Price ceilings are the wrong solution to inflation

With more discouraging inflation news and cost increases stretching household budgets, a growing chorus chanting "do something" will undoubtedly increase in volume. Yet, doing something about the inflation surge rests with the Federal Reserve and involves pain. How long the pain lasts – higher unemployment, slower economic growth and falling disposable income – depends on the Fed's effectiveness in convincing the public that lower inflation is coming. The public's inflation expectations are key for the Fed to meet its 2% inflation target, and there is no way around that fact.

With that hard truth in mind, specific "do something" policies can worsen things if enacted. People who study policy contribute to society by either pointing out solutions and their trade-offs or, equally important, advising what not to do.

At the top of the list of what not to do about inflation is enacting wage and price controls. More specifically, what we mean by wage and price controls is a price ceiling. As the term implies, these are legal barriers to raising prices above a given point.

Governments and regimes worldwide have enacted price ceilings for thousands of years. The federal government is no exception. Currently, members of Congress have proposed legislation to prevent price gouging and charging excessive prices. Make no mistake. These proposals are price ceilings.

The political incentives to enact price ceilings are seductive. First, the government is doing something, and second, the goal of keeping prices from increasing will succeed at least for a time.

But what then? Do we end the price ceilings at some point? When do we end them? Along with those questions, there will be ongoing consequences since this sort of policy does not exist in a vacuum. Price ceilings shut down the essential signals prices send to buyers and sellers. Price flexibility coordinates public tastes, demands and other economic dynamics, which all do not stand still.

Since price ceilings eliminate sellers' ability to raise their prices, fewer products will be produced. Shortages are the result. If you believe the shortage situation we are experiencing now is bad, then price ceilings will make them a good deal worse.

Price ceilings also invite other consequences such as the rise of black markets and product quality deterioration.

Over time, and in the face of increasing shortages, governments can resort to rationing high-demand resources and consumer goods. During the 1970s, due to a price ceiling on certain domestically produced oil, gas lines formed where states instituted odd-even rationing based on the car owner's license plate number. Going back further in time, someone who lived during World War II will tell you about rationing coupons on all sorts of goods.

Still, price ceilings would likely be lifted at some point. The result will inevitably be a spike in inflation as price flexibility returns and prices again align to accurately reflect supply and demand conditions.

Taken in its entirety then – the initial price freeze, the surge in shortages and the eventual spike in inflation – there is only one conclusion: price ceilings are self-defeating. Accordingly, the corrective policy rests with the Fed, and it has the means, and we hope, the will to follow through on its efforts to achieve price stability.

Data, theory and history are simply not on the side of price ceiling advocates. Indeed, in the aftermath of the last American episode in the early 1970s when national price ceilings were instituted, economist Milton Friedman summed up the social and economic consequences best:

“There is hardly a person today who will not recognize that price and wage controls meant more inflation — not less — that they meant disruption, distortion, a reduction in output and an increase in the power of the government over the individual.”

If, in the end, price ceilings are instituted, it will be a triumph of hope over experience.

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