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Price Controls Are Popular but Wrong, Morally and Economically

Writing in his classic book *Economics in One Lesson*, Henry Hazlitt — journalist and economist of the Austrian school of economics — gave a lucid explanation of the problem with minimum-wage laws. "We cannot distribute more wealth than is created," he wrote, adding, "Real wages come out of production, not out of government decrees."

A long, long history of government decrees in this area reveals insights into the effects of such laws. In ancient Babylon, King Hammurabi decreed the politically correct wage level for field laborers, herdsmen, potters, tailors, carpenters, rope makers, and others. As Robert Schuettinger and Eamonn Butler commented on this ancient effort at minimum-wage laws in their book *Forty Centuries of Wage and Price Controls*, "It appears that the very people who were supposed to benefit from the Hammurabi wage and price restrictions were driven out of the market by those and other statutes."

Likewise, in the days of the Roman Empire, the Emperor Diocletian experienced similar results. He attempted to simply decree, under penalty of death, certain controlled wages and prices because merchants were raising prices, causing upward pressure on wages. Though prices were rising because Diocletian had debased the Roman currency, leading to its drop in value, like a typical politician we might meet in our century, he placed the blame for rising prices on sellers and speculators in the empire. To remedy the supposed problem, Diocletian issued his edict in 301 A.D. The edict covered more than a thousand individual wages and prices, from the price of beer to the wages of reading teachers.

Edward Gibbon, writing in *The Decline and Fall of the Roman Empire*, explained the results: "The consequences might have been foreseen and were soon felt. The imperial wheat was purchased by the rich merchants; the proprietors of land, or of corn [grain] withheld from that city the accustomed supply, and the small quantities that appeared in the market were secretly sold at an advanced and illegal price."

Government can no more repeal the laws of supply and demand — which determine the prices of products and labor (wages) and the price of money (interest rates) — than it can repeal the law of

gravity. They cannot make 2 + 2 = 5 by a law.

The law of demand states that the demand for a product varies inversely with its price. If the price of a product is high, the quantities demanded will be low. If prices are low, the quantities demanded will be high. On the other hand, the law of supply says that the quantity of a product offered for sale varies directly with its price. Therefore, if the prices/profits are high, suppliers will offer greater quantities for sale. And if the prices/profits are low, they will offer smaller quantities for sale.

Keeping the above laws in mind, we can predict with unerring accuracy the results of any government price control: Interference with the price-system method of allocation of resources inevitably leads to distortions, in some cases shortages, and in other cases, surpluses.

In *Economics in One Lesson*, Hazlitt made this point: "There is no point in assuming a price control that would fix prices exactly where a free market would place them in any case. That would be the same as having no price control at all." In other words, any government price control is essentially a lie — it is stating that a product or service has a value either above or below what exists if a free people determined its price in the free market. Hazlitt presented an example of a price control *below* the market price. "Now we cannot hold the price of any commodity below its market level without in time bringing about two consequences. The first is to increase the demand for that commodity. Because the commodity is now cheaper, people are both tempted to buy, and can afford to buy, more of it. The second consequence is to reduce the supply of that commodity. Because people buy more, the accumulated supply is more quickly taken from the shelves of merchants. But in addition to this, production of that commodity is discouraged. Profit margins are reduced or are wiped out. The marginal producers are driven out of business." Thus, a shortage is produced.

Authors Schuettinger and Butler provide multiple examples of government price controls leading to shortages throughout history, all over the world, from ancient times to the modern era. During the American War for Independence, the Pennsylvania Legislature attempted to "help" the Continental Army under General George Washington, which was in winter quarters at Valley Forge. They legislated price controls on those commodities needed for use by the army. Farmers, believing the price was too low, refused to bring their produce to market. Sadly, some Americans resorted to selling food to the British, who paid in gold, not in inflated Continental dollars. Fortunately, the sad experiment in price controls ended, but not before it led to severe suffering by Washington's army, which was short on footwear, food, and many other supplies.

Despite the ample evidence of the deleterious effects of such controls on prices, politicians continued to propose them. During the Great Depression, President Franklin Roosevelt led Congress to create the National Recovery Administration. The NRA proposed the cartelization of industry, with suppliers in various industries setting price *floors* instead of *ceilings*. Such price floors were based upon the thesis that the way to come out of the Depression was to drive up wages and prices, which many supposed intellectual giants of the day believed was a sign of prosperity. This did not originate with the Democrat Roosevelt presidency, but was rather an expansion of the concept pushed by the previous Republican Hoover administration.

Soon after the October 1929 stock market crash, Hoover held a series of conferences, at which he extracted assurances from most major business leaders to not lower wages. Hoover desired to keep "purchasing power" high, but the results were predictable — a surplus of labor was created because of

the high price of workers, leading to rising unemployment.

