PRICE CONTROLS: HOW THE US HAS USED THEM AND HOW THEY CAN HELP SHAPE INDUSTRIES

ISSUE BRIEF BY **TODD N. TUCKER** | NOVEMBER 2021

As the rate of transmission of COVID-19 lessens and workers return to jobs, demand for numerous goods and services is rising far above where it was in the policy-induced frozen economy. However, due to just-in-time production methods and trade imbalances—for example, countries like China exporting far more to the US than vice versa—everything from shipping containers to computer chips is located in the "wrong" place.

In an uncontrolled market, sellers of these scarce products can "pick their price," leading to shortages and further price hikes in sectors such as used cars (Whalen 2021). Selective price controls on these products could be a way to guard against price gouging by producers of goods and help consumers.

WHAT ARE PRICE CONTROLS?

Price controls are an industrial policy tool whereby the government sets rules on what private firms are allowed to charge their customers. These controls can be set either for one or multiple industries, but this kind of tool is different than overall macroeconomic inflation management through monetary policy, where overall price levels are indirectly controlled through interest rate adjustments. In turn, through increased or decreased bank lending, this affects the pace of economic activity. Price controls, on the other hand, take a more direct form: as instructions to specific producers (including, notably, many if not mostly non-banks) on how much they may or may not legally demand for their products. In so doing, government limits or expands the distribution of money between different industries—our definition of industrial policy (Tucker 2021).

HOW DO PRICE CONTROLS WORK?

There are numerous modalities for how price control instructions can be formulated.

First, prices can be set at some baseline—say, where they were the day or month before a war, national emergency, or other disruption that caused distress in an industry or economy. Alternatively, they could be set at a level intended to achieve a policy goal, such as when minimum prices for wheat are established to ensure a decent livelihood for farmers, or when steel prices are set to ensure that the government is able to buy up all the steel it needs at a price that will not put higher-cost or smaller firms out of business. Finally, prices could be allowed to fluctuate within a band that allows producers to increase prices if their costs go up, but not so high that consumers are priced out of the market.

Controls on the prices producers can sell for are often accompanied by controls on their internal costs. When labor unions are strong, policymakers will introduce wage controls, so that workers do not demand pay increases above the level at which firms will be viable. Profit controls can impose similar discipline on owners of firms, so that they do not respond to price caps by taking money away from their workers. Excess profit taxes are another way of recouping unfair gains that CEOs make due to tight supply conditions, or when the second type of price control noted above (a minimum price to keep small businesses soluble) leads to mega profits for larger firms that could meet demand at much lower prices.

WHAT ARE THE ARGUMENTS FOR AND AGAINST PRICE CONTROLS?

Though ultimately unconvincing, many of the arguments against price controls command respect among mainstream economists and have thus found their way into conventional thinking about how the economy works. As libertarian economists like Friedrich Hayek have argued, the price system "economizes on knowledge" (Barry 2018). Prices communicate a lot of information to everyone in the marketplace. For example, the price of avocadoes might indicate that there is more demand for them than supply—either because elder millennials are earning (and eating) more, or because a drought in Mexico took a year's crop out of circulation. The price mechanism has an easy solution for that: Sellers will demand a higher price, and some group of relatively well-off millennials will be willing to pay it while other, less well-off millennials will drop out of the market, switching instead to peanut butter. Over time, other producers in Mexico will see the higher price and start producing more avocadoes, allowing the price to drop down to a new equilibrium so that the peanut butter eaters can switch back. No one in Michoacán or Fort Greene needs to know anything about the factors behind these changing prices, but such price changes effectively communicate to buyers and sellers the relative scarcity—and thus market value—of products. The argument against price controls, therefore, is that putting the state in the middle frustrates the market's ability to deliver this type of adjustment.[1]

There's just one problem with this story about self-regulating markets: Price mechanisms perform their role best in a world of what economists call "perfect competition." Perfectly competitive markets require many elements that are in fact rarely present in actually existing economic activities—near-zero profits, that all goods are alike, that trades don't have any transaction costs, that buyers and sellers have access to the same information, that property rights are perfectly defined, that there are no government distortions in the market, that "bigger" firms don't do any better than smaller ones, and so on (Tucker 2018).

As economist John Kenneth Galbraith (1980) wrote in his book *A Theory of Price Control*, many industries are far from perfectly competitive. In sectors from steel to automobiles, a limited number of firms hold the lion's share of production. In such oligopolistic or monopolistic industries, there are already price controls—they are just set by private actors rather than publicly accountable governments. Galbraith, who helped run the Office of Price Administration (OPA) under the Roosevelt administration, observed that it was relatively easy for producers to reach agreement within those highly concentrated industries. In contrast, in sectors that were not as concentrated at the time—such as second-hand machine tools, retail clothing, etc.—price controls were difficult to administer, and black markets in which sellers charged above the official prices were an ever-present risk.

