LACHMANN ON PRICE RIGIDITY IN THE REAL WORLD

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"The legacy of Ludwig Lachmann"

David Cayla, University of Angers

Thibault Laurentjoye, EHESS Paris

1- THE MARKET AS A PROCESS

- In the **General equilibrium model** there is no time, therefore no process: the 'universal auctioneer' solve any issue linked to the problem of adjustment.
- Economic agents are merely reacting to prices variations. There is no '**action**' in the full sense of the term.

"A choice is the prototype of indeterminate action. The modern 'theory of choice', by contrast, […] has made the word denote a situation in which, with given preferences and market price, there literally *nothing to choose*" (L. Lachmann (1986), *The Market as an Economic process*, p. 113).

1- THE MARKET AS A PROCESS

- The goal of Lachmann is to give up the pretention to establish a formal model of markets and to provide instead a **description** of the way markets work.
- Von Mises 1949 p. 123: "*The Austrian school endeavours to explain prices that are really paid in the market, and not just prices that would be paid under certain, never realizable conditions*" (quoted by Lachmann)
- But this project was never achieved by economists, especially Austrians. Lachmann concludes (p. 131): "*The lack of curiosity on the part of Austrian economists is even more astonishing than that of others*".

1- THE MARKET AS A PROCESS

- An Austrian conception of Markets must be made compatible with **radical subjectivism** and its implications.
- Subjectivism of **preference** vs. subjectivism of **expectations**:
- Mises 1949: "human action is a manifestation of the mind". Therefore for Lachmann: "choice is not a result of anything , but a *creative act*" (p. 55).
- If human actions are indeterminate, the result of an economic process is not forecastable, although every action rests on expectations and forecasts: : "The market process is by nature a diachronic, while general equilibrium is a synchronic model" (p. 26).

1- THE MARKET AS A PROCESS

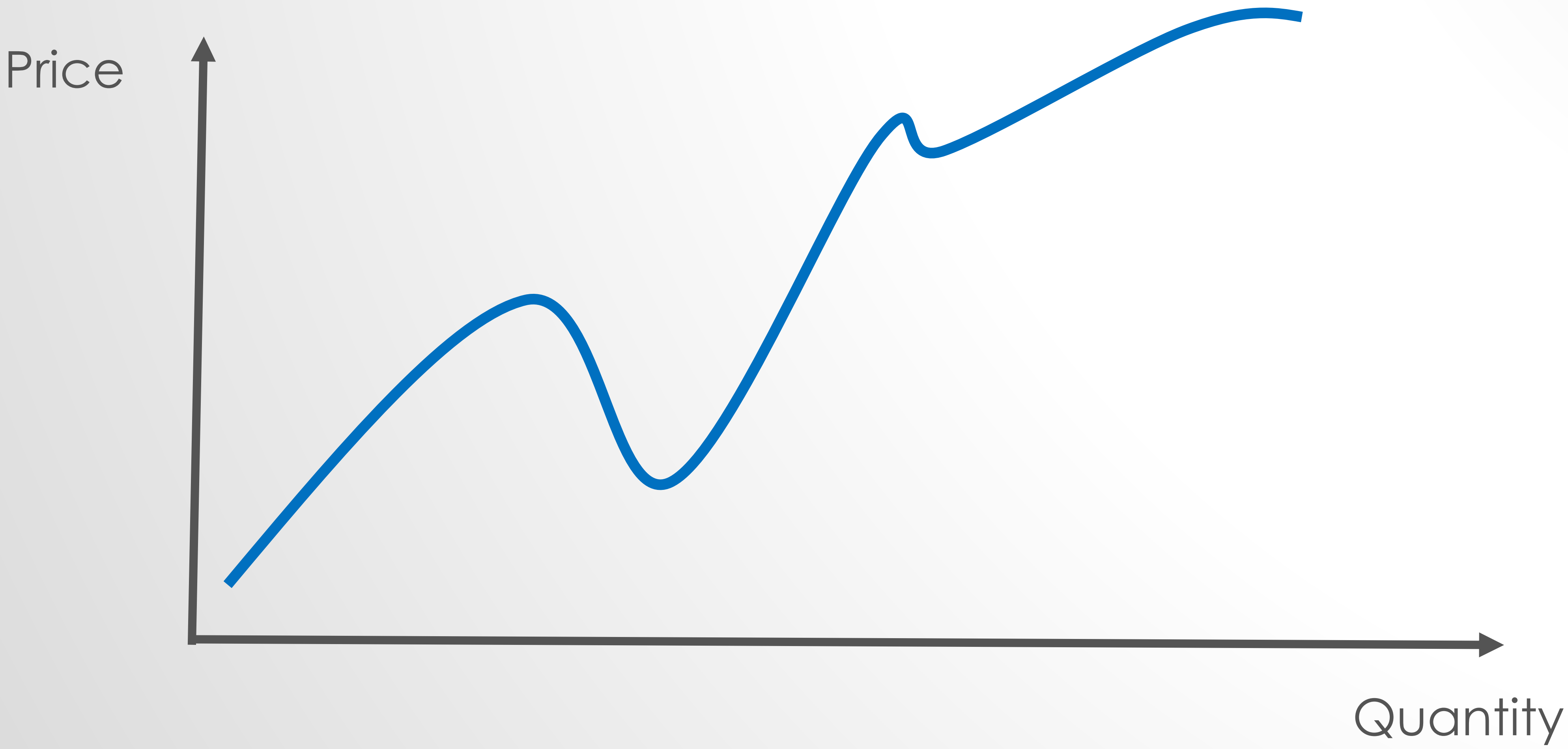
- **Subjectivism of interpretations**: "In general, however, different men's aptitude to make use of information will differ for many reasons other than differences in their stock of knowledge. What needs emphasis is the subjective character of all activity concerned with information and knowledge, as contrasted with the necessarily objective nature of the information market." (p. 50)
- Boland 1978: "different agents with the same information will revise their plans at different intervals".

