

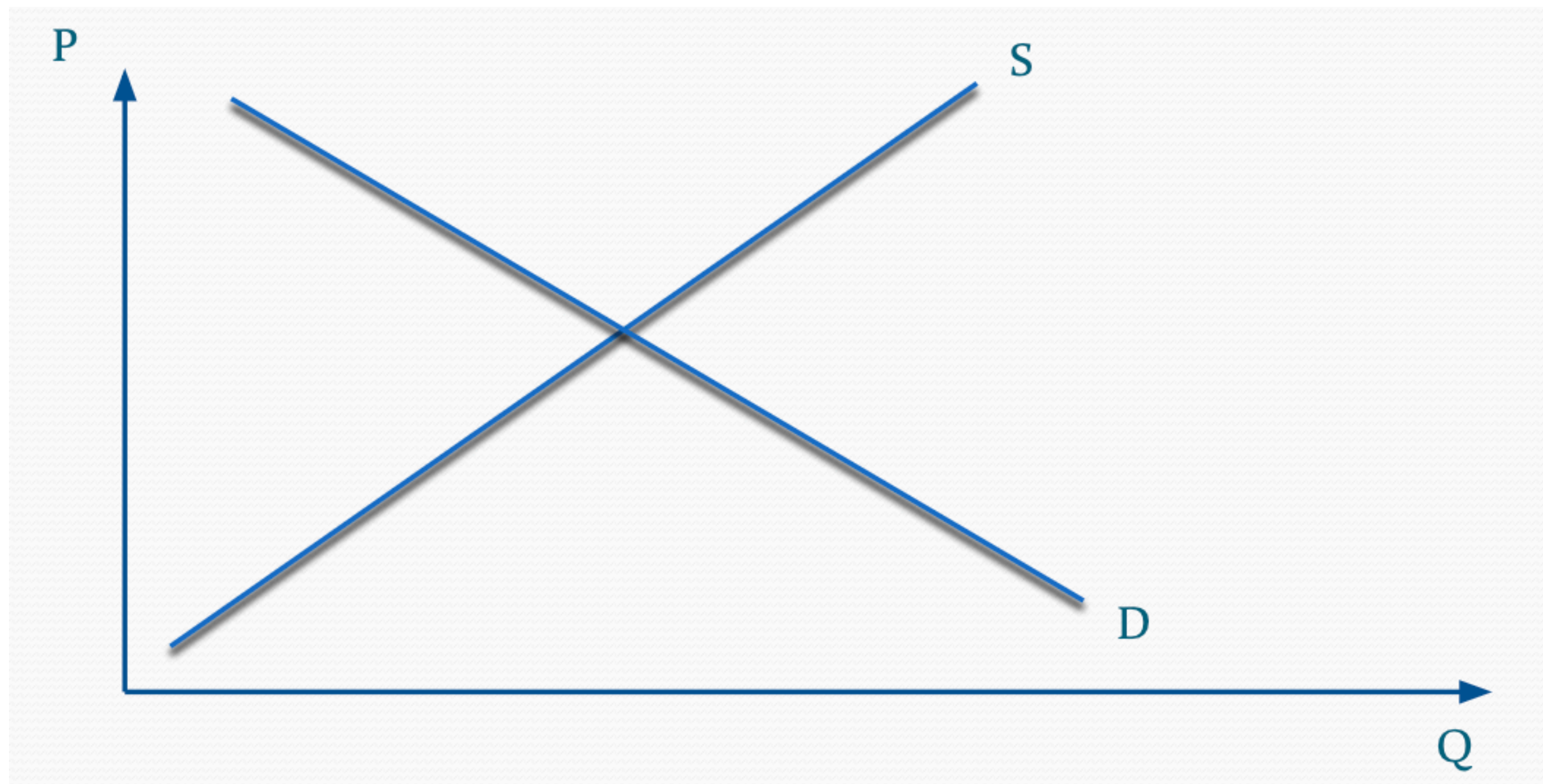
# The Price System

BECO-3310 Fall 2025

- What role do prices play in the economy?

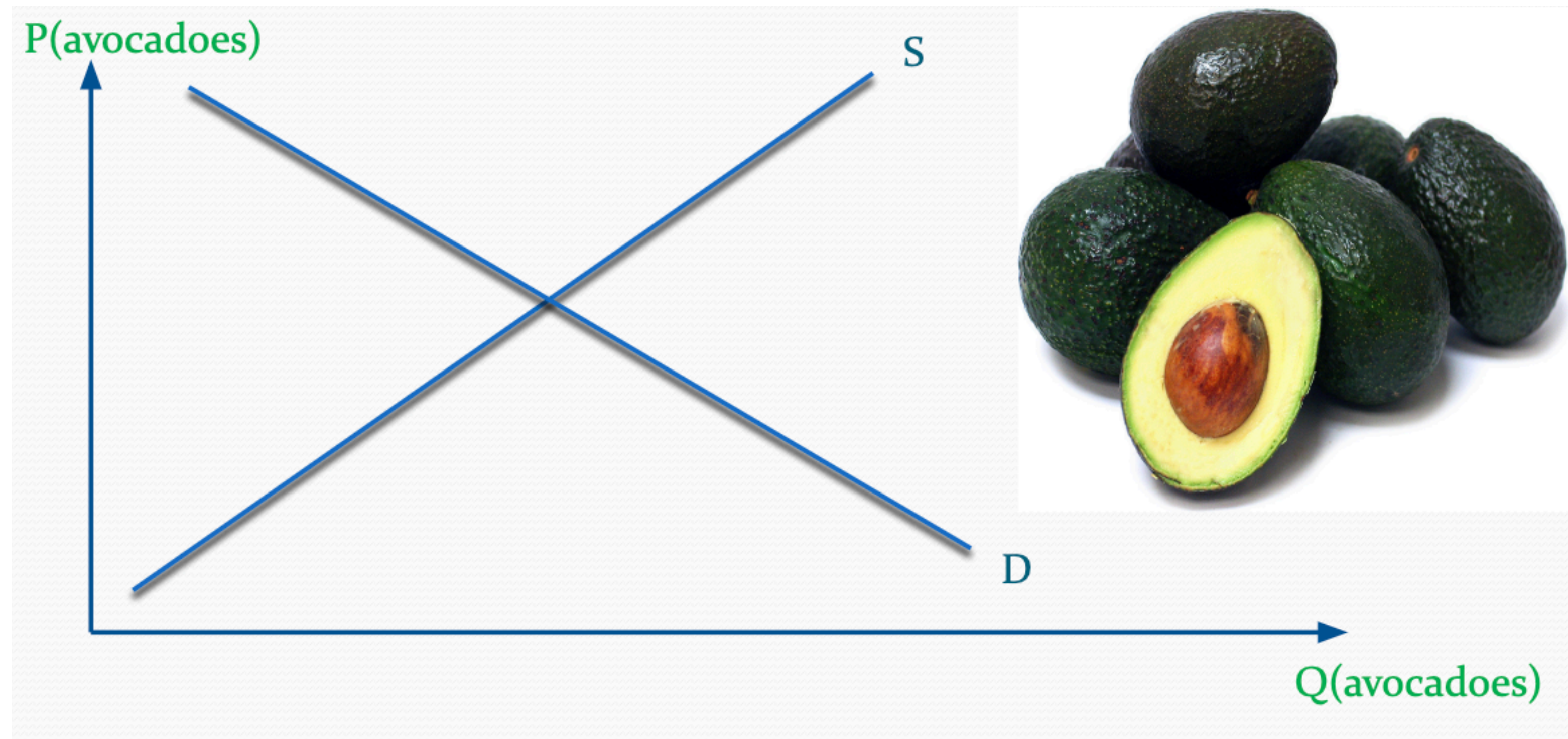
# What role do (money) prices play in the economy?

- Textbook Econ 101: prices adjust so that markets clear.



