A Refinement to the Typology of "Goods"

Howden, David

2016

Unintended Consequences

A Refinement to the Typology of "Goods"

David Howden
St. Louis University – Madrid Campus
Email: dhowden@slu.edu

One of Carl Menger's greatest contributions was to outline the nature of the problem under examination in economic science. Although it would take a further sixty years for Lionel Robbins to give a proper definition of the scope of economics as "the science which studies human behavior as a relationship between ends and scarce means that have alternative uses" (Robbins 1935: 16), it was Menger's original groundwork in defining the characteristics that define an economic "good" that made possible these subsequent developments. A "good", properly defined, must fulfil four criteria (Menger 1871: 52): 1) it must satisfy a human need, 2) it must have a causal connection to satisfy the need sought, 3) someone must be cognizant of this causal connection, and 4) someone must have command over the good. When all of these four prerequisites are present, a "thing" becomes a good. And the corollary holds true: a loss of any of these criteria results in a good losing its goods-character.

A unified definition of what defines a "good" made possible a standard theory that could analyse the principles of supply, demand and price determination, regardless of the specific nature of the good in question (Rothbard 1962: pp. 162-69). In this way, it matters not whether

the economist is dealing with a haircut, an automobile, a tool or an insurance policy, the general principles guiding the allocation of each good is standard.

Notwithstanding that all economics goods as Menger defines them can be treated within the same standard framework, additional questions arise when a good fails to meet one of his criteria. Bohm-Bawerk (1962: 30) contended that the "basic *economic doctrine of the theory of goods* … was in need of correction in several respects, or at least of such revision as to make it truly comprehensive and universally valid." Specifically the thorny issue in need of an answer was whether legal rights and contractual relationships could be classified as "goods" from the viewpoint of economic science. As Bohm-Bawerk stressed, the nature of a good is "not a purely objective attribute of a thing, but a relationship that must exist between a thing and an economic subject" (Salerno 2008: 100). His refinement to Mengerian goods theory was in adding a fifth point lacking in Menger's enumeration: that the individual must have knowledge of the object's usefulness in satisfying a want *irrespective* of his ownership of the good (Bohm-Bawerk 1962). This final point allows for not only a physical control over the good (as in Menger's fourth criterion) but also that someone must have mental "ownership" (i.e., knowledge) of the goods usefulness.

These definitional criteria of goods are admirable in two respects. First, they constrain the type of objects eligible to be economized and thus set a limit on the type of question that economics can answer in a positive way (though the science can still give informed speculation on economizing-type behaviour of goods not fulfilling the criteria of an economic good). Second, and perhaps more importantly from the standpoint of technical economics, the criteria allow one to distinguish between goods that directly satisfy a want (a consumers' good) and those that are capable of only doing so indirectly (a higher-order, or producers' good). This final point is important as all goods are valued according to how well they satisfy an individual's want. This theory of "imputation", pioneered by Menger, maintains that all factor prices of higher-order goods are determined by the final good they help to produce. Rothbard (1962: chap. 7) took this theory to its full conclusion to show how time preference, the rate of interest and an expected value of a consumers' good interact to determine all prices throughout the economy.

Pigeonholing Money in a Typology of Goods

Fitting money into a typology of goods that makes only a binary distinction between consumers' goods and producers' goods leads to somewhat irreconcilable conflicts. On the one hand it is apparent that money in and of itself is not an input factor in making any consumers' good. On the other hand it is commonly noted that money confers no direct utility to the holder; its value is derived from its ability to be exchanged for other goods, whether consumers' or producers' goods in nature.[1] It is for this reason that some economists, notably among them Ludwig von Mises, adopted a three-way classificatory scheme for goods.

It is usual to divide economic goods into the two classes of those that satisfy human needs directly and those which only satisfy them indirectly: that is goods, or goods of the first

1 Herein I treat money *qua* money, and abstract from non-exchange uses, such as numismatic demands.

order; and goods, or goods of higher orders. The attempt to include money in either of these groups meets with insuperable difficulties. It is unnecessary to demonstrate that money is not a consumption good. It seems equally incorrect to call it a production good.

Of course, if we regard the twofold division of economic goods as exhaustive we shall have to rest content with putting money in one group or the other. This has been the position of most economists; and since it has seemed altogether impossible to call money a consumption good, there has been no alternative but to call it a production good. (Mises 1971: 79, footnote omitted)

With no obvious fit in the existing goods dichotomy, Mises (following Karl Knies) opts for a third category: media of exchange (Mises 1971: chap. 5). Unfortunately such a broadening of the goods typology is not without its own difficulties. Barnett and Block (2005) find this solution unconvincing because all actions must be either oriented towards producing a good or consuming it. If the scope of actions is binary, and all goods are bestowed their character because of an action making use of it, it must follow that all goods must be either classified as either consumers' or producers'.

