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Say's Law of Markets

David (dmg) got this discussion started with a post by Horwitz. This is my first participation in the thread.

Thank you for a very interesting post. I just read Horwitz's discussion of Say' Law and found it very interesting.

Trying to build an economic model is like trying to build a house out of air balloons, never very steady. There are simply too many variables many of which are not controllable. For example, people speak of money as if it were some fixed thing in fixed amounts. Nothing could be further from the truth. Banks create and destroy money as they lend and collect. Gold mines create money. Bull markets create money and bear markets destroy it. OK, so Greenspan calls it the Wealth Effect, but it's the same thing, more or less liquidity.

One of the great fallacies is that supply and demand have to be in equilibrium. Not at all. In commodity markets money takes up the slack in the form of inflation or deflation, an increase or decrease in prices. It is my contention that "franchise" markets operate differently than commodity markets. It is further my contention that most economists, when they think and talk about markets, are thinking about commodities and not franchises. I am using here the term "franchise" as Warren Buffett uses it, the ability of the producer to obtain premium prices and to control the market to a certain extent. Commodity markets, agriculture and fishing, for example, are subject to the whims of nature and the staples are not distinguishable one from the other. According to Adam Smith, farmers and fishermen have no chance of ever becoming rich because they are subject to outside whims over which they have no control and because they don't have pricing power. A franchise market does not work like a commodity market. While commodity markets seeks equilibrium between supply and demand through the medium of money, franchise markets operate more like machines, they are controlled by feedback. The producer measures the demand (feedback) and adjusts price and production to optimum levels. In franchise markets the producer can choose between mutually exclusive goals, he can go for market share (big volume and low price), for maximum margin (lower volume, higher price) or for some point in between. These choices are simply not available in commodity markets.

It is quite clear that Adam Smith did not think that the economy was a zero sum game. He talks about increased productivity brought about by the division of labor. All modern dooms day politicians and environmentalists do fall into the zero sum game trap.

The world has changed radically since Say and Smith. Back then, industry was labor intensive. Today it is capital intensive. While you must pay for labor weekly, you can hold off paying for capital for 30 and 50 years. I wonder how this changes the ancient laws of economics.

>>>I think you are falling into a common trap, and you are misinterpreting Say's Law.

I'm not too sure to which common trap you refer to ;-(I would much rather fall into an uncommon one ;-))))

I think that you might be referring to the one-to-one relationship of "build a better mouse trap and people will beat a path to your door." This, of course, is not Say's Law, this is a marketing concept. This is the principle behind franchises!!! On the other hand, my Darwinian model comes pretty close to what Say had to say.

The problem with economics is that the experts do not seem to agree and all of them seem to have a political agenda as well. The intention of my post was to try to present a simplified model of the economy representing the principles of Say's Law. The reason for Denny's Law is that it is an easily visualized model of how the world works. It is not Say's Law of Markets but a pretty close analogy.

I, too, have a political agenda (even if I'm not an economist). The one thing I am absolutely certain of is that Say' Law of Markets totally discredits demand side economics. If you want progress, support individual initiative, private property, all the rights of man supported by the Constitution, the separation of church and state and fight taxes in every which way you can.

Denny

"Demand creates queues. Supply gets rid of them."