PRICE CONTROLS

The record of price controls goes as far back as human history. They were imposed by the Pharaohs of ancient Egypt. They were decreed by Hammurabi, king of Babylon, in the eighteenth century B.C. They were tried in ancient Athens.

Henry Hazlitt[37]

Nothing makes us understand the many roles of electricity in our lives like a power failure. Similarly, nothing shows more vividly the role and importance of price fluctuations in a market economy than the ***absence*** of such price fluctuations when the market is controlled. What happens when prices are not allowed to fluctuate freely according to supply and demand, but instead their fluctuations are fixed within limits set by law under various kinds of price controls?

Typically, price controls are imposed in order to keep prices from rising to the levels that they would reach in response to supply and demand. The political rationales for such laws have varied from place to place and from time to time, but there is seldom a lack of rationales whenever it becomes politically expedient to hold down some people's prices in the interest of other people whose political support seems more important.

To understand the effects of price control, it is first necessary to understand how prices rise and fall in a free market. There is nothing esoteric about it, but it is important to be very clear about what happens. Prices rise because the amount demanded exceeds the amount supplied ***at existing prices***. Prices fall because the amount supplied exceeds the amount demanded ***at existing prices***. The first case is called a "shortage" and the second is called a "surplus"—but both depend on ***existing prices***. Simple as this might seem, it is often misunderstood, sometimes with disastrous consequences.

PRICE "CEILINGS" AND SHORTAGES

When there is a "shortage" of a product, there is not necessarily any less of it, either absolutely or relative to the number of consumers. During and immediately after the Second World War, for example, there was a very serious housing shortage in the United States, even though the country's population and its housing supply had both increased by about 10 percent from their prewar levels—and there was no shortage when the war began.[38] In other words, even though the ratio between housing and people had not changed, nevertheless many Americans looking for an apartment during this period had to spend weeks or months in an often futile search for a place to live, or else resorted to bribes to get landlords to move them to the top of waiting lists. Meanwhile, they doubled up with relatives, slept in garages or used other makeshift living arrangements, such as buying military surplus Quonset huts or old trolley cars to live in.

Although there was no less housing space per person than before the war, the shortage was very real and very painful ***at existing prices***, which were kept artificially lower than they would have been, because of rent control laws that had been passed during the war. At these artificially low prices, more people had a demand for more housing space than before rent control laws were enacted. This is a practical consequence of the simple economic principle already noted in Chapter 2, that the quantity demanded varies according to how high or how low the price is.

When some people used more housing than usual, other people found less housing available. The same thing happens under other forms of price control: Some people use the price-controlled goods or services more generously than usual because of the artificially lower price and, as a result, other people find that less than usual remains available for them. There are other consequences to price controls in general, and rent control provides examples of these as well.

Demand under Rent Control

Some people who would normally not be renting their own apartments, such as young adults still living with their parents or some single or widowed elderly people living with relatives, were enabled by the artificially low prices created by rent control to move out and into their own apartments. These artificially low prices also caused others to seek larger apartments than they would ordinarily be living in or to live alone when they would otherwise have to share an apartment with a roommate, in order to be able to afford the rent.

Some people who do not even live in the same city as their rent-controlled apartment nevertheless keep it as a place to stay when they are visiting the city—Hollywood movie stars who keep rent-controlled apartments in New York or a couple living in Hawaii who kept a rent-controlled residence in San Francisco,[39] for example. More tenants seeking both more apartments and larger apartments create a shortage, even when there is not any greater physical scarcity of housing relative to the total population.

When rent control ended after World War II, the housing shortage quickly disappeared. After rents rose in a free market, some childless couples living in four-bedroom apartments could decide that they would live in two-bedroom apartments and save the difference in rent. Some late teenagers could decide that they would continue living with their parents a little longer, until their pay rose enough for them to be able to afford their own apartment, now that rent was no longer artificially cheap. The net result was that families looking for a place to stay found more places available, now that rent-control laws were no longer keeping such places occupied by people with less urgent requirements. In other words, the housing shortage immediately eased, even before there was time for new housing to be built, in response to market conditions that now made it possible to recover the cost of building more housing and earn a profit.

Just as price fluctuations allocate scarce resources which have alternative uses, price controls which limit those fluctuations reduce the incentives for individuals to limit their own use of scarce resources desired by others. Rent control, for example, tends to lead to many apartments being occupied by just one person. A study in San

Francisco showed that 49 percent of that city's rent-controlled apartments had only a single occupant,[40] while a severe housing shortage in the city had thousands of people living considerable distances away and making long commutes to their jobs in San Francisco. Meanwhile, a Census report showed likewise that 46 percent of all households in Manhattan, where nearly half of all apartments are under some form of rent control, are occupied by only one person—compared to 27 percent nationwide.[41]

In the normal course of events, people's demand for housing space changes over a lifetime. Their demand for space usually increases when they get married and have children. But, years later, after the children have grown up and moved away, the parents' demand for space may decline, and it often declines yet again after a spouse dies and the widow or widower moves into smaller quarters or goes to live with relatives or in an institution for the elderly. In this way, a society's total stock of housing is shared and circulated among people according to their changing individual demands at different stages of their lives.

This sharing takes place, not because the individuals themselves have a sense of cooperation, but because of the prices—rents in this case—which confront them. In a free market, these prices are based on the value that other tenants put on housing. Young couples with a growing family are often willing to bid more for housing, even if that means buying fewer consumer goods and services, in order to have enough money to pay for additional housing space. A couple who begin to have children may cut back on how often they go out to restaurants or to movies, or they may wait longer to buy new clothes or a new car, in order that each child may have his or her own bedroom.