Indeed, once we step away from the restrictive assumptions of perfect competition, there are a variety of reasons price controls might be attractive, especially during a national emergency. Price controls can ensure that:

- Distribution of goods can happen in new or destroyed industries where markets do not yet exist, or exist imperfectly;
- Government (and foreign allies) can access the supplies they need without price spirals busting their budgets or enriching monopolists;
- Government demand does not end up bidding prices so high that civilian markets are unduly disrupted;

[1] Historically, another major objection to price controls was that they would be unenforceable or unwieldy. But now that most transactions are conducted electronically, it is much easier for government to enlist financial service companies to monitor the prices that are being charged.

- Government planning of the economy—a complicated affair in the best of times—is not made harder by chaotic price movements;
- There is clarity in markets about government's intentions for the economy, as rumors could otherwise generate speculation that disrupt prices;
- There is no reward for speculation, as predictions that prices will go up reward buying low now to sell high later. Instead, price controls send a signal that this will not be tolerated;
- Critical industries do not risk bankruptcy or displacement by imports from seeing the cost of their inputs into production rising out of control;
- The government can convey the seriousness of the situation, which makes appeals to sacrifice some comforts more tenable;
- Business leaders retain positive reputations, rather than being seen as "emergency profiteers";
- Industry is reassured that stronger measures like nationalization can be avoided, and that businesses can retain ownership of their operations after the emergency passes;
- Particularly vulnerable populations are protected without having to use the blunt, economy-wide tool of interest rate hikes, as my colleagues J.W. Mason and Lauren Melodia (2021) wrote in a recent issue brief;
- Basic needs like food and medical care are met at prices all workers and families can afford, thereby sidestepping a revolt when the government could least handle it; and
- Inequality does not increase, as may happen when the basket of goods workers consume sees prices increase more than luxury goods consumed by the elite, which can make it harder to forge national unity to fight an emergency.

HOW HAVE PRICE CONTROLS ALREADY BEEN USED IN THE US?

Price controls have been used in various industries throughout US history. Today, price controls still exist in certain notable sectors, including:

- *Public utilities like electrical power and sewage*. Because public utilities are natural monopolies that have market power to set rates at any level they wish, government agencies (or agencies operated under delegated power) set the maximum permissible rates or price bands that they are allowed to charge.

- *Rent*. Many municipalities have rent control regulations that cap the maximum amount of rent landlords can charge or that limit the speed at which those rates can increase.[2]
- *Health care*. Various health care programs like Medicare and Medicaid establish rates of reimbursement for various goods and services, through what are effectively price controls.[3]

There were four occasions during the 20th century when more systematic price controls were employed: during World War I, World War II, the Korean War, and the economic dislocations of the Nixon administration (which were partly, but not exclusively, related to the Vietnam War). The most ambitious experiment with price controls was during World War II, when (as economic historian Hugh Rockoff [1984] has detailed) nearly 160,000 federal employees worked for the OPA and related agencies. The OPA controlled prices on goods from scrap steel to shoes to milk. The Roosevelt administration circulated colorful posters educating working families about price controls and enlisting their support in reporting violators. These strategies were a way of exerting greater democratic control over price levels.

An important lesson from these historical experiences is that government agencies overseeing price controls need to be given some autonomy from both business and other branches of government. The US political system—with its high number of "veto points" (see Tucker 2021)—needs special, "distinctly American" workarounds to succeed. The controls implemented during World War I—at a time when the federal government was relatively undeveloped—were administered largely by personnel temporarily drawn into government from the regulated businesses, leading to charges of war profiteering. In contrast, the Roosevelt administration drew on independent experts trained at universities and in New Deal agencies like the Commodity Credit Corporation. And what some observers credit as the single biggest facilitator of the OPA's work was that its decisions could not be subject to stays of enforcement upon being challenged in court. Indeed, its decisions could not be reviewed by the normal court system at all, where decisions would be rendered by judges untrained in, and likely unsympathetic to, the aims of price controls. Rather, jurisdiction was given to a new Emergency Court of Appeals—a specialized bench with industrial expertise that applied a deferential

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2 For more on rent control as a policy lever to tame inflation, see Aibinder and Owens 2021.

3 For more on health care pricing policy as a policy lever to tame inflation, see Amarnath and Datta 2021.

standard of review and allowed the price controls to go into effect while courts reviewed the lawsuits. These checks on business and courts are a way to ensure more democratic control and legitimacy of industrial policy.

Partly as a result of that more tailored judicial process, US courts have repeatedly upheld the constitutionality of price controls. In [*Yakus v. US*](), a 1944 case dealing with wholesalers charging over the maximum prices allowed for cuts of beef, a 6—3 Supreme Court majority wrote, "That Congress has constitutional authority to prescribe commodity prices as a war emergency measure, and that the Act was adopted by Congress in the exercise of that power, are not questioned here, and need not now be considered." And in [*Bowles v. Willingham*](), another 1944 case (this time over rent controls), an 8—1 Supreme Court wrote that, "A nation which can demand the lives of its men and women in the waging of that war is under no constitutional necessity of providing a system of price control on the domestic front which will assure each landlord a 'fair return' on his property."