# What role do (money) prices play in the economy?

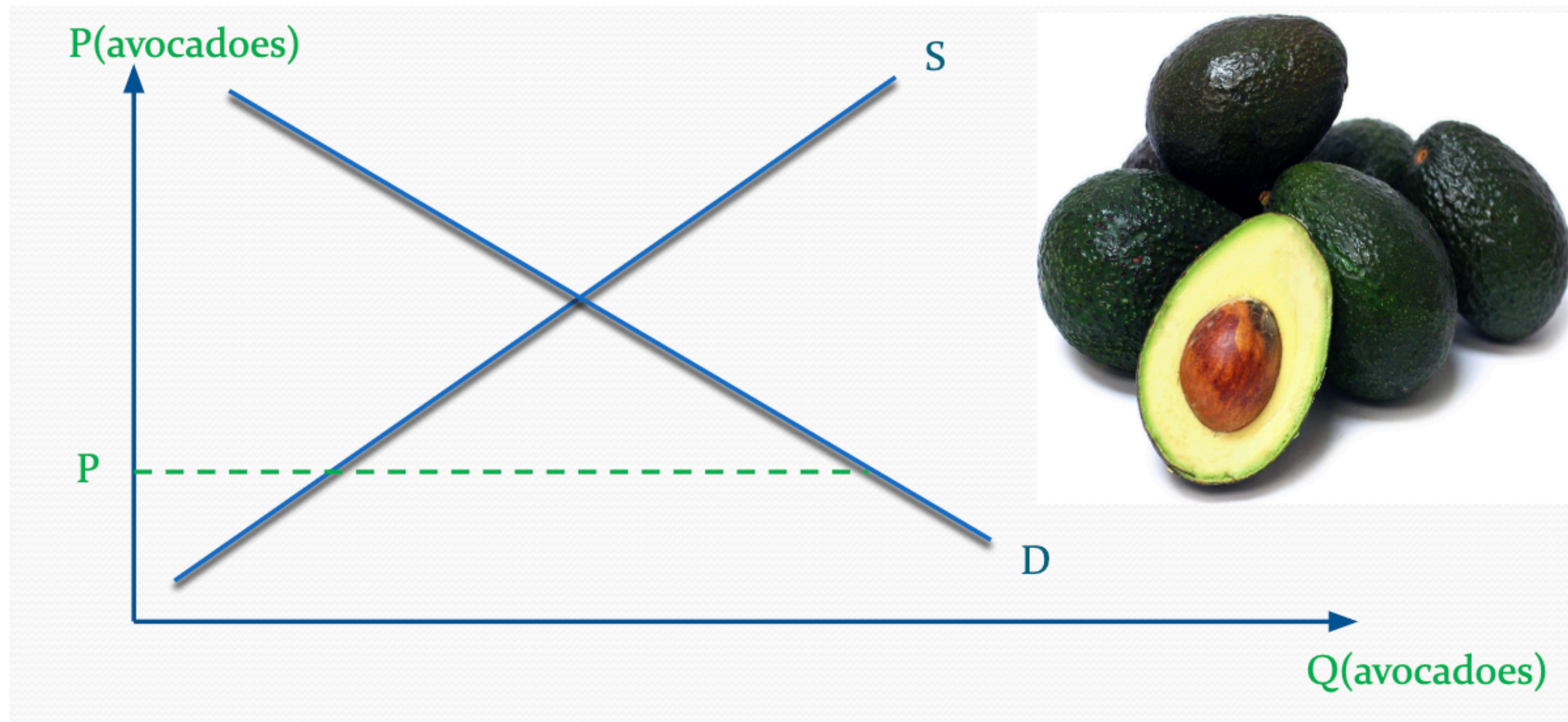
- Textbook Econ 101: prices adjust so that markets clear.



# What role do (money) prices play in the economy?

## Shortage

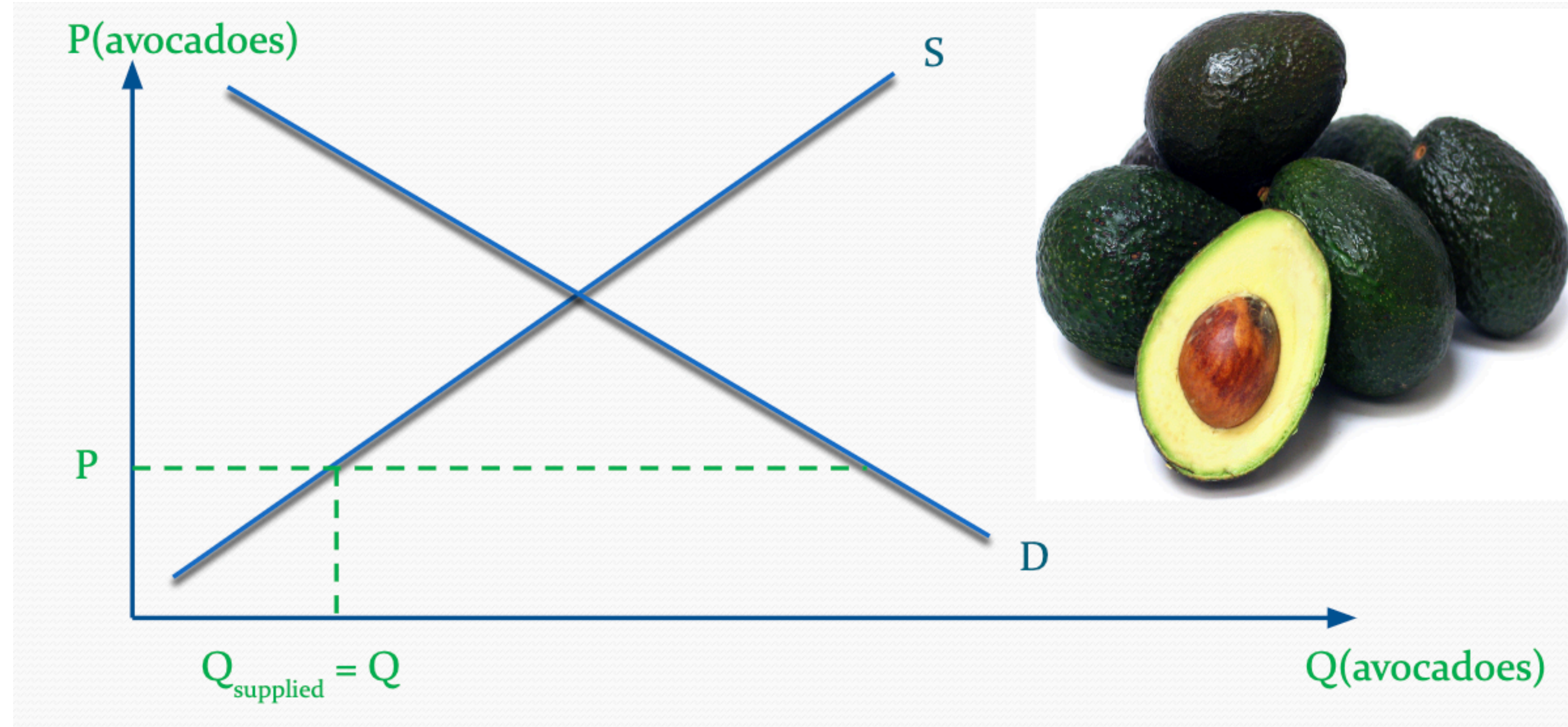
- Textbook Econ 101: prices adjust so that markets clear.



# What role do (money) prices play in the economy?

## Shortage

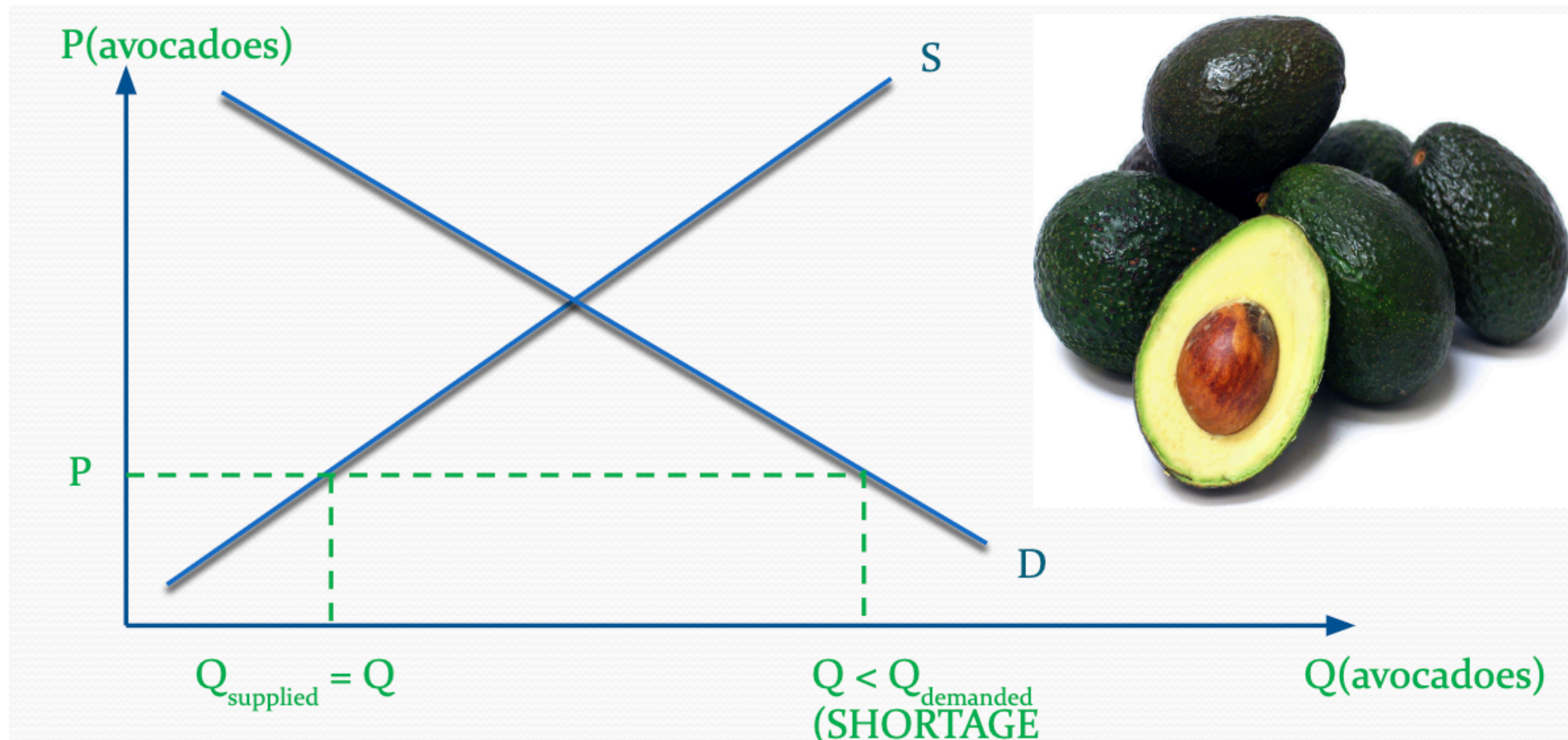
- Textbook Econ 101: prices adjust so that markets clear.