But, once the children are grown and gone, such sacrifices may no longer make sense, when additional other amenities can now be enjoyed by reducing the amount of housing space being rented.

Given the crucial role of prices in this process, suppression of that process by rent control laws leaves few incentives for tenants to change their behavior as their circumstances change. Elderly people, for example, have less incentive to vacate apartments that they would normally vacate when their children are gone, or after a spouse dies, if that would result in a significant reduction in rent, leaving them more money with which to improve their living standards in other respects. Moreover, the chronic housing shortages which accompany rent control greatly increase the time and effort required to search for a new and smaller apartment, while reducing the financial reward for finding one. In short, rent control reduces the rate of housing turnover.

New York City has had rent control longer and more stringently than any other major American city. One consequence has been that the annual rate of turnover of apartments in New York is less than half the national average, and the proportion of tenants who have lived in the same apartment for 20 years or more is more than double the national average.{42} As the ***New York Times*** summarized the situation:

> New York used to be like other cities, a place where tenants moved frequently and landlords competed to rent empty apartments to newcomers, but today the motto may as well be: No Immigrants Need Apply. While immigrants are crowded into bunks in illegal boarding houses in the slums, upper-middle-class locals pay low rents to live in good neighborhoods, often in large apartments they no longer need after their children move out.{43}

Supply under Rent Control

Rent control has effects on supply as well as on demand. Nine years after the end of World War II, not a single new apartment building had been built in Melbourne, Australia, because of rent control laws there which made such buildings unprofitable.{44} In Egypt, rent control was imposed in 1960. An Egyptian woman who lived through that era and wrote about it in 2006 reported:

> The end result was that people stopped investing in apartment buildings, and a huge shortage in rentals and housing forced many Egyptians to live in horrible conditions with several families sharing one small apartment. The effects of the harsh rent control is still felt today in Egypt. Mistakes like that can last for generations.{45}

Declines in building construction have likewise followed in the wake of rent control laws elsewhere. After rent control was instituted in Santa Monica, California in 1979, building permits declined to less than one-tenth of what they were just five years earlier.{46} A housing study in San Francisco found that three quarters of its rent-controlled housing was more than half a century old and 44 percent of it was more than 70 years old.{47}

Although the construction of office buildings, factories, warehouses, and other commercial and industrial buildings requires much of the same kind of labor and materials used to construct apartment buildings, it is not uncommon for many new office buildings to be constructed in cities where very few new apartment buildings are built. Rent control laws often do not apply to industrial or commercial buildings. Thus, even in cities with severe housing shortages, there may be much vacant space in commercial and industrial buildings. Despite a severe housing shortage in New York, San Francisco, and other cities with rent control, a nationwide survey in 2003 found the vacancy rates in buildings used by business and industry to be nearly 12 percent, the highest in more than two decades.[48]

This is just one more piece of evidence that housing shortages are a price phenomenon. High vacancy rates in commercial buildings show that there are obviously ample resources available to construct buildings, but rent control keeps those resources from being used to construct apartments, and thereby diverts these resources into constructing office buildings, industrial plants, and other commercial properties.

Not only is the supply of new apartment construction less after rent control laws are imposed, even the supply of existing housing tends to decline, as landlords provide less maintenance and repair under rent control, since the housing shortage makes it unnecessary for them to maintain the appearance of their premises in order to attract tenants. Thus housing tends to deteriorate faster under rent control and to have fewer replacements when it wears out. Studies of rent control in the United States, England, and France have found rent-controlled housing to be deteriorated far more often than non-rent-controlled housing.

Typically, the rental housing stock is relatively fixed in the short run, so that a shortage occurs first because more people want more housing at the artificially low price. Later, there may be a real increase in scarcity as well, as rental units deteriorate more rapidly with reduced maintenance, while not enough new units are being built to replace them as they wear out, because new privately built housing can be unprofitable under rent control. Under rent control in England and

Wales, for example, privately-built rental housing fell from being 61 percent of all housing in 1947 to being just 14 percent by 1977.[49] A study of rent control in various countries concluded: "New investment in private unsubsidized rented housing is essentially nonexistent in all the European countries surveyed, except for luxury housing."[50]

In short, a policy intended to make housing affordable for the poor has had the net effect of shifting resources toward the building of housing that is affordable only by the affluent or the rich, since luxury housing is often exempt from rent control, just as office buildings and other commercial properties are. Among other things, this illustrates the crucial importance of making a distinction between intentions and consequences. Economic policies need to be analyzed in terms of the incentives they create, rather than the hopes that inspired them.

The incentives towards a reduced supply of housing under rent control are especially pronounced when people who have been renting out rooms or apartments in their own homes, or bungalows in their back yards, decide that it is no longer worth the bother, when rents are kept artificially low under rent control laws. In addition, there are often conversions of apartments to condominiums. During 8 years of rent control in Washington during the 1970s, that city's available rental housing stock declined absolutely, from just over 199,000 units on the market to just under 176,000 units.[51] After rent control was introduced in Berkeley, California, the number of private rental housing units available to students at the university there declined by 31 percent in five years.[52]

None of this should be surprising, given the incentives created by rent control laws. In terms of incentives, it is likewise easy to understand what happened in England when rent control was extended in 1975 to cover furnished rental units. According to ***The Times*** of London:

> Advertisements for furnished rented accommodation in the London ***Evening Standard*** plummeted dramatically in the first week after the Act came into force and are now running at about 75 per cent below last year's levels.[53]

Since furnished rooms are often in people's homes, these represent housing units that are easily withdrawn from the market when the rents no longer compensate for the inconveniences of having renters living with you. The same principle applies where there are small apartment buildings like duplexes, where the owner is also one of the tenants. Within three years after rent control was imposed in Toronto in 1976, 23 percent of all rental units in owner-occupied dwellings were withdrawn from the housing market.[54]

Even when rent control applies to apartment buildings where the landlord does not live, eventually the point may be reached where the whole building becomes sufficiently unprofitable that it is simply abandoned. In New York City, for example, many buildings have been abandoned after their owners found it impossible to collect enough rent to cover the costs of services that they are required by law to provide, such as heat and hot water. Such owners have simply disappeared, in order to escape the legal consequences of their abandonment, and such buildings often end up vacant and boarded up, though still physically sound enough to house people, if they continued to be maintained and repaired.

