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Problems and Consequences of a Price Stop

by Dr Johann Baptist Schöllhorn, Bonn *

When prices at the consumer level undergo a cyclical rise, one frequently hears the question being asked by wide circles of the population whether such a development should not be checked by means of a price stop.

Though among experts there is a wide measure of agreement that a price stop is not an appropriate means, among the population the opposite view appears to be deeply engrained. Its grave adverse repercussions on the overall economic process, and even the economic order, are for the most part unknown. It may therefore be opportune to re-examine the problems and consequences of a price stop.

The first consideration when a price stop is introduced is that the mere fact of such plans becoming known will release a wave of price increases. Though the legislative procedure may be speeded up as much as possible, the preparations are bound to sound an alarm and lead to anticipatory price advances. Such *precautionary* price rises would imperil the aim in view already before the measure itself has come into force, and back-dating the price stop to avoid this undesirable effect must raise grave problems.

Freezing All Costs

An effective price stop would have to go hand in hand with a freeze of all costs. Hence it could not be confined to consumer prices but would have to apply also to the prices of goods at preceding stages and likewise to the remuneration for the use of capital (interest) and—a fact which most advocates fail to appreciate—to the price of labour (wages). So there would be considerable difficulties. In a situation marked by a cyclical uptrend of prices a wage stop, which means interference with the autonomy of the wage negotiating parties, would create incomparably greater political hazards than a price stop. While announcement of a price stop would probably meet with wide consent among the public which has no understanding of economic interrelations, a wage stop would certainly not be borne without

wide-spread political tensions. It is fairly certain that there would be less inclination to work; working morale would deteriorate. This in turn would lead to loss of production and a fall in the supply of goods needed to satisfy demand.

Erosion of a Principle

To these inescapable difficulties of the announcement of a wage stop there would be added other grave problems. As all prices must be kept constant to make a price stop effective, imported goods would have to be included. There are technical means for offsetting higher world commodity prices and advances in foreign manufacturers' prices by price regulation in the home market, but this might mean cutting off domestic manufacturers largely from their foreign accessory suppliers and incurring difficulties in the supply of important foreign consumer goods. Besides, there are always cost increases in an economy which are entirely outside the range of state regulation. To give an example, cost increases due to greater repair needs of obsolescent machinery cannot be annulled by any government order. So some progressive adjustment of prices to unavoidable cost increases could not be evaded even with a price stop in force. The principle of immutable prices would thus be eroded all the time at least in some sectors.

Curing Symptoms

But fundamentally success in freezing all costs would still not bring stability a single step nearer. Disregarding the special aspects of economic power positions, advancing prices are the outcome of an excess of demand over the available

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supply of goods. Such a demand surplus would not simply disappear because the state proclaimed a price stop. The gap between supply and demand would not in any way be altered. Fixing of prices and costs by the state is merely an attempt to cure symptoms; it hides the true position. The underlying causes of the faulty development would not be removed. A price stop would not have the ultimate result of neutralising the factors making for rising prices but, at best, only postpone increases until prices are again allowed to move freely — a typical example of banked-up inflation. Besides, it must be feared that many goods will be stockpiled in anticipation of the removal of the price stop.

A price stop does no more than impair the quality of the instrument of economic measurement called *price* without really alleviating the movement of prices, and thereby impedes a diagnosis of the true state of affairs. When a price stop is imposed, the price loses its ability to reflect scarcity of supplies and thus its function as an important stress indicator which in certain circumstances may reveal excessive demands being made on the factors of production¹. A price stop is basically nothing but "a means of making people believe that an inflation is not an inflation"².

Aggravated Disequilibrium

Since a price stop thus merely defers price increases, so that prices will start up all the faster when the freeze ends, a price stop devised as a short-term measure would perforce become a perpetual solution if the apparent stabilisation successes are not to be imperilled. Very soon it would become evident that the fixing of prices was merely the first step in a more or less automatic sequence of state intervention. Businessmen faced in the longer term with a prospect of rigid selling prices artificially induced would search for other means of covering their costs and securing profits than rising prices. There would be many opportunities for that. They could, for instance, intensify their export efforts so as to recoup in their foreign business the desired profits which because of the price stop cannot be achieved in the domestic market. Businessmen might also think of clandestinely lowering quality standards, giving inferior service and similar means of recoupment. The production and sale of products which leave no adequate profit at the prices fixed by the state would probably, contrary to the

wishes of the consumer, be given up completely or be replaced by manufacture and distribution of goods offering more remunerative prices.

In the longer term a price stop would therefore even tend to aggravate the market disequilibrium. It would thus achieve almost the opposite of its aim of adequate supplies at *appropriate* prices for the population. The supply would be reduced, and goods in special demand might disappear altogether from the market.

Induced State Intervention

To avoid such evasive action on the part of suppliers the state would have to resort to a great deal of *price-stop-induced* intervention to implement the price stop, including for instance the imposition of export quotas, the issue of quality standards, directives to manufacture certain articles or continue certain productions, regulations as regards investment, bans on the accumulation of stocks, etc. Such measures, in conjunction with the price stop regulations proper, would amount to a far-reaching curtailment of virtually all parameters of business activity; they would be an invidious step towards a state-controlled economy. Whether all the devices to which inventive businessmen might resort could be successfully countered by state regulations is an open question. Experience in this field suggests that they cannot.

