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PRICE MECHANISM ANOMALIES : Why the market allows the business cycle to occur

Personal and Market Value

Henry George gave the name 'personal value' to subjective value. He went on to note that 'use value', the subject of Adam Smith's famous query, is actually personal value. George shrewdly noted that 'use value' refers not to the *capacity of something to be useful*, but to its *usefulness to you.*

Personal value is of interest to the economist only because of its relationship to market value. Value at the market can be thought of as objective as it can be seen by many people at the same time. The market value of a trade good **at the point of exchange** confirms itself in the very act of exchange.

We are obliged to make use of market value, for it's the only hard evidence we have. When, at a particular time and place an exchange takes place two values define themselves in full view for all to see. These values are always equal which leads one to conclude there can be no such thing as an imbalance of trade.

Market value is clearly visible. Personal value is hidden, perhaps even from the person who holds it. Yet, in the act of exchange we are comparing these two. In our minds we have placed a value on the thing we have. This value we compare with the market offer. Should the market offer be higher, we are likely to trade. Should our personal valuation be higher, we forgo the opportunity.

Capital and Wealth

Trade, along with its implied division of labor, leads the advance of civilization. This advance may be gauged by the continual decrease in the cost of products. Cheapness is by far the best index of general economic advance.

The tendency for goods to become cheaper keeps production moving through the market process. Holding a good means holding something that is diminishing in value over time. But, there is a more immediate pressure - rising market prices. As the act of reaching the market and supplying demand reduces prices, the first to arrive will get the best price. Tardiness is penalized by a smaller return. So, in the long run and in the short, the trader who would succeed must hurry to market.

Other pressures push production into the market process. Storage costs, even with minimum maintenance, are a drain on profit. Furthermore, goods kept from buyers don't merely lose the lustre of newness, they may also inherit the mantle of obsolescence. Finally, production is continuous. To keep the machines running, goods must be moved out.

Trade goods, and indeed all products still in the productive process are given the name Capital. Such goods, to remain capital, must earn enough to maintain their value and compensate the lender. Theoretically, a third requirement must be met. Enough must be earned to make the use of the capital profitable to the borrower. Ricardian analysis suggests this isn't quite so. But, in any event, if Capital fails to pay its way, it will not long be left in the productive process.

Another class of products are not capital but Wealth - a name given to goods in the hands of the consumer. The primary characteristic of consumer goods is that they diminish in value as wear and tear take their toll. Consumer goods are *used* and are thus subject to physical depreciation.

Economists are inclined to allow size and longevity to influence definition. Thus, a home is given false status as a 'durable' when it can be likened without prefix to a suit of clothes, or your lunch or any other consumable. Breaking like things out of their conceptual category is not helpful to scientific reasoning, even though it can usefully pad a curriculum. With maintenance, a house may last forty years. With patching and other care, a suit may last for several years. Cryogenically or chemically, food may outlast both. But, common to them all will be a depreciating value, the result of cheaper replacements, rising maintenance costs and the inevitable onset of obsolescence.

This simple division of products between capital which earns, and wealth which is consumed appears to cover it all, but a third category of goods must be considered. This is a class of consumable which appreciates in value, the class we call collectibles. Why people initially collect is a matter for the psychologists to ponder. Certainly age is a factor. Perhaps because our first need is to survive, advanced age is attractive. If you are old, you've made it. Our reverence for age transfers to old things, living and dead. So, elephants, whales, sequoias, stately homes, antiques, early comic books become desirable simply because they have been around for a while.

People collect things which are old - because they are old. This demand for old things is reflected in their higher market value. Soon, these things are collected because they are old *and* because they have an increasing market value.

The Price Mechanism

At this point, we must re-examine the market price mechanism. This is the most endlessly pawed over segment of economic theory. The argument usually divides along political lines, with one side praising the market as the best method for 'allocating scarce resources', even as the other side points to its imperfections and outright failures.

Both sides are somewhat right as will become evident by reminding ourselves of the actual process of the price mechanism. When prices rise, goods come to market - and reduce prices. That, along with its reverse, is all there is to it. However, an assumption is made. That, in response to a price increase, goods can be produced and brought to market. This may not be the case.

In fact, we can say that when replacement goods either cannot be produced, or cannot reach the market, the price mechanism fails. This condition may arise from coercive political action, non-coercive market decision, or non-coercive natural monopoly. Whichever is responsible, when demand asserts itself and prices increase, goods do not reach the market. Unsatisfied demand presses price upward seeking to draw fresh supply and fails. It does not escape the attention of the owners of such goods that price today is greater than price yesterday and, with fresh supplies unavailable, the prospect for tomorrow looks even better. It is better to wait than to sell. Unique goods achieve a value based not on their utility, or their intrinsic worth, but on their unique ability to subvert the price mechanism and appreciate as they are held.

So, a Rosalie Beer can may achieve an exchange value of $10,000 for no better reason than it is the only one of its kind and may therefore be considered a valid collectible. This is a non-coercive natural monopoly. A limited print edition, or first cover, or 'we broke the mold', contrive collectibles by market decision. Import bans, or patent restrictions may create high prices by coercion, but do not always create 'collectibles'.

Collectibles

A collectible is a consumable that offers greater benefit from collection than use. Collectibles stay away from the market, for tomorrow the price may be higher. Non-collectibles must face multiple attacks on their value from decreasing replacement prices, rising storage costs, and the threat of obsolescence). They must rush to market for tomorrow may be too late. In one case, the first to get to market gets the highest price; in the second, the last to market gets the highest price.

