The Dangers of Price Controls

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Henry Hazlitt and Brian Wesbury

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*The First Issue of *Imprimis*—Updated for Today*

Editor's Note:

The first issue of Imprimis*, published in May 1972, featured an article titled "The Dangers of Price Controls" by Henry Hazlitt. The Federal Reserve back then was printing large amounts of money to fund massive government spending on Great Society programs launched during the presidency of Lyndon Johnson. As a result of printing so much money, the U.S. economy was suffering from rapid inflation. To address inflation, Federal Reserve Chair Arthur Burns and the Nixon administration dreamed up wage and price controls.*

Today we face a similar situation. The Federal Reserve has been printing a lot of money to fund the huge expansion in the size and scope of government that took place during and after the Covid pandemic. In response to the resulting inflation and the political unrest that comes with it, Vice President Harris and others are promising to outlaw "price gouging"—in other words, to impose price controls—which will eventually lead to wage controls as well, since production and prices involve both in an intimate way.

Because economic truth remains the same today as it was 52 years ago, we are reprinting Henry Hazlitt's article from 1972, but with edits and updates by Brian Wesbury that bring Hazlitt's classic piece into today's world.

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The first thing to be said about price and wage fixing is that it is harmful at any time and under any conditions. It is a giant step toward a dictated, regimented, and authoritarian economy. It makes impossible arrangements that both sides are willing to agree to. It sets aside contracts that have already been made in good faith. If an employer wishes to give a man a raise in pay, and the man deserves it, he is nonetheless forbidden to do it under the new regulations. This is a grave abridgment of individual liberty.

Price and wage fixing does harm even if there is no inflation. In a free economy prices are constantly changing. They are changing to reflect changes in supply and demand, in costs, and in a hundred other conditions. Some prices are going up, other prices are going down. If an effort is made to freeze prices and wages exactly where they are, it immediately disturbs the relationship of prices and comparative profit margins, which decides what things will be made and what quantities they will be made in. It upsets the process by which the free market decides how thousands of different commodities and services are to be made in the proportions in which people want them.

Of course, if we are in a period of inflation, price fixing does immensely *more* harm. It is never a cure for inflation. Rather it is an attempt to direct the blame away from government. What causes inflation is an increase in the supply of money and credit. This is often brought on, directly or indirectly, by government policies—especially when the Federal Reserve decides to print new money to fuel government deficits.

Since the onset of Covid, government deficits have soared to spectacular levels. Roughly $5 trillion of new debt was issued to pay people not to work and to buy vaccines, as well as to fund Green New Deal policies. The massive spending bills that accomplished this were cynically called the "CARES Act" and, comically, the "Inflation Reduction Act." Even in the past two years, with the pandemic over and the unemployment rate down near four percent, the government—in adopting what may be the most irresponsible budgets in U.S. history—has been running deficits as high as $2 trillion.

These deficits have mostly been financed by the Fed's creation of new money. At the end of 2019, demand bank deposits and currency in the hands of the public totaled $15.3 trillion. Today that figure is $21.1 trillion. That is an increase of 38 percent, most of which occurred in 2020–2021. This is the major cause of the worst U.S. inflation in over 40 years, with consumer prices up 22 percent.

Proposals to address this monetary inflation with price fixing, if carried out, will lead to shortages and a profit squeeze and will tend to distort and reduce production.

Sometimes people talk as if it would be possible to have universal price fixing. That is to say, the government would fix every wage, every price, and every cost. This is absolutely impossible. While nobody knows how many separate prices and wages there are, there are good reasons for thinking that there cannot be fewer than about ten million. If you try to fix ten million prices, what you are trying to fix is something on the order of 50 trillion cross-relationships of prices. This is something that no government is capable of determining—or policing. If government *could* police it, government would have to impose rationing and allocation of individual goods in order to keep prices where they were if it kept increasing the money supply. And even then, the whole project would be impossible for the simple reason that the government cannot control prices of imports. And it would not know how to pass these increases in import prices through the economy without creating disruptions and distortions.

In 1971, President Nixon announced what purported to be a complete freeze of both wages and prices for 90 days. But this freeze was purely rhetorical. There was not even an attempt to police it. To attempt to police price controls today would be a fool's errand. In fact, nobody can police the actions and decisions of millions of employers and sellers and of 158 million workers.

Likewise, a president today could *pretend* to control prices for a fixed period. But the trouble with controlling prices for a fixed period is that if you continue to increase the money supply—and if all the other factors are what they were—then at the end of that fixed period, prices will jump to where they would have been anyway. When the Nixon administration recognized this in 1971, it had to extend the wage and price controls in order to avoid criticism that the 90-day price control policy was pointless. The extension was called Phase Two.

Nobody knew when Phase Two would end. And for a very good reason. Giving a specific timeframe would have led to fears: “As soon as we stop this price fixing, prices will jump, won’t they?” So there’s a self-perpetuating gimmick in so-called temporary price fixing. Once you hold prices down by edict, you have to keep holding them down in order to prove that you are doing some good.

If, on the other hand, the money supply were kept down, prices would not tend to rise and the price fixing would not be at all necessary. Admittedly, this is a somewhat simplified explanation of the effects of changes in the money supply. There is usually a lag between increases in the supply of money and increases in prices. This may range from six months to a year. Everything depends on the special conditions that exist. Nevertheless, the important thing to remember is that changes in the money supply determine changes in the level of prices.