The number of abandoned buildings taken over by the New York City government over the years runs into the thousands.[55] It has been estimated that there are at least four times as many abandoned housing units in New York City as there are homeless people living on the streets there.[56] Homelessness is not due to a physical scarcity of housing, but to a price-related shortage, which is painfully real nonetheless. As of 2013, there were more than 47,000 homeless people in New York City, 20,000 of them children.[57]

Such inefficiency in the allocation of resources means that people are sleeping outdoors on the pavement on cold winter nights—some dying of exposure—while the means of housing them already exist, but are not being used because of laws designed to make housing "affordable." Once again, this demonstrates that the efficient or inefficient allocation of scarce resources is not just some abstract notion of economists, but has very real consequences, which can even include matters of life and death. It also illustrates that the goal of a law —"affordable housing," in this case—tells us nothing about its actual consequences.

The Politics of Rent Control

Politically, rent control is often a big success, however many serious economic and social problems it creates. Politicians know that there are always more tenants than landlords and more people who do not understand economics than people who do. That makes rent control laws something likely to lead to a net increase in votes for politicians who pass rent control laws.

Often it is politically effective to represent rent control as a way to keep greedy rich landlords from "gouging" the poor with "unconscionable" rents. In reality, rates of return on investments in housing are seldom higher than on alternative investments, and landlords are often people of very modest means. This is especially so for owners of small, low-end apartment buildings that are in constant need of repair, the kinds of places where tenants are likely to be low-income people. Many of the landlords with buildings like this are handymen who use their own skills and labor as carpenters or plumbers to repair and maintain the premises, while trying to pay off the mortgage with the rents they collect. In short, the kind of housing likely to be rented by the poor often has owners who are by no means rich.[v]

Where rent control laws apply on a blanket basis to all housing in existence as of the time the law goes into effect, even luxurious housing becomes low-rent housing. Then, after the passage of time makes clear that no new housing is likely to be built unless it is exempted from rent control, such exemptions or relaxations of rent control for new housing mean that even new apartments that are very modest in size and quality may rent for far more than older, more spacious and more luxurious apartments that are still under rent control. This non-comparability of rents has been common in European cities under rent control, as well as in New York and other American cities. Similar incentives produce similar results in many different settings. A news story in the ***Wall Street Journal*** pointed up this non-comparability of rents under New York City's rent control laws:

> Les Katz, a 27-year-old acting student and doorman, rents a small studio apartment on Manhattan's Upper West Side for $1,200—with two roommates. Two sleep in separate beds in a loft built atop the kitchen, the third on a mattress in the main room.
>
> Across town on Park Avenue, Paul Haberman, a private investor, and his wife live in a spacious, two-bedroom apartment with a solarium and two terraces. The apartment in an elegant building on the prestigious avenue is worth at least $5,000 a month, real-estate professionals say. The couple pay around $350, according to rent records.[58]

This example of cheap rent for the affluent or the wealthy under rent control was by no means unique. Ironically, a statistical study indicated that the biggest difference between prices under New York's rent control law and free-market prices is in luxury apartments.[59] In other words, the affluent and the wealthy get more economic benefit from rent control than do the poor who are invoked to justify such laws. Meanwhile, city welfare agencies have paid much higher rents than those just mentioned when they housed poverty-stricken families in cramped and roach-infested apartments in run-down hotels. In 2013, the ***New York Times*** reported that the city's Department of Homeless Services was "spending over $3,000 a month for each threadbare room without a bathroom or kitchen" in a single room occupancy hotel—half of that money going to the landlord for rent and the other half for "security and social services for homeless tenants."[60]

The image that rent control protects poor tenants from rich landlords may be politically effective, but often it bears little resemblance to the reality. The people who actually benefit from rent control can be at any income level and so can those who lose out. It depends on who happens to be on the inside looking out, and who happens to be on the outside looking in, when such laws are passed.

San Francisco's rent control laws are not as old as those in New York City but they are similarly severe—and have produced very similar results. A study published in 2001 showed that more than one-fourth of the occupants of rent-controlled apartments in San Francisco had household incomes of more than $100,000 a year.[61] It should also be noted that this was the first empirical study of rent control commissioned by the city of San Francisco. Since rent control began there in 1979, this means that for more than two decades these laws were enforced and extended, with no serious attempt being made to measure their actual economic and social consequences, as distinguished from their political popularity.

Ironically, cities with strong rent control laws, such as New York and San Francisco, tend to end up with ***higher*** average rents than cities without rent control.[62] Where such laws apply only to rents below some specified level, presumably to protect the poor, builders then have incentives to build only apartments luxurious enough to be priced above the rent-control level. Not surprisingly, this leads to higher average rents, and homelessness tends to be greater in cities with rent control—New York and San Francisco again being classic examples.

One of the reasons for the political success of rent control laws is that many people accept words as indicators of reality. They believe that rent control laws actually control rents. So long as they believe that, such laws are politically viable, as are other laws that proclaim some apparently desirable goals, whether those goals end up being served or not.

Scarcity versus Shortage

One of the crucial distinctions to keep in mind is the distinction between an increased scarcity—where fewer goods are available relative to the population—and a "shortage" as a ***price*** phenomenon. Just as there can be a growing shortage without an increased scarcity, so there can be a growing scarcity without a shortage.

As already noted, there was a severe housing shortage in the United States during and immediately after the Second World War, even though the ratio of housing to people was the same as it had been before the war, when there was no housing shortage. It is also possible to have the opposite situation, where the actual amount of housing suddenly declines in a given area without any price control—and without any shortage. This happened in the wake of the great San Francisco earthquake and fire of 1906. More than half the city's housing supply was destroyed in just three days during that catastrophe. Yet there was no housing shortage. When the ***San Francisco Chronicle*** resumed publication a month after the earthquake, its first issue contained 64 advertisements of apartments or homes for rent, compared to only 5 ads from people seeking apartments to live in.

Of the 200,000 people suddenly made homeless by the earthquake and fire, temporary shelters housed 30,000 and an estimated 75,000 left the city.{63} Still, that left nearly 100,000 people to be absorbed into the local housing market. Yet the newspapers of that time mention no housing shortage. Rising prices not only allocate existing housing, they provide incentives for rebuilding and for renters to use less space in the meantime, as well as incentives for those with space in their homes to take in roomers while rents are high. In short, just as there can be a shortage without any greater physical scarcity, so there can be a greater physical scarcity without any shortage. People made homeless by the huge 1906 San Francisco earthquake found housing more readily than people made homeless by New York's rent control laws that took thousands of buildings off the market.

Hoarding

In addition to shortages and quality deterioration under price controls, there is often hoarding—that is, individuals keeping a larger inventory of the price-controlled goods than they would ordinarily under free market conditions, because of the uncertainty of being able to find it in the future. Thus, during the gasoline shortages of the 1970s, motorists were less likely to let their gas tanks get down as low as usual before going to a filling station to buy more gas.

Some motorists with their tanks half full would drive into any filling station that happened to have gas, and fill up the other half, as a precaution. With millions of motorists driving around with their gas tanks more full than usual, vast amounts of gasoline disappeared into individual inventories, leaving less available for sale from the general inventory at filling stations. Thus a relatively small shortage of gasoline nationally could turn into a very serious problem for those motorists who happened to run out of gas and had to look for a filling station that was open and had gas to sell. The sudden severity of the gasoline shortage—given how little difference there was in the total amount of gasoline produced—baffled many people and produced various conspiracy theories.

One of these conspiracy theories was that oil companies had their tankers from the Middle East circling around in the ocean, waiting for a price increase before coming ashore with their cargoes. Although none of these conspiracy theories stood up under scrutiny, there was a kernel of sense behind them, as there usually is behind most fallacies. A severe shortage of gasoline with very little difference in the total amount of gasoline produced meant that there had to be a large amount of gasoline being diverted somewhere. Few of those who created or believed conspiracy theories suspected that the excess was being stored in their own gas tanks, rather than in oil tankers circling in the ocean. This increased the severity of the gasoline shortage because maintaining millions of larger individual inventories of gasoline in cars and trucks was less efficient than maintaining general inventories in filling stations' storage tanks.

The feasibility of hoarding varies with different goods, so the effect of price controls also varies. For example, price controls on strawberries might lead to less of a shortage than price controls on gasoline, since strawberries are too perishable to be hoarded for long. Price controls on haircuts or other services may also create less of a shortage because services cannot be hoarded. That is, you would not get two haircuts on the same day if you found a barber with time available, in order to go twice as long before the next haircut, even though barbers might be less available when the price of haircuts was kept down by price controls.

Nevertheless, some unlikely things do get hoarded under price controls. For example, under rent control, people may keep an apartment that they seldom use, as some Hollywood stars have kept rent-controlled apartments in Manhattan where they would stay when visiting New York.[64] Mayor Ed Koch kept his rent-controlled apartment during the entire 12 years when he lived in Gracie Mansion, the official residence of New York's mayor.[65] In 2008, it was revealed that New York Congressman Charles Rangel had four rent-controlled apartments, one of which he used as an office.[66]

Hoarding is a special case of the more general economic principle that more is demanded at a lower price and of the corollary that price controls allow lower priority uses to preempt higher priority uses, increasing the severity of the shortages, whether of apartments or of gasoline.

Sometimes the reduction in supply under price controls takes forms that are less obvious. Under World War II price controls, ***Consumer Reports*** magazine found that 19 out of 20 candy bars that it tested in 1943 were smaller in size than they had been four years earlier.[67] Some producers of canned foods let the quality deteriorate, but then sold these lower quality foods under a different label, in order to preserve the reputation of their regular brand.

Black Markets

While price controls make it illegal for buyer and seller to make some transactions on terms that they would both prefer to the shortages that price controls entail, bolder and less scrupulous buyers and sellers make mutually advantageous transactions outside the law. Price controls almost invariably produce black markets, where prices are not only higher than the legally permitted prices, but also higher than they would be in a free market, since the legal risks must also be compensated. While small-scale black markets may function in secrecy, large-scale black markets usually require bribes to officials to look the other way. In Russia, for example, a local embargo on the shipment of price-controlled food beyond regional boundaries was dubbed the "150-ruble decree," since this was the cost of bribing police to let the shipments pass through checkpoints.[68]

Even during the early Soviet period, when operating a black market in food was punishable by death, black markets still existed. As two Soviet economists of a later era put it: "Even at the height of War Communism, speculators and food smugglers at the risk of their lives brought as much grain into the cities as all the state purchases made under ***prodrazverstka***."[69]

Statistics on black market activity are by nature elusive, since no one wants to let the whole world know that they are violating the law. However, sometimes there are indirect indications. Under American wartime price controls during and immediately after the Second World War, employment in meat-packing plants declined as meat was diverted from legitimate packing houses into black markets. This often translated into empty meat counters in butcher shops and grocery stores.[vi]

As in other cases, however, this was not due simply to an actual physical scarcity of meat but to its diversion into illegal channels. Within one month after price controls were ended, employment in meat-packing plants rose from 93,000 to 163,000 and then rose again to 180,000 over the next two months.[70] This nearly doubling of employment in meat-packing plants in just three months indicated that meat was clearly no longer being diverted from the packing houses after price controls were ended.

