only did Apple extract value from Irish taxpayers, but the Irish government has extracted value from the US taxpayer. Why so? Apple created its intellectual property in California, where its headquarters are based. Indeed, as I argued in my previous book, *The Entrepreneurial State*,⁶ and discuss briefly here in Chapter 7, all the technology that makes the smartphone smart was publicly funded. But in 2006 Apple

formed a subsidiary in Reno, Nevada, where there is no corporate income or capital gains tax, in order to avoid state taxes in California. Creatively naming it Braeburn Capital, Apple channelled a portion of its US profits to the Nevada subsidiary instead of reporting it in California. Between 2006 and 2012, Apple earned \$2.5 billion in interest and dividends reported in Nevada to avoid Californian tax. California's infamously large debt would be significantly reduced if Apple fully and accurately reported its US revenues in that state, where a major portion of its value (architecture, design, sales, marketing and so on) originated. Value extraction thus pits US states against each other, as well as the US against other countries.

It is clear that Apple's highly complex tax arrangements were principally designed to extract the maximum value from its business by avoiding paying substantial taxes which would have benefited the societies in which the company operated. Apple certainly creates value, of that there is no doubt: but to ignore the support taxpayers have given it, and then to pit states and countries against each other, is surely not the way to build an innovative economy or achieve growth that is inclusive, that benefits a wide section of the population, not only those best able to 'game' the system.

There is yet another dimension to Apple's value extraction. Many such corporations use their profits to boost share prices in the short term instead of reinvesting them in production for the long term. The main way they do this is by using cash reserves to buy back shares from investors, arguing that this is to maximize shareholder 'value' (the income earned by shareholders in the company, based on the valuation of the company's stock price). But it is no accident

that among the primary beneficiaries of share buy-backs are managers with generous share option schemes as part of their remuneration packages – the same managers who implement the share buy-back programmes. In 2012, for example, Apple announced a share buy-back programme of up to a staggering \$100 billion, partly to ward off ‘activist’ shareholders demanding that the company return cash to them to ‘unlock shareholder value’.⁷ Rather than reinvest in the business, Apple preferred to transfer cash to shareholders.

The alchemy of the takers versus the makers that Big Bill Haywood referred to back in the 1920s continues today.

COMMON CRITIQUES OF VALUE EXTRACTION

The vital but often muddled distinction between value extraction and value creation has consequences far beyond the fate of companies and their workers, or even of whole societies. The social, economic and political impacts of value extraction are huge. Prior to the 2007 financial crisis, the income share of the top 1 per cent in the US expanded from 9.4 per cent in 1980 to a staggering 22.6 per cent in 2007. And things are only getting worse. Since 2009 inequality has been increasing even more rapidly than before the 2008 financial crash. In 2015 the combined wealth of the planet’s sixty-two richest individuals was estimated to be about the same as that of the bottom half of the world’s population – 3.5 billion people.⁸

So how does the alchemy continue to happen? A common critique of contemporary capitalism is that it rewards ‘rent seekers’ over true ‘wealth creators’. ‘Rent-seeking’ here refers to the attempt to generate income, not by producing

anything new but by overcharging above the ‘competitive price’, and undercutting competition by exploiting particular advantages (including labour), or, in the case of an industry with large firms, their ability to block other companies from entering that industry, thereby retaining a monopoly advantage. Rent-seeking activity is often described in other ways: the ‘takers’ winning out over the ‘makers’, and ‘predatory’ capitalism winning over ‘productive’ capitalism. It’s seen as a key way – perhaps *the* key way – in which the 1 per cent have risen to power over the 99 per cent.⁹ The usual targets of such criticism are the banks and other financial institutions. They are seen as profiting from speculative activities based on little more than buying low and selling high, or buying and then stripping productive assets simply to sell them on again with no real value added.

More sophisticated analyses have linked rising inequality to the particular way in which the ‘takers’ have increased their wealth. The French economist Thomas Piketty’s influential book *Capital in the Twenty-First Century* focuses on the inequality created by a predatory financial industry that is taxed insufficiently, and by ways in which wealth is inherited across generations, which gives the richest a head start in getting even richer. Piketty’s analysis is key to understanding why the rate of return on financial assets (which he calls capital) has been higher than that on growth, and calls for higher taxes on the resultant wealth and inheritance to stop the vicious circle. Ideally, from his point of view, taxes of this sort should be global, so as to avoid one country undercutting another.