Roosevelt repeated Hoover's mistaken notion, with the NRA, and thus contributed to the unnecessary prolonging of the Depression. The NRA's codes, designed to keep prices and wages high, had the effect of law, as an unfortunate tailor, Jack Magid, found out. He was jailed for charging 35 cents to press a suit, when the NRA code required a floor of 40 cents.

Most financially astute individuals understand the general concept of free market prices. Few want the government to *set all* prices, but far too many are under the illusion that government can somehow simply dictate prices, at least in some situations, that are "fairer" than what one finds in a free market.

Among the more "popular" price controls are rent controls, laws against "price gouging," laws against "ticket scalping," and laws controlling interest rates. But "popular" doesn't indicate "pain free."

Rent Controls

As Hazlitt writes, "Rent control is initially imposed on the argument that the supply of housing is not 'elastic' — i.e., that a housing shortage cannot be immediately made up, no matter how high rents are allowed to rise." This leads rent-control advocates to argue that government, by forbidding increases in rents, protects tenants from extortion and exploitation.

But there are negatives. Hazlitt explained that, by holding the price of housing below the market price, rent control "encourages wasteful use of space. It discriminates in favor of those who already occupy houses or apartments in a particular city or region at the expense of those who find themselves on the outside."

Because profits under controls are so small, there is little incentive to build new housing, and so new housing construction is delayed, thus exacerbating the housing shortage. As well, landlords are not encouraged to make improvements or repairs, and the existing property deteriorates. Eventually, the property may even be abandoned altogether, since the owner is either making no money on it, or it is such a small profit that it is not worth the "headache."

If rents are allowed to rise in response to a housing shortage, however, space is made available. After the 1906 San Francisco earthquake, no price controls were imposed on housing, and the free market quickly took care of the situation. In the first edition of the *San Francisco Chronicle* after the disaster, which left 225,000 homeless, no mention is made of a housing shortage. As Schuettinger and Butler demonstrate, "The classified advertisements listed 64 offers (some for more than one dwelling) of flats and houses for rent, and 19 houses for sale, against five advertisements of flats or houses wanted."

The same economic truisms hold true in the case of temporary shortages caused by storms or natural disasters — and "price gouging." (Price gouging is when sellers raise the price of goods a supposedly inordinate amount in response to an emergency.)

Price Gouging

Like rent controls in cities, claims are made that price-gouging laws are a needed exception to the normal workings of the free market. Oklahoma is known for its frequent tornadoes, and after the May 3, 1999 tornadoes struck the state, causing particularly heavy loss of life and extensive property damage in several cities, a price-gouging statute was enacted. It prohibited an increase in excess of 10 percent on the price of most goods and services when a state of emergency has been declared.

Other states have similar laws.

As I reported in my October 21, 2013 article in The New American in which I focused on "The Price of Price-gouging Laws," these laws get used. Following a December 2008 ice storm, then-Oklahoma Attorney General Drew Edmondson discovered that La Quinta Inns had committed "price-gouging." Edmondson was indignant at La Quinta for supposedly overcharging consumers, as much as $20 per night. For these violations, the hotel chain agreed to pay the state $50,000, to be used for "consumer protection enforcement activities," and provide some free lodging to those eligible.

Edmondson lamented in 2010, "Unfortunately, there are a few people who look to profit from someone else's tragedy." Of course, if one eliminated all occupations that "profit" from another person's tragedy, then physicians, nurses, pharmacists, roofers, plumbers, electricians, funeral home directors, ambulance drivers, trial lawyers, and politicians would have to look for different lines of work.

The argument for such laws is that some people will not be able to afford to buy necessary goods if prices go too high in an emergency, contending that this is "taking advantage" of people and is somehow morally wrong. But the greater harm is the shortage resulting from laws mandating below-market prices.

Common complaints after a tornado are that the rebuilding of homes and the removal of fallen trees take too long. But delays are aggravated by price-gouging laws, not alleviated by the laws, which do not allow the price of building supplies or labor costs to rise to their market level.

To repair or rebuild houses takes building materials, which quickly run in short supply, owing partially to the fact that prices of the materials were held artificially low by government regulations. To resupply lumberyards at low prices, materials would normally be shipped in by train because trains use very little fuel to carry goods. So lumberyards will generally be fully restocked when train schedules allow. If, however, prices are allowed to rise to meet market demand, lumber retailers will willingly pay to have supplies brought in by truck — the more expensive option — even from great distances, because they are allowed to charge enough to make the shipping charges worth it.

This increase in the supply would then have the salutary effect of driving prices back down. Price-gouging laws eliminate this option. Of course, if one preferred to wait a few more months to have a house built, then that person would not need to pay these higher prices.

Getting rid of fallen trees requires manpower and a specific set of tools, such as chainsaws. And again, if the prices rise high enough, people will fill the need. Jason Hood, writing for Reason.com, explained in the article entitled "Natural Disasters: Gouge Away" his personal experiences with so-called price gouging after natural disasters.

