PRICE REGULATION AND ITS COST

Throughout history, peoples faced with rising price levels on basic commodities required for survival have repeatedly turned to price controls by government as a means of solving their economic dilemma. Just as repeatedly, this approach to rising prices has failed to better economic conditions and has, instead, resulted in shortages, confusion, misallocation of resources, repression of individual liberties, and in some cases has actually accelerated price increases at a later date. In short, historically price controls have been a uniform failure. Understanding the reasons for the failure of price controls does not require a deep background in economics nor does it require advanced knowledge of mathematics. It only requires a basic understanding of how people act in a free market and how they react in a controlled one.

Understanding why price controls fail to work must begin with understanding why prices rise in the first place. Here we must differentiate between *the general price level* and specific prices.

The general price level refers to the aggregate of prices charged for all goods and services in an economy relative to a base period. Thus when we say that the general price index was up 12% last year, we are saying that the average price of *all* goods and services in the economy rose by 12% over the previous year's prices.

Unlike the general price level, *specific prices* refer not to the average price charged for all goods and services, but rather refer to the prices of *particular* goods and services.

Economists have long recognized that the general price level is directly related to the total money supply in a society. As the money supply increases faster than the increase in production of goods and services, prices rise. The reason for this relationship is simply that if people in general have more money they will spend it on *something*, bidding up the general level of prices.

Specific prices, on the other hand, are influenced by a variety of factors, including the supply and demand for particular products and the general price level. Because of changing consumer desires, resource depletion, new manufacturing processes and other factors, specific prices will rise and fall. However it should be obvious that the *more* we spend on one thing, the *less* we have to spend on something else. Thus while specific prices are always in a state of flux, so long as the money supply is constant (and a catastrophe, such as war does not decrease the general level of production) all prices cannot rise at the same time.

Let us now consider the effect that price controls have on both general and specific prices.

Economists have long noted that the most apparent negative effect of price control is that it fosters *shortages* in the very goods and services that were rising before the institution of controls. This is due to a variety of causes.

If the price of a product (or service) is frozen during a period of rising prices, demand for that product is encouraged to rise since consumers once discouraged by the rising price are now able to buy the good at the (lower) frozen price. To put it another way, when a good's price is set below its price in the free market, consumer demand for the good will exceed what producers are willing to supply.

At the same time, price freezes tend to decrease the supply of many goods and services since producers are less willing to supply a good at a price lower than what they would have charged before controls. Also in certain areas of the economy, such as agriculture, production is discouraged when producers who invested funds in anticipation of *higher* prices find that prices are frozen. Rather than sell at a loss, these producers will destroy their goods (e.g., kill pigs and burn wheat).

Another reason that price controls decrease supply is that at any given time some firms in the same industry sell at prices higher than the "market clearing price" (i.e., the price at which supply and demand meet) and other firms sell at prices lower than the market clearing price. Normally firms act quickly to bring their prices into adjustment with the market clearing price, but the moment price controls come, those firms temporarily lower than equilibrium are unable to raise their prices and therefore are effectively sentenced to bankruptcy.

Finally, and worst of all, in the free market rising prices serve as an incentive for capital investment *in precisely those areas where demand is high.* Artificially holding down a price prevents the flow of capital to these high demand areas. So there is no more capital available to expand production in these areas once controls are instituted, and again there are shortages.

The history of price regulation has been a history of shortages. When controls are comprehensive or protracted, basic necessities of life completely disappear from legal markets, making even simple survival difficult. During such periods only the illegal black market has enabled consumers victimized by price controls to survive at all.

The shortage problem created by price controls is well known and advocates of controls argue that shortages are the "price society must pay" to stop rising prices. However a basic fact of economics is that costs can never truly be avoided. If prices cannot legally rise, other, non-monetary costs will increase.

Let us assume gasoline prices rise from $.70 to $1.00 a gallon. Certain consumer groups demand that prices be rolled back to the previous, "more reasonable" level. The will of the people being clear, government freezes gasoline prices at $.70 a gallon. So now consumers pay less for their gas—or do they?

When gasoline prices rise from $.70 to $1.00 a gallon there are reasons for it other than the whims of petroleum companys. Costs may have increased, or demand may have increased, or supply may be less—or all three things may have occurred. Whatever the reason for the price increase, petroleum companies can produce less gas at $.70 a gallon than they could at $1.00 a gallon, and hence price controls will mean less gasoline. Suddenly there is not enough gasoline to meet consumer demands, and drivers now queue up in long lines to buy what little gas is produced. The greater the discrepancy between the legal price and the market price, the longer lines will be at the gas station.

Being forced to wait in long lines to buy gas, being unable to drive as much as you would like to, and other frustrations attendant to a gasoline shortage are all costs consumers must bear under price controls. If an individual earning $10 an hour must now spend an extra hour buying 20 gallons of gas at a controlled price of $.70 a gallon, in fact he is not paying $.70 a gallon but $.70 a gallon plus the cost of his extra waiting time, or (in this example) $1.20 a gallon. Thus when all economic costs have been taken into account, price controls have not really lowered the price of gas but actually raised it for most people!