Another leading thinker, the US economist Joseph Stiglitz, has explored how weak regulation and monopolistic practices

have allowed what economists call ‘rent extraction’, which he sees as the main impetus behind the rise of the 1 per cent in the US.¹⁰ For Stiglitz, this rent is the income obtained by creating impediments to other businesses, such as barriers to prevent new companies from entering a sector, or deregulation that has allowed finance to become disproportionately large in relation to the rest of the economy. The assumption is that, with fewer impediments to the functioning of economic competition, there will be a more equal distribution of income.¹¹

I think we can go even further with these ‘makers’ versus ‘takers’ analyses of why our economy, with its glaring inequalities of income and wealth, has gone so wrong. To understand how some are perceived as ‘extracting value’, siphoning wealth away from national economies, while others are ‘wealth creators’ but do not benefit from that wealth, it is not enough to look at impediments to an idealized form of perfect competition. Yet mainstream ideas about rent do not fundamentally challenge how value extraction occurs – which is why it persists.

In order to tackle these issues at root, we need to examine where *value* comes from in the first place. What exactly is it that is being extracted? What social, economic and organizational conditions are needed for value to be produced? Even Stiglitz’s and Piketty’s use of the term ‘rent’ to analyse inequality will be influenced by their idea of what value is and what it represents. Is rent simply an impediment to ‘free-market’ exchange? Or is it due to their positions of power that some can earn ‘unearned income’ – that is, income derived from moving existing assets around rather

than creating new ones?¹² This is a key question we will look at in Chapter 2.

WHAT IS VALUE?

Value can be defined in different ways, but at its heart it is the production of new goods and services. How these outputs are produced (production), how they are shared across the economy (distribution) and what is done with the earnings that are created from their production (reinvestment) are key questions in defining economic value. Also crucial is whether what it is that is being created is useful: are the products and services being created increasing or decreasing the resilience of the productive system? For example, it might be that a new factory is produced that is valuable economically, but if it pollutes so much to destroy the system around it, it could be seen as not valuable.

By ‘value creation’ I mean the ways in which different types of resources (human, physical and intangible) are established and interact to produce new goods and services. By ‘value extraction’ I mean activities focused on moving around existing resources and outputs, and gaining disproportionately from the ensuing trade.

A note of caution is important. In the book I use the words ‘wealth’ and ‘value’ almost interchangeably. Some might argue against this, seeing wealth as a more monetary and value as potentially a more social concept, involving not only *value* but *values*. I want to be clear on how these two words are used. I use ‘value’ in terms of the ‘process’ by which wealth is created – it is a flow. This flow of course results in actual things, whether tangible (a loaf of bread) or intangible (new knowledge). ‘Wealth’ instead is regarded as a

cumulative stock of the value already created. The book focuses on value and what forces produce it – the process. But it also looks at the claims around this process, which are often phrased in terms of ‘who’ the wealth creators are. In this sense the words are used interchangeably.

For a long time the idea of value was at the heart of debates about the economy, production and the distribution of the resulting income, and there were healthy disagreements over what value actually resided in. For some economic schools of thought, the price of products resulted from supply and demand, but the value of those products derived from the amount of work that was needed to produce things, the ways in which technological and organizational changes were affecting work, and the relations between capital and labour. Later, this emphasis on ‘objective’ conditions of production, technology and power relationships was replaced by concepts of scarcity and the ‘preferences’ of economic actors: the amount of work supplied is determined by workers’ preference for leisure over earning a higher amount of money. Value, in other words, became *subjective*.

Until the mid-nineteenth century, too, almost all economists assumed that in order to understand the prices of goods and services it was first necessary to have an objective theory of value, a theory tied to the conditions in which those goods and services were produced, including the time needed to produce them, the quality of the labour employed; and the determinants of ‘value’ actually shaped the price of goods and services. Then, this thinking began to go into reverse. Many economists came to believe that the value of things was determined by the price paid on the ‘market’ – or, in other words, what the consumer was prepared to pay. All of a

sudden, value was in the eye of the beholder. Any goods or services being sold at an agreed market price were by definition value-creating.

The swing from value determining price to price determining value coincided with major social changes at the end of the nineteenth century. One was the rise of socialism, which partly based its demands for reforms on the claim that labour was not being rewarded fairly for the value it created, and the ensuing consolidation of a capitalist class of producers. The latter group was, unsurprisingly, keen on the alternative theory, that price determined value, a story which allowed them to defend their appropriation of a larger share of output, with labour increasingly being left behind.

