

Can't Hold Us Down!

an ode to prices



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31 March 2009

I.

Some theories of the natural universe are straightforward enough to be laid out as scientific certainties, like Isaac Newton's laws of motion (Krull 80). Other nuances are less obvious – especially those relating to human behavior. Economists experience some of the most puzzling dilemmas that face any scientific discipline. One of the most complex problems in economics is that of explaining the way that prices work in a market economy. Over the past few hundred years, economists and political scientists have disagreed about the nature of prices, often attempting to modify the way that prices work. Their efforts have invariably failed, perhaps because the price system is much more resilient than many social scientists at first believed. Prices continue to function smoothly under even the most oppressive totalitarian dictatorship. When it has experienced interference, the price system has evolved and changed, like language, in response to the needs of the situation. No government has ever truly controlled prices, since the price system evolves so quickly and so effectively as to stay one step ahead of any type of fixed pricing scheme.

Economics is a fairly new discipline. “Until the nineteenth century, academics considered economics a branch of philosophy” (Buchholtz 13). Thus, it should not be surprising that economists are still discovering the way the market really works. Attempts to change price signals are ineffective because prices are not a *cause* but rather an *effect*. An apparently excessive price is not a “disease” but rather a “symptom.” The same is true of a surplus or a shortage. These blips in the market are not examples of market failure, but rather the result of some change in the market which is not immediately apparent. The job of an economist is to listen carefully to the message conveyed by the price system, rather than attempt to force the price system to lie about the nature of reality. Market forces will make themselves known in one

way or another; no attempt to modify market outcomes through price fixing will be effective in the long run.

II.

The price system is the language of the market economy. Prices are the market's answer to the information problem; they are essentially an economic version of Star Trek's universal translator¹. The price system, like the market itself, is a social process which has evolved over the course of centuries. It is a highly adaptive process and it is deceptively simple. It is crucial to understand its identity as a social process:

“Social processes cover an enormous range, from language to warfare, from love to economic systems. Each of these in turn comes in a great variety of forms. But there are also some things in common among social processes in general ... social processes have certain characteristics – an order, whether or not intentionally designed” (Sowell 69).

Prices are truly central to the swift and efficient functions of the market. A price is a signal; it sends a message which implicitly includes a potentially infinite amount of information.

Prices typically indicate the monetary amount that a buyer is willing to surrender to a seller in exchange for a certain amount of goods and/or services. However, any market transaction may have hidden costs. Sometimes these costs are hidden from the seller or buyer; sometimes they are hidden from any outside observers (as in the case of a secret bribe). It is paramount to remember to look for “that which is not seen,” as the French economist Frederic Bastiat pointed out: “There is only one difference between a bad economist and a good one: the bad economist confines himself to the *visible* effect; the good economist takes into account both the effect that can be seen and those effects that must be *foreseen*” (1). The price system operates

¹ The universal translator is a fictional invention central to the *Star Trek* TV series. It is a “sophisticated computer device capable of real-time conversion of a given language into nearly any other language” (Okuda 675).

best in a market where money can change hands freely and without restriction, but it will continue to function (if indirectly) in a market where price fixing occurs.

III.

Prices are a barometer for the constant change and flux that occurs within the market. The Austrian school of economists saw the “social process” aspect of the market as being central to its identity. In a nutshell, this group of economists tended to agree that

“ ... the market is best viewed as a dynamic process of never-ending change; knowledge of the market is imperfect and divided among the participants in the social division of labor; prices are used not only as incentives for various types of actions, but as the primary method by which knowledge about changing market conditions is transmitted to every corner of the market; the entrepreneur is the central agent in a market economy; and market competition is a discovery process for finding out least-cost methods of production and the comparative advantages of each member of the social system of the division of labor” (Ebeling xvii).

The turbulence and eternal upheaval of the free market is the key to understanding the importance of the price system. It is precisely because of this constant change that prices exist. The price system is essential as a tool for keeping up with the unpredictable subtleties of the market.