If the collectible phenomenom adversely affected us, the activity might provoke our concentrated attention, but as Winston Churchill said in addressing this question, "Paintings don't get in anybody's way". However, a vital part of the economic system, a part crucial to all production acts like a collectible. This is Land, which in classical political economy named the concept of natural resources untouched by Man.

The term Land covers many things, but common to them all is location. Location is perhaps the single characteristic of land that, in these days of atomic fission fits the description provided by John Stuart Mill - 'the original and indestructible power of the soil'.

And locations can be 'collected'.

In every way, location fulfills the conditions of collectibility. The number of locations is fixed, no more can be produced. Each is unique and clearly cannot be moved. The price mechanism cannot draw new locations to the market in response to price increase, yet will try by pressing prices ever higher.

It becomes obvious that location prices (albeit with an occasional stutter) move always upward. The usefulness of a location in production becomes secondary to its value as a collectible, so locations are kept from the market. When an economic factor essential to human existence is disciplined by a market where everyone is trying to be the last to sell, the economy has a problem.

Given this situation, land sales become less a reaction to market pressure, than to outside circumstances. A death in the family, a cashflow shortage, a pressing tax demand may serve to place land on the market. And, increasingly important, is the governmental 'solution', enforced purchase with heavily discounted resale to a developer.

Future Anticipated Value

We recall that trade takes place when market value is seen to be greater than personal value. When your personal valuation of something is $1,000, but the market is offering $2,000, you are likely to trade. When your personal assessment is $2,000, but the market offers $1,000, you are unlikely to trade.

As a collector, you are concerned, not with present market value, but with the future anticipated value of the collectible. If you did not believe that this future value would be higher, you probably would not collect. Thus, your personal valuation of the collectible is the future value which you anticipate will be greater than present market.

So, *ceteris paribus* you do not sell.

But, this is not the end of the story. When pent-up demand is such that a location similar to your own sells at your anticipated future value, this new sale price becomes present market value. ***Your response will be to adopt a new personal value based on yet higher anticipations.***

The land market suffers a paralysis that casts a shadow over all productivity. Government compulsory purchase is used to attack the problem, but it is an expediency that merely compounds the problem, for nothing raises anticipations more than the prospect of a governmental bottomless purse intervening in the market. Breaking the land-price barrier by force simply raises higher the future barriers to production.

As does control of rising housing rentals. Price mechanism failure in the land market spills over into every market with which land is intimately connected. When apartment rents rise in response to demand, apartment construction should gain pace until, with demand met, rents should fall. Even high *in situ* costs are no longer a factor, for factory manufactured housing can be produced both speedily and cheaply. (Factory produced module housing can be manufactured and erected on site for a total of 50 man-hours!)

But, apartments need a site on which to perch, and sites cannot be factory made and trucked to market. So, even though both factory and traditionally constructed apartment costs exhibit continuing decline, they are not built and apartment rents continue to rise.

Rent control does nothing to address the problem of site 'collection'. It has political manifestations as landholders and government indulge in newsworthy thrusts and parries. But, it exacerbates rental housing shortages, does little to help the poor, the supposed beneficiaries of the exercise, and creates, in random fashion, both privileged and underprivileged classes.

Slump!

There have been more theories of the business cycle than there have been business cycles. Most of them suggest hauling an economy up from slump by stimulating demand. Almost forgotten is the truism that before consumption there must be production. Full warehouses at the bottom of the depression indicates that the problem is lack of consumption and this is correct. The question that is never asked, yet is equally obvious is "How do people consume"?

The answer is, of course, by producing first. If they are unable to produce, they will have nothing to consume - whether they produce for themselves or for trade. The right of a consumer to demand is a function of his ability to produce.

When land is 'collected' the price of sites climbs ever higher. Production, which cannot take place without land, is forced to pay a speculative premium which continually becomes more exacting. Eventually, Labor and Capital cannot pay the tab, and production slows and stops. Industries most closely linked to the land, such as farming and construction, are usually the first to collapse, but others are not far behind.

To some degree this is recognized by the huge governmental assistance - at all levels - to these basic industries. Yet, all these subsidies do is pay an existing personal value, stimulate increases in the personal values of other landholders, and raise the ante for the next round.

The situation at the moment is that governments, at all levels, are quite openly buying land at the collectible price and reselling to builders for little more than a promise to build. This appears to be the only choice if their downtowns are to be revived. Yet, each time they solve their problem this way, they simply raise a barrier of rising personal expectation around their downtown. These are tomorrow's slums - the problems that arise from a false solution.

Ending Land Collection

It should be understood that the act of land speculation is not a crime. The 'site collectors' can hardly be blamed for acting like normal human beings, within the law and according to common practice. However, if the process is harmful - in general to the economy, and in particular to each individual who wishes to to rent, to buy, or to build a home or factory - the community is obliged to protect itself.

Effectively to deal with this problem, we must return 'location' to the discipline of the market price mechanism. By far the most promising direction to take would be the introduction of Community Rent Charges for land use. As site value measures the positive advantages of community activity, it would seem both just and equitable to levy a charge for this benefit on each site-holder - whether or not he chooses to take advantage of the benefit.

The economic consequences of such a charge would be to push unused and underused sites onto the market. Basic economic difficulties errupt out of our natural propensity to collect sites for future gain. If the prospect of future gain was removed even as present holding without use became unprofitable, sites would be released to the market, prices would tumble and a variety of apparently insoluble basic economic problems would disappear.

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