In the intellectual world, economists wanted to make their discipline seem 'scientific' – more like physics and less like sociology – with the result that they dispensed with its earlier political and social connotations. While Adam Smith's writings were full of politics and philosophy, as well as early thinking about how the economy works, by the early twentieth century the field which for 200 years had been 'political economy' emerged cleansed as simply 'economics'. And economics told a very different story.

Eventually the debate about different theories of value and the dynamics of value creation virtually vanished from economics departments, only showing up in business schools in a very new form: 'shareholder value',¹³ 'shared value',¹⁴ 'value chains',¹⁵ 'value for money', 'valuation', 'adding value' and the like. So while economics students used to get a rich and varied education in the idea of value, learning what different schools of economic thought had to say about it, today they are taught only that value is determined by the

dynamics of price, due to scarcity and preferences. This is not presented as a particular theory of value – just as Economics 101, the introduction to the subject. An intellectually impoverished idea of value is just taken as read, assumed simply to be true. And the disappearance of the concept of value, this book argues, has paradoxically made it much easier for this crucial term ‘value’ – a concept that lies at the heart of economic thought – to be used and abused in whatever way one might find useful.

MEET THE PRODUCTION BOUNDARY

To understand how different theories of value have evolved over the centuries, it is useful to consider why and how some activities in the economy have been called ‘productive’ and some ‘unproductive’, and how this distinction has influenced ideas about which economic actors deserve what – how the spoils of value creation are distributed.

For centuries, economists and policymakers – people who set a plan for an organization such as government or a business – have divided activities according to whether they produce value or not; that is, whether they are productive or unproductive. This has essentially created a boundary – the fence in Figure 1 below – thereby establishing a conceptual boundary – sometimes referred to as a ‘production boundary’ – between these activities.¹⁶ Inside the boundary are the wealth creators. Outside are the beneficiaries of that wealth, who benefit either because they can extract it through rent-seeking activities, as in the case of a monopoly, or because wealth created in the productive area is redistributed to them, for example through modern welfare policies. Rents, as understood by the classical economists, were *unearned*

unproductive or even destroys value. The issue is politically loaded and deeply colours current debates, ranging from whether the UK can afford Trident nuclear weapons to whether there is a 'magic number' for the size of government, defined as government spending as a proportion of national output, beyond which an economy will inevitably do less well than it might have done if government spending had been lower. As we will explore in Chapter 8, this question is more tainted by political views and ideological positions than informed by deep scientific proofs. Indeed, it is important to remember that economics is at heart a social science, and the 'natural' size of government will depend on one's theory of (or simply 'position' on) the purpose of government. If it is seen as useless, or at best a fixer of occasional problems, its optimum size will inevitably be notionally smaller than if it is viewed as a key engine of growth needed to steer and invest in the value creation process.

Over time, this conceptual production boundary was expanded to encompass much more of the economy than before, and more varied economic activities. As economists, and wider society, came to determine value by supply and demand – what is bought has value – activities such as financial transactions were redefined as productive, whereas previously they had usually been classed as unproductive. Significantly, the only major part of the economy which is now considered largely to lie outside the production boundary – and thus to be 'unproductive' – remains government. It is also true that many other services that people provide throughout society go unpaid, such as care given by parents to children or by the healthy to the unwell, and are not well accounted for. Fortunately, issues such as

factoring care into the way we measure national output (GDP) are increasingly coming to the fore. But besides adding new concepts to GDP – such as care, or the sustainability of the planet – it is fundamental to understand why we hold the assumptions about value that we do. And this is impossible if value is not scrutinized.

WHY VALUE THEORY MATTERS

First, the disappearance of value from the economic debate hides what should be alive, public and actively contested.¹⁷ If the assumption that value is in the eye of the beholder is not questioned, some activities will be deemed to be value-creating and others will not, simply because someone – usually someone with a vested interest – says so, perhaps more eloquently than others. Activities can hop from one side of the production boundary to the other with a click of the mouse and hardly anyone notices. If bankers, estate agents and bookmakers claim to create value rather than extract it, mainstream economics offers no basis on which to challenge them, even though the public might view their claims with scepticism. Who can gainsay Lloyd Blankfein when he declares that Goldman Sachs employees are among the most productive in the world? Or when pharmaceutical companies argue that the exorbitantly high price of one of their drugs is due to the *value* it produces? Government officials can become convinced (or ‘captured’) by stories about wealth creation, as was recently evidenced by the US government’s approval of a leukemia drug treatment at half a million dollars, precisely using the ‘value-based pricing’ model pitched by the industry – even when the taxpayer contributed \$200 million dollars towards its discovery.¹⁸

