

FREEMarket

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THE MARKET PROCESS IN ACTION

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A quick scan of any newspaper suggests that high fuel prices have disrupted our daily affairs. While politicians and pundits across the political spectrum are fretting about the need for a national energy policy, wringing their hands about the apparent un-American-ness of our dependence on foreign oil, and worrying that the massive run-up in gas prices in recent months will lead to an economic downturn, market forces are quietly adjusting so as to soften the blow and solve the problems that arise.

In a market economy, profits and losses are the signals that tell entrepreneurs whether they are choosing wisely or choosing poorly in their undertakings. Profits and losses also tell entrepreneurs how to adjust these undertakings to ever-changing conditions. The changes Toyota is making to its car and truck lineup illustrate this important principle.

When you do a lot of driving, \$4 gas eats up a pretty big chunk of your disposable income and requires a few adjustments to the way you live. So how does the market coordinate these changes? Toyota is responding in a predictable fashion: their plant in Blue Springs, Mississippi (which is under construction) will produce the gas-sipping hybrid Prius, not gas-guzzling SUVs. They are also going to consolidate their truck production operations in their San Antonio plant. Paraphrasing an analyst quoted in the July 11 *Memphis Commercial Appeal*, no one, not even Toyota, is immune from the pressure of gas prices hovering at or above \$4 per gallon.

The myriad adjustments to expensive gas show us how market processes change our activities and behavior. We use less of some things and more of others, and we innovate. In more concrete terms, we drive less and walk more, and we invest in alternative sources of energy. Perhaps we telecommute instead of driving to the office. The number of venture capital firms focusing on alternative energy sources has increased rapidly in the last few years, and blueprints for do-it-yourself solar iPod chargers, solar lawn mowers, and other solar technologies are all over the Internet. Some students at my institution made a solar iPod charger as part of a year-end project this past semester. The list of innovative responses to high gas prices goes on and on.

Some of these ideas will work well and some will not. It is not the specific technologies and ideas that are important; rather, it is the *process* that matters. Some ideas will work and others will fail; it is the profit-and-loss mechanism of the market ➡



process that helps us separate the good ideas from the bad. Scholars like F.A. Hayek have referred to “competition as a discovery procedure,” and in an article that appeared in the *Business and Society Review* in 2006, Walter Block, Stephen W. Carson, and I referred to the market as a “discovery process.”

Competition in the market economy separates the good ideas from the not-so-good and helps us economize on scarce resources. We cannot predict which technologies will emerge or how problems will be solved, but we can understand the institutional conditions under which this process will emerge.

Toyota’s decision to consolidate truck production in San Antonio and to produce the Prius in Blue Springs is one way to adjust to higher gas prices. Whether this is a wise choice or not will be determined over time. Toyota announced the changes on Thursday. The stock ticked upward slightly and then back down again the day after, suggesting that we can’t draw too much information about how the market is assessing the move right now. The market, though, is a process by which information about successes and failures will be revealed.

“The market” is not an outcome, nor is it an end unto itself. Rather, the market is a process by which people discover effective (and not so effective) ways to satisfy our needs and wants. Entrepreneurship is essential; this consists of appraising the factors of production in the market and undertaking new production plans based on the expectation that such an endeavor will be profitable. Those who choose wisely are

rewarded with profits. Those who choose poorly are punished with losses.

Toyota did not need to follow the *diktat* of a centralized bureau of automobile construction and distribution. They made their decision based on their expectations of the future structure of prices for inputs and outputs, complements and substitutes. They decided that their resources were better spent improving and building hybrids rather than larger vehicles. Money talks, and firms have to listen.

Even a large concern like Toyota has to yield to the wants and wishes of consumers. Consumers are the ones who pay the piper and are therefore the ones who call the tune. As gas gets more expensive, people want to purchase smaller, more fuel-efficient vehicles. Any company that wishes to remain profitable must listen and respond, and any company that refuses to listen to consumers does so at its peril. ■



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THE MARKET DURING CRISIS

Llewellyn H. Rockwell, Jr.

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If you are glued to the evening news or the radio, you might believe that the whole nation is waiting in suspense to see how our leaders are going to deal with the economic challenges of our day: recession, inflation, unemployment, bank runs, etc. There are proposed laws, bills flying everywhere, candidates promising this and that, press conferences, debates, op-eds, talking heads, regulations, investigations, proposals, and policies.

Then there is the real world.

The real world is the market economy. It is making a trillion decisions every hour. The decisions are dramatic, decisive, and life changing. They deal with real stuff, not vapid promises. We see this in a crisis more than ever: the takeovers, production shifts, whole industries rising and falling, patterns of imports and exports reversing themselves, jobs changing, with tens of billions of dollars changing hands minute by minute.

Here is the pith of life. The rest of what people think matters is just white noise.