1- THE MARKET AS A PROCESS

- **Market prices cannot be taken as an pure objective information**
- It is needed to reconsider both the General Equilibrium analysis (obviously) but also the Hayekian (1937, 1949) view of cattalactic processes.
- A change in price cannot be used to forecast a specific behaviour: the price of the boat count as well as the fish market price (p. 65).
- Equilibrium is not a question mere price flexibility, but a dynamic process based on continuous individual plan rectifications in an uncertain world (p. 119).

1- THE MARKET AS A PROCESS

Ex. of a Lachmannian market supply / demand curve



2- FIXPRICE VS. FLEXPRICE

- For Lachmann, economic sciences should be able to "explain prices that are really paid in the market, and not just prices that would be paid under certain, never realizable conditions" (p. 116).
- This project is only possible if the principle of a **'one-fit-all' model** of markets is abandoned.

> "As regards the distinctions to be introduced, we shall speak not just of agents, but of producers and traders, not just of entrepreneurs, but of innovators and speculators, not just agents who passively react to market prices, but price-takers and price-fixers (who may have different functions in different markets). Also, different agents in different markets may enjoy different ranges of action" (p. 117).

2- FIXPRICE VS. FLEXPRICE

"In the neoclassical schemes markets are as a rule highly stylized as commodity markets, labor markets, etc. We would not, however, permit such stylistic artifacts to make us forget that a highly significant difference between the Stock Exchange and the potato market lies in the fact that, except for the potato merchants, in the latter market everybody is either a producer or a consumer, while in the former it is easy to switch sides, between morning and afternoon if required. It is a fact that the neoclassical orthodoxy has, to this day, failed to grasp the consequences of the volatility of asset markets. It does matter which features of reality we accentuate in our schemes, and which we abstract from." (pp. 41-42)

2- FIXPRICE *VS.* FLEXPRICE

- A "**fixprice market**" is not a market where prices are rigid but a market where prices evolves by the will of a "pricemaker".
- A "**flexprice market**" is a market where prices evolves in accordance with the forces of supply and demand.
- "different markets, characterized by the encounter of different classes of agents with different interests and functions, will give rise to market processes of various kinds … all statements suggesting that *the market* will produce this or that result must be regarded with some suspicion" (p. 124).
- '*Markets*' rather than '*the market*'.