In the Soviet Union, where price controls were more pervasive and longer lasting, two Soviet economists wrote of a "gray market" where people paid "additional money for goods and services." Although these illegal transactions "are not taken into account by official statistics," the Soviet economists estimated that 83 percent of the population used these forbidden economic channels. These illegal markets covered a wide range of transactions, including "almost half of the repair of apartments," 40 percent of automobile repairs and more video sales than in the legal markets: "The black market trades almost 10,000 video titles, while the state market offers fewer than 1,000."[71]

Quality Deterioration

One of the reasons for the political success of price controls is that part of their costs are concealed. Even the visible shortages do not tell the whole story. ***Quality*** deterioration, such as already noted in the case of housing, has been common with many other products and services whose prices have been kept artificially low by government fiat.

One of the fundamental problems of price control is defining just what it is whose price is being controlled. Even something as simple as an apple is not easy to define because apples differ in size, freshness, and appearance, quite aside from the different varieties of apples. Produce stores and supermarkets spend time (and hence money) sorting out different kinds and qualities of apples, throwing away those that fall below a certain quality that their respective customers expect. Under price control, however, the amount of apples demanded at an artificially low price exceeds the amount supplied, so there is no need to spend so much time and money sorting out apples, as they will all be sold anyway. Some apples that would ordinarily be thrown away under free market conditions may, under price control, be kept for sale to those people who arrive after all the good apples have been sold.

As with apartments under rent control, there is less incentive to maintain high quality when everything will sell anyway during a shortage.

Some of the most painful examples of quality deterioration have occurred in countries where there are price controls on medical care.[72] At artificially low prices, more people go to doctors' offices with minor ailments like sniffles or skin rashes that they might otherwise ignore, or else might treat with over-the-counter medications, perhaps with a pharmacist's advice. But all this changes when price controls reduce the cost of visits to the doctor's office, and especially when these visits are paid for by the government and are therefore free to the patient.

In short, more people make more claims on doctors' time under price control, leaving less time for other people with more serious, or even urgent, medical problems. Thus, under Britain's government-controlled medical system, a twelve-year-old girl was given a breast implant while 10,000 people waited 15 months or more for surgery.[73] A woman with cancer had her operation postponed so many times that the malignancy eventually became inoperable.[74] The priorities which prices automatically cause individuals to consider are among the first casualties of price controls.

A study conducted by the international agency Organisation for Economic Co-operation and Development found that, among five English-speaking countries surveyed, only in the United States was the percentage of patients waiting for elective surgery for more than four months in single digits. All the other English-speaking countries—Australia, Canada, New Zealand, and the United Kingdom—had more than 20 percent of their patients waiting more than four months, with 38 percent of those in the United Kingdom waiting at least that long. In this group, the United States was the only country without government-set prices for medical treatment. Incidentally, the term "elective surgery" was not confined to cosmetic surgery or other medically unnecessary procedures, but in this study included cataract surgery, hip replacement and coronary bypass surgery.[75]

Delayed medical treatment is one aspect of quality deterioration when prices are set below the levels that would prevail under supply and demand. The quality of the treatment received is also affected when doctors spend less time per patient. In countries around the world, the amount of time that physicians spend per patient visit has been shorter under government-controlled medical care prices, compared to the time spent by physicians where prices are not controlled.

Black markets are another common feature of price controls that apply to medical care as to other things. In China and Japan, black markets have taken the form of bribes to doctors to get expedited treatment. In short, whether the product or service has been housing, apples, or medical care, quality deterioration under price control has been common in the most disparate settings.

PRICE "FLOORS" AND SURPLUSES

Just as a price set below the level that would prevail by supply and demand in a free market tends to cause more to be demanded and less to be supplied, creating a shortage at the imposed price, so a price set ***above*** the free market level tends to cause more to be supplied than demanded, creating a surplus.

Among the tragedies of the Great Depression of the 1930s was the fact that many American farmers simply could not make enough money from the sale of their crops to pay their bills. The prices of farm products fell much more drastically than the prices of the things that farmers bought. Farm income fell from just over $6 billion in 1929 to $2 billion in 1932.[76]

As many farmers lost their farms because they could no longer pay the mortgages, and as other farm families suffered privations as they struggled to hang on to their farms and their traditional way of life, the federal government sought to restore what was called “parity” between agriculture and other sectors of the economy by intervening to keep farm prices from falling so sharply.

This intervention took various forms. One approach was to reduce by law the amount of various crops that could be grown and sold, so as to prevent the supply from driving the price below the level that government officials had decided upon. Thus, supplies of peanuts and cotton were restricted by law. Supplies of citrus fruit, nuts and various other farm products were regulated by local cartels of farmers, backed up by the authority of the Secretary of Agriculture to issue “marketing orders” and prosecute those who violated these orders by producing and selling more than they were authorized to produce and sell. Such arrangements continued for decades after the poverty of the Great Depression was replaced by the prosperity of the economic boom following World War II, and many of these restrictions continue to this day.

