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Price and Wage Controls
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by Allan H. Meltzer

Any system of price and wage controls reduces freedom of contract and freedom of choice. Decisions to restrict these or other personal freedoms are justified in a totalitarian society by reference to some alleged, often vague and illusory, social benefit. In a democratic society, we require or expect some demonstration that the benefits to society exceed the costs of government policies, so that individuals who suffer losses can be compensated without eliminating the entire social gain.

Let me accept this principle and ask how it applies to the present system of wage and price controls. The costs are clear and positive; we have reduced freedom and efficiency. In exchange, we have received little more than unsubstantiated hopes, unverified conjectures and rhetoric about a new era and a "new ballgame." Can we expect benefits in the future that will more than match past and future costs? I know no reason to expect any such benefit or, indeed, any net benefit at all. We have treated freedom and efficiency as worthless by sacrificing both in exchange for nothing more tangible than promises based on the hopes and beliefs of those who have been urging us to adopt controls for the past several years.

The Alleged Benefits

What are the alleged benefits? I find three main arguments for controls as a solution to our present set of problems. One argues that
controls reduce current inflation by reducing anticipated inflation. A second sees price and wage controls as a type of incomes policy. Although many of the people who make this argument recognize that incomes policies have not worked here or abroad, they claim to be hopeful that current efforts will meet with success because we start from a position in which output is below potential. A third argument views wage and price controls as a means of reducing the monopoly power of large corporations and large unions. I believe this argument is of particular interest to the members of the committee since it proposes price and wage controls as a substitute for more vigorous enforcement of existing anti-trust laws or as an alternative to new laws. I will discuss each of the arguments briefly.

The first argument is reversed. The public becomes convinced that the rate of inflation is slowing when they find themselves able to buy the same baskets of goods and services with a smaller increase in expenditure. Price indexes are useful devices for monitoring broad changes in the economy. To expect the public to regard changes in such indexes as more reliable measures of the rate of inflation than the facts they encounter in the market place is a poor principle on which to build a policy.

Perhaps the government can convince people that prices are falling by controlling some components of an index. Our knowledge of short-term changes in anticipations and in price levels is not so firm that we can dismiss the argument completely. Pushing beyond that weak general statement, however, we can say much more about the role of anticipations in the current inflation and in the attempt to control inflation.
Broad-based measures of prices rose at an annual rate of 4% in the second quarter of 1971 and about 2.8% in the third quarter. Almost every forecast I have seen for 1972 puts the anticipated rate of inflation between 3 and 3-1/2%. If these forecasts are credible, the rate of inflation is expected to rise next year. Apparently, the forecasters have either not heard or have not accepted the argument that price controls reduce inflation by reducing anticipations of inflation.

A possible remedy might be a law controlling the anticipated rate of inflation that forecasters are permitted to announce.

It is now generally agreed that controls or incomes policies cannot reduce inflation when total demand exceeds our capacity to produce. At most, controls suppress inflation under these conditions and only temporarily. Proponents of controls dismiss this argument as irrelevant now. They point to the number unemployed and to the low operating rate in manufacturing and conjecture that output can increase without raising prices or wages.

The broad record of experience offers very little support for their conjecture. During the twenties, unemployment rates were low, and resources were, for the most part, employed. Output increased by approximately 50%, and prices changed little. During the recovery from the worst depression of modern times, 1933-37, prices rose ten to twelve per cent while large parts of the labor force remained idle. Prices rose very little both when unemployment rates were relatively high, from 1961 to 1964, and when unemployment rates were generally low, from 1952 to 1956.

Government monetary and fiscal policies are considerably more important than the current unemployment rate or the current rate of capacity utilization.
for determining the rate of inflation. Moreover, it is a mistake to believe that inflation can be controlled by controlling a few prices and wages. Inflation means that a broad based price index rises. Preventing a few prices and wages from rising distorts the numbers we use to measure the rate of inflation and misleads some people. I know of no reason to believe that changes of this kind have any significant effect on the actual rate of inflation, the rate of price change experienced by consumers and businessmen in the market place.

This brings me to the monopoly issue. Probably the most widely accepted myth about inflation is that inflation is produced by the independent actions of some special group. In recent inflations, business and labor monopolies have been cast as villains. At earlier times, "speculators" were often blamed for inflation.

There is no basis for the belief that monopolists are responsible for the current inflation or for earlier inflations. Nor, is there evidence that large firms raise prices more than small. The rate of price increase in the heavy industries -- steel, coal, aluminum, autos, glass, or chemicals -- in the year before the price freeze was lower than the rate of increase in many other sectors of the economy. Of the 25 consumer prices that rose most in the year ending June 1971, ten are food prices, mainly fresh foods, and seven are prices controlled and regulated by governments at various levels. The latter include airfares, taxi fares, freight rates, postage stamps and auto insurance rates. Hardly any of these goods or services are produced or sold by the type of monopoly usually pictured as a price leader.
The Role of Anti-Trust

There is an obvious reason why monopoly power and inflation are commonly associated in the public mind. The reason is that those who make this change fail to distinguish between high prices and rising prices. Monopoly firms raise prices above the competitive level by restricting output. Unions that are able to restrict entry into a craft or occupation raise wages for the particular craft or occupation. Government restrictions that reduce entry and competition raise product prices or the wages of employees in the occupations to which entry is limited.

An increase in monopoly power produces a one-time increase in the prices of those goods and services that are newly monopolized. If the government's monetary and fiscal policies are non-inflationary, a properly constructed price index will not show any increase in the rate of inflation. In short, anti-trust policy is not a substitute for controls, and controls are not a substitute for anti-trust policy.

I do not want to leave you with the idea that you should be unconcerned about prices. There is much that you can do, and that I hope you will do, to lower the prices the consumer pays for the goods or services he receives. High on my list of proposed activities would be an investigation of the costs to consumers of restrictions enforced by governments at all levels. Quotas on oil imports, restrictions on the importation of meat, vegetables, and other commodities, restrictions on the number of banks and their branches, laws regulating the wages received on contract construction, restrictions
on the number of licensed taxicabs by most municipalities, restrictions on price cutting by airlines, tariffs on imports, laws restricting entry into crafts and professions, these are but a few of the restrictions maintained and enforced by government that prevent competition and raise the prices paid by consumers. Removing these restrictions would lower the prices paid by consumers for the services they receive. Removing the restrictions would have no noticeable effect on the rate of inflation.