My second story is set just after Hurricane Hugo devastated South Carolina and Charlotte in 1989. My next-door neighbor then worked for a construction company in Raleigh. The day after the storm, I saw him packing up his pickup truck with a chain saw and other tools. "I'm taking the day off," he said, "and driving to Charlotte." He had heard that one could make really good money cutting trees and clearing debris.

Was he taking advantage of a disaster? In a sense, of course he was. But if there were no prospect of making more money in Charlotte than at his job in Raleigh, he would have stayed put — thus reducing by one the number of skilled workers helping clean up Charlotte. Most people can't afford to take

unpaid holidays and volunteer their time, or sell products below cost, or transport products from distant climes without compensation. (An aside: North Carolina's governor eliminated this barrier to compassion for state employees by giving them the week after the hurricane off, with pay. That meant that the rest of us had to pay millions of dollars in salaries to state employees out cleaning up their yards during the daytime, while we cleaned up our yards after work and on weekends.)

The Foundation for Economic Education's article entitled "On Price Gouging: Is It Fair to Raise Prices After a Natural Disaster?" explains that the negative effects of price-gouging laws run pretty much across the board, using the price of bottled water as an example.

The article explains that when infrastructure gets damaged and drinkable tap water becomes unattainable, many people become angry when bottled water prices skyrocket, yet if the prices didn't jump, most people would not be able to acquire bottled water at all.

The reasons for this are several: Many roads are closed, hindering new supplies; without high prices, the market is not responsive to the needs of the citizens because high prices signal high need; people buy more than they absolutely need (essentially hoarding), because long lines, rather than high prices, tell them that there is a scarcity; because prices are not high, people aren't as careful with the product's use as they should be and essentially waste it; and black market prices will be higher than would be the prices if stores were allowed to sell the product at an inflated price.

The article also questions whether long lines are a more fair way to ration products among a populace than are prices, and it points out that the time spent in lines waiting for scarce goods and driving to find goods ought to be counted as a cost, as should be the stress that arises from the search. If those are counted as costs, price-gouging laws really don't reduce costs at all.

Interestingly, many of those who would complain about a retailer selling gasoline for prices much higher than they paid for the gasoline don't hold themselves to the same standards. When those complainers put their houses on the market after their houses' values have appreciated for years — say, from $200,000 to $275,000 — they make no complaint. The price they paid for the house did not change, but they have no guilt about "gouging" a young couple wanting to buy their house.

The consequences of price-gouging statutes are many and harsh, but they don't dissuade many politicians from enacting them and acting on them. When Greg Abbott, now the Republican governor of Texas, was attorney general in 2010, he promised, "We are prepared to act quickly if gas prices in a Governor-declared disaster area spike beyond what the normal market forces set."

Ironically, Abbott's phraseology shows him contradicting himself: Disasters such as hurricanes, tornadoes, droughts, or even terrorist attacks are "normal market forces" to which prices react in a free market. Prices are the language of the marketplace. They communicate to sellers and buyers alike that a *new normal* has arrived. Following a disaster, the supply of a product has typically declined, and the demand has typically increased. This means that the price should rise. When the price is not allowed to increase to this new market price, an acute shortage is quickly transformed into a chronic shortage.

Ticket Scalping and Payday Lenders

Not only do our erstwhile nannies want to protect us from market forces, they want to prohibit transactions that are completely voluntary by all parties involved. Perhaps among the silliest laws imposed by local governments are those that prohibit someone with sports or entertainment tickets

from reselling those tickets at a profit. Brutal language — ticket scalping — is used to describe this supposedly nefarious practice. A person who wants to resell his ticket is not allowed to sell that ticket to a person who wants to buy the ticket.

Amazingly, many who decry ticket sellers for making money on a ticket have no concern about people forced to sell their tickets at a loss or those ticket holders who are stuck with tickets that cannot be resold for any price.

In many instances, sidewalk "ticket brokers" provide a valuable service to a ticket holder who is unable to attend the event. Rather than stand around waiting to sell a ticket directly to another person who is going to use the ticket himself, the ticket holder can sell the ticket, albeit generally at a loss, to a sidewalk salesman. The broker is actually performing a service for those who do not want to or cannot wait to make the sale personally.

Walter Block addressed this issue in *Defending the Undefendable*: "Consider a typical first-come, first-served (FCFS) method, since this is the type of system most widely used and the one usually thought to be 'fair.' Though tickets are not scheduled to be sold until 10:00 a.m. of the day of the event, hopeful customers line up outside the box office long before. Some join the line at the crack of dawn; some even begin the night before. FCFS is thus discriminatory against those who find waiting in line particularly onerous, those who cannot take a day off from work to wait in line, or those who cannot afford to hire servants or chauffeurs to wait in line for them."

