The Profound Value of Market Values

Written by Gary Galles.

I have heard it many times: “An economist is someone who knows the price of everything and the value of nothing.” But only recently did I discover that its origin was an Oscar Wilde definition of a cynic. That led to “Economists are Skeptics, not Cynics” (FEE 12/20/16), airing objections to equating economists with cynics. But the idea that an economist can be adequately described as “someone who knows the price of everything and the value of nothing” is so wrongheaded, I can’t seem to get it out of my mind.

“Knowing the price of everything” misrepresents the most important things about market prices economists know, and “knowing the value of nothing” is perhaps an even more misleading criticism of economists.

Knowing the Price of Everything

As with all socially influential misrepresentations, describing economists as those who know the price of everything has an element of truth. Prices are one of the most crucial variables economists study. From principles of economics on, students are faced with many optimization exercises based on given prices or designed to determine market prices. Intermediate microeconomics is commonly called price theory. And the budget constraint and indifference curve tools developed in that course cannot be used in the absence of market prices (you need market prices to determine the budget constraint). But to define economists in such a narrow, reductionist way ignores the most valuable things economists actually know about prices, crowded out by a caricature of economic man as a calculating machine trading off goods with assumed to be known relative prices in search of maximum profit as a producer and maximum utility as a consumer.

Such a misleadingly limited view ignores that market prices communicate information to decision makers, much of which is unknowable in the absence of the property rights and voluntary agreements about those rights that determine market prices. Similarly, market prices coordinate the actions of market participants in the face of pervasive disagreement and frequent change better than coercion-based “command and control” approaches. Market pricing also does a superior job of motivating those on both buying and selling sides of exchanges, including providing a mechanism to induce voluntarily dealing with those someone doesn’t know or even doesn’t like.

Knowing Prices versus What?

When granting that economists know the prices of things, employers of Wilde’s phrase suggests that others do not. If so, that credits economists with truly valuable information, as Ludwig von Mises argued so forcefully. If there were no known market prices, how could sellers anticipate what benefit they would receive from consumers in exchange for their wares, to know what production choices would advance their self-interest? Similarly, how could buyers know what they would have to give up to acquire such wares, to know what consumption choices would advance their self-interest? And since only voluntarily agreed-to arrangements reveal this information accurately, any imposed alternative reduces participants' knowledge, and with it, their well-being. This is one way in which market competition is not a less-friendly, and therefore inferior, alternative to cooperation, as often portrayed, but a means of better revealing who individuals can gain the most from cooperating with, and how, leading to more effective cooperation.

Resolving Disagreements About Value

The market prices economists study also resolve people's pervasive differences in preferences and circumstances in mutually beneficial ways. Every unit of a good someone who was self-interested would buy has an expected benefit greater than the expected cost they must bear; every unit of a good a person would sell has an expected marginal cost less than the revenues expected in return. So buyers and sellers disagree about the benefits and costs of every unit, until for the last unit traded, they are approximately equal to the market price. The freedom to determine how much to exchange allows agreements on market prices which provide benefits to all parties involved. Without such a mechanism of producing agreement at the margin, inherent disagreements can instead easily lead to wars over whose preferences should dominate.

Further, the fact that all parties to trades benefit from each unit traded has important consequences for alternatives to market organization, enforced by governments. When taxes or tariffs, regulations or mandates, price ceilings or price floors are imposed, to "fix" the market result, they reduce the quantity exchanged, wiping out the mutual gains that those trades would have otherwise generated.

In addition, market prices also resolve changes in preferences and circumstances in a flexible, peaceful way. Such changes require renegotiated terms. When transaction partners need only agree on the value of the last unit exchanged, prices can solve the temporary conflict produced by such changes in a way that is jointly voluntary, rather than coercively imposed by one party on another, backed by threat of violence.

Knowing the Value of Nothing

Saying that a person knows the value of nothing is an insulting way of saying that there is no reason to pay any attention to what they have to say about anything. But the phrase actually demonstrates an absence of understanding about value.

To say that economists don't know the value of anything is true, but irrelevant. Nobody knows the objective value of anything, because values are not objective. Values are in the eye of the beholder. They are subjective, and differ widely, particularly when it comes to things we find ultimately important (e.g., love, respect, self-respect, etc.). Our disagreement on values is illustrated every time we penetrate beyond gross generalities (e.g., we are unified in desiring food, but we disagree about what kind of food, how much food, food for whom, available when and where, not to mention who should pay for it and the trade-offs we desire between food and other things we value). This is why economists are skeptical of unity language in politics. We are not in fact unified in the ends we want and the tradeoffs we are willing to make among them.

To say economists don't know what doesn't exist is not a valid criticism of economists. After all, it is just as true of those criticizing them. What it does illustrate is the ignorance or willful misrepresentation of those critics, which they use to claim their values are definitive and so others' judgements should be forcibly conformed to theirs.

For example, demands to preserve "historic" structures are used to strip property rights from their owners because someone else with no ownership claim liked them. Similarly, preserving green spaces is a popular NIMBY excuse where I live (though we have often moved beyond "not in my back yard" to BANANA, or "build absolutely nothing anywhere near anything") for homeowners on land that was converted from, say, orange groves, to deny the same conversion rights to others who haven't yet done the same, because once they are there, everything they liked about the area is redefined as their inviolable right, regardless of the evisceration of others' established rights.

Total Value versus Marginal Value

The criticism that economists don't know the value of anything also reflects critics' confusion about marginal values versus total values, often called the water-diamond paradox. The total value of water to human existence easily exceeds that for diamonds. Shouldn't far more valuable water be more expensive than diamonds? No. The market price reflects the marginal value of water, not the total value of water. We don't exchange entire abstract classes of goods; we trade concrete, marginal units of goods, and the marginal value of water is lower than for diamonds, since the supply is far more plentiful relative to demand.

This confusion is also behind objections that market prices do not reflect individual merit. Someone with far greater merit in producing what others value via the marketplace could well be less meritorious in other ways, but the former is what markets reward. Of course, there is also no objective way to measure merit, and so no other means of allocating resources can reward merit accurately, either.

Revealing More about Value

While market prices are criticized for not revealing values, they actually reveal more about peoples' values than any coercively-imposed system of resource allocation. Voluntary exchanges can incorporate all the preferences and circumstances known only to those making the choices into relative prices that provide valuable information about marginal values to others, while any centrally planned "solution" necessarily throws away that valuable information, and the wealth it can enable, as Friedrich Hayek demonstrated. And revealing more about marginal values than other allocation mechanisms is not a reason to endorse those alternatives over markets that perform far better in that respect.

Even though economists, like others, don't know the objective value of anything, they do know that as long as people voluntarily enter market arrangements, all parties to each transaction expect that the subjective value they will receive as benefits will exceed the subjective value they bear as costs. Greater subjective values for all is the result. And any coercive intrusion that forcibly moves the quantity exchanged away from what individuals would voluntarily choose destroys joint gains to participants, making the "solutions" offered by economists' Wilde-eyed critics worse than the supposed problems used to justify them.

Economists are far from limited solely to knowledge of market prices. In fact, their understanding of the voluntary market process and the beneficial consequences that result is far more important. Economists also have more accurate insights into the values people place on goods and services than their muddled accusers, who wish to displace replace people's own preferences, revealed by their choices, with very different ones. As Max Borders once wrote, "thinking slides from subjectivity to false objectivity. Once you concede the existence of objective good to the statist, you must argue with him on his terms." And the consequence is a clear demonstration that, in Frank Knight's words, "It ain't ignorance that does the most damage; its knowin' so much that ain't so."

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