

# Study Guide to *Human Action* by Robert P. Murphy

## Chapter XXX. Interference with the Structure of Prices

### Chapter Summary

#### 1. The Government and the Autonomy of the Market

The government interferes with the structure of the market by enforcing price floors or ceilings that deviate from the levels that would have obtained on an unhampered market. The particular price or wage may have an enforced maximum or minimum, depending on the circumstances and the political strength of the groups involved. Historically, only interest rates have always been subject to ceilings; it has never been politically popular to support the earnings of moneylenders.

If the government imposes controls on all prices, wages, and interest rates, we have socialism of the German pattern. However, many advocates for price control want to retain a market economy; they indeed may claim that only select price controls can prevent the coming of socialism. Economics must inquire whether these programs really can achieve their stated ends.

History is replete with failed attempts at price ceilings and antiusury laws. The failures were always attributed to sinful men and lax enforcement by the authorities. Thinkers in the last centuries of the Middle Ages began to realize there was more to the story, that there were general laws of market phenomena that did not answer to the police power. These laws or regularities in market activity were first discovered in the context of monetary debasement and legal-tender laws, and summarized by Gresham's law ("bad money drives out good," meaning people will hold the genuine coins and trade away the debased ones).

Those interventionists who defy the teachings of the economists regarding price controls deny the existence of economics itself. They cannot admit that there are laws governing market phenomena, independent of men's will, just as there are laws governing nature. Only the insane boast of their defiance of the laws of physics or biology, but governments routinely (try to) defy the laws of economics.

#### 2. The Market's Reaction to Government Interference

The characteristic feature of market prices is that they equate the quantity of product supplied with the quantity demanded. If the government enforces a maximum price below the market price, there will necessarily be a shortage; buyers will demand more units of the product than sellers wish to supply at the artificial price. Without the use of money to ration the available supply among the potential buyers, other means will have to be used, such as personal connections or even threats of violence. (To avoid these undesirable outcomes, the government often imposes its own alternative system of rationing.) On the other hand, a legal minimum price, set above the level of the unhampered market, will result in a surplus; sellers will supply more of the product than buyers will demand.

Besides these effects, price controls also rearrange the structure of production, and ultimately thwart the intentions of those supporting the controls. For example, the government may impose a price ceiling on a food staple, in order to make it more affordable for poor consumers. Yet now capital and labor will flow to other, unregulated industries, because their earnings have been artificially reduced in the targeted industry. Therefore the amount of the food staple being produced is diminished, which is the opposite of the government's aim. The government may try to remedy the situation by imposing price ceilings on the inputs used by producers of the staple, in order to maintain their profitability, but this would simply cause the producers of those inputs to move to other lines. In the end, the government must resort to outright socialism (of the German pattern), or concede that it cannot use intervention to assist consumers of the food staple.

### ***Observations on the Causes of the Decline of Ancient Civilization***

The Roman Empire in the 2nd century had reached a high degree of the division of labor. Farmers sold grains and other staples to city dwellers, in exchange for handicrafts and other products made in the cities. However, ever more draconian enforcement of price controls on "essential" foodstuffs, in conjunction with currency debasement, ultimately destroyed the civilization of antiquity and yielded the manorial system of largely autarkic households.

### **3. Minimum Wage Rates**

Governments have generally found it popular to enact minimum floors on wage rates, fixing them at levels above the unhampered market rate. Often the government may defer its use of violence to the exercise of labor unions, who are not punished by the police and courts when they beat "scabs" for crossing picket lines.

If the minimum-wage rates are imposed only on a subset of workers, this will raise the wages of those who remain in the occupation, but drive the rest into other lines (as the employers will choose to hire fewer workers at the higher price). The wage gains of the privileged workers will be matched by reduced wages in the nonunionized sectors. However, if the government or unions succeed in raising wages above their market levels in most or all industries, then the effect is institutional unemployment.

All of the labor-union propaganda overlooks the crucial fact that the only way to raise the average level of wages is to increase the amount of capital per worker. Even the labor unions themselves are dimly aware of this fact, as they have historically sought to exclude immigrants, children, women, and other competitors from the labor force, as well as to oppose the export of capital.

Governments have tried many remedies for the problem of mass unemployment, but each is worse than the disease. Unemployment doles, for example, simply exacerbate the problem by subsidizing leisure; the higher the payment, the less incentive the unemployed have to find jobs. Government spending and public works simply transfer economic activity from the private to the public sphere, where there is no link to consumer satisfaction. Finally, credit expansion can be used in an attempt to trick the workers with illusory nominal pay hikes that do not keep pace with other prices, but the unions will soon adjust their wage demands to compensate for the declining purchasing power of money.