Other business people who are vilified and regulated for offering a service are payday money lenders. Payday lenders are widely accused of drawing poor people into debt by charging "exorbitant" interest rates. Many American Christians even regard payday lending a sin.

Barrett Duke, the vice president for public policy of the Southern Baptist Convention's Ethics and Religious Liberty Commission, wanted to cap interest rates at an annual percentage rate of 36 percent, the same as for federal loans to military members: "If it's good enough for the military, that interest rate cap should be good enough for everyone."

Tom Strode of the *Baptist Press* claimed, "Payday lending, as it is commonly known, often draws poor people into a debt trap by charging exorbitant, and often misleading, interest rates. Though an interest rate may be portrayed by a lender as 15 percent, for instance, it actually is only for a two-week period until a person's next payday. The annual interest rate typically is about 400 percent, making it extremely difficult for a borrower to repay the loan."

Lenders with high interest rates are accused of "predatory lending." However, in almost all cases, the business relationship is initiated by the borrower, not the lender.

Finally, Stephen Reeves, associate coordinator for partnerships and advocacy of the Cooperative Baptist Fellowship, added, "We want to show you that Christians widely agree that the laws and regulations should protect against expensive interest and loans that cannot be repaid."

It is amazing that Reeves would contend payday lenders are making loans "that cannot be repaid," since lenders could not stay in business if they made very many loans "that cannot be repaid." In fact, those would not be loans, but gifts. But of course, that is not what Reeves is saying. He is arguing that borrowers cannot pay back the entire loan all at once, because of the "excessive" interest rates.

But contemplate what would happen if these Christian leaders got their way and "government caps"

were instituted on interest rates. Block asked readers of *Defending the Undefendable* to "imagine the results of a law which prohibits *usury*, which can be defined as charging a rate of interest higher than the law-maker approves of. Since the poor and not the rich pay the higher interest rate, the law would have its first effects on them. The effect would be to *hurt the poor*." While the law appears "designed to protect the poor from having to pay high interest rates," Block argues "in reality it would really make it impossible for them to borrow money at all!"

In most cases, the loans are taken out for necessities of life — food, rent payments, electric bills, car payments — and if they could have obtained the money another way, one presumes they would have done so. In other words, if the payday lender did not exist (and with government price controls below the market price they just might not), the poor person would not be able to, say, make a car payment that month. And if his car was repossessed, he couldn't get to work. If he lost his job, it would probably be a bigger concern than paying back $230 for a $200 loan. Similarly a loan to pay the electric bill would be cheaper than getting the electricity re-connected.

It should be clearly understood that most poor people who take out payday loans are huge credit risks. They often have no collateral, so the lender must "trust" the borrower to pay back the loan. Block explains, "One is hardly a victim of a moneylender if one has agreed to repay a loan, and then reneges on the contractual promise. On the contrary, the moneylender is the victim of the borrower."

Simply put, if the interest rates charged by payday lenders were controlled below the true market price, then the payday lender would make fewer loans, and may even do something else for a living.

Also, assertions arguing that the annual interest rate of a two-week payday loan is 400 percent are nonsensical, unless the person intends to pay the $200 back over the span of a year.

While these laws against "excessive interest rates, ticket-scalping, price-gouging," and the like are promoted by vote-seeking politicians and accepted by the general public largely uninformed as to their actual effects, the expanse and use of these price controls is fortunately limited. What is dangerous about these laws is they leave the impression that government can, by decree, alter the natural workings of the free market in such a way as to benefit the public. Sadly, many will conclude that since the free market does not work well during a disaster, or for poor borrowers, or other "special" situations, we shouldn't even have a free market at all.

Barrett Duke of the Southern Baptist Convention hinted as much, when he said that interest-rate caps should be in place "for everyone." However, price controls all have negative effects, and spreading them throughout the economy would just spread the negative effects, and do even more damage to the economy and our liberty.

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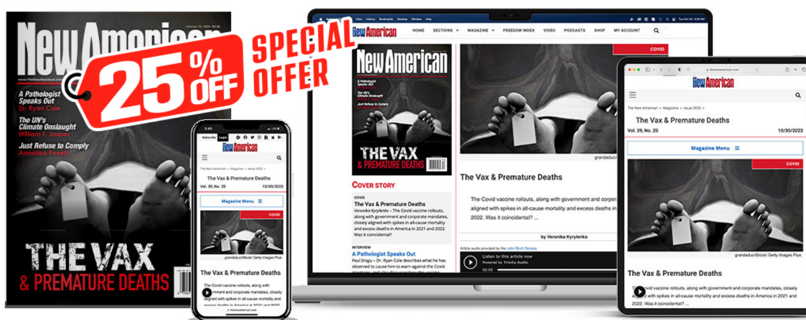

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