# What role do (money) prices play in the economy?

## Shortage

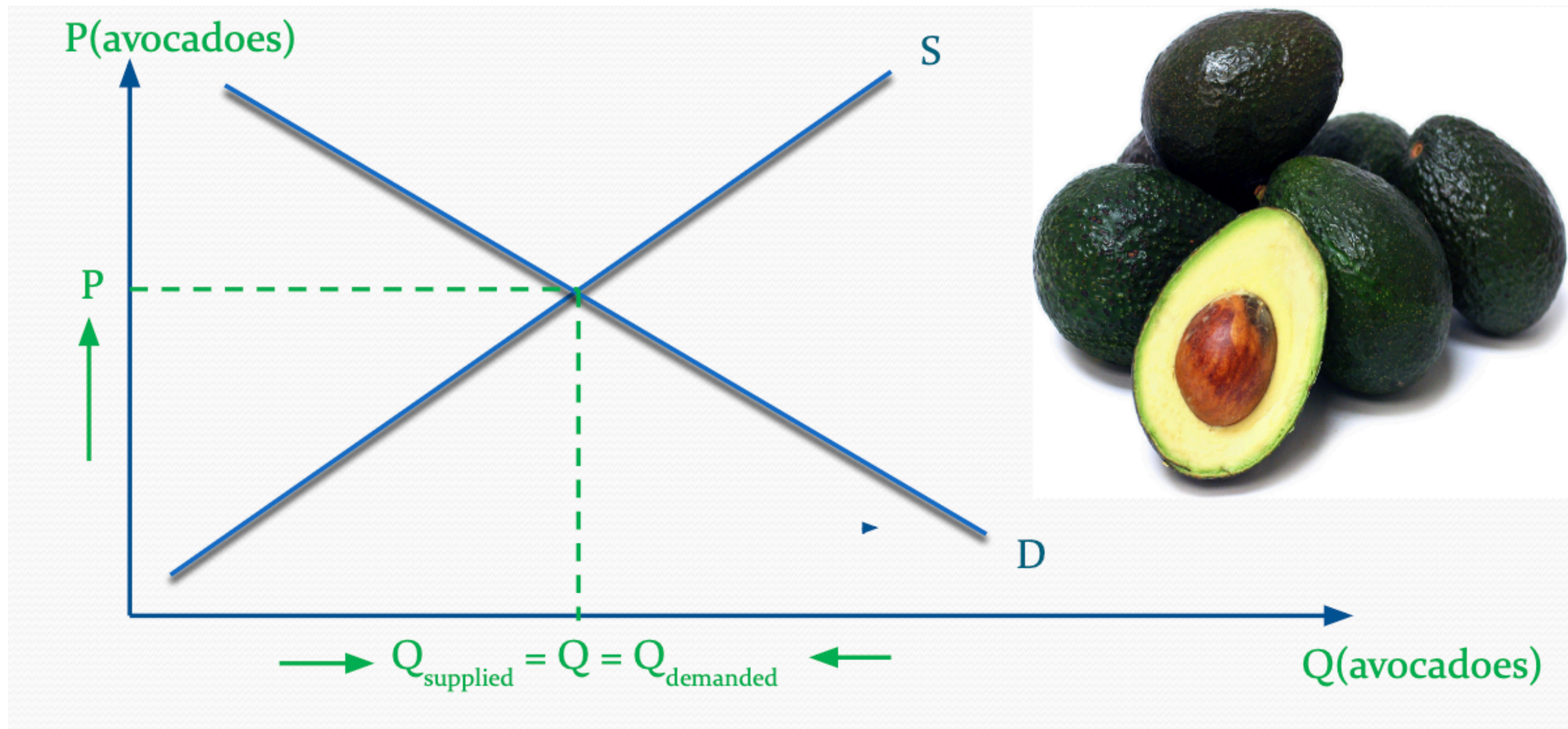
- Textbook Econ 101: prices adjust so that markets clear.



# What role do (money) prices play in the economy?

## Shortage

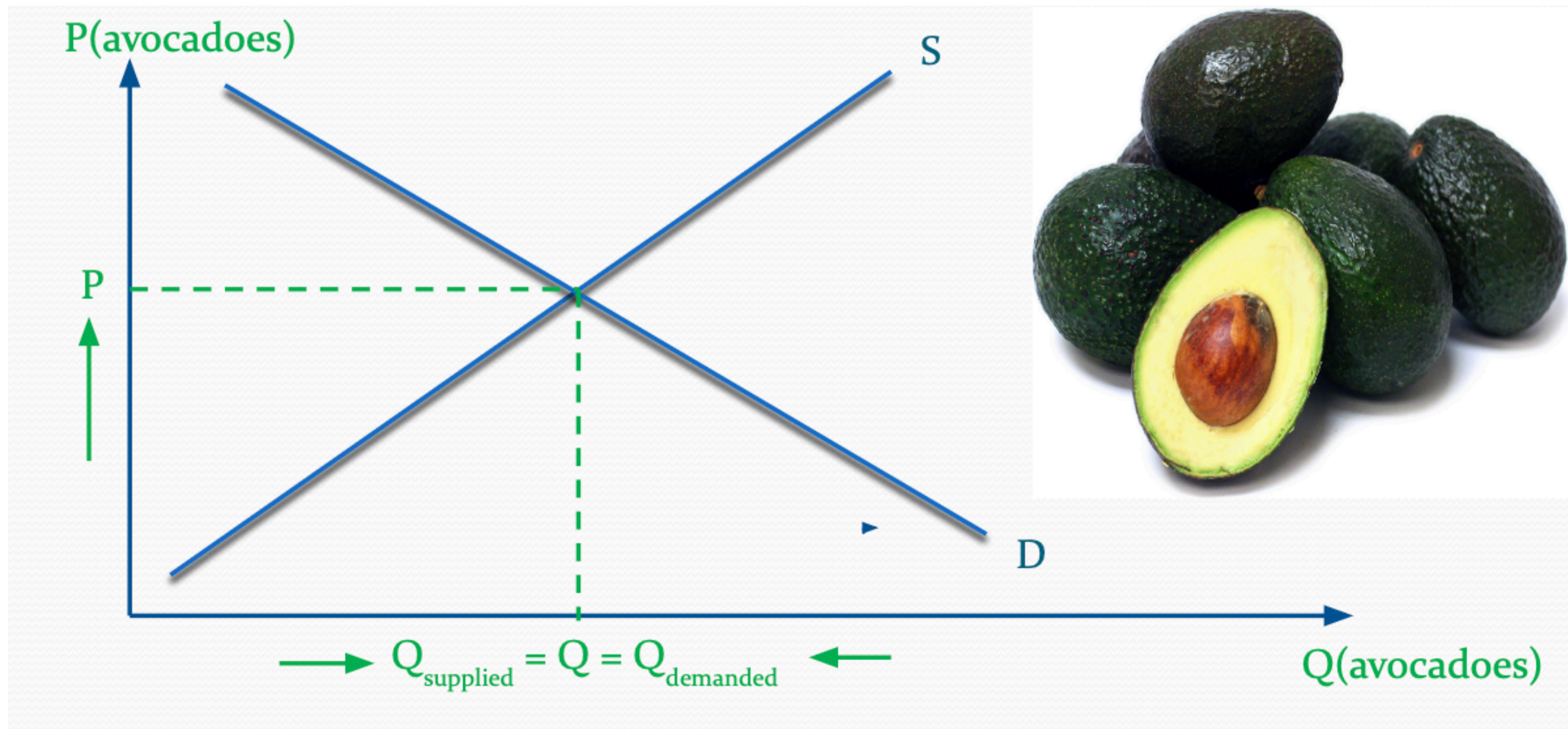
- Textbook Econ 101: prices adjust so that markets clear.



# What role do (money) prices play in the economy?

## Shortage

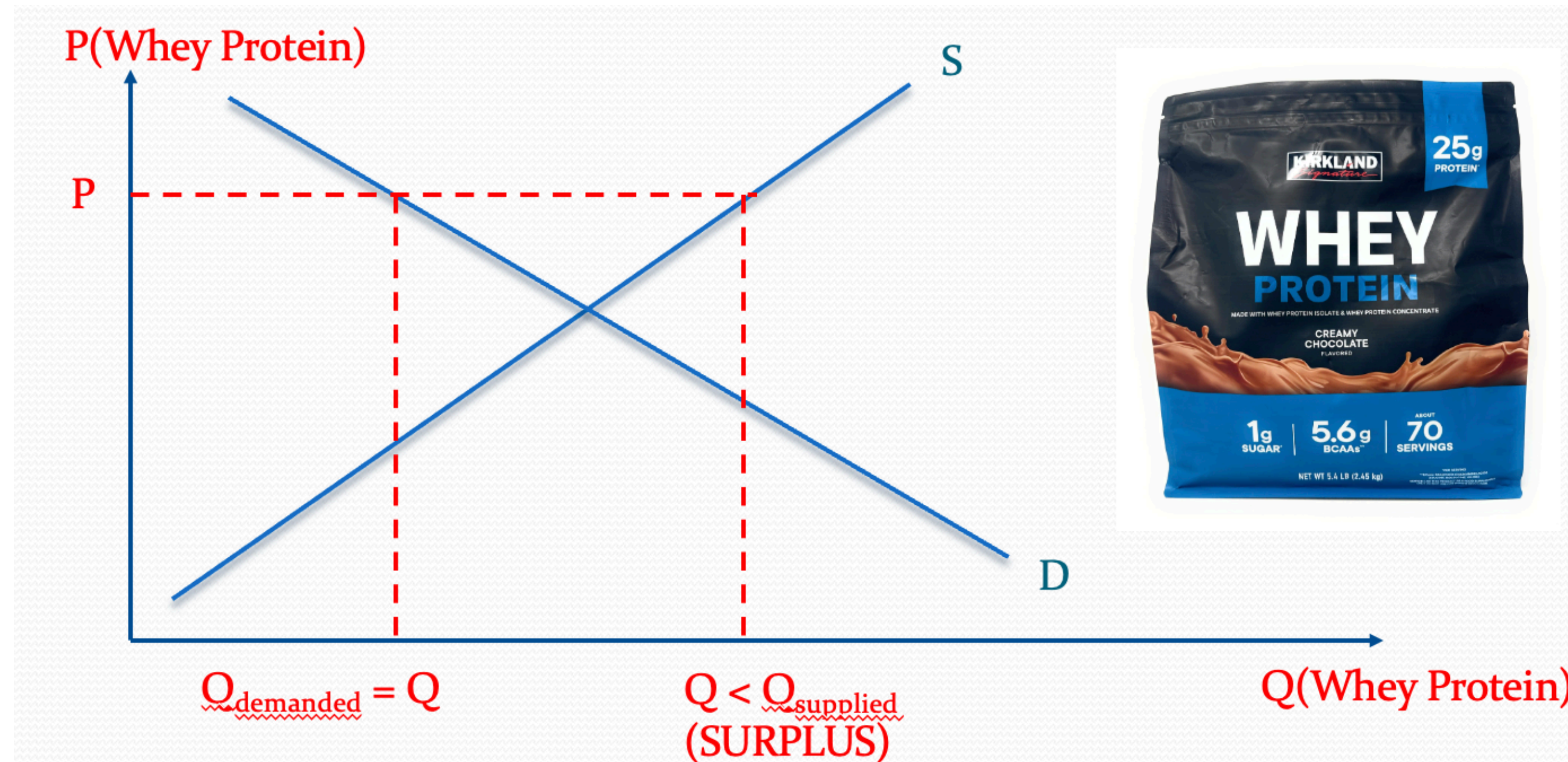
- Textbook Econ 101: prices adjust so that markets clear.



# What role do (money) prices play in the economy?

## Surplus

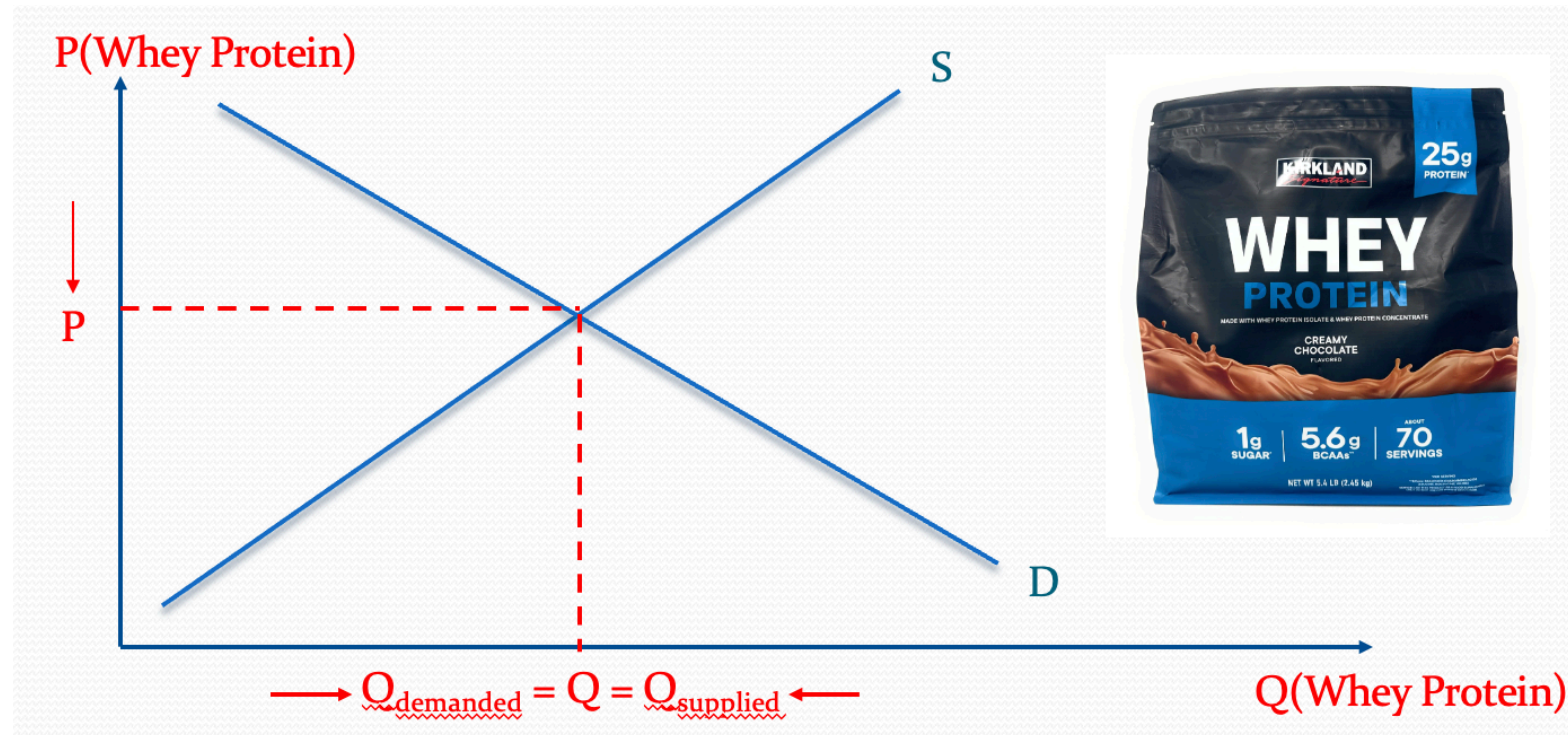
- Textbook Econ 101: prices adjust so that markets clear.