An interesting case is how production in some sectors is increasing in the midst of an economic slowdown. Cars, computers, and steel—important aspects of industrial production—actually experienced a marginal boost in June. Why might this be? The declining value of the dollar on international exchange has made imports more expensive, and made domestic production more appealing. This complex activity—a signal of bad economic times but a praiseworthy response to massive shifts in the investment environment—is driven by nothing

less than loss avoidance strategies by entrepreneurs.

No one needed to issue a command to make sure this happened. There were no debates or polls. No regulator had to issue a press release. It happens because considerations of profit and loss provide the right signals to entrepreneurs. The entrepreneurs saw the new conditions and acted on them. And why? To do what they always do: try to stay out of loss-imposing lines of production and find profitable ones.

Another dimension of this is the industrial takeover. InBev SA of Belgium has taken over Anheuser-Busch in the hope that it can make the company profitable. This is partly a response to the falling dollar but also a handoff to a management team that might do a better job at doing what the company is supposed to be doing. Concerning the nativists who say that only Americans should own beer companies in America, consider that the foreigners are doing us a favor: taking over one line of production to free up domestic resources to help dig out of recession. Oh—and beer from Belgium is far superior to any Bud.

Earlier this year, the Royal Bank of Canada, from its US headquarters in North Carolina, swept in and took over First American Bank and nine other banks in Alabama, Florida, and Georgia. In bank after bank, they close on Friday and reopen on Monday with a completely new name and face. Nothing in politics happens this fast. It is all to the good for everyone, since it puts the banks on a more profitable path. Historically, by the way, Canadian banks are far more prudent than their US

competition, so as a customer, I can only say: Hooray!

Again, the motivation is the same: loss avoidance and profit seeking, which is just another way of saying that these are efforts to make sure that society's resources are used in the most efficient (least wasteful) way. A recession makes this approach all the more critical. But what is really impressive is the way in which markets respond to dramatic change. Resources move and shift in a manner that makes economizing part of the very structure of life itself.

Another example is oil. The prices at the pump reflect not only existing supply and demand conditions but also the best possible guesses about future conditions, discounted to the present. The prices reflect what producers believe to be profitable and they also serve to bring about the best possible conditions for economizing. Should prices go up or go down? We are fortunate that this doesn't have to be decided by a government committee. It is a matter worked out by billions of real trades around the world within the global market framework. The response time to new information is mind-boggling. Prices soar for months and then suddenly plummet based on changing conditions. Everything is constantly in flux, with present prices representing the best possible guess concerning the least wasteful use of resources.

Every business in America right now is in the position of having to assess how it does business, what it pays its workers, how much to invest for the future, whether to cut back on some lines of production now, how and whether to advertise, when and how to raise prices in response to increased costs of doing business. Again, no one waits for an order from Washington. The orders are issued by balance sheets at the end of the day. A company must stay in the black or else shut its doors.

Consumers too participate in these large movements of resources. We see prices going up in all goods and services, but some more than others. We

shift to substitutes, we consider more carefully what we buy, we think hard about alternative ways of stretching the value of declining dollars. In this way, we reward producers who best adapt to the changing environment, and best serve our needs.

Finally, consider the fate of mortgage lenders and homeowners. The markets became wise to the fact that loose credit led to a fantastic bubble and that trillions in traded mortgages might not be serviceable in an environment of downward price pressure. Companies that were once seen as valuable and liquid are suddenly seen as unstable and wasteful. Their stocks are shorted by sellers. Their price crashes. Reality is revealed.

This is not an attack. It is not a result of malign "rumor mongering." It is not even regrettable from an economic point of view. Truth is a precondition for economic recovery. Bad investments need to be avoided. Good ones need to replace them. That is the very core of what all this economic activity is about. If the informed guesses of traders turn out to be wrong, there is a profitable opportunity for other traders to guess more accurately. To dampen this spirit is to do nothing but prop up illusions and perpetuate error.

What can the state contribute to this cause? It can get out of the way. It is not necessary to somehow demonstrate the superiority of markets over state planning. This is demonstrated every single second of every day. The politicians blather while the markets act with confidence and wisdom to achieve real results. The only positive contribution that politicians can make is to make the market a freer environment for resources to travel to their most profitable production lines.

People say that markets are not democratic. In fact, what we have here is the ultimate economic democracy, one in which all of us as individuals vote in the

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News from the Institute

Books from the Mises Institute

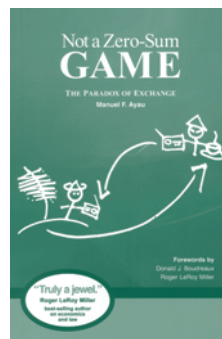
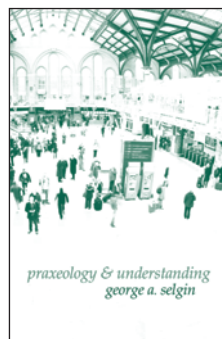
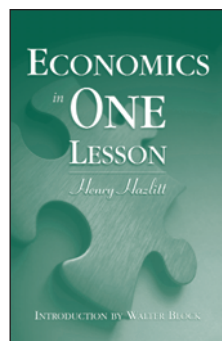
Working furiously through the summer months, the Mises Institute has brought out some wonderful titles. Top among them is Henry Hazlitt's *Economics in One Lesson* in hard-back, priced for the widest possible distribution. It immediately became the top seller in our online store. We've also made it easy to buy the book in larger quantities. We all know feeling of wishing we had some excellent introduction to economics to give our friends and associates. Now this is possible.