Another serious danger of price regulation is that it tends not only to freeze prices but also attempts to freeze people's tastes, desires and attitudes. In a normal, free market, when consumers change their preferences—for example when people start buying less high caloric food and start buying more exercise equipment—sales of the former will fall and sales of the latter will increase. Such changing demand is normally reflected in changing prices which act as a signal to increase or decrease production. Thus the free market reflects the preferences and desires of consumers. Under price regulation, however, prices cannot change and the impact of demand upon prices and hence upon production is much less. In the free market you get what you want. In the controlled market you take what you can get.

Price control is also innately discriminatory. Those products for which prices were raised just prior to the enactment of price control (either by chance or because of political contacts) have a vast competitive advantage over those products whose prices had been held constant despite rising costs. Thus price regulation guarantees failure to some firms and gives protection to others. This also explains why firms are reluctant to *lower* prices when conditions demand it for fear that the imposition of controls will occur when their prices are temporarily low.

While the economic case against price controls is overwhelming, the strongest argument against controls is actually not economic but moral. Morally each individual has a right to his own body, mind and life, and the right to choose how and under what terms to dispose of the fruits of his labor. A price is nothing more than a voluntary agreement between buyer and seller, each freely exchanging his goods and services for those of another. No third party, no gang and no government, has a right to dictate to free men what price they should charge for their own justly acquired property or for their labor. For any government to tell a man what he may or may not charge for his own property, is for the government to that extent to enslave and subjugate its citizens, and to substitute for the moral order of voluntary contracts the brute power of a loaded gun.

Wage and price controls cannot achieve any desirable result. To the extent that they allow loopholes they will be evaded. To the extent they are enforced they guarantee only shortages, misallocations, discrimination, and the abrogation of individual rights—all without reducing the *total* economic costs of goods and services.

The fact is that wage and price controls are not actually imposed out of economic wisdom or for social benefits. They are imposed because of widespread economic ignorance and in pursuit of political power. When the government tells you that it is going to impose controls for *your* benefit, you can be sure that your benefit is the farthest thing from the politicians' minds. Wage and price controls only serve to increase the power of government at the expense of the freedom and prosperity of everyone else.

SIL DECLARATION OF PRINCIPLE

Adopted October 1969

As Advocates of Individual Liberty We Affirm:

That every person has an inalienable right to their own life, liberty and property;

That the only proper use of force is in retaliation against those who violate human rights;

That the basic violation of human rights consists of the initiation or the threat of the initiation of force against the individual;

That all proper social organization can only be a consequence of voluntary association between individuals;

That the only economic system consistent with human prosperity and happiness is laissez-faire capitalism;

That the ideologies and instrumentalities of coercive collectivism are the basic threat to human rights and the existence of moral human societies;

And that both moral individuals and moral societies have the obligation to act in their own rational self-interest to protect themselves from those who seek to coercively control, direct and enslave them.

With the apostles of coercion increasingly predominant in the councils of man, it is the duty of all those who value their life, liberty and property to take appropriate action—intellectual and social—to preserve and extend their freedom.

We as libertarians resolve to resist all forms of involuntary collectivism and all programs and activities of government which violate our rights and attempt to take from us the ability to set our own goals and to determine our own destiny.

We work for the day when all individuals are free, and we look forward to a society of peace, plenty and freedom where the individual's rights are truly politically inalienable. As advocates of reason and liberty we seek and will settle for no less than:

FREEDOM IN OUR TIME

Copies of this brochure are available for 25 for $1 from: Society for Individual Liberty, PO Box 1147, Warminster, PA.

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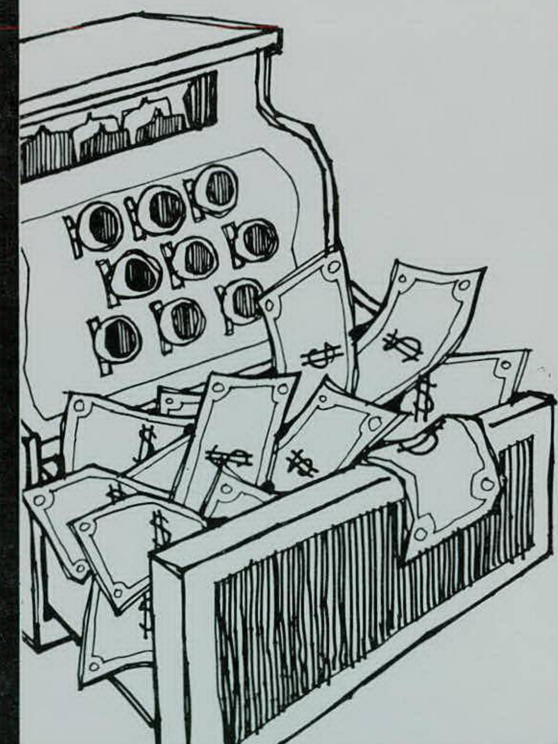
DONALD C. ERNSBERGER
& JARRET B. WOLLSTEIN



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