Nixon’s Phase One ostensibly froze every price and wage just where it was. Phase Two was supposed to be looser and more flexible to prevent hardships to individual producers. Therefore the control over prices and wages was placed in the hands of a group of boards that were allowed to use discretion. But discretion in the hands of bureaucrats is a dangerous thing. The members of these boards were not even officials of the American government. They were ostensibly private citizens, and to have groups of private citizens controlling what businesses can charge and what they can pay their workers raises serious legal and constitutional questions.

Who knows what bureaucratic nightmare would arise from an attempt to fix prices today. Even more than in the 1970s, bureaucrats today act as if they are omnipotent and untouchable. In the Nixon-era price control bureaucracy, unions held a great deal of power. In fact, George Meany, head of the AFL-CIO, made it clear early on that the unions would feel free to pay no attention to any ruling that wasn’t in their favor.

Back then, wages were allowed to rise 5.5 percent a year, while prices were supposedly capped at a 2.5 percent annual increase. I say “supposedly” because there were instances where this was immediately violated. For example, the Pay Board announced this 5.5 percent figure for wages on November 8, 1970. But eleven days later, on November 19, it ratified a wage increase in the coal industry that came to 16.8 percent in the first year. Then on December 9, it awarded railway signal men a 46 percent increase over forty-two months—an annual rate of 13 percent.

On the price side, American Motors and General Motors were granted 2.5 percent price increases, but Ford was granted a 2.9 percent increase and Chrysler a 4.5 percent increase. It is impossible to construe that as fair.

Can you imagine what these politically motivated decisions would look like today? Given that regulators are typically leftists, Disney Corporation, with its wholehearted commitment to diversity, equity, and inclusion, would likely be allowed larger increases, as would any company involved in green energy. But fossil fuel companies and any company controlled by Elon Musk would likely be held back. The corruption of such a system could be enormous, further undermining individual liberty and destroying the free market system in favor of centralized and politicized control.

In a free market system, wages tend to rise faster than prices over time. Why? Because workers become more productive. We often measure this in terms of so-called man-hour productivity. But there are two false assumptions that go into measuring it that way. One false assumption is that it is simply labor productivity; the other is that the increase occurs automatically. We would get a much better idea of what we are talking about if, instead of speaking of man-hour productivity, we spoke of man-machine-hour productivity or labor-capital productivity.

The increase in productivity doesn't occur because workers work three percent harder or better every year. It increases only because capital investment is increasing. If a man, for example, can mow a half an acre of lawn in an hour with a hand mower and his employer gets him a power mower, he can now mow an acre in an hour; then if his employer gets him a still bigger power mower and he can mow two acres in an hour, productivity has gone up fourfold. Suppose he then came around and asked for a fourfold increase in pay per hour? Well, first of all, the employer who bought the machine, if he had known in advance that his employee was going to demand this, wouldn't have bought the machine in the first place.

New investment goes on in industry, increasing man-hour productivity, only if there has been enough profit in the past to yield the added capital to make that investment, and only if the outlook for future profits and future return on new investment remains sufficiently attractive. But if labor gets the whole gain from every increase in productivity, and nothing is left for capital, then investment will stop and productivity increases will stop. This is a point that is quite often overlooked.

What the government ought to be doing to counter inflation and get prices low is to free and encourage the producers—not to put them in a straitjacket by fixing prices.

Price and wage fixing is always harmful. There is no right way of doing it. There is no right way of doing a wrong thing. There is no fair way of doing something that oughtn't be done at all.

We can't even define a fair price or a fair profit or a fair wage apart from the market or apart from the state of supply and demand. Instead of talking about "fair" prices, "fair" profits, and "fair" wages, we ought to be talking about functional wages, functional prices, and functional profits. Prices have work to do. What they do in effect is give the necessary signals to production. They direct production into the things that are most wanted socially, to provide a balance among the thousands of different commodities and services in the proportions that the consumers want them.

Price fixing destroys the signals on which this ever-changing balance depends. It always does harm. And it is never a cure for inflation.

Not only is price fixing never a cure for inflation, but in the long run it prolongs and increases inflation. Quack cures divert attention from real causes and real cures. The real cause of the inflation we have been experiencing has been the increase in the supply of money resulting from the Fed monetizing the enormous deficits we have been piling up.

Yet today, when the attention of Congress, the administration, and the media is focused on whether price fixing is a good idea or not, or whether price gouging is really happening, we are building up the greatest deficit in our peacetime history. We have also built up a massive money supply that threatens to intensify the problem. Under the auspices of "crisis management," the Federal Reserve has added 60 percent to the money supply and increased its balance sheet by 85 percent in just 16 years.

Yes, you read that right. The Federal Reserve was founded in 1913. In the 95 years between then and 2008, just 40 percent of the money supply was created. In the subsequent 16 years, between 2008 and 2024, we have almost *tripled* the money supply. No wonder inflation is a problem!

We'd like to say a final word about the morality of all this. We prefer not to make our own judgment, but rather to quote one of the price controllers back in the early 1970s. Mr. Earl D. Rhode, who was executive secretary of the Cost of Living Council, explained the key to enforcement: "The citizen's role in this program is to rat on his neighbor if his neighbor violated the controls." We leave the moral judgment of that to each of you.