While this provides one solution to the classificatory problem of "what money is" it leaves open many unanswered questions. Foremost among these is whether there can be more than one criterion according to which we can classify goods. By focusing exclusively on whether a good is present or future oriented, one removes the possibility that there are alternative attributes of all goods as valued by their users. As an additional difficulty, while Barnett and Block (2005) solve one problem with Mises' ternary classificatory scheme for goods, namely that money is different than both consumers' and producers' goods, their solution introduces the difficulty that money is quite different from all other producers' goods. After all, "[p]roduction goods derive their value from that of their products. Not so money" (Mises 1953: 86). Unlike all other goods, the value of money comes not from using it but by getting rid of it (Rothbard 2004: 756). All other goods trade and have their price determined on a specific market, but the price of money - it's purchasing power – has no unique market on which it is determined (Yeager 1968: 64). While all other economic goods can be dealt with adequately with equilibrium models, money can only arise and be analysed in disequilibrium (Mises 1938: 75). Increases in the supply of money yield no improvement to the "welfare of the members of society", unlike when other goods increase in supply (Mises 1953: 86).[2] Money can only be useful if a pre-existing array of prices exists from which to base its demand, while other goods can be valued even if there prices are unknown (Rothbard 1981:. 3–4). Finally, all money income can be directed in one of three ways: expenditure on consumers' goods, expenditure on producers' goods, or additions to one's cash balance (Rothbard 2004: 219). Given the three channels money can be directed to, does it not follow that there are potentially three types of goods representative of them? (Of course, this brings us back to the original problem - why only three different types of goods?)

The usual distinction between different types of goods distils to whether a good directly

2 Although, as we will see, "[t]hat money does not satisfy consumptive or productive goals does not impair in the least its ability to supply its own – monetary – services, on which account precisely there is a demand for it" (Gertchev 2004: 65-66).

provides utility to its user, as is the case with consumers´ goods, or whether it only indirectly does so as is the case with producers´ goods. This distinction, incidentally, can also be expressed by way of present and future goods, and is useful in demonstrating why it is that producers´ goods derive their value from that of consumers´ goods. The distinction also creates difficulty for money, as money is a present good on the one hand and also has attributes more akin to a producers´ good on the other.

All goods are valuable to their holder to the extent that they can be used for the utility they can create or because they can be exchanged for other goods that the holder can derive utility from. Of course, if value exists because of a goods use value or because of its exchange value, these values must also be able to be applied directly (in the present) or indirectly (at some future date). In table 1 below, I outline a typology of goods that results from these two distinctions.

		Type of Value	
		Use	Exchange
Time Dimension	Present (Direct)	Consumers' Goods	Medium of Exchange
	Future (Indirect)	Producers´ Goods	Nonmonetary Financial Assets

Figure 1: Typology of Goods

The conventional typology of goods focuses on the use value column. As all goods are valued according to how useful they are to the individual so too, as the common reasoning goes, must money be valued. The value money confers to the holder comes not from its ability to be used as such, but rather from its ability to be exchanged for other goods that will be able to do so. This exchange value is apparent as discussions of the demand for money centre on the demand to hold real money balances, not nominal sums. It should also be clear from discussions of the definition of money that commonly centre on its role as the generally accepted medium of exchange. (Though, as I´ve shown elsewhere (Howden 2015a), defining money in such terms begs the question of what money is rather than answers it.)

The value that a good confers can either be in the present or after some period in the future. It is this distinction between present and future goods that demarcates the difference between consumers´ goods and producers´, or capital, goods. Yet a different way to consider this dimension, as in Hülsmann (2002), is between means and ends. This interpretation can be distilled further as to whether a good is able to directly provide value, as is the case with

consumers´ goods, or whether it will only create value in a roundabout or time consuming way, in which case it will be defined as a producers´ good.

The two axes in figure 1 are not ad hoc, but representative of the *only* two dimensions one can be concerned with when assessing the value their goods will bestow on them. On the one hand, any good can only provide value to the user by its use or by giving it away to someone else (to get something in return). On the other hand, due to the the fact that actions today are aimed only at the future, value can either be accessed in the here and now or at some future date. It would be nonsensical to discuss the value that something will give to an individual by its use in the past (as the value has already been realised). In the same way, if an exchange had already taken place the individual would not have the good any longer and no value could be realised.