Henry Hazlitt was a great man and a great economist. He named the Mises Institute in his estate, and we've fought hard to put all his books back in print, including the most rare editions of early works such as *Thinking as a Science* and *The Way to Will Power*. These are all back alongside his more scientific works.

Congratulations to George Selgin for his outstanding book *Good Money*, now online at Mises.org. In here he provides the historical detail to an insight first offered by Murray Rothbard in *What Has Government Done to Our Money?*. In particular, Rothbard offered his view that coinage could be entirely private. Selgin, an early Mises Institute fellow, shows that this is precisely what happened in the early years of the Industrial Revolution. The state failed in his job as always, so private enterprise took over.

Selgin is also the author of one of the longest-running big sellers in the Mises Store: *Praxeology and Understanding*. He shows in this book that deductive logic is the best means to excellent economic theory. It provides the best answer yet to the revival of the historical school that vexed economics in the 1980s.

We should also note that Manuel Ayau, founder of the University of Francisco Marroquin in Guatemala has written a great primer on the division of labor: *Not a Zero Sum Game*. The Mises Institute is cooperating with Marroquin to make an American edition available for sale. ■



Summer Seminars

This summer's Rothbard Graduate Seminar was a smash success, as selected students were given a detailed tour through *Man, Economy, and State* under the guidance of our faculty. A special thank you to Alice J. Lillie for making this possible.

Thank you also to everyone who attended our Mises Circle seminar in Seattle, as sponsored by Curt and Allora Doolittle. It was great to see old friends again and meet new ones. The conference was completely sold out weeks ahead of time! ■

Continued from page 4

use of our time and resources, as William H. Peterson argues. We determine, through our buying and selling decisions, which lines of production succeed and which ones fail.

But if the critics mean that markets are not politically democratic, they are precisely right, and it is a good thing too. The price system is a system of action, not words. It is decisive and takes

responsibility. Where political democracy ignores those without power, market democracy collects and uses all available information for the benefit of everyone.

Markets are beautiful in good times, but especially impressive in bad. There is no better occasion than a crisis of this size and scale to marvel at how the institutions of private enterprise can cope better than any political leader, or all of them put together. ■

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You can give much-needed support to the Institute by simply including the following words in your will: "I give, devise, and bequeath to the Ludwig von Mises Institute for Austrian Economics, Inc., 518 West Magnolia Avenue, Auburn, Alabama 36832 [insert amount being given here] to be used in the Institute's work." It is recommended, of course, that a lawyer help in drafting or amending a will.

For more information, call James Fogal, CFP®, Director of Development, at 800-636-4737 or email james@mises.org

For reasons of history and bad economics, it is usually assumed that government must have sole control over the nation's money, and enforce this control with demands that no one may use any money other than that which the government has approved. So how can we return money to its natural market home? Why is this necessary? This conference will address these questions and provide answers that are radical but practical too.

Speakers:

Walter Block, David Gordon, Joseph Salerno, and Lew Rockwell

Registration: \$75 US includes sessions and lunch. Valid passport required for US citizens.

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(A Morgan J. Poliquin, Almaden Minerals Seminar)

Saturday, September 13, 2008
Vancouver Convention Centre
999 Canada Place

For registration info, see mises.org, call 800-636-4737, or email pat@mises.org.

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(Sponsored by Morgan Poliquin, Almaden Minerals)
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- ANNUAL SUPPORTERS SUMMIT AND SCHLARBAUM AWARD
October 31–November 1, 2008 • Auburn, Alabama
- THE MISES CIRCLE IN HOUSTON
(Sponsored by Jeremy S. Davis)
January 24, 2009 • Houston, Texas
- AUSTRIAN SCHOLARS CONFERENCE
March 12–14, 2009 • Auburn, Alabama



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and Schlarbaum Award Presentation

October 31–November 1, 2008
Auburn Marriott at Grand National

From Menger to the present day, Austrians have favored sound money over government-manipulated paper currency. The very first Mises Institute conference in 1983 was on the gold standard. Twenty-five years later people are still looking for answers, and the Misesian answer is the same now as it was when Mises wrote his first book on the topic: restore sound money, stop the inflation, and get government out of the money business.

On Friday evening, **Andrew Napolitano** will receive the 2008 George Koether Award for Free-Market Writing. Saturday will feature a day of speakers and include a luncheon with **Ron Paul**. At the Saturday evening dinner at the Auburn Marriott at Grand National, **Pascal Salin** will receive the 2008 Gary G. Schlarbaum Award for Lifetime Achievement in Liberty.

For more information, call Patricia Barnett (pat@mises.org),
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