Everything we know about price formation is wrong

It doesn't take a PhD in economics to see that large chunks of economic theory have little to do with reality. However, alternative narratives that could explain price formation are few and far between. I took a shot at one - and already apologize for the preposterous title.

I'm no economist, but…

Much of economics revolves around the idea of markets. Markets are physical or imagined places where buyers and sellers meet. Buyers have preferences and sellers have cost structures ; when a buyer is ready to pay for a good at a price that ensures the seller a profit, the deal is done and the market price is defined.

This theory is brilliant in its simplicity and in its explanatory power. Look at a fruits market. When apples are rare, their price goes up because the seller has higher costs (she probably needs to import them from Chile). Volumes are low because only a few people are willing to spend more on the delicacy. On the other hand, when apples are in season and plentiful, prices go down because sellers can profitably assuage the needs of the many who are ready to buy apples at low prices.

Market economics run into trouble when it tries to explain anything beyond a fruits market. Economists invented the term "labor market" to describe work relationships, as if workers were selling their time to entrepreneurs looking to buy "work" for their organizations. If a company sells a good or a service at a certain price, it will pay the people it needs to produce it a certain wage, the theory goes. In this context, rare skills needed to produce goods or services fetching a high market price command high salaries. Correspondingly, low salaries are paid to people with common skills or with rare skills that cannot be used to produce anything of value for the market.

This is roughly what you will have learned at school if you took an economics 101 course. However, reality does not fit the model.

Despite the Wall Street Journal's complaining that truck drivers are hard to find and demand higher pay,[1] the median salaries for truck drivers did not increase much. Statistics from the United States' Bureau of Labor show that an average trucker can expect to make 35,000$ a year, despite the talk of a "red-hot" employment market for drivers.[2] In Europe, we can observe the same thing with parcel delivery (DHL, UPS and others) or nurses. Despite shortages, salaries do not budge.

Not only do low-paying jobs rarely become high-paying due to shortages, the earnings of people making a lot of money are rarely reduced by market forces. People employed in many "bullshit jobs" such as marketing or consulting make a lot more money than truckers.[3] Some consultancies even specialize in techniques known to be useless, such as graphology or

Myers–Briggs (human resources love them), but still make millions. Even if their work is meaningless, even if the companies that pay them could make more profit by doing away with them, they stay in place.

This is most obvious when looking at the top-level positions. CEOs and other highly-compensated personnel can earn one hundred or one thousand times the salaries of lower-ranking employees. We know that CEO pay has little to do with firm performance and that hedge fund managers perform less well than unmanaged portfolios.[45] If shareholders were willing to maximize profit, they should hire managers at the lowest possible rate. Yet, it's hard to imagine a Uber for CEOs. The idea is not as absurd as it sounds. Rich people entrust their lives to total strangers when they choose to hire a Uber driver. They could entrust part of their wealth to uberized managers, too.

Sociology helped us understand the reasons for what seems like irrational behavior. Jobs are expressions of social status. It might be financially detrimental for a company to retain an army of useless consultants, but their very uselessness might be the symbol of power the managers want to exhibit. CEOs love to acquire large rivals in mega-mergers that make the news and put their names on the front page of the Financial Times, even if we've known for decades that mergers and acquisitions tend to fail. The role of private bankers is less to increase returns than, by their very existence, to define a certain social class (the class of people who do not use commercial banks).

This is fine, but does not help us understand how prices are created and why some goods are being produced and others are not. If there are no markets, there must be something else.

Social rank as the defining element of value

Maybe economists got the causality wrong. Maybe it's not the price that determines the salary, but the salary that determines the price.

Humans are very good at ranking other humans on the social scale. Our everyday language is replete with expressions that illustrate it. Someone can *marry up* or *above* in English, engage in a *Treppenheirat* in German or *faire un bon mariage* in French. Take any two people in the street ; you can probably easily guess at who's higher on the social scale. The social scale is not even a specifically human feature. It seems like all animals have it, too, from fish to apes.[6] If trouts can rank their members on a unidimensional scale, surely Homo sapiens can, too.

This scale need not exist in any tangible form. Real human interactions are probably much too complex to be put along only one dimension. However, this abstraction seems to be well-understood and used, even unconsciously, by everyone (evolutionary biologists might even argue that social ranking is an innate trait). It's not more absurd to consider that prices have their origin in an imaginary social scale than in an imaginary market.

Humans are distributed along this scale according to their rank. Now, going back to economics, we can assume that, depending on his or her rank, a human is entitled (by other humans) to a given salary. It is up to him or her to thereafter busy him or herself to justify the social rank to others.

A white male socialized at the higher end of the scale is entitled to earnings starting at the higher end of the wage distribution. He would probably not accept anything below that and few would think of offering him less. Bullshit jobs exist for people like him, as a justification for their position on the social scale.

It explains why a manager who's a total failure at his job can keep finding new positions at the same salary. It explains why entire industries, such as development aid or graphology, can keep existing even when everyone knows of their complete uselessness (or of their counter-productive effects). Their existence is the justification for the high salaries of the people - who were, for the most part, born in the higher echelons of society - working in it. And it explains why people at the lower end of the scale, like truckers, will not see any substantial increase in their wages, even if there is a shortage of workers with their specific skills.

To rise up the social scale, a human needs to convince all other humans around that his or her right position is not where everyone thought it was. To justify this stance, one needs to be credited with extraordinary talent (think of football players) or, as is more often the case, bluff. Rags-to-riches stories are full of instances when the protagonist simply pretends to be someone he's not to gain social advancement. Such strategies can be deployed at wider scales. A series of cultural artifacts (books, films, academic articles) can be produced to change social perceptions of a given group and facilitate its ascension or descent on the ladder. If the salaries of bankers increased so much in the last forty years, it's not because bankers got better at their job, it's because they themselves convinced everyone (helped in that by neoclassical economists) that they were worth more than people thought.

Prices, in turn, are determined by the wages claimed by the people producing goods or services. Because bankers and financial intermediaries went up the social scale, the prices of financial products increased accordingly. The cost of clothing articles did not decrease because of an increase of the supply over demand, but because production was shifted from people relatively high on the social scale (workers in Europe and in the United States) to people of relatively lower rank (workers in Bangladesh).

Profit is simply a construct needed to provide the income due to the ones atop the social scale, no different in nature from salaries and other forms of income. A higher level of profit is required when shareholders manage to increase their position on the social scale. Investors do not become rich because they squeeze more profit from their companies ; they demand a larger share of the revenue because they went up the social scale.

In this framework where supply and demand play only a side role, products are bought because the consumption of produce made by people of equal or superior rank is a prerequisite to maintain one's social rank. As such, all consumption is conspicuous consumption. There are no indifference curves (a basic tenet of almost all schools of economics), just a desire to imitate the higher-ups.

Racism and sexism

One of the reasons I started to look for alternatives to market economics lies in the discipline's inability to explain racism. Work is clearly divided along racial lines pretty much everywhere.

In Moscow, the sellers of antifreeze on the highway are all Central Asians. In Paris, garbage collectors are very rarely white. In Louisiana, Blacks are kept in menial jobs in ways that are hardly different from slavery.[7]

Some, like Immanuel Wallerstein, say that racism is the foundation of capitalism, in that it allows for the creation of underclasses that make the exploitation of workers bearable.[8] Even if it were accepted (it's not - very few economists work on racism) such a view fails to explain why racism would play an important role in non-capitalist societies.

Racism was rife in the Soviet Union, for instance. Almost one in six Soviets were of Turkic descent, but just two of the 97 Politburo members up to 1989 were (Aliyev and Mukhitdinov).[9] Other non-capitalist systems, such as fascism and national-socialism, used racism as their core belief. But their practice of racism, where millions were put to work in atrocious conditions because of their perceived race, is not very different from what capitalist systems did in the Congo or in Cameroon or in South Africa in the 20th century.

If humans are ranked on a unidimensional scale, that women and people of color fetch lesser wages than their white male counterparts is due to their lesser social position and has nothing to do with their skills. (The question of why the distribution of social rank should be so is the work of historians.[10]) This fits better with reality than the idea of a "labor market" where, as if because of their lesser qualities, women and persons of color fetched lesser wages well than white males.

This explains also why the same service, performed by Blacks or Turks, cost much less than when performed by whites. A haircut in Berlin in a Turkish-German salon costs less than ten euros ; it can cost over fifty euros at an upscale - and mostly white - hairdresser. Market economics will try to explain the difference by arguing that the cost structure and the decor of the salons are different, I find it much simpler (and closer to reality) to say that affluent people are afraid to be seen going to a Turkish-German hairdresser because it could harm their social standing.