These indirect methods of keeping prices artificially high were only part of the story. The key factor in keeping farm prices artificially higher than they would have been under free market supply and demand was the government’s willingness to buy up the surpluses created by its control of prices. This they did for such farm products as corn, rice, tobacco, and wheat, among others—and many of these programs continue on to the present as well. Regardless of what group was initially supposed to be helped by these programs, the very existence of such programs benefitted others as well, and these new beneficiaries made it politically difficult to end such programs, even long after the initial conditions had changed and the initial beneficiaries were now a small part of the constituency politically organized and determined to keep these programs going.[vii]

Price control in the form of a "floor" under prices, preventing these prices from falling further, produced surpluses as dramatic as the shortages produced by price control in the form of a "ceiling" preventing prices from rising higher. In some years, the federal government bought more than one-fourth of all the wheat grown in the United States and took it off the market, in order to maintain prices at a pre-determined level.

During the Great Depression of the 1930s, agricultural price support programs led to vast amounts of food being deliberately destroyed, at a time when malnutrition was a serious problem in the United States and hunger marches were taking place in cities across the country. For example, the federal government bought 6 million hogs in 1933 alone and destroyed them.[77] Huge amounts of farm produce were plowed under, in order to keep it off the market and maintain prices at the officially fixed level, while vast amounts of milk were poured down the sewers for the same reason. Meanwhile, many American children were suffering from diseases caused by malnutrition.

Still, there was a food surplus. A surplus, like a shortage, is a ***price*** phenomenon. A surplus does not mean that there is some excess relative to the people. There was not "too much" food relative to the population during the Great Depression. The people simply did not have enough money to buy everything that was produced at the artificially high prices set by the government. A very similar situation existed in poverty-stricken India at the beginning of the twenty-first century, where there was a surplus of wheat and rice under government price supports. The ***Far Eastern Economic Review*** reported:

> India's public stock of food grains is at an all-time high, and next spring, it will grow still further to a whopping 80 million tonnes, or four times the amount necessary in case of a national emergency. Yet while that wheat and rice sits idle—in some cases for years, to the point of rotting—millions of Indians don't have enough to eat.{78}

A report from India in the ***New York Times*** told a very similar story under the headline, "Poor in India Starve as Surplus Wheat Rots":

> Surplus from this year's wheat harvest, bought by the government from farmers, sits moldering in muddy fields here in Punjab State. Some of the previous year's wheat surplus sits untouched, too, and the year's before that, and the year's before that.
>
> To the south, in the neighboring state of Rajasthan, villagers ate boiled leaves or discs of bread made from grass seeds in late summer and autumn because they could not afford to buy wheat. One by one, children and adults—as many as 47 in all—wilted away from hunger-related causes, often clutching pained stomachs.{79}

A surplus or "glut" of food in India, where malnutrition is still a serious problem, might seem like a contradiction in terms. But food surpluses under "floor" prices are just as real as the housing shortages under "ceiling" prices. In the United States, the vast amount of storage space required to keep surplus crops off the market once led to such desperate expedients as storing these farm products in unused warships, when all the storage facilities on land had been filled to capacity. Otherwise, American wheat would have had to be left outside to rot, as in India.

A series of bumper crops in the United States could lead to the federal government's having more wheat in storage than was grown by American farmers all year. In India, it was reported in 2002 that the Indian government was spending more on storage of its surplus produce than on rural development, irrigation and flood control combined.[80] It was a classic example of a ***misallocation*** of scare resources which have alternative uses, especially in a poor country.

So long as the market price of the agricultural product covered by price controls stays above the level at which the government is legally obligated to buy it, the product is sold in the market at a price determined by supply and demand. But, when there is either a sufficient increase in the amount supplied or a sufficient reduction in the amount demanded, the resulting lower price can fall to a level at which the government buys what the market is unwilling to buy. For example, when powdered milk was selling in the United States for about $2.20 a pound in 2007, it was sold in the market but, when the price fell to 80 cents a pound in 2008, the U.S. Department of Agriculture found itself legally obligated to buy about 112 million pounds of powdered milk at a total cost exceeding $90 million.[81]

None of this is peculiar to the United States or to India. The countries of the European Union spent $39 billion in direct subsidies in 2002 and their consumers spent twice as much as that in the inflated food prices created by these agricultural programs.[82] Meanwhile, the surplus food has been sold below cost on the world market, driving down the prices that Third World farmers could get for their produce. In all these countries, not only the government but also the consumers are paying for agricultural price-support programs—the government directly in payments to farmers and storage companies, and the consumers in inflated food prices. As of 2001, American consumers were paying $1.9 billion a year in artificially higher prices, just for products containing sugar, while the government was paying $1.4 million per ***month*** just to store the surplus sugar. Meanwhile, the ***New York Times*** reported that sugar producers were "big donors to both Republicans and Democrats" and that the costly sugar price support program had "bipartisan support."[83]

Sugar producers are even more heavily subsidized in the European Union countries than in the United States, and the price of sugar in these countries is among the highest in the world. In 2009, the ***New York Times*** reported that sugar subsidies in the European Union were "so lavish it even prompted cold-weather Finland to start producing more sugar,"[84] even though sugar can be produced from cane grown in the tropics for much lower costs than from sugar beets grown in Europe.