The typology of goods in figure 1 resolves many of the difficulties in the existing binary or ternary classificatory schemes. It also introduces new difficulties.

On the one hand, distinguishing between value in exchange and value in use allows one to avoid pigeonholing money into inappropriate categories. It also allows one to include goods that are difficult to address, e.g., stocks, bonds and financial derivatives, into a category specifically tailored for them. As such it leaves no doubt as to the role that non-monetary financial assets serve in the production process – not as inputs that mature into consumers´ goods in the future, but as "inputs", or claims, that mature into money.

		Type of Value	
		Use	Exchange
Time Dimension	Present (Direct)	Consumers' Goods/ Money Held for Reservation Demand	Medium of Exchange
	Future (Indirect)	Producers´ Goods	Nonmonetary Financial Assets

Figure 2: "Money" in a Typology of Goods

The assignment of money to the north-east quadrant of the typology is done with some caveats in mind. One difficulty with money is that economists use one word to describe two goods (Howden 2013; 2015a, compare with Rothbard 1962: pp. 756–62). In some instances money is demanded because the individual desires a good to exchange to make payment for another good or to settle a debt obligation. Alternatively, money is demanded to be held in reserve and thus provide a hedge against perceived uncertainty by the individual (Howden 2015b). Because of this two-fold nature to money, it is actually appropriate to place it in two

categories dependent on the role the individual is holding it for, as in figure 2.

Money held as a guard against perceived uncertainty confers their holder with a value not only in the present, but also without needing to be exchanged into something else. Indeed, money may be held with the expectation that in the future they *may* be exchanged into another good, but in the meantime the individual foregoes no benefit by holding a cash balance. In other words, the cash balance the individual holds as a reserve is not idle, notwithstanding the fact that the money is not apparently being put to use (Hutt 1956; Hülsmann 1996: 12; Hoppe 2009; Bagus and Howden 2013). In this way, money held to satisfy the individual´s reservation demand is akin to a consumers' good, and thus it belongs in the north-west quadrant. Alternatively, individuals hold money to satisfy their exchange demand (what most economists have in mind when they discuss money as the generally accepted medium of exchange) and as such it belongs in the north-east quadrant of figure 2, which is why I have labelled it as containing the "media of exchange", of which money could be one such good (though not necessarily the unique good).

Conclusion

Perhaps the main benefit of this typology is that it allows the economist to define the relationships between goods in a way that reveals where value comes from. It is commonly understood that value is imputed to producers´ goods by way of their discounted marginal value in creating a consumers´ good, but what of other goods, e.g., money and nonmonetary financial assets?

Less commonly understood is where money gets its value, or purchasing power, from. From the typology it becomes clear that money must be valued exclusively according to its claim on consumers' goods, as in figure 3 (an insight recently reached through a different analysis in Braun 2014: chap. 16). Indeed, it could not be any other way. Even if held to be exchanged against producers' goods, those goods derive their value from their ability to produce consumers' goods.

