

03. Theory of productive and unproductive labour

The theory of productive and unproductive labour, primarily developed by Adam Smith and expanded by Karl Marx, distinguishes labor that creates surplus value for capital accumulation from labor that consumes revenue without producing new value. Productive labor creates goods or services that add value, while unproductive labor is generally consumed directly, such as in service or management.

Key Aspects of the Theory:

- ❖ **Adam Smith's Definition:** Productive labour adds value to the subject it is bestowed upon, fixes itself in a vendible commodity, and is paid for out of capital. Unproductive labor (e.g., servants) does not create lasting value and is paid out of revenue (income).
- ❖ **Marxian Definition:** In capitalist production, productive labor is defined strictly as labor that creates surplus value for the capitalist, not just any value. Unproductive labor, regardless of its utility, does not produce surplus value.
- ❖ **Value Creation:** Productive labourer works to expand capital. If a worker is employed to create profit, they are productive.
- ❖ **Usage in Economics:** This framework was crucial in early classical economics to analyze capital accumulation and was used to distinguish between production (goods) and circulation (commerce, banking) or consumption services.

Key Differences:

- ❖ **Productive:** Manufacturing, agricultural labour, services that embody themselves in products (e.g., a tailor making a coat).
- ❖ **Unproductive:** Personal services (e.g., domestic servants), state administration, and sometimes, the labour of salespeople (circulation costs).

While this theory is central to Marxist economics, modern neoclassical economics largely disregards this distinction, treating all labour that is paid for and creates utility as productive.

The classical political economists, such as Adam Smith and David Ricardo, raised the economic question of which kinds of labour contributed to increasing society's wealth, as against activities which do not increase wealth. In the introduction to *The Wealth of Nations*, Smith spoke of the "annual labour" and "the necessities and conveniences" a nation "annually consumes" before explaining that one of the two steps to increase wealth is reducing the amount of "unproductive labour". "Annual" and "annually" refer to a cyclical reproduction process; "unproductive labor" are commodities and services which are not inputs to the next economic cycle and are therefore lost to economic growth. In contrast, theories with no such time horizon tend to understand Smith's unproductive labor as referring to services, and productive labor as meaning vendible goods. Smith's distinction between productive and unproductive labor corresponds to Sraffa's (1960) distinction of basic and non-basic goods, as basic goods re-enter the productive process, whereas non-basic goods are destined for consumption, with no value for reproduction.

In neoclassical economics, the distinction between productive and unproductive labour was however rejected as being largely arbitrary and irrelevant. All the factors of production (land, labour and capital) create wealth and add value; they are all "productive".

If the value of a good is just what somebody is its marginal utility, then regarding some activities as value-creating and others not is a purely subjective matter; any activity which produces anything, or generates an income, could be considered production and productive, and the only question that remains is how productive it is.

This could be measured by striking a ratio between the monetary value of output produced, and the number of hours worked to produce it (or the number of workers who produce it). This is called a "output/labour ratio". The ratio "GDP per capita" is also used by some as an indicator of how productive a population is.

However, in calculating any output value, some concept of value is nevertheless required, because we cannot relate, group and aggregate prices (real or notional) at all without using a valuation principle. All accounting assumes a value theory, in this sense - we always need to distinguish conceptually the definition of value equivalence, comparable value, value transfer, loss of value, conservation of value and newly created value. For this purpose, a knowledge of prices is ultimately not sufficient, since the decision to group and categorize prices in a certain way involves criteria and valuations which themselves cannot be derived from prices.

A persisting management preoccupation, particularly in large corporations, also concerns the question of which activities of a business are value adding. The reason is simply that value-adding activities boost gross income and profit margins (note that the "value-added" concept is a measure of the net output, or gross income, after deduction of materials costs from the total sales volume).

If the aim is to realise maximum shareholder value, two important valuation problems occur. Firstly, productive assets being used in production have no actual market price, being withdrawn from the market and not offered for sale. They have at best an historic cost, but this cost does not apply to inventories of new output produced. The current value of productive assets can therefore be estimated only according to a probable price that they would have, if they were sold, or if they were replaced. Secondly, there is the problem of what exactly the increases or decreases in the value of productive assets being held can be attributed to.

In what has become popularly known as "value-based management", these problems are pragmatically tackled with the accounting concepts of market-value added (MVA) and economic value-added (EVA). This style of management focuses very closely on how assets and activities contribute to maximum profit income.