Second, the lack of analysis of value has massive implications for one particular area: the distribution of income between different members of society. When value is determined by price (rather than vice versa), the level and distribution of income seem justified as long as there is a market for the goods and services which, when bought and sold, generate that income. All income, according to this logic, is earned income: gone is any analysis of activities in terms of whether they are productive or unproductive.

Yet this reasoning is circular, a closed loop. Incomes are justified by the production of something that is of value. But how do we measure value? By whether it earns income. You earn income because you are productive and you are productive because you earn income. So with a wave of a wand, the concept of *unearned income* vanishes. If income means that we are productive, and we deserve income whenever we are productive, how can income possibly be unearned? As we shall see in Chapter 3, this circular reasoning is reflected in how national accounts – which track and measure production and wealth in the economy – are drawn up. In theory, no income may be judged too high, because in a market economy competition prevents anyone from earning more than he or she deserves. In practice, markets are what economists call imperfect, so prices and wages are often set by the powerful and paid by the weak.

In the prevailing view, prices are set by supply and demand, and any deviation from what is considered the competitive price (based on marginal revenues) must be due to some imperfection which, if removed, will produce the correct distribution of income between actors. The possibility that some activities perpetually earn rent because they are

perceived as valuable, while actually blocking the creation of value and/or destroying existing value, is hardly discussed.

Indeed, for economists there is no longer any story other than that of the subjective theory of value, with the market driven by supply and demand. Once impediments to competition are removed, the outcome should benefit everyone. How different notions of value might affect the distribution of revenues between workers, public agencies, managers and shareholders at, say, Google, General Electric or BAE Systems, goes unquestioned.

Third, in trying to steer the economy in particular directions, policymakers are – whether they recognize it or not – inevitably influenced by ideas about value. The rate of GDP growth is obviously important in a world where billions of people still live in dire poverty. But some of the most important economic questions today are about how to achieve a particular type of growth. Today, there is a lot of talk about the need to make growth ‘smarter’ (led by investments in innovation), more sustainable (greener) and more inclusive (producing less inequality).¹⁹

Contrary to the widespread assumption that policy should be directionless, simply removing barriers and focusing on ‘levelling the playing field’ for businesses, an immense amount of policymaking is needed to reach these particular objectives. Growth will not somehow go in this direction by itself. Different types of policy are needed to tilt the playing field in the direction deemed desirable. This is very different from the usual assumption that policy should be directionless, simply removing barriers so that businesses can get on with smooth production.

THE STRUCTURE OF THE BOOK

In Chapters 1 and 2 I look at how economists from the seventeenth century onwards have thought about steering growth by increasing productive activities and reducing unproductive ones, something they conceptualized by means of a theoretical production boundary. The production boundary debate, and its close relationship to ideas of value, has influenced government measures of economic growth for centuries; the boundary, too, has changed, influenced by fluctuating social, economic and political conditions. Chapter 2 delves into the biggest shift of all. From the second half of the nineteenth century onwards, value went from being an objective category to a more subjective one tied to individual preferences. The implications of this revolution were seismic. The production boundary itself was blurred, because almost anything that could get a price or could successfully claim to create value – for example, finance – suddenly became productive. This opened the way to increased inequality, driven by particular agents in the economy being able to brag about their extraordinary ‘productivity’.

As we will see in Chapter 3, which explores the development of national accounts, the idea of the production boundary continues to influence the concept of output. There is, however, a fundamental distinction between this new boundary and its predecessors. Today, decisions about what constitutes value in the national accounts are made by blending different elements: anything that can be priced and exchanged legally; politically pragmatic decisions, such as accommodating technological change in the computer industry or the embarrassingly large size of the financial sector; and the practical necessity of keeping the accounting

manageable in very big and complex modern economies. This is all very well, but the fact that the production boundary debate is no longer explicit, nor linked openly to ideas about value, means that economic actors can – through sustained lobbying – quietly place themselves within the boundary. Their value-extracting activities are then counted in GDP – and very few notice.

Chapters 4, 5 and 6 examine the phenomenon of financialization: the growth of the financial sector and the spread of financial practices and attitudes into the real economy. In Chapter 4 I look at the emergence of finance as a major economic sector and its transition from being considered largely unproductive to becoming accepted as largely productive. As late as the 1960s, national accountants viewed financial activity not as generating value but as simply transferring existing value, which placed it outside the production boundary. Today, this view has changed fundamentally. In its current incarnation, finance is seen as earning profits from services reclassified as productive. I look at how and why this extraordinary redefinition took place, and ask if financial intermediation really has undergone a transformation into an inherently productive activity.

In Chapter 5 I explore the development of ‘asset manager capitalism’: how the financial sector expanded beyond the banks to incorporate an increasingly large number of intermediaries dedicated to managing funds (the asset management industry), and ask whether the role of these intermediaries, and the actual risks they take on, justify the rewards they earn. In doing so, I question the extent to which fund management and private equity have actually contributed to the productive economy. I ask, too, whether

financial reform can be tackled today without a serious debate over whether activities in the financial sector are properly classified – are they what should be seen as rents, rather than profits? – and how we can go about making this distinction. If our national accounting systems are really rewarding value extraction as though it is value creation, maybe this can help us understand the dynamics of value destruction that characterized the financial crisis.

Building on this acceptance of finance as a productive activity, Chapter 6 examines the financialization of the whole economy. In seeking a quick return, short-term finance has affected industry: companies are run in the name of maximizing shareholder value (MSV). MSV arose in the 1970s as an attempt to revitalize corporate performance by invoking what was claimed to be the main purpose of the company: creating value for shareholders. I will argue, however, that MSV has been detrimental to sustained economic growth, not least because it encourages short-term gain for shareholders at the expense of long-term gains for the company – a development closely linked to the increasing influence of fund managers seeking returns for their clients and for themselves. Underlying MSV is the notion of shareholders as the biggest risk takers, meriting the large rewards they often obtain.

Risk-taking is often the justification for the rewards investors reap, and Chapter 7 continues to look at other types of value extraction carried out in its name. Here I consider the kind of risk-taking required for radical technological innovation to occur. Innovation is without doubt one of the most risky and uncertain activities in capitalism: most attempts fail. But who takes it on? And what sort of

investments that can help foster a more innovative economy, as well as changing measures in the tax code that reward long-term investments over short-term ones. Similarly, as I discuss in Chapter 7, changes to the current unhelpful use of patents could help them stimulate innovation rather than stifle it.

To create a fairer economy, one where prosperity is more broadly shared and is therefore more sustainable, we need to reinvigorate a serious discussion about the nature and origin of value. We must reconsider the stories we are telling about who the value creators are, and what that says to us about how we define activities as economically productive and unproductive. We cannot limit progressive politics to taxing wealth, but require a new understanding of and debate about wealth creation so that it is more fiercely and openly contested. Words matter: we need a new vocabulary for policymaking. Policy is not just about ‘intervening’. It is about shaping a different future: co-creating markets and value, not just ‘fixing’ markets or redistributing value. It’s about taking risks, not only ‘de-risking’. And it must not be about levelling the playing field but about tilting it towards the kind of economy we want.

This idea that we can shape markets has important consequences. We can create a better economy by understanding that markets are outcomes of decisions that are made – in business, in public organizations and in civil society. The eight-hour working day has formed markets – and that was the result of a fight held in labour organizations. And perhaps the reason there is so much despair across the globe – despair now leading to populist politics – is that the economy is presented to us simply as ‘made’ by trade rules,



1

A Brief History of Value

There is one sort of labour which adds to the value of the subject upon which it is bestowed: there is another which has no such effect. The former, as it produces a value, may be called productive; the latter, unproductive labour.

Adam Smith, *The Wealth of Nations* (1776)

Today we take increasing prosperity for granted. We assume that by and large the next generation will be better off than the last. But it was not always so. For most of human history people had no such expectations and, partly because living standards improved at best very slowly, few thinkers devoted much time to asking why some economies grow and others do not. In the early modern period, the pace of change quickened. Previously static economies became dynamic. Movement was in the air. The rise of the nation state in Europe, the need to finance war, colonization, machinery, factories and coal, combined with expanding populations to stimulate new thinking across many fields. Governments and people of all stations in life wanted to know what was causing

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