2- FIXPRICE *VS.* FLEXPRICE

- The **fixprice market** appear in markets controlled by industrial constraints:
    1. The **industrial capital** is costly and difficult to redeploy, sometime irreversible.
    2. Industrial production rests on **complementarities** which tend to create **high transaction costs.**
    3. Industrial production rests on **entrepreneurs expectations**, a creative process, that short-run price variations do not affect.
- Fixprice markets are a **salesman's market**. But salesmen are not price setters: they are member of a hierarchy.

2- FIXPRICE VS. FLEXPRICE

- "[in a saleman's market] the mode of organization is here that of bureaucracy. A large number of people cooperate, on the basis of division of labour, to produce an output stream which has to conform to a large number of requirements, technical, economic and otherwise. Men and women cooperating are organized in the form of a hierarchy in which orders and instructions issued by those in the higher have to be carried out by those in the lower echelons. [This] bureaucratic mode of organization is the most efficient in the application of modern methods of mass production" (pp. 135-6).

2- FIXPRICE VS. FLEXPRICE

- The **flexprice market** is a market where buyers and sellers can switch roles: "a merchant may refuse another merchant's offer and counter it with a different offer of his own. In a salesman's market this is hardly possible. In a merchant's market a merchant may be price setter or price taker, and he may 'switch sides' between one day and the next. In a salesman's market nobody can do that" (p. 132).
- The merchant capital is flexible: stocks management is the principal issue of a merchant. "There is good reason to believe that in a merchant's market prices will be flexible and the mode of price adjustment to changes in demand or supply will prevail" (p. 133).

2- FIXPRICE VS. FLEXPRICE

- The merchant's market is a world of flexible prices. It mostly characterize the **row material markets** and the **financial markets**.
- "banks and similar institution can no longer be regarded as simple intermediaries between lenders and borrowers, but have in effect become merchants whose stock consists of financial assets. They enjoy one remarkable advantage over commodity traders: as financial assets can be created and modified almost at will, by agreement between lender and borrower, they are, unlike wool merchants, not constrained by physical and technical limits" (p. 135).

2- FIXPRICE *VS.* FLEXPRICE

	FIXPRICE MARKETS	FLEXPRICE MARKETS
Type of markets	Saleman’s market	Merchant’s market
Capital	Long-run, irreversible investments	Flexible, stocks management issues
Entrepreneurs	innovators	speculators
Price setters	A bureaucratic authority	Many: buyers and sellers can switch sides
Products	Industrial production	Row material, financial assets

3- THE ROLE OF STORES IN PRICES FLEXIBILITY

- The role of stores in markets is ambiguous in Lachmann's model.
- Stores act as intermediaries between producers and final consumers: a "**middleman**".
- The **wholesale merchant** was historically a price-setter. In the Victoria area, he acted as "a 'middleman' whose economic function was not so much to 'distribute goods' as to collect and impart information and to fix such prices as would maximize his turnover. And such prices evidently had to be flexible!" (Lachmann 1956, p. 64).

