CHAPTER 7. DEPENDENCE OF THE DIVISION OF LABOR ON CAPITALISM III: PRICE CONTROLS AND ECONOMIC CHAOS

PART A. PRICE CONTROLS AND SHORTAGES

_______1. The definition of inflation as being rising prices implies that
a. inflation comes into being only as and when prices rise and would not exist if prices did not rise
b. businessmen are responsible for inflation, since prices would not rise if they did not raise them
c. price controls are capable of eliminating inflation
d. all of the above

_______2. In place of rising prices inflation has also been defined as an
a. undue increase in the quantity of money
b. increase in the quantity of money at a rate in excess of the rate of increase in the supply of gold and silver
c. increase in the quantity of money caused specifically by the government
d. all of the above

_______3. Defining inflation as an increase in the quantity of money at a rate in excess of the rate of increase in the supply of gold and silver is tantamount to defining it as an increase in the quantity of money caused specifically by the government, inasmuch as, in the absence of government interference, the quantity of money could not for very long increase at a faster rate than the increase in the supply of precious metals.

_______4. Rising prices are
a. inflation
b. a leading symptom of inflation, not the phenomenon itself, which can exist, and, indeed, accelerate, even though this particular symptom is prevented from appearing
c. both (a) and (b)

_______5. The general consumer price level, i.e., the weighted average of the actual prices at which goods and services are sold, *is*, literally, nothing more than the total spending to buy them divided by the total quantity of them sold. It is thus an arithmetical quotient, with demand (spending) as the numerator and supply (quantity of goods sold) as the denominator.

_______6. Rising aggregate demand or falling aggregate supply are the only two possible direct causes of a higher price level. Any other, indirect cause must operate through one or both of these two direct causes.

_______7. In explaining the chronically rising prices of the last 70 years,
a. falling supply must be ruled out, because in practically every year supply in the economic system has increased rather than decreased
b. the contribution of supply to the general consumer price level has not only not been to make prices higher, but to make them lower than they otherwise would have been
c. the explanation of rising prices is a rise in aggregate demand great enough to overcome the price reducing effects of growing supply
d. all of the above

_______8. The rise in aggregate demand is what
a. bids up the prices of all goods and services in limited supply
b. enables price increases initiated by sellers, whether businessmen or labor unions, to take place as a repeated phenomenon
c. both (a) and (b)

_______9. In the absence of the rise in aggregate demand, price increases initiated by sellers would reