Exam 1 9/29. wed.

* prices and Profits.

Price lecture

Prices are signals. They convey information to the seller (the marketer) as well as to the buyer (the consumer, end user, or intermediate user).

The corollary of prices is profit. Marketing has as it's objective to set prices at the level where maximum profits can be realized. When prices are set too low, a firm cannot cover its costs and will eventually close its doors. When prices are set too high, the firm's products or services will not be purchased and sales will be too low to make a profit.

There are three elements in the pricing decision:

1. Cost
2. Competition
3. Profit

"Supply and demand" is a term for economics and is too vague for use in marketing. This would be an incorrect answer to an exam question, "List the three elements in a marketer's pricing decision."

"If prices are signals, then profits are magnets. They attract entrepreneurship, innovation, quality, and better service."

Possible exam question: based on the lecture, what four things do profits attract?

The source of wealth

The source of wealth

Adam Smith's book, *The Wealth of Nations*, demonstrated that free markets, were the way to produce wealth and prosperity. Not protectionism and mercantilism, which were the prevailing policies of his day. However, monetary thought was not well developed in his book.

*In one of his first books, *The Theory of Money and Credit*, Ludwig von Mises built on Adam Smith's foundation and showed how **innovation, hard work, savings, and investment** were the means of achieving wealth, not manipulation of the money supply by governments. *

"There will always be planning. The question is, who plans. Should each member of society plan for himself or should government bureaucrats decide." (von Mises)

Money is valuable because we can use it to purchase products and services Increasing the number of monetary units, dollars, $$$, for example., printing money or the Federal Reserve buying bonds or other assets, does not add new goods and services to those already produced. It only reduces the value of each dollar already in circulation. This is commonly known as inflation.

Inflation discourages saving and encourages spending. Inflation distorts the prices system and leads to mal-investment.

*Exam questions: According to von Mises, what four things are the means of achieving wealth? Why is money valuable?

Mises Insights

Mises' most remarkable argument for the free market came in his 1922 piece, "Socialism: an Economic and Sociological Analysis."

*In a Socialist state, there were no (free market determined) prices, essential to allocating resources. Prices are signals. Prices are information. Prices signal, they convey, information to hundreds and thousands and millions of people all the way up and down the supply chain, from producers and wholesalers to end users and consumers. *

In this scholarly work, Professor von Mises also predicted the fall of communism in Europe, which indeed did occur in 1991.

In his book, Professor von Mises delivered a devastating intellectual, scholarly, and scientific blow to socialism, which the socialists were unable to refute. Unable to refute his scholarly presentation, the prevailing academic establishment at the time ignored it. Even to this very day, no academic or scholar has successfully refuted Mises.

Fortunately for us and for all of mankind, Mises' student Frederick Hayek achieved prominence and recognition, first in England then in the United States. Hayek's book The Road to Serfdom was widely read and became a best seller.

*Another of Mises' insights was how the free market helps poor people better than central planning. They have better access to products and services; higher standards of living; more job opportunities; and the opportunity to save and invest, the opportunity to become rich.

Potential exam questions: "According to Ludwig von Mises, what is the role of prices in a free market economy?"
"According to von Mises, the free market helps poor people better than central planning. List three benefits according to his insight."

* indicates answer to potential exam question.

Hayek Insights

Professor and Nobel prize winner Frederick Hayek explained this all over half a century ago, most famously in his book *The Road to Serfdom*. At the simplest level the problem is that the government can never have enough knowledge to properly guide a market through a command and control structure.

A free market can adjust itself as prices and quantities change in response to surpluses and shortages, to profits and losses.

A huge amount of information is efficiently transmitted to all the market participants through the simple mechanism of prices.

Possible exam questions:

"What was the insight of Hayek regarding prices?"

"According to Hayek, what is the problem with government setting prices through a command and control structure?"

"Fill in the blanks. A huge amount of information is efficiently transmitted to all market participants through the simple mechanism of prices."

Let them eat cake

We have seen too many tragic examples in history of what happens when government price controls shrink supply while increasing demand. Queen Marie Antoinette of 18th century France, when told the peasants lacked bread, reportedly said: "Let them eat cake."

*Why did the peasants lack bread? It was because the French government controlled the price of wheat, made it so low, with the result that farmers were losing money on their crops, and simply stopped planting.

Government Price Control.

The result was starving peasants, the French Revolution, and, of course, Marie Antoinette losing her head on the guillotine

*possible exam question

the wealth of natuins

The Wealth of Nations was Adam Smith's observation about how wealth was created.

*How did people know what to produce? How did they know what price to sell it at? How did they know when to shift to other things, or when to increase production?

Answer: Smith saw individuals guided by an 'invisible hand' that led them to follow their own interests and thereby respond to the needs and desires of others.

Source: Bill Bonner *How Too Much of a Good Thing Leads to Disaster*.

*potential exam question