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Where Markets Fail: Markets Assume Fungibility

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Have you ever lent a postage stamp to someone who rather than paying you back with an actual postage stamp, gave you the nominal amount of the stamp, say US 40¢, instead?

This is aggravating because while the transaction is fungible due to the presumed exchangeability of currency, it is not an equal transaction. Why? Because acquiring a postage stamp requires much more than just 40¢. It also means a trip to the post office, waiting in line, transacting, and then returning home.

In the last two articles in the Where Markets Fail series, this fan of capitalism pointed out ways that our main mechanisms — markets — are flawed. First I demonstrated that markets are poor estimators of future states because [people are poor predictors of what comes next](#). Next, I observed that [markets assume a context](#), with deleterious consequences.

A third way that markets fail is that transactions assume fungibility.

Even when a currency is not present, markets involve an assumption of fungibility. Why? Because in a market transaction, both parties are free to either reject or accept the terms of the deal. So a dentist providing dental work to a bricklayer in exchange for repair of a brick wall is a transaction. This does not mean, however, that the transaction is *always* fungible.

While there is a degree of exchangeability in this example, barter systems fail because of the "double coincidence of wants." That is, a dentist looking for brickwork must find a brick worker looking for dentistry. Such a search is time-consuming, and therefore inefficient and a drag on capitalist activity. And absent currency, independent and universal prices for these goods and services are difficult to ascertain. Consequently, markets break down.

I know what you are thinking: But we have currency! Currency provides a universal denominator for goods and services so exchanges can occur indirectly in currency rather than directly in goods and services. True. But that does not mean that the fungibility is perfect, as in the postage stamp example.

But who cares about a postage stamp?

What happens when clean air and clean water are exchanged for cash? It may seem that since clean air and clean water can be priced in currency that cash and clean air are fungible. But try making that transaction in outer space on a space station.

Or what about the destruction of an entire ecosystem? Is its elimination fungible for the equivalent value in Kewpie dolls? Or compare the value of your education with the money it cost to attain it. There is a large-sized consumer surplus (your benefit) in those who hold the CFA charter relative to its cost. This is a fungibility mismatch in the opposite direction.

What these two examples illustrate is that the fungibility assumption makes no distinction for uniqueness.

For example, if a hurricane destroys your home and kills your spouse, the cash received from your property and life insurance policies are *not* replacements, and not fungible with the underwritten.

This is also true for your health. How much money will you accept to saw off your leg? I don't mean to be garish, I am just pointing out that markets denominated in currency help with the fungibility of commoditized goods, but the same assumption does not apply to more important things.

For that which is irrevocable, fungibility is a poor assumption. Witness: your professional or personal reputation.

Of course, an understanding of supply and demand does not fully describe or rectify the problem. After all, clean air is in vast abundance and demand for it is also universal. But that does not mean that currency in exchange for clean air is fungible.

In investing, a share of stock in two different companies, each share costing £50.00, is not necessarily of equal values over the long term, though the market is accurately discounting the prospects of each business. Clearly, the fungibility assumption fails frequently in capitalism.

I am not saying abandon markets. I am saying know your assumptions so that you can make more fully conscious decisions.

Possible Remedies

- Pay attention in a transaction and remember: “Just because a thing is priced does not necessarily mean that *is* its price.”
- In capitalism, we treat capital as precious, yet the fungibility assumption runs counter to that metaphysical assumption — ¥100 is not the same in every instance. So pay attention to what you value and ask, “What am I trying to maximize/minimize, and is fungibility the correct assumption?” Put another way, “Am I being fairly compensated at this price?”

Here is the future trajectory of this series:

- Markets are not systemic.
- Markets have “visible hands.”