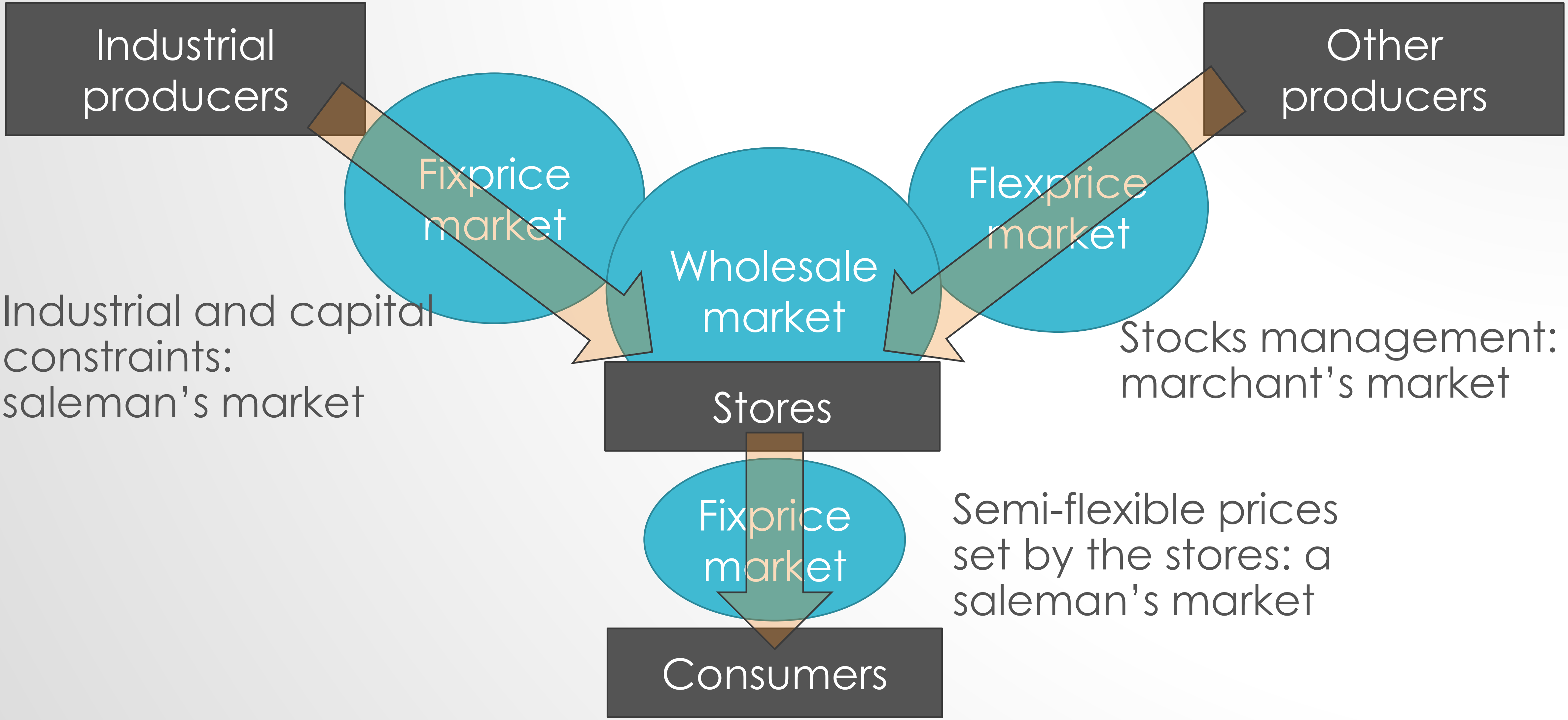
3- THE ROLE OF STORES IN PRICES FLEXIBILITY

- A store is a place where consumers are unable to negociate: "The modern consumer, on entering a department or chain store, confronts a range of goods each of which has a price tag attached to it. All he or she is able to do is to make a choice between them in accordance with preferences and budget constraint. Price and qualities of the goods on offer are literally 'given' to him or her. Any attempt to vary them by negotiation would be utterly futile" (p. 121).
- But today, "the wholesale merchant as a pricemaker has been succeeded by the industrial cost accountant" (p. 124), and therefore a fall in demand does not result on a fall in price but in the reduction of production and employment.

3- THE ROLE OF STORES IN PRICES FLEXIBILITY

- **Upstream**, the wholesale merchants can be pricemakers in flexprice markets (row materials, agricultural markets…), but have to be pricetakers in industrial goods.
- **Downstream**, with final consumers they are pricemakers: The “market” seen by final consumers is always a saleman’s market since final consumers cannot “switch side” and negotiate the prices.
- Overall, the “laws of supply and demand” affect few markets.

3- THE ROLE OF STORES IN PRICES FLEXIBILITY



4- A RESEARCH AGENDA: THE NATURE OF THE STORE

- Lachman thinking is a starting point to think contemporaries issues about the role of stores in markets.

1. **Negotiation power** with industrial producers and agricultural producers: how a store deal with both fixprice markets and flexprice markets?
2. **Price flexibility in stores** and stock management issues (sales, discount prices…)
3. **The store as an institution**: the role of transaction cost / bounded rationality / routines… in the functioning of stores and how it affects markets (cf. Williamson 1987).