# What role do (money) prices play in the economy?

## Surplus

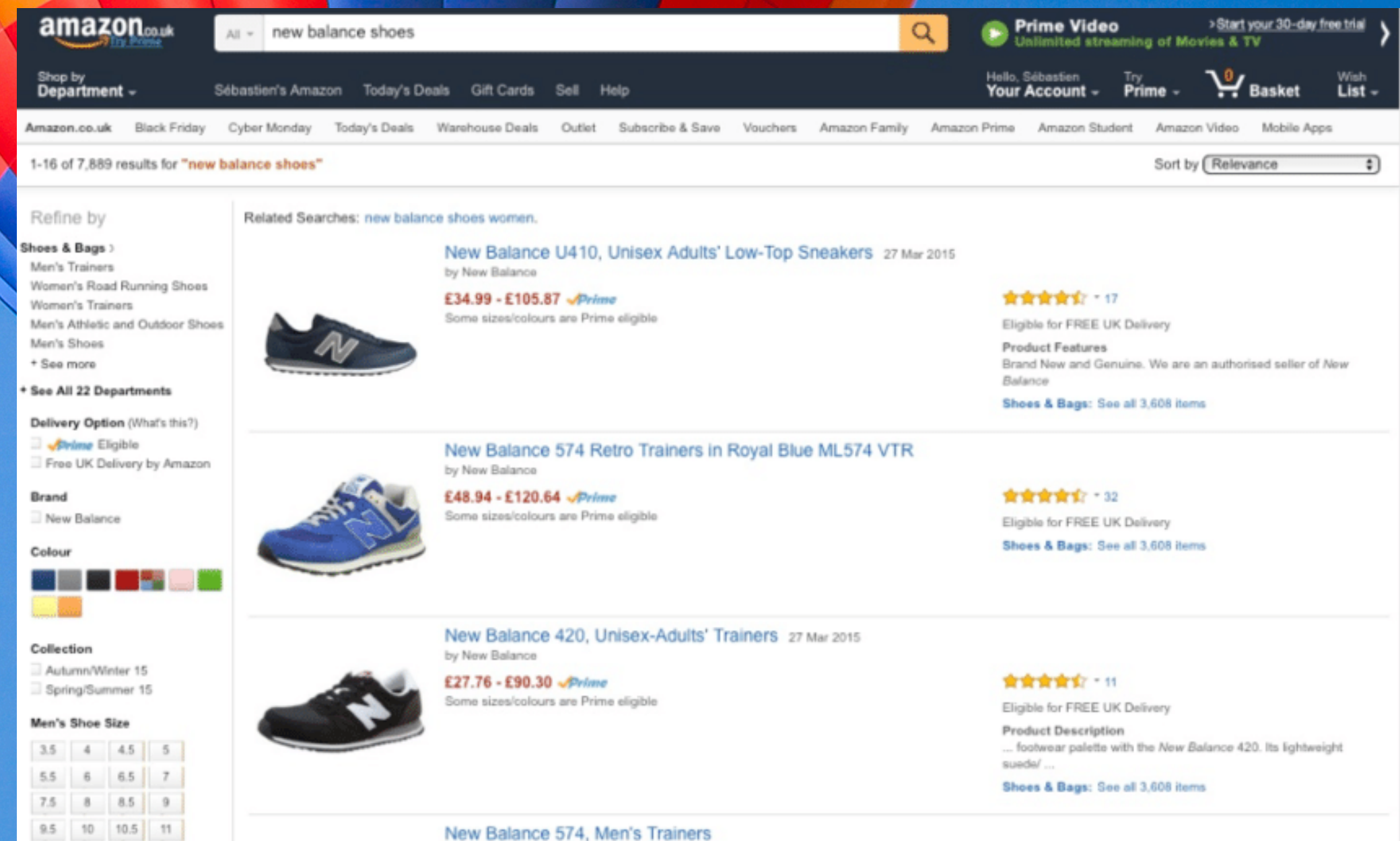
- Textbook Econ 101: prices adjust so that markets clear.

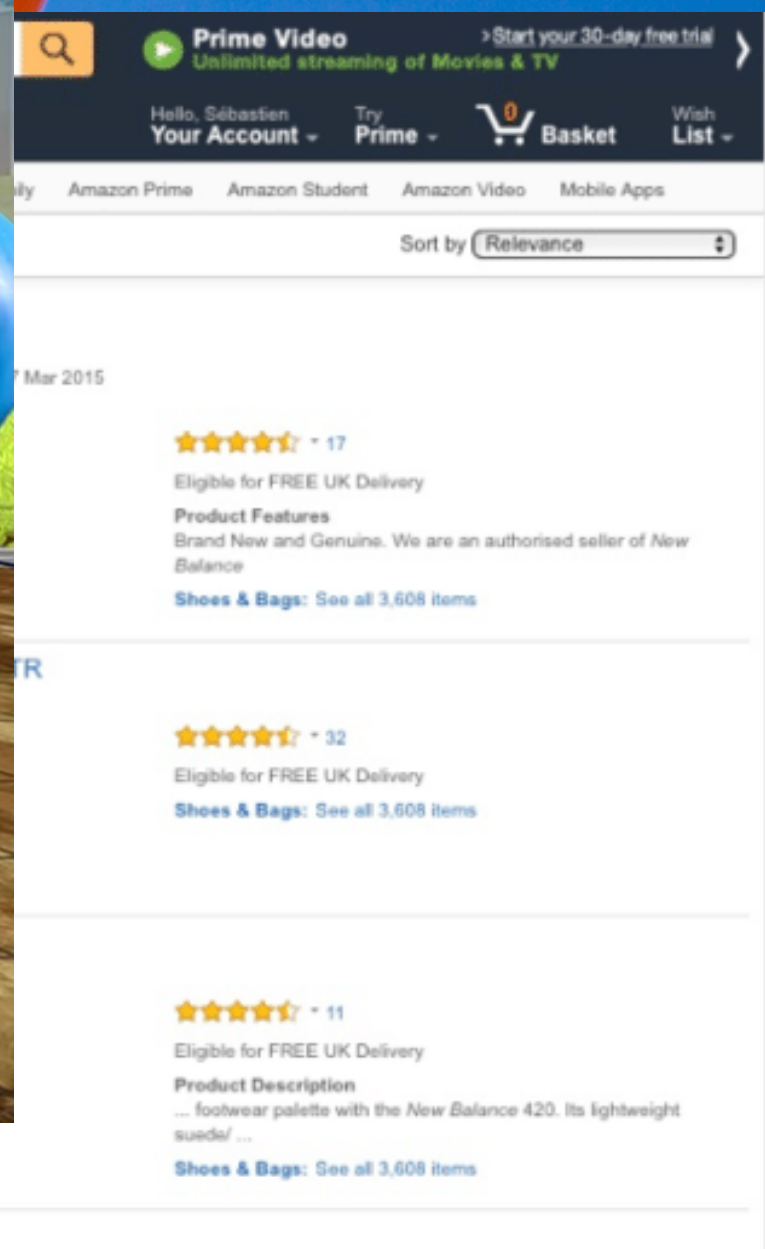


# What role do (money) prices play in the economy?

- Textbook Econ 101: prices adjust so that markets clear.
- But they don't do so magically!
-









Gas stations in the US, 70s



Food Rationing in Venezuela



Bread lines in Soviet Union



PRODUCTOS	ENTREGA MES DE:	
	ENERO	FEBRERO
Arroz	5 510	
Granos	50	
Aceite	1250	
Azúcar R.		
Azúcar C.	5 44 43	
Compota		
Sal	3	
P. Alimen.		
Café	112	
Fósforos	5	