III. a.

In 1945 Fredrick Hayek published an article titled “The Use of Knowledge in Society.” Hayek’s thesis was essentially that no one person or group of people could ever effectively set market prices, thanks to the overwhelming amount of constantly changing information in existence in the market. His article pointed “to the dispersion of information as one of the

biggest obstacles for society” (Buchholtz 30). Hayek believed that the market pricing system solved this “information problem” in an eloquent and efficient manner. As he put it:

“The peculiar character of the problem of a rational economic order is determined precisely by the fact that the knowledge of the circumstances of which we must make use never exists in concentrated or integrated form but solely as the dispersed bits of incomplete and frequently contradictory knowledge which all the separate individuals possess ... Fundamentally, in a system in which the knowledge of the relevant facts is dispersed among many people, prices can act to co-ordinate the separate actions of different people in the same way as subjective values help the individual to co-ordinate the parts of his plan” (pars. 3, 19).

The process of a market economy functions in a similar manner to that of a vast ecosystem. Each member of the economy goes about his work without really knowing much about the big picture. He follows his own rational self-interest without necessarily considering the needs of others. Yet at the end of the day, the activities of market tend to drive society as a whole toward a more prosperous state of affairs than previously existed. It is the price system which makes this possible, by sending a signal to each actor in the market, telling him where his efforts are most needed. The amazing thing about the free market is that each person can only get ahead (that is, only act in his own direct self interest) by engaging in activities that bring value to others. Paradoxically, each member of the society must help others in order to help himself.

III.b.

The unfortunate truth about life on this planet is that resources are scarce. “To be human is to know that our days on Earth are numbered, and that we must choose how to use them. Because we live in a world of scarcity, the use of means to pursue an end involves *costs*”

(Callahan 24). This creates an interesting problem for human beings who strive to better their situations. Each actor in the market is faced with a multitude of choices. How should he spend his time? How should he spend his money? How should we take advantage of the natural resources at his disposal? “Although we live in a world of limited resources, we have unlimited wants ... given the existence of scarcity, we must make choices; we cannot have more of everything, so to get more of some things, we must give up other things” (Miller 2). This is not to imply that all actors in the market strive for the highest monetary profits possible; that is certainly not the case. However, a college student who chooses to backpack around Europe for a summer instead of accepting a highly paid internship in Washington is still pursuing his rational self-interest. He deemed it best for *him* to take the backpacking trip. He may later regret his choice, or discover that he underestimated the importance of the job experience in Washington, or even catch pneumonia in Europe and die. This does not change the fact that given the information he had at the time he made the decision, he chose in accordance his own preferences. The backpacking trip meant more to him *at that time* than the potential experience he believed might have gained working in Washington.

III. c.

Prices provide implicit information which allows people to compare their preferences amongst themselves. Prices matter because the value that an individual places on something is subjective. A good or service is only worth as much as someone is willing to pay for it. Intuitively, we can see that this is true by thinking about the “blue book” value of a car. Anyone who has sold a used car knows that Kelly Blue Book values mean very little when it comes to actually selling a vehicle! What really matters? The buyer’s preferences and opinions are what

really matters. An economist will tell you that "...the value of the particular ends we might choose is subjective" (Callahan 25). Values in the real world are extremely situational.

The concept of subjective value is extremely important when it comes time to think about why prices function the way that they do. Indeed, it is likely one of the most important concepts in economics. As Gene Callahan puts it in his book *Economics for Real People*:

"The subjective nature of value was one of Carl Menger's major insights. For the classical economists, value was a paradox. They attempted to base their theory of value on the labor involved in producing a good or the usefulness of the good, by some objective measure. But consider such a simple case as finding a diamond lying on the ground during a stroll. No labor was required to produce the diamond, nor is it more useful, at least to directly maintaining life, than a cup of water. And yet a diamond is generally considered much more valuable than a cup of water. Menger cut this Gordian knot by basing his theory of value on just that fact—things are valuable because acting humans consider them to be so" (25).

The value of any good or service exists not in itself, but in the mind of the buyer. Though intangible (and frustratingly difficult to measure), this value is very real.

III. d.

The price system tells entrepreneurs when their efforts are valuable (and when they are not!). If a need for a product exists, then the price for that product will be high, offering profits to the entrepreneur who becomes a provider of that product.