### ***The Catalactic Aspects of Labor Unionism***

All that economics needs to stress regarding labor unionism is that widespread efforts to use violence to fix wage rates above their market levels will lead to institutional unemployment. When the government abdicates its role as enforcer of property rights and allows unions to exercise such threats, the analysis is the same as if the government itself enforced the wage hikes. The issue is not "freedom of association" or whether workers have a "right to strike"; the issue is whether they should be allowed to threaten violence on strikebreakers who are eager to work at wages lower than the union deems satisfactory.

### **Why It Matters**

This chapter illustrates Mises's view on the only admissible role for the economist to critique government policy: as an economist, one cannot question others' value judgments, but one can point out that proposed measures will not attain the desired ends. Much of this chapter's analysis of price controls' pernicious effects is consistent with standard textbook treatments. However, Mises adds his historical understanding, educating the reader not only on the history of labor unionism but also explaining the fall of the Roman Empire.

### **Technical Notes**

- (1) Mises concedes that in very special cases, a price ceiling need not restrict the quantity supplied of a good. He uses the example of apartments in a city: "Thus the amount by which the urban rent of a piece of land exceeds the agricultural rent provides a margin in which rent control can operate without restricting the supply of rental space" (p. 759). Although certainly possible, even here—and especially in a large city—the price control will probably reduce the number of rental units available. Even though the owner of an apartment building won't bulldoze it and plant corn, nonetheless he may be slower in renovating his units, or he may be less aggressive in advertising vacancies, or he may decide to keep some units empty for his own personal storage. At any snapshot in time after the imposition of the rent control, the actual number of apartment units available for tenants would most likely be smaller, even though none of the buildings had been diverted to another use.
- (2) The "Ricardo effect" refers to the substitution of machinery for labor when wage rates rise. In general, goods can be produced with varying quantities of workers and capital goods; the cheapest combination for yielding a desired quantity of output will depend on the relative wage rates and rental prices of the services of capital goods. Apologists for labor unions have argued that the Ricardo effect implies that a general increase in wage rates should lead all employers to invest in more machinery, thus raising the productivity of labor and justifying the initial wage increase. Mises points out (pp. 767–770) that labor-union activism cannot increase the quantity of capital goods available to employers; only saving and investment can do that. The Ricardo effect is sensible in isolated cases; a new factory opening in a small town may draw teenage boys from other occupations and raise their wages, which in turn will cause some of the other employers to invest in more "labor-saving" equipment to adjust to the new reality, as they too must pay higher wages to retain those teenage boys who

choose to remain with them. But this simply means that such equipment will now be more expensive and redirected from other lines where it would have been channeled were it not for the new factory. In and of itself, the rise in wage rates does not create a larger supply of labor-saving equipment; the increased purchases by the employers in the small town are offset by reduced purchases by other employers, perhaps in other towns.

## Study Questions

### 1. The Government and the Autonomy of the Market

- What does interference with the structure of the market mean?
- What are the forms of price control?

Comment: "But the interventionist, in advocating price control, cannot help nullifying the very existence of economics."

Comment: "The laws of the universe about which physics, biology, and praxeology provide knowledge are independent of the human will..."

### 2. The Market's Reaction to Government Interference

- What are the consequences if the government establishes
  - a minimum price higher than the market price?
  - a maximum price lower than the market price?
- If rent control is imposed only on preexisting apartment units, will it have any influence on the supply of new apartments?
- According to Mises, what are the two exceptions to the rule that price ceilings restrict the quantity supplied of a product?

Comment: "The marvelous civilization of antiquity perished because it did not adjust its moral code and its legal system to the requirements of the market economy.... The Roman Empire crumbled to dust because it lacked the spirit of liberalism and free enterprise."

### 3. Minimum Wage Rates

Comment: "Where there is neither government nor union interference with the labor market, there is only voluntary or catallactic unemployment."

- How can unemployment be voluntary?

- Why does Mises say that Ricardo's proposition and the union doctrine derived from it "turn things upside down"? Why does he think Ricardo has misunderstood the direction of causality?
- Why can real wage rates only rise to the extent that, other things being equal, capital becomes more plentiful?
- Does Mises believe workers have a right to bargain?
- Does Mises approve of measures outlawing unions?