431  
NO  
15





North Korea

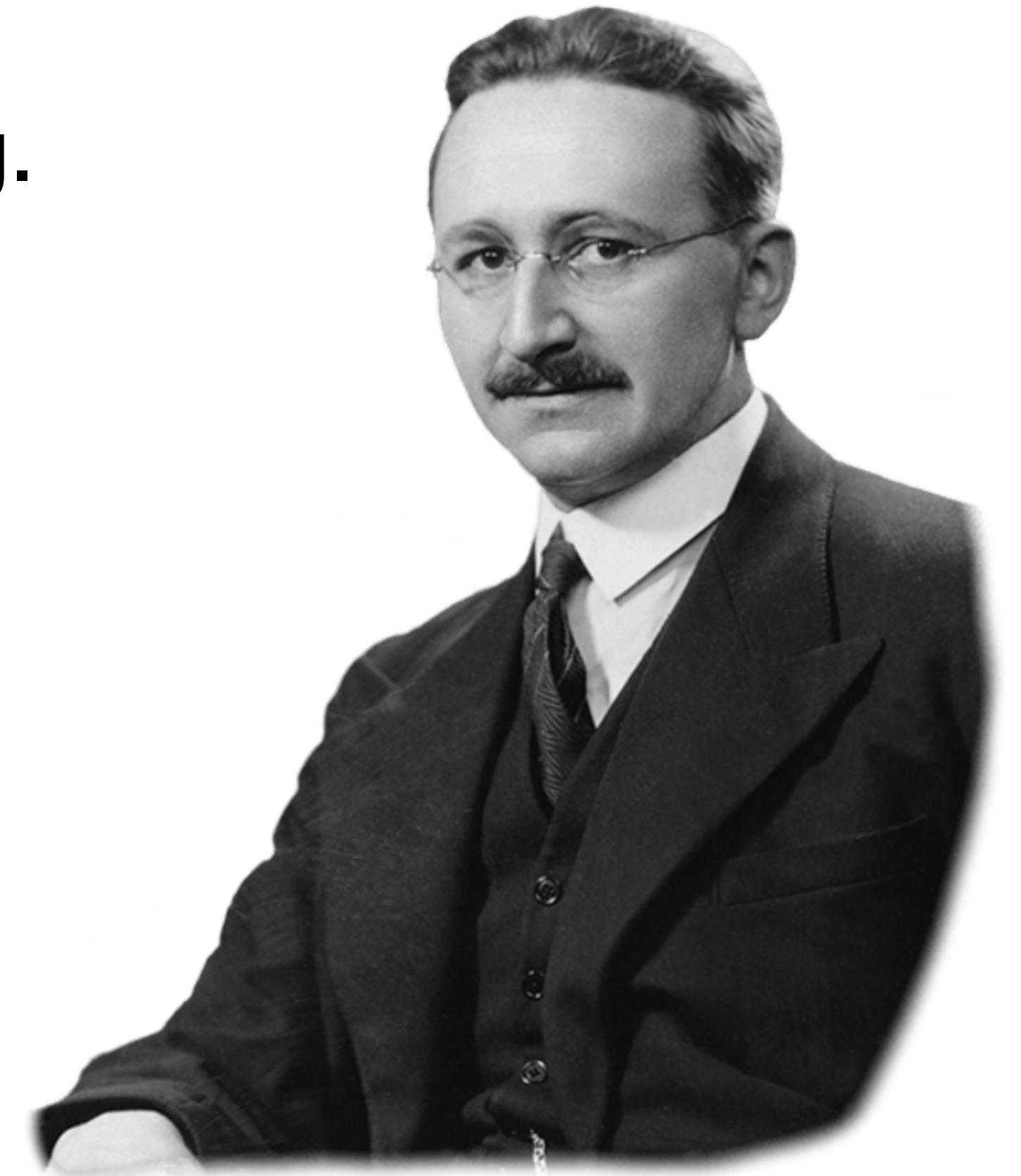
South Korea

# How do hundreds of millions of people (billions of goods) coordinate?

- Individuals have very limited information
- Each has *knowledge of his or her particular circumstances of time and place* but often little else.
- But that's not enough to make an economy work
- Individuals need to effectively make use of other's knowledge.

# The Price System

- We most often don't know *why* prices are changing.
- But we adjust our behavior in response.
- 



Friedrich Hayek

# The Price System

- Example: price of cedar increases
- Did this occur because saws became more expensive? Because loggers' coffee became more expensive? Because the demand for building materials increased?
- Regardless, pencil factories buy less
- The resource *moves in the right direction*.



Friedrich Hayek

# The Price System

“We must look at the price system as [...] a mechanism for communicating information[.]”

“The most significant fact about this system is the economy of knowledge with which it operates, or how little individual participants need to know in order to be able to take the right action.”



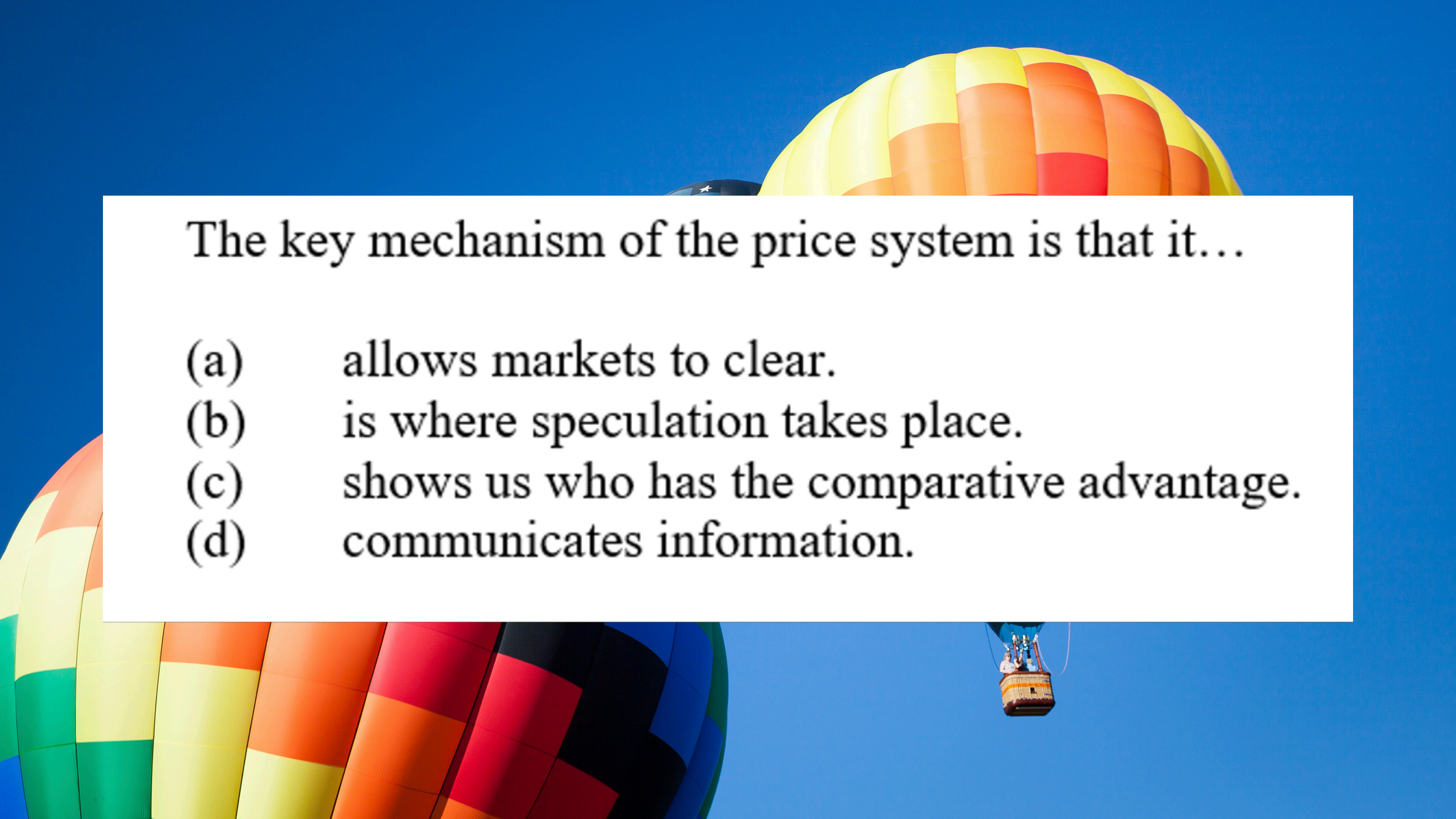
Friedrich Hayek

# How do we function in this world?

- The price system communicates information;
- Prices act as **signals** that convey important information about the supply and demand of goods and services.
- They reflect scarcity, consumer preferences, and production costs without requiring individuals to have complete knowledge of the economy.




Friedrich Hayek



The key mechanism of the price system is that it...

- (a) allows markets to clear.
- (b) is where speculation takes place.
- (c) shows us who has the comparative advantage.
- (d) communicates information.



The key mechanism of the price system is that it...

- (a) allows markets to clear.
- (b) is where speculation takes place.
- (c) shows us who has the comparative advantage.
- (d) communicates information.

# What does this “marvel” require to function effectively?

- First, a *reliable and stable currency*.

# What does this “marvel” require to function effectively?

- **First, a *reliable and stable currency.***
  - “Monetary calculation is the guiding star of action under the social system of division of labor”
  - Prices ultimately convey the quantity of certain goods that we must sacrifice to obtain certain quantities of other goods.