"Prices and profits signal to entrepreneurs what to produce and what price to charge.

High prices and high profits sound alarms in the ears of entrepreneurs, screaming at them

to start producing a certain good. Low profits or losses grab a businessman by the shirt collar and shake him mercilessly until he stops producing” (Buchholtz 24).

A transparent pricing system is essential to the successful flow of innovation and invention in any economy. When prices are obscured, the market tends to experience surplus or shortage.

“With prices altered, entrepreneurs are discouraged from pursuing genuine opportunities in some areas. For example, farm subsidies will make the search for more efficient methods of farming less urgent. Meanwhile, entrepreneurs pursue other opportunities that, in the unhampered market, would have been considered superfluous – consider the proliferation of lobbyists and tax accountants” (Callahan 180).

Though simple, it is a concept that bears repetition: prices are the language of the market. They quietly send messages to anyone who cares to hear. These messages tell each market participant where he is most needed, and herd natural resources towards their best use.

IV.

Prices never cease to communicate the information that is relevant to the buyer and seller of the product at hand. In a social system which obscures prices, such as rent control, humans will ultimately come to discover the same information they would have under a free market. The information may become more costly, and the process less efficient, but the truth will out.

“An unhampered market brings about its outcome through the voluntary choices of all people in that market. Any interference with the market process ... will, to some extent, thwart the realization of people’s preferences. People, the face of such interference, will act to reassert their desires. However, the process has been made less efficient. One reason is the overhead of the government program itself. Another is the fact that market forces will reassert themselves, though in unexpected ways” (Callahan 178).

An almost infinite number of solutions to the information problem will manifest themselves. However, in a system which represses simple monetary price signals the price of an item will be less obvious than in a society which encourages freely transparent money pricing.

IV. a.

Goods and services can move around through human society in a number of ways. Brute force is an effective measure, though it tends to create enemies who will later hold grudges. Simple barter is another method, but is plagued by that pesky problem of the double coincidence of wants (if Jane wants a shirt and Tarzan only has pants to offer her, they won't trade, no matter how great the pants are). Prices, more than money, are the real lubricant of society. Prices are less limited than money. Prices can easily be translated from one currency to another.

For instance, friends may trade among themselves using a currency of "favors." This currency will rely heavily on trust and personal integrity. Each friend counts on the other to repay him down the road. It's unlikely the friends will maintain an accounting system to track the favors. A ride to the airport here, a week of pet-sitting there, occasional assistance moving furniture or fixing broken electronics, and at the end of the day it evens out.

A recent internet innovation is that of websites where members can barter movies and books amongst themselves:

"At PaperBackSwap.com, you can trade books you've read for ones you want—for no more than the cost of postage. How It Works: Become a member (it's free), then list books you'd like to offload. The site notifies you when another member wants your book; you mail it with a label you print from home. (Most books cost \$2.23 to ship.) Then you get a credit you can use to order any book on the site" (Pham pars 1 – 2).

This, too, relies on personal integrity to a certain extent, but the successful bartering websites tend to have some pretty ironclad security systems and insurance backups.

Another currency is well known to most people: standing in line. What you do not pay in monetary cost, you may very well pay in the cost of your time. If you chose to go out to dinner at six o'clock on Friday night you'll discover that going to dinner then is more expensive than if you wait about four hours. The prices on the menu may not change, but you will wait in line for twenty or thirty minutes before you can sit down and eat. Make no mistake about it; the time spent waiting in line is part of the price of going out to dinner.

V.

The key to understanding the importance of a price system is to understand that prices are nothing more *and nothing less* than information. The market will provide all the information needed to make any particular decision. It is up to us to understand that information. Understanding becomes more difficult when price signals are obscured by outside interference (however well intentioned), but at the end of the day prices in an oppressed system mean just as much as those in a free market.

If the market and the price system had voices, they might sing along with Cristina Aguilera's turn of the millennium anthem for independence:

Take a deep breath and say it loud

Never can, never will, can't hold us down!

Can't hold us down!

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