In 2002, the U.S. Congress passed a farm subsidy bill that was estimated to cost the average American family more than $4,000 over the following decade in taxes and inflated food prices.[85] Nor was this a new development. During the mid-1980s, when the price of sugar on the world market was four cents a pound, the wholesale price within the United States was 20 cents a pound.[86] The government was subsidizing the production of something that Americans could have gotten cheaper by not producing it at all, and buying it from countries in the tropics. This has been true of sugar for decades. Moreover, sugar is not unique in this respect, nor is the United States. In the nations of the European Union, the prices of lamb, butter, and sugar are all more than twice as high as their world market prices.[87] As a writer for the ***Wall Street Journal*** put it, every cow in the European Union gets more subsidies per day than most sub-Saharan Africans have to live on.[88]

Although the original rationale for the American price-support programs was to save family farms, in practice more of the money went to big agricultural corporations, some of which received millions of dollars each, while the average farm received only a few hundred dollars. Most of the money from the 2002 bipartisan farm bill will likewise go to the wealthiest 10 percent of farmers—including David Rockefeller, Ted Turner, and a dozen companies on the ***Fortune*** 500 list. {89} In Mexico as well, 85 percent of agricultural subsidies go to the largest 15 percent of farmers.{90}

What is crucial from the standpoint of understanding the role of prices in the economy is that persistent surpluses are as much a result of keeping prices artificially high as persistent shortages are of keeping prices artificially low. Nor were the losses simply the sums of money extracted from the taxpayers or the consumers for the benefit of agricultural corporations and farmers. These are internal transfers within a nation, which do not directly reduce the total wealth of the country. The real losses to the country as a whole come from the misallocation of scarce resources which have alternative uses.

Scarce resources such as land, labor, fertilizer, and machinery are needlessly used to produce more food than the consumers are willing to consume at the artificially high prices decreed by the government. All the vast resources used to produce sugar in the United States are wasted when sugar can be imported from countries in the tropics, where it is produced much more cheaply in a natural environment more conducive to its growth. Poor people, who spend an especially high percentage of their income on food, are forced to pay far more than necessary to get the amount of food they receive, leaving them with less money for other things. Those on food stamps are able to buy less food with those stamps when food prices are artificially inflated.

From a purely economic standpoint, it is working at cross purposes to subsidize farmers by forcing food prices up and then subsidize some consumers by bringing down their particular costs of food with subsidies—as is done in both India and the United States. However, from a political standpoint, it makes perfect sense to gain the support of two different sets of voters, especially since most of them do not understand the full economic implications of the policies.

Even when agricultural subsidies and price controls originated during hard times as a humanitarian measure, they have persisted long past those times because they developed an organized constituency which threatened to create political trouble if these subsidies and controls were removed or even reduced. Farmers have blocked the streets of Paris with their farm machinery when the French government showed signs of scaling back its agricultural programs or allowing more foreign farm produce to be imported. In Canada, farmers protesting low wheat prices blocked highways and formed a motorcade of tractors to the capital city of Ottawa.

While only about one-tenth of farm income in the United States comes from government subsidies, about half of farm income in South Korea comes from such subsidies, as does 60 percent in Norway.[91]

THE POLITICS OF PRICE CONTROLS

Simple as basic economic principles may be, their ramifications can be quite complex, as we have seen with the various effects of rent control laws and agricultural price support laws. However, even this basic level of economics is seldom understood by the public, which often demands political “solutions” that turn out to make matters worse. Nor is this a new phenomenon of modern times in democratic countries.

When a Spanish blockade in the sixteenth century tried to starve Spain’s rebellious subjects in Antwerp into surrender, the resulting high prices of food within Antwerp caused others to smuggle food into the city, even through the blockade, enabling the inhabitants to continue to hold out. However, the authorities within Antwerp decided to solve the problem of high food prices by laws fixing the maximum price to be allowed to be charged for given food items and providing severe penalties for anyone violating those laws.

There followed the classic consequences of price control—a larger consumption of the artificially lower-priced goods and a reduction in the supply of such goods, since suppliers were less willing to run the risk of sending food through the Spanish blockade without the additional incentive of higher prices. Therefore, the net effect of price control was that “the city lived in high spirits until all at once provisions gave out” and Antwerp had no choice but to surrender to the Spaniards.[92]

Halfway around the world, in eighteenth-century India, a local famine in Bengal brought a government crackdown on food dealers and speculators, imposing price controls on rice. Here the resulting shortages led to widespread deaths by starvation. However, when another famine struck India in the nineteenth century, now under the colonial rule of British officials and during the heyday of free market economics, opposite policies were followed, with opposite results:

> In the earlier famine one could hardly engage in the grain trade without becoming amenable to the law. In 1866 respectable men in vast numbers went into the trade; for the Government, by publishing weekly returns of the rates in every district, rendered the traffic both easy and safe. Everyone knew where to buy grain cheapest and where to sell it dearest and food was accordingly bought from the districts which could best spare it and carried to those which most urgently needed it.[93]

As elementary as all this may seem, in terms of economic principles, it was made possible politically only because the British colonial government was not accountable to local public opinion. In an era of democratic politics, the same actions would require either a public familiar with basic economics or political leaders willing to risk their careers to do what needed to be done. It is hard to know which is less likely.

Politically, price controls are always a tempting "quick fix" for inflation, and certainly easier than getting the government to cut back on its own spending that is often behind the inflation. It may be considered especially important to keep the prices of food from rising. Accordingly, Argentina put price controls on wheat in the early twenty-first century. Predictably, Argentine farmers reduced the amount of land that they planted with wheat, from 15 million acres in 2000 to 9 million acres in 2012.[94] Since there is a large international market for wheat, where the price is higher than the price permitted domestically in Argentina, the government also found it necessary to block wheat exports that would have made the domestic wheat shortage worse.