Ludwig von Mises

# What does this “marvel” require to function effectively?

- **First, a *reliable and stable currency.***
  - “Monetary calculation is the guiding star of action under the social system of division of labor”
  - Prices ultimately convey the quantity of certain goods that we must sacrifice to obtain certain quantities of other goods.
- Money allows us to express all of those rations in terms of a single *unit of account.*



Ludwig von Mises

# What does this “marvel” require to function effectively?

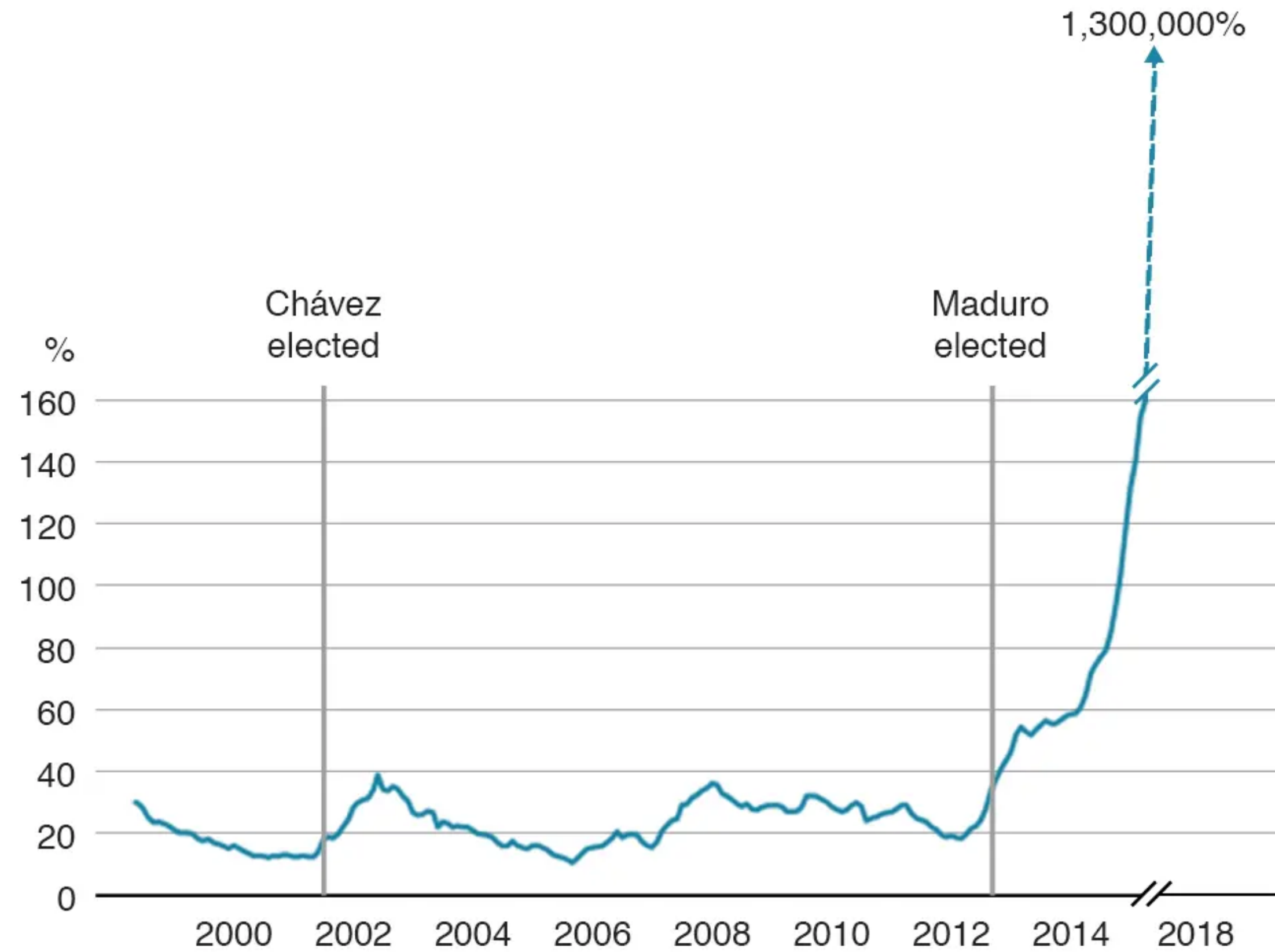
- “Loose” monetary policy
  - It can make monetary calculation less reliable.
  - Inflation can make price changes hard to interpret.