In line with Wallerstein's arguments cited above, racism and sexism, along with all the other devices invented to justify the current distribution on the social scale, exist to ensure an element of social stability, much like a godly design was invented to justify the higher social standing of the aristocracy in the 18th century. By making it much harder for some to evolve along the scale, dominant groups reduce the risk to see their position attacked from below.

Product quality as an externality

In this framework, the characteristics of the goods and services cease to become answers to market demands but become random externalities. Because work's sole purpose is to justify one's position on the social scale, the output of work loses meaning. Produce will be consumed by virtue of coming from people of higher social rank, so that the exact purpose of a good or service is irrelevant (advertisers always choose actors and settings that are slightly above the social class of the target audience, for instance). In other words, rich people could have their companies sell whatever they want and they would - eventually - sell it.

The randomness of the output of the economy forces to review some historical analyses. That the United States' economy was stronger than the Soviet Union, for instance, might have been sheer luck. Take cigarette sales. Up until the 1990's, Americans smoked roughly four times more (per capita) than the Soviets,[11][12] which was widely seen as a sign of American superiority. Imagine for one second that cigarettes, instead of killing us within 40 years, killed us within 10. Higher cigarette consumption would have greatly deteriorated the American position and the Cold War might have ended differently. A similar case can be made today around painkillers such as Oxycodone, one of the drugs responsible for the opioid epidemic. Their net social impact is largely negative even as they enrich their producers.

Whether a society produces Penicillin, an antibiotic, or Oxycodone, an addictive opioid, could have nothing to do with the economic rules in place. Instead, I believe that it has to do with the position of truth-seekers such as academics on the social scale. Their role, I argued before, is much more important than what market economics would have us believe.[13] In the end, that market-based societies ended up producing more and better things could be due to luck.

The centrality of the social scale and the irrelevance of production in such a framework imply that social changes do not follow technical evolutions. Instead, they are the outcome of changes in perception of certain social groups. The bourgeois revolutions, for instance, do not follow from the bourgeoisie's embrace of new technologies and techniques, such as trade. Instead, they followed from the bourgeoisie's higher sense of self. It sounds like circular reasoning, but it isn't. Under this theory, the reason trade brought in more value has nothing to do with market forces. Instead, trade became more valuable because those who did it thought of themselves as more worthy. Again, this is not as absurd as it sounds. Societies have already stopped trade on political grounds, declaring that it wasn't needed after all (such as imperial China in the middle of the 15th century[14]).

The mirror argument of the above paragraph's lies in the importance of the dominating group's sense of self. If production is irrelevant, the dominating group's only means of staying in power is its image. As such, those higher up on the social scale need to constantly remind others of the reason for their domination. They need to display their power (by having coercive forces defend their body and property) and to find credible stories explaining their position.

The dominant social group risks losing power when it fails to convince others that its being on top of the social scale is right. This is why corruption in the dominant group is one of the keys to social change, as it undermines the group's ability to pretend that its domination is just.

Implications

A theory is of little use if it cannot be used in real life. From the assumptions above, the most interesting implication concerns universal basic income. If social interactions are, indeed, based on a unidimensional scale and if one's activity is defined by one's position on that scale (and not vice-versa), giving a lump sum of money to all people on the scale would have zero impact. Everyone on the scale would move up by the amount given, while those at the top would not budge because their income would be reduced by a small share. All the while, the perception of work would not change ; people would still need an activity to justify their social position.

Social justice would be much better served by trying to compress the scale as much as possible. One way to do this would be to reintroduce high taxes on income above a certain threshold (for instance, by taxing all income above three times the median wage at 90%), as well as increasing wealth and inheritance taxes.

Another consequence of this theory is the relative importance of cultural artifacts in social change. If social change follows changes in perception of social rank, cultural goods showing that the current social order is wrong have more power than actions rooted in the production system. In other words, the fight against racism is better served by films like *Black Panther* than by affirmative action.

This theory might be a tautological brain fart, but it was fun to write. As I've argued before,[15] I believe that much of the analytical framework we use to understand the world is sinking along with the liberal order upon which it grew. As the era opened with the Enlightenment is coming to a close, people interested in understanding the world should feel less constrained by older theories.

New ideas are needed. If you know of any - I'm always interested in reading suggestions - do add them to the issues of this blog. Thanks for reading!

Cover illustration: Otto Rudolf Schatz, Fabrik, 1927