The greater the difference between free market prices and the prices decreed by price control laws, the more severe the consequences of price control. In 2007, Zimbabwe's government responded to runaway inflation by ordering sellers to cut prices in half or more. Just a month later, the ***New York Times*** reported, "Zimbabwe's economy is at a halt." It detailed some specifics:

> Bread, sugar and cornmeal, staples of every Zimbabwean's diet, have vanished, seized by mobs who denuded stores like locusts in wheat fields. Meat is virtually nonexistent, even for members of the middle class who have money to buy it on the black market. Gasoline is nearly unobtainable. Hospital patients are dying for lack of basic medical supplies. Power blackouts and water cutoffs are endemic.{95}

As with price controls in other times and places, price controls were viewed favorably by the public when they were first imposed in Zimbabwe. "Ordinary citizens initially greeted the price cuts with a euphoric—and short-lived—shopping spree," according to the ***New York Times***.{96} Both the initial reactions and the later consequences were much as they had been in Antwerp, centuries earlier.

When a local area is devastated by a hurricane or some other natural disaster, many people consider it unconscionable if businesses in that area suddenly raise the prices of such things as bottled water, flashlights or gasoline—or if local hotels double or triple the prices of their rooms when there are many local people suddenly made homeless who are seeking temporary shelter. Often price controls are regarded as a necessary quick fix in this situation.

The political response has often been to pass laws against "price gouging" to stop such unpopular practices. Yet the role of prices in allocating scarce resources is even more urgently needed when local resources have suddenly become more scarce than usual, relative to the increased demand from people suddenly deprived of the resources normally available to them, as a result of the destruction created by storms or wildfires or some other natural disaster.

Where homes have been destroyed, for example, the demand for local hotel rooms may rise suddenly, while the supply of hotel rooms at best remains the same, assuming that none of these hotels has been damaged or destroyed. When the local population wants more hotel rooms than there are available locally, these rooms will have to be rationed, one way or another, whether by prices or in some other way.

If the prices of hotel rooms remain what they have been in normal times, those who happen to arrive at the hotels first will take all the rooms, and those who arrive later will either have to sleep outdoors, or in damaged homes that may offer little protection from the weather, or else leave the local area and thus leave their homes vulnerable to looters. But, if hotel prices rise sharply, people will have incentives to ration themselves. A couple with children, who might rent one hotel room for themselves and another for their children, when the prices are kept down to their normal level, will have incentives to rent just one room for the whole family when the rents are abnormally high—that is, when there is "price gouging."

Similar principles apply when there are local shortages of other things suddenly in higher demand in the local area. If electric power has been knocked out locally, the demand for flashlights may greatly exceed the supply. If the prices of flashlights remain the same as before, those who arrive first at stores selling flashlights may quickly exhaust the local supply, so that those who arrive later are unable to find any more flashlights available. However, if the prices of flashlights skyrocket, a family that might otherwise buy multiple flashlights for its members is more likely to make do with just one of the unusually expensive flashlights—which means that there will be more flashlights left for others.

If there is an increased demand for gasoline, whether for electric generators or to drive automobiles to other areas to shop for things in short supply locally, or to move out of the stricken local area entirely, this can create a shortage of gasoline until new supplies can arrive at filling stations or until electric power is fully restored, so that the pumps at more filling stations can operate. If the price of gasoline remains what it has been in normal times, those who get to the filling stations first may fill up their gas tanks and exhaust the local supply, leaving those who arrive later with no gasoline to buy. But, if the price of gasoline skyrockets, motorists who arrive earlier may buy just enough of the unusually expensive gasoline to get them out of the area of local destruction, so that they can then fill up their gas tanks much less expensively in places less affected by the natural disaster. That leaves more gasoline available locally for others.

When local prices spike, that affects supply as well, both before and after the natural disaster. The arrival of a hurricane is usually foreseen by meteorologists, and their predictions of approaching hurricanes are usually widely reported. Supplies of all sorts of things that are usually needed after a hurricane strikes—flashlights, bottled water, gasoline and lumber, for example—are more likely to be rushed to the area where the hurricane is likely to strike, before the hurricane actually gets there, if suppliers anticipate higher prices. This means that shortages can be mitigated in advance. But if only the usual prices in normal times can be expected, there is less incentive to incur the extra costs of rushing things to an area where disaster is expected to strike.

Similar incentives exist after a hurricane or other disaster has struck. To replenish supplies in a devastated area can cost more, due to damaged roads and highways, debris and congested traffic from people fleeing the area. Skyrocketing local prices can overcome the reluctance to take on these local obstacles that entail additional costs. Moreover, each supplier has incentives to try to be the first to arrive on the scene, since that is when prices will be highest, before additional suppliers arrive and their competition drives prices back down. Time is also of great importance to people in a disaster area, who need a continuous supply of food and other necessities.

Prices are not the only way to ration scarce resources, either in normal times or in times of sudden increases in scarcity. But the question is whether alternative systems of rationing are usually better or worse. History shows repeatedly the effect of price controls on food in creating hunger or even starvation. It might be possible for sellers to ration how much they will sell to one buyer. But this puts the seller in the unenviable role of offending some of his customers by refusing to let them buy as much as they want—and he may lose some of those customers after things return to normal. Few sellers may be willing to risk that.

The net result of having neither price rationing nor non-price rationing may well be the situation described in the wake of the super storm "Sandy" in 2012, as reported in the ***Wall Street Journal***:

> At one New Jersey supermarket, shoppers barely paused for a public loudspeaker announcement urging them to buy only the provisions needed for a couple of days of suburban paralysis. None seemed to be deterred as they loaded their carts to the gunwales with enough canned tuna to last six weeks. A can of Bumblebee will keep for years: Shoppers take no risk in buying out a store's entire supply at the normal price.[97]

Appeals to people to limit their purchases during an emergency, like other forms of non-price rationing, are seldom as effective as raising prices.