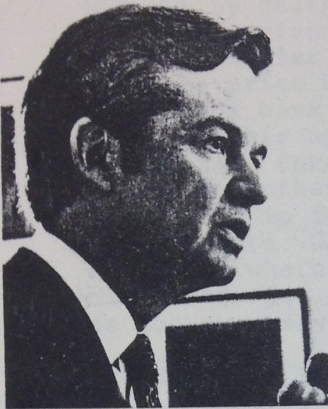


# CLARK



## ON THE ISSUES

ISSUE PAPER NO. 8

### Wage And Price Controls

The politics of the past, as exemplified by Republicans and Democrats, consists largely of simplistic solutions that not only are unrelated to the causes of problems, but are themselves the causes of new problems. Since the government is usually the cause of the original problem, we invariably end up much worse off whenever the government tries to "help" us. Not only is the economy thrown further out of whack, we have less liberty as well.

The issue of wage and price controls is an excellent illustration of this process. I cannot think of a clearer case in which government planners assume that people are unable to live intelligently and freely. One of the basic consequences of freedom is the right of people to bargain over the terms of exchange. When you recall that the American Revolution was fought in part so that Americans could trade freely with people other than the British, you see how basic this freedom is to our heritage.

Wage and price controls are a cruel assault on that freedom. The controllers say to Americans, in effect, you may not decide what the price of your labor or your products will be. I believe that such controls are but a breath away from chattel slavery.

Today, when politicians reject wage and price controls, they usually do so on grounds of expedience. "They don't work," said Jimmy Carter in opposing attempts to have the Democratic platform endorse controls. This is not reassuring, for it implies that if they are later thought to be workable, they will be imposed. It is true that they have never worked -- as we saw most recently when Richard Nixon tried them -- but this is a mere consequence of a much deeper objection.

Controls don't work because they interfere with people's free and peaceful trading of products and services. Specifically, they interfere with an important result of this activity: the price system. The price system is one of those amazing phenomena -- which



include language -- that men and women create by their actions but not by design. Have advocates of price controls ever wondered how prices are set in a free society? Many may think that the seller sets them. But let's look deeper. The seller sets the price he thinks people will be willing to pay. Since they don't have to buy any particular item from any particular seller, their agreement is needed before a sale can be made. By the same token, a buyer's ability to bring a price down is limited by other buyers who may be willing to pay a higher price. So in fact, prices are set by the actions of all market participants. One's choice to buy or not buy exerts influence on prices whether it is realized or not. This is perhaps most clear when you see a sale on items that last week you passed up as too expensive.

#### PRICES AS A COMMUNICATION SYSTEM

This discussion illuminates an important, yet unappreciated, function of the pricing system: its communications function. Prices inform us about the relative scarcity and demand for products and services. When a product becomes more scarce relative to our demand for it, its price goes up. This encourages conservation and the search for cheaper substitutes.

Prices not only guide us as buyers, they guide entrepreneurs -- those people who make it their business to discover what we want and to produce it. When they see a price go up, they are signalled that the supply of a product is smaller relative to demand than previously. The opportunity for profit encourages entrepreneurs to satisfy the unfulfilled demand either by expanding production of the item or by offering a satisfactory substitute.

Prices, then, serve a similar purpose as a thermostat. They not only signal changes, they bring about adjustment to changes. But they are actually more important than a thermostat. Without a thermostat, you can still tell if the temperature of a room is comfortable. Without prices, there is no way to tell what should be produced and how much. An economy without prices would necessarily be plagued by chronic shortages and surpluses. Prices make rational production guided by consumer choices possible. If there are too many shirts and too few shoes -- by consumers' standards -- the prices of shirts will drop relative to those of shoes. Entrepreneurs, seeking profit, will divert labor and capital from shirts to shoes.

#### THE CHAOS OF CONTROL

Only one thing would approach the chaos of an economy without prices; an economy with controlled prices. You can now see why. Just as in an "economy" without prices consumers have no way to tell entrepreneurs about their changing tastes and preferences, so in an economy with controlled prices they are muted. The prices that emerge from the activities of buyers and sellers reflect at a given moment the subjective preferences and subjective costs of people. But since our tastes, expectations and



plans change unpredictably, today's prices may be inappropriate to tomorrow's conditions. Price and wage controls try to ignore these changes and pretend that life is motionless and the economy is static. If consumers decide they want more shoes and fewer shirts, they have no way to tell the entrepreneurs, because the law, if effect, forbids it. (When prices are looked at this way, price controls become a violation of the First Amendment's guarantee of free speech.)

But price and wage controls do more than this. They themselves set in motion a process that makes consumers worse off. Because price and wage controls forbid the search for market-clearing prices, where supply and demand meet, the controlled prices will always be either too high or too low. When prices are held below market level, consumers are misled into overstating their demand for products. They will tend to buy more at the artificially low price than at the market's higher price. But since the increased demand cannot, by law, be communicated by the price system, sellers have no incentive to increase supply. Demand outstrips supply and some consumers will be disappointed. Shortages develop, as they developed during the Nixon program from 1971-74, as they developed at the gasoline pumps in 1973 and 1979, and as they occur with apartments in rent-controlled cities like New York.

If prices are held above the market level, surpluses occur, as consumers understate their demand.

I want to stress that from the consumers' point of view, price controls are the cause of great hardship. Products are less accessible, despite intentions. When the shelves are empty, it is no comfort to know that the law is holding prices down.

Price and wage control have even more horrible consequences, which I will briefly mention. In the marketplace, buyers and sellers have a harmony of interests. Each has what the other wants; they have only to arrive at mutually satisfactory terms. But they have an interest in seeking those terms and benefiting each other because they also benefit themselves. Price and wage controls drive an unnatural wedge between these dovetailing interests. If prices cannot rise overtly in response to new conditions, they will rise covertly; sellers will lower quality or stop offering extras, which, in effect, raises the price of the basic item. If the price-control procedures allow cost pass-through allowances, sellers have an incentive to jack costs up as high as possible. Once shortages develop, sellers need not worry about pleasing consumers because there is a glut of consumers demanding the product.

Today, the major reason controls are advocated is the rising prices associated with inflation. Since rising prices are a mere symptom of inflation, which is caused exclusively by the Federal



Reserve's expanding the money supply, price controls obviously cannot fight inflation. As we've seen, they just make the distortions of inflation worse. To say that high price causes inflation is like saying wet pavement causes rain.

Wage and price controls violate liberty, destroy the smooth working of the market, provide subsidies to privileged interests, deny consumers access to products and mask the government's responsibility for inflation. On all counts, controls have no place in American society.