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Prices Communicate - Price Controls Censor

By Dwight R. Lee

[Editor's note: Everyone wants to see victims of natural disasters recover from their losses as quickly and effectively as possible; however, sometimes actions taken with the best of intentions can lead to more problems than progress.]

Economists are sometimes thought of as lacking compassion because they oppose government policies popularly believed to help people in need, but there is no serious evidence that economists are less compassionate than non-economists. My guess is that economists are at least as charitable and compassionate as others. True, economists sometimes oppose well-intentioned policies that many people view as helpful. This is not evidence, however, that economists lack compassion. Far more likely, economists simply have a different understanding of the most effective ways to help those in need. As a result, economists oppose some popular policies because they sincerely believe those policies harm the very people they are supposed to help.

Let's consider one of the most popular price controls—legislation which outlaws charging high prices for goods following a natural disaster. If price controls don't make sense in this situation, they almost never will. Almost everyone expresses outrage at "price gouging" and supports government price controls to protect disaster victims. Yet most economists oppose price controls, even after natural disasters.

It's not that economists have no concern for the victims. Quite the opposite. Economists oppose such price controls precisely because they are concerned with the well-being of the victims of these disasters. Indeed, economists care enough to have tried to understand the consequence of price controls, and have concluded that these controls actually reduce the help natural disaster victims receive from outside suppliers and from each other.

Price Communication

Fundamentally, economists oppose price controls because these controls interfere with the

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way market prices allow people to communicate. When a good is in short supply (consumers want more of it at the prevailing price than is available), the most effective way for them to communicate to those who are in the best position to reduce the shortage is through market prices. When there is a shortage of a good, its market price increases and informs suppliers that more of the good should be made available and motivates them to make more available. The higher price also informs consumers that the good should be used sparingly, and motivates them to use it only for the most important uses. This price communication is the best hope for victims of disasters to receive the cooperation from suppliers and from each other needed to alleviate shortages as quickly and efficiently as possible.

Given this understanding of the communicative power of market prices, economists see price controls as a form of censorship. Censoring communication is harmful, and censoring price communication is no exception. And the harm is particularly great following natural disasters, because censorship through price controls prevents victims from communicating their need for help in the most effective way possible. Let's consider some examples.

Lumber to New Orleans

Not long after Hurricane Katrina devastated New Orleans, I was giving a talk in Alabama and mentioned the need for victims of Katrina to communicate through market prices. During questions and comments, a gentleman in the audience told a story about his son, a building contractor outside Montgomery, who had started constructing the house he and his wife had dreamed of for years. The foundation had been laid and the lumber was being delivered as Katrina hit. Instead of using that lumber to frame his new house, however, he shipped it to New Orleans. The news he responded to wasn't what he saw on television, but the high price of lumber in Louisiana he heard about from fellow contractors—informing him that his lumber was more valuable in New Orleans than in Montgomery.

Was the Montgomery contractor an unscrupulous profiteer who harmed victims of Hurricane Katrina by taking advantage of their plight? In reality, he was no more unscrupulous than those who sell their labor or their house to those who are willing to pay the most for them. And he clearly didn't harm the hurricane victims - Katrina did that. He helped them by providing lumber that they needed and were willing to pay a higher price for - but a price lower than it would have been if he and others hadn't quickly shipped lumber to New Orleans. Certainly the contractor did far more good for the victims of Katrina than did those who sat around expressing contempt for "price gougers." True, some people helped the hurricane victims for nothing by sending supplies to New Orleans. These people should be commended. But their help was small in comparison to the help given by suppliers from all over the country who responded to higher prices by supplying more of those things Katrina's victims indicated (through higher prices) that they most needed. After all, if people had donated sufficient supplies of the goods most needed in Louisiana after the hurricane, the price of those goods would not have increased, and there would have been no "price gouging" to complain about.

Those who express contempt for people who sell products to natural-disaster victims at high prices should look closer to home for someone to criticize. Their criticism (based on not thinking carefully about the role of market prices) and the public opinion it reflects and inflames, provoke politicians to impose price controls that muzzle those crying out for help. For example, Georgia, where I live, has a "price gouging" law forbidding suppliers from charging, "one penny more than they charged the day before the disaster struck." This law was favorably mentioned, with no hint of irony, in an Atlanta newspaper article reporting that building contractors and construction supplies from several states had poured into Atlanta immediately after it suffered massive tornado damage a few years ago. Does anyone seriously believe that this help would have poured in from far away if the "price gouging" law had been rigorously enforced, or that the help was not reduced by the threat of that enforcement?

Shaving versus Saving Food

Victims of a natural disaster need to communicate with one another in ways that can be done effectively only through market prices. Everyone in the stricken area will value the products being made available, but those products should go to those who can put them to the best use—who value them the most. Price controls prevent this from happening by censoring price communication among victims. A friend of mine, who lived in Charleston, South Carolina when Hurricane Hugo hit in 1989, saw firsthand the harm done by this censorship. Electricity was out for over a week in Charleston, and people were anxious to get gas powered electric generators. Unfortunately, local hardware stores had fewer than people wanted and were unable to get more because of price controls. But there was another problem with the price controls—one that benefited my friend's father, though at great cost to others.

My friend's father preferred shaving with his electric razor, since he disliked having to lather up to shave. Fortunately for him, he was a good friend of the owner of a local hardware store that had two electric generators in stock. Since the owner of the hardware store couldn't legally sell the generators for more than the price determined by the "price gouging" law, it made no difference to him whether he sold to my friend's father, which he did, or anyone else. Unfortunately, grocery stores in town desperately needed electricity, and quickly, to prevent thousands of dollars' worth of food from spoiling. Without price controls, one of these stores would have effectively communicated, through offering a higher price, its need for generators that it (and its customers) valued far more than my friend's father did. One person would have had to give up the convenience of using an electric razor, but hundreds of his neighbors would have persuaded him, through offering a high price for the generator, that their desire for fresh food was more important.

Without price controls, of course, grocery stores could have quickly secured electric generators, by communicating through market prices with suppliers outside the disaster area. This might have priced my friend's father out of the market for a generator, but that would have been compelling evidence that he valued a generator less than the grocery stores and their customers did.

Conclusion

Natural disasters don't create easy situations, but they do provide a vivid example of the unintended harm caused by price controls. Yes, some people might temporarily charge high prices without price controls, but with price controls, the alternative is that there would exist unacceptable scarcities of essential goods affecting far too many people for far too long. Higher prices are necessary to communicate needs, move supplies quickly to affected areas and temporarily ration available supplies. Well-intentioned as price controls may be, they invariably slow the recovery process. Of course, governments do not need natural disasters to justify undermining social cooperation and well-being by dictating prices. All they need is a well-intentioned, uninformed public. Governments have a long history of imposing price controls on a wide range of goods and services. And they will continue to do so until it becomes more widely appreciated that price controls are a particularly harmful form of censorship.

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