These cases touched on a key matter of concern today in effective crisis response: how much power Congress can delegate to the executive. The New Deal and subsequent buildup of the administrative state were enabled by justices that came to see the value and permissibility of robust state action. As the *Yakus* court wrote:

> *"[the 1942 Emergency Price Control Act is] an exercise by Congress of its legislative power. In it Congress has stated the legislative objective, has prescribed the method of achieving that objective—maximum price fixing—and has laid down standards to guide the administrative determination of both the occasions for the exercise of the price-fixing power, and the particular prices to be established . . . As we have said: 'The Constitution has never been regarded as denying to the Congress the necessary resources of flexibility and practicality... to perform its function.' . . . Hence it is irrelevant that Congress might itself have prescribed the maximum prices or have provided a more rigid standard by which they are to be fixed; for example, that all prices should be frozen at the levels obtaining during a certain period or on a certain date . . . Congress is not confined to that method of executing its policy which involves the least possible delegation of discretion to administrative officers."*

The 1950 [Defense Production Act]() (DPA) renewed the powers granted to Franklin D. Roosevelt. While initially aimed at empowering the Truman administration to execute the Korean War, the DPA is still on the books, and in the years since, it has been expanded to be applicable not just in wartime but in other types of emergencies (Else 2009).

HOW COULD PRICE CONTROLS BE USED TODAY?

As noted in the introduction, several contemporary challenges precipitated by the COVID-19 era indicate a role for price controls. The central one is this: Anytime policymakers freeze and then unfreeze the economy—or convert resources from one type of production (war mobilization) to another (peacetime production)—normal markets and price mechanisms are disrupted, and prices can soar. In these times, price controls can help guard against unfair or inequitable economic dislocations. These interventions can also be geared toward industries of particular concern; by making vaccines available to anyone that wants one regardless of ability to pay, the US government has effectively put in place a price ceiling of zero. Meanwhile, restrictions earlier in the COVID-19 crisis on the export of personal protective equipment (PPE) limited the price being set by the highest global bidder.

Even beyond COVID, industrial policy tools like price controls will be essential to combat future supply issues: for instance, cost increases due to scarcity of inputs into production—either because there is no more availability of certain materials on Earth (Wendorf 2021), or because they are controlled by economic competitors like China. As supplies tighten, policymakers will face a choice: Either prices will rise to a level that only the richest 1 percent of the population can afford, or some attempt at a more egalitarian distribution can be achieved through a system of price controls and democratic allocation (the latter of which will be explored in more detail in future issue briefs).

But we need not look solely to novel crises to see a need for price controls. The longer-standing crisis of health care costs has already put the tool in the spotlight this fall, as policymakers debate whether to allow Medicare to negotiate drug prices with pharmaceutical companies, something government is currently prohibited from doing under law—unlike most of America's economic competitors (Sarnak, Squires, and Bishop 2017). Were this to change, prices could be brought down for all consumers, since Medicare plays such a central role in the overall pharmaceutical market, as private insurers demand to "get the deal Medicare got." Indeed, some scholars have called for using existing authorities under the Bayh-Dole Act to bring down the costs of pharmaceuticals developed from public research (Arno and Davis 2001), or to set new price ceilings on drugs based on their projected social value (using metrics already in use in the federal government's regulatory evaluation process) (Persad 2020). This is justified even under a conventional neoclassical economics approach, given that the sellers of pharmaceuticals enjoy government-granted monopolies and the purchasers (insurance companies) neither select nor consume the product (these are the roles typically played by doctors and patients) (Persad 2020). In short, because the pharmaceutical industry is not a perfectly competitive market, appeals to perfect competition cannot be a basis for rejecting price controls.

In the years since 1950, the specific DPA provisions for the executive to regulate prices, wages, rents, and credit have lapsed. As policymakers grapple not only with COVID-19 but with displacement caused by the climate crisis, revisiting this broader spectrum of powers that price controls offer would be wise.

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ABOUT THE AUTHOR

Todd N. Tucker is a political scientist and the director of governance studies at the Roosevelt Institute, where he helps lead research on global governance, democracy, and the administrative state.

A recognized expert on trade and political economy, Dr. Tucker has testified before legislatures and expert committees around the world. His writing has been featured in *Politico*, *Time Magazine*, *Democracy Journal*, the *Financial Times*, and the *Washington Post*. He is author of *Judge Knot: Politics and Development in International Investment Law* (Anthem Press, 2018), as well as other academic research published by Cambridge University Press, Oxford University Press, and other publishers. Prior to his doctoral work, he led research on international issues for a number of DC think tanks and research organizations. He has authored over 70 major reports, including *Fixing the Senate: Equitable and Full Representation for the 21st Century* and *Industrial Policy and Planning: What It Is and How to Do It Better*. Dr. Tucker received his BA from George Washington University and his PhD and MPhil from the University of Cambridge. He is also a lecturer at Johns Hopkins University.

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