Nevertheless it would be hardly possible to avoid the system of self-direction in the market economy being shaken to its foundations by intervention which is as incompatible with it as the measures mentioned. A price stop destroys the efficacy of the price mechanism which in our economic order is of course the prime instrument for allocating the factors of production and guiding production in line with consumer requirements. The regulator systems which always steer the labour and capital participating in the process of production and distribution in the direction where they can be used most advantageously, and which concentrate production on the goods which attract the buying interest of the consumer most, would be thrown out of gear by a price stop and the consequent acts of state intervention complementing it. Official interference with the price mechanism excludes the possibility and necessity of adjustment to the continually changing economic data of a dynamic economy by those who take part in economic life. On the one hand, the continuous need for rationalisation which competitive pressures create when prices can move freely would be removed; uneconomical structures would be preserved. On the other hand, innovation and technical progress would be im-

¹ Cf. HWWA-Institut für Wirtschaftsforschung-Hamburg: KONJUNKTUR VON MORGEN (The Economic Situation of Tomorrow), 13th year (1970), No. 325, p. 1.

² Leonhard Miksch: Die preispolitischen Grundgedanken (The Basic Ideas of Price Policy). In: L. Miksch and W. Rubarth: Die Preisfreigabe (The Release of Prices), Wirtschaftspolitik und Recht (Economic Policy and Law), Siegburg, 1948, p. 3.

peded by lack of adequate profit incentives for their adoption. Price stop measures therefore also impair growth.

Rationing Supplies

As a price stop would tend to curtail further the supply which is already too small while demand would if anything increase owing to artificially low prices, the state would inevitably in the long term have to exercise an influence on demand, in addition to the above-mentioned regulations in the sphere of supply. As, prices being fixed, equilibrium between supply and demand could thus not be accomplished by price adjustment, the available supply would in the end have to be rationed.

The abolition of free consumer's choice implied therein would falsify the purpose of all economic activity, which in the final analysis is the provision of goods for consumption. The economic requirements of the individual would no longer be satisfied according to the urgency of the need, but supplies would primarily go to the buyer who can queue up longest or has the best connections³. Those who have other goods to offer in barter would no doubt find it easier to satisfy their demand wishes than those who have *only* money. The function of money as an exchange medium would be undermined.

Even though supply and demand in the regular market would necessarily be re-aligned by rationing, the surfeit of money in buyers' hands would not thereby be eliminated. It would give rise to the emergence of illegal black markets in which goods removed from the official market would be on offer. The underlying upward trend of prices would manifest itself openly and more markedly in them, despite far-reaching state intervention. To buttress the price stop measures ways and means would therefore have to be devised to mitigate the surfeit of money. If this were done by taxation, the expropriation of the consumer would merely be effected in a different way. Higher taxes would take the place of rising prices.

Expansion of the State Apparatus

The multitude of state measures required to enforce a price stop would necessitate a substantial expansion of the state's administrative apparatus which for many reasons could only slowly be set in motion. The tasks involved in implementing a price stop, e.g. the approval of unavoidable price increases or investment controls, would also de-

mand an intuitive understanding of problems of costing in individual enterprises and technical production processes which can scarcely be expected of state authorities.

A general price stop and the cumulatively ensuing state intervention would result in such growth of the state's power as no longer to be compatible with the principle of freedom. As the evasive actions taken by the parties in the economic process would provoke more and more new regulations, the entire economy would gradually become entangled in a cobweb of state orders and controls. All these measures would hinder the development of the individual's personality to a crucial extent. The fixing of economic data by the state contrary to the market mechanism would moreover in many cases lead to circumvention of regulations. Price stop orders and supporting measures would frequently give rise to corruption and constitute a general threat to public morality. The corpus of criminal law would consequently have to be extended, more severe penalties would follow, and an intolerable element of *retributive justice* would permeate the whole economic process.

Objectively Unsuitable

All these consequences of a price stop show that such a step would be an objectively unsuitable means of countering intrinsic upward tendencies of the prices. The blatant disproportion between the objective desired and the result achieved makes it impossible to give serious consideration to a price stop as a means of curbing cyclical strains and stresses. From an overall economic point of view the system of free prices is unquestionably cheaper and more efficient. A glance across our frontiers shows by the way that the countries in the western world which have tried to overcome their economic difficulties by means of state-regulated prices have not achieved a greater measure of price stability than others did by leaving prices free to find their own level. In such countries as France, Great Britain, Holland, Denmark and Sweden prices have, on the contrary, as a rule risen much farther than, e.g., in Germany. The efficiency of the incomparably more efficient system of the market economy with its price freedom should therefore be maintained by stabilisation measures in conformity with the system, i.e. primarily by means of overall guidance and a policy of competition even during critical phases of the business cycle. Only when price increases are induced by exceptional outside influences in connection with periods of political crisis and tension or in major natural emergencies may circumstances suggest the advisability of applying a price stop as an *emergency brake*.

³ Cf. Helmut Meinhold: Preispolitik (Price Policy). In: Handwörterbuch der Sozialwissenschaften (Encyclopedia of Social Sciences), 8th volume, Tübingen-Göttingen 1964, p. 503.