# Examples

## Venezuela's inflation spiked after Maduro's election

Estimate for 2018 is off the scale

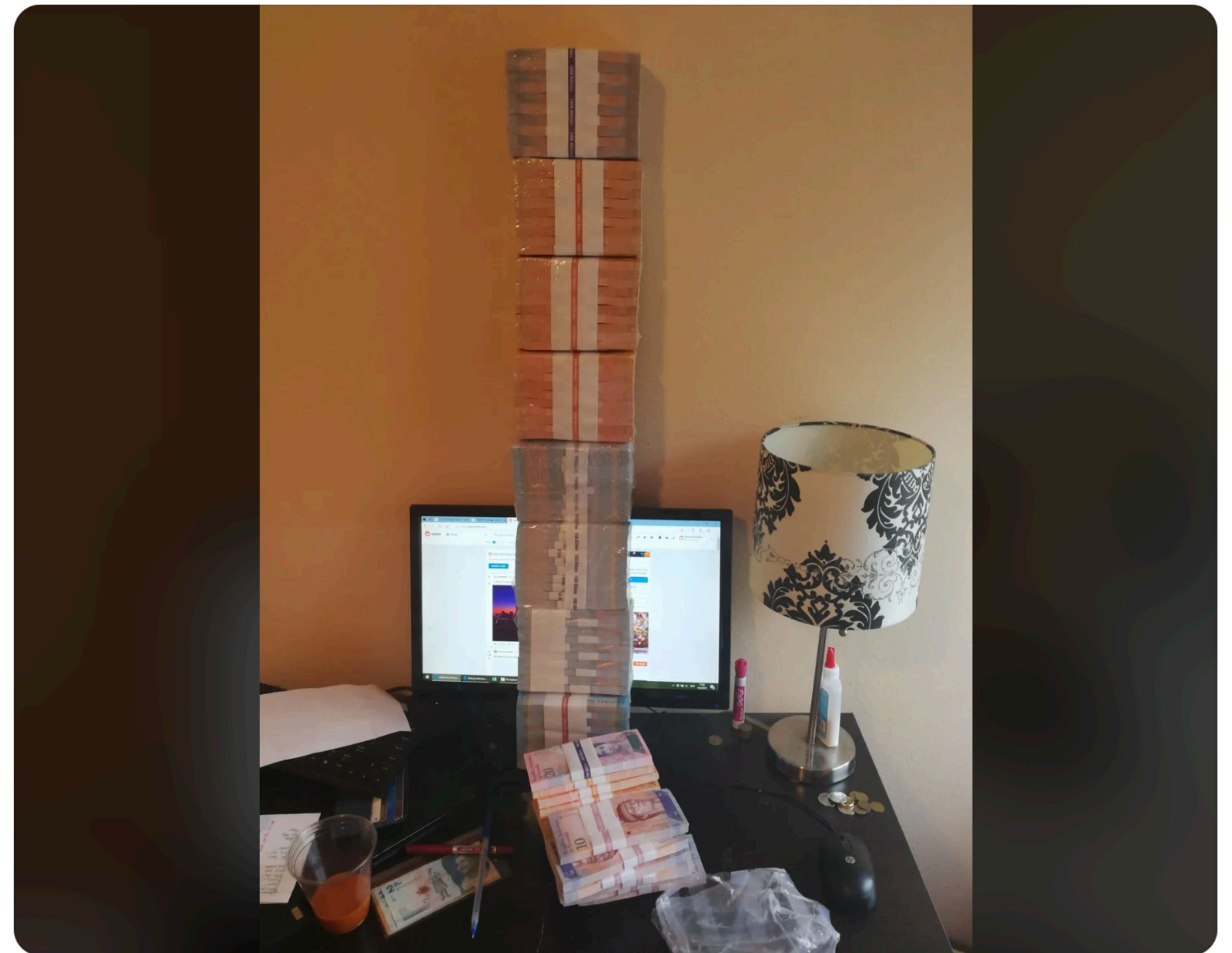


Source: Bloomberg/Reuters estimate for 2018

BBC

r/mildlyinteresting · 6 yr. ago  
1poundbookingfee

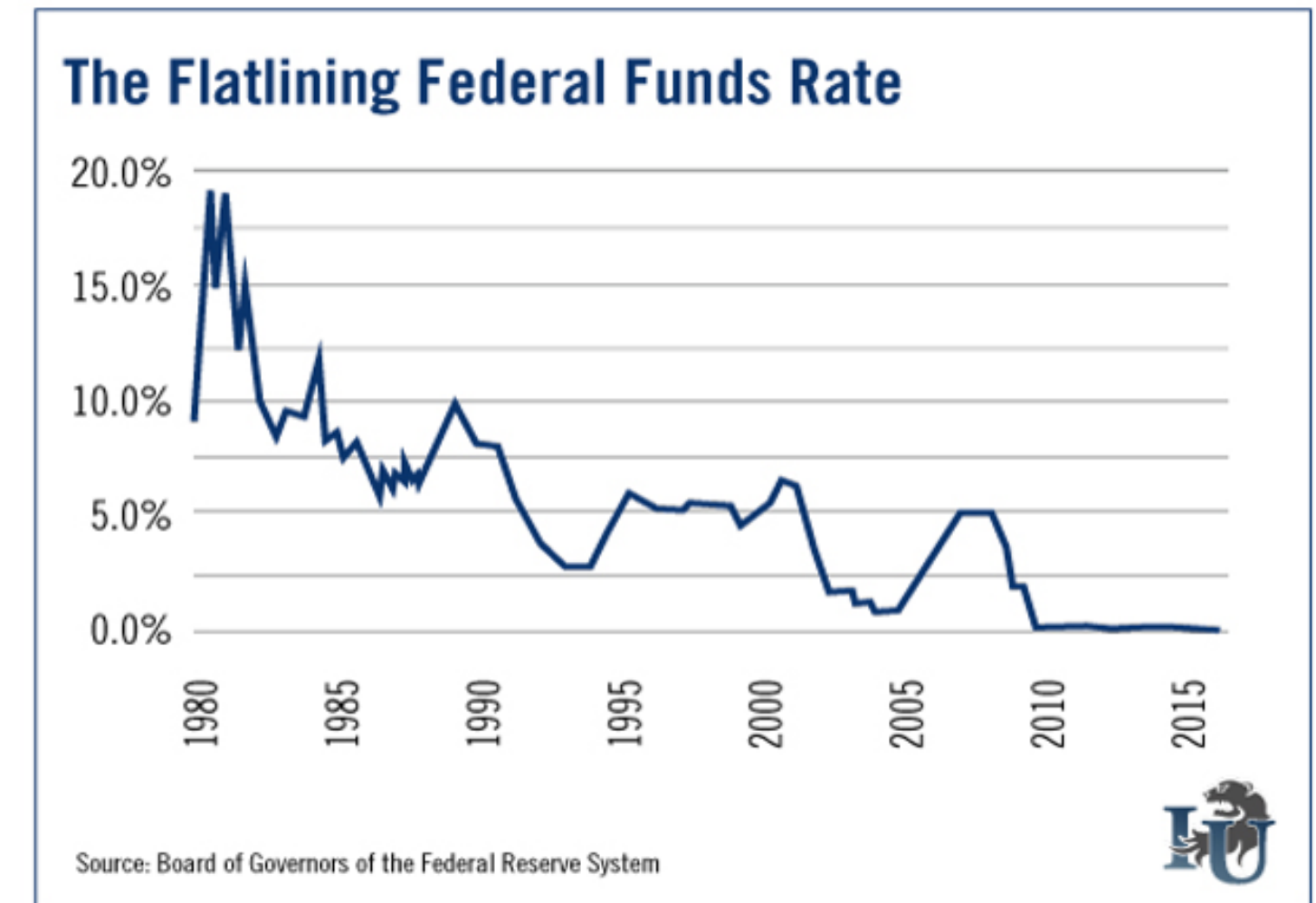
## About US \$10 in Venezuelan currency





# What does this “marvel” require to function effectively?

- **“Loose” monetary policy**
  - It can make monetary calculation less reliable.
  - Inflation can make price changes hard to interpret.
  - It can distort interest rates and other relative prices.



# What does this “marvel” require to function effectively?

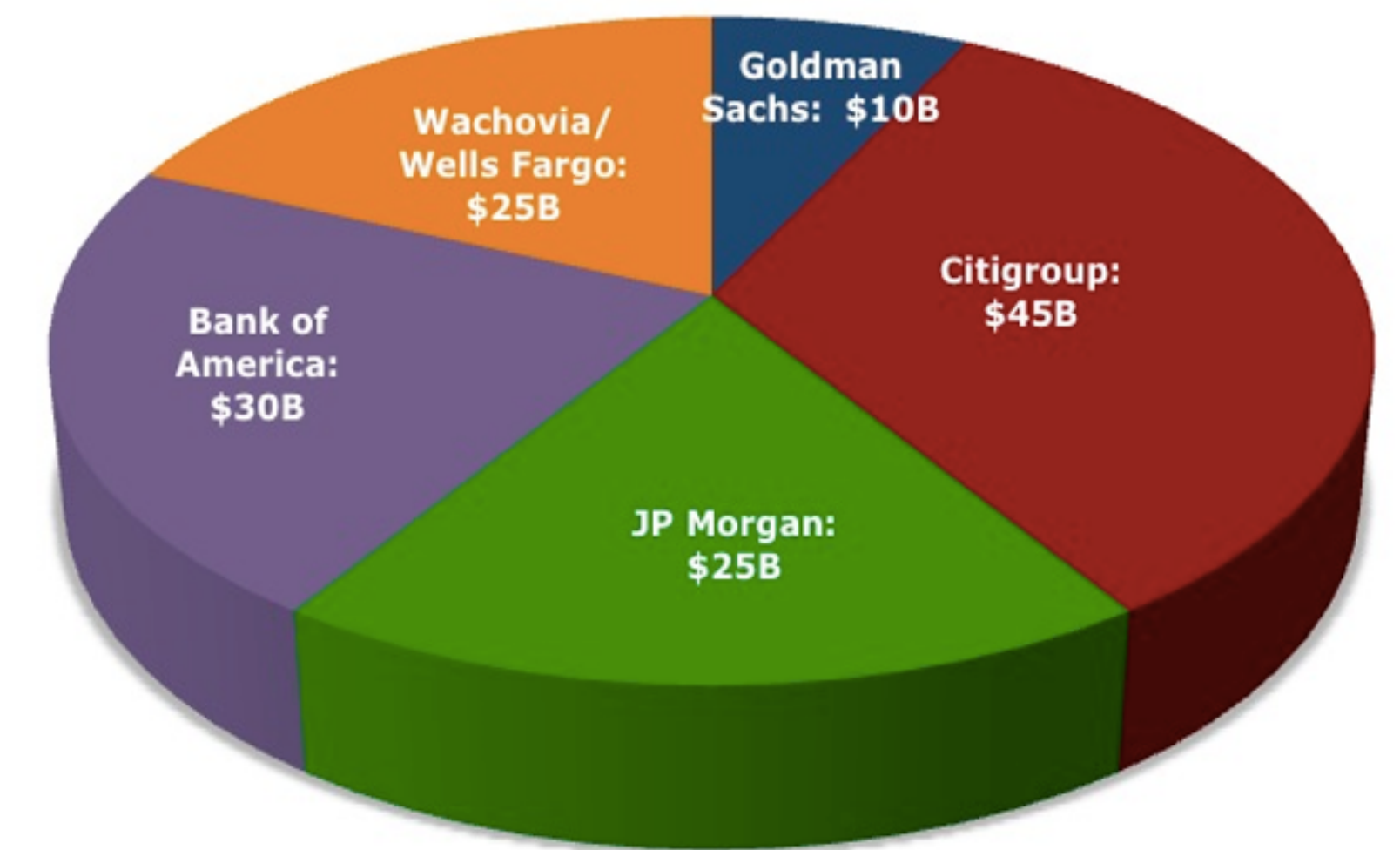
- ***Second, individuals and businesses must enjoy their profits and bear the consequences of losses.***
  - Price changes provide incentives for changed behavior because they create profits or losses.
  - Resources move towards uses that are profitable; they move away from uses where losses are incurred.

# What does this “marvel” require to function effectively?

- Policies that insulate individuals and businesses from losses make the price system ineffective.
- Resources will move in the *wrong direction*.

## TARP Bailout

(source: ProPublica)



# What does this “marvel” require to function effectively?

- **Third, *prices must be allowed to adjust to changes in market conditions.***
  - Policies that prevent price changes (or make them unnecessarily costly) will render prices uninformative.



# The use of knowledge in society

- Hayek emphasized that no central authority can ever possess the vast amount of dispersed knowledge held by individuals. The price system solves this “knowledge problem” by aggregating and distributing information through prices.
- Wikipedia



Friedrich Hayek

**End of class.  
Thanks for your attention!**