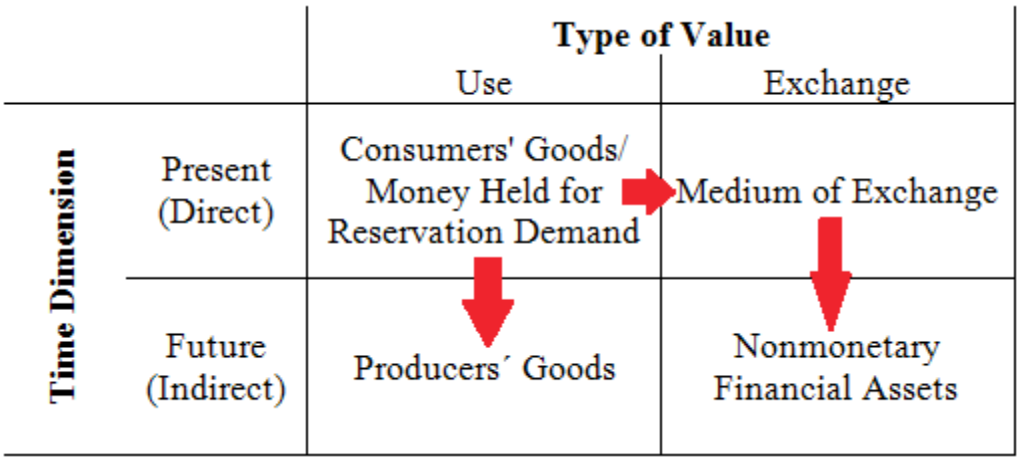

Figure 3: Imputation of Value Between Goods

A more striking insight is that the value of non-monetary financial assets derives from their ability to be converted, or exchanged, into money. This tells a consistent story as standard asset-pricing models in two ways. First, the amount of money that a nonmonetary financial asset redeems for is determined by the profitability of the ultimate claim, typically a producers' good involved in the production of a consumers' good. The value of the nonmonetary financial asset thus increases if, 1) the ultimate value placed on the consumers' good increases, 2) the productivity of the producers' good increases (such that its discounted marginal product increases), or 3) the value of money increases, which can only happen through a relative fall in the ratio of the stock of money to the value of produced consumers' goods. Second, the certainty with which the nonmonetary financial asset can be converted to money will affect its value through the standard channels, i.e., default risk, duration risk, etc.

The four-fold typology of goods provided here allows for one additional benefit. While it expands the scope of mutually exclusive goods, at the same time it must be apparent that the value of each is ultimately determined according to the standard market force of consumer preferences and values combined with the related concept of supply. When coupled with a novel method to look at the causal chain of how value is transmitted to various goods from its origin (at the value of consumers' goods) one can gain insights into the scope of factors affecting the prices of goods beyond those apparent by way of the more standard consumers' good/producers' good dichotomy.

References

Bagus, Philipp, and David Howden. 2013. Some Ethical Dilemmas with Modern Banking. *Business Ethics: A European Review* 22(3): 235-45.

Bohm-Bawerk, Eugen von. 1962. "Whether Legal Rights and Relationships are Economic Goods", (*trans*.) George D. Hunke, in *Shorter Classics of Bohm-Bawerk*, pp. 25-138. Spring Mills, PA: Libertarian Press.

Braun, Eduard. 2014. *Finance Behind the Veil of Money: An Essay on the Economics of Capital, Interest, and the Financial Market*. Liberty.me.

Gertchev, Nikolay. 2004. Dehomogenizing Mises's Monetary Theory. *Journal of Libertarian Studies* 18(3): 57-90.

Hoppe, Hans-Hermann. 2009. The Yield from Money Held reconsidered. *New Perspectives on Political Economy*, 5 (2): 129-136.

Howden, David. 2013. The Quantity Theory of Money. *Journal of Prices & Markets* 1(1): 17-30.

Howden, David. 2015a. "Money", in Per Bylund and David Howden (*eds*.) *The Next Generation of Austrian Economics: Essays in Honor of Joseph T. Salerno*, pp. 43-58. Auburn, AL: Ludwig von Mises Institute.

Howden, David. 2015b. Money in a World of Finance. *Journal of Prices & Markets* 4(1), Papers & Proceedings of the 3rd Annual International Conference of Prices & Markets, Toronto, ON, Nov. 6-7, 2014: 13-20.

Hülsmann, Jörg Guido. 1996. Free banking and the free bankers. *The Review of Austrian Economics,* 9(1): 3-53.

Hutt, William H. 1956. ¨The Yield of Money Held.¨ In: Sennholz Mary (ed) *On Freedom and Free Enterprise: Essays in the Honor of Ludwig von Mises*. Princeton, NJ: Van Nostrand, 196-216.

Menger, Carl. [1871] 2007 *Principles of Economics*, (*trans*.) James Dingwall and Bert F. Hoselitz. Auburn, AL: Ludwig von Mises Institute.

Mises, Ludwig von. [1912] 1953. *The Theory of Money and Credit*. New Haven, CT: Yale University Press.

Mises, Ludwig von. [1938] 1990. "The Non-Neutrality of Money", reprinted in *Money, Method, and the Market Process*, Richard M. Ebeling (ed.). Norwell, MA: Kluwer Academic Publishers.

Robbins, Lionel. 1935. *An Essay on the Nature and Significance of Economic Science*. London: MacMillan and Co.

Rothbard, Murray N. [1962] 2004. *Man, Economy, and State with Power and Market*, Scholar's edition. Auburn, AL. Ludwig von Mises Institute.

Rothbard, Murray N. 1981. *What Has Government Done to Our Money?* Novato, Calif.: Libertarians Publishers.

Salerno, Joseph T. 2008. Bohm-Bawerk's Vision of the Capitalist Economic Process: Intellectual Influences and Conceptual Foundations. *New Perspectives on Political Economy* 4(2): 87-112.

Yeager, Leland B. 1968. Essential Properties of the Medium of Exchange. *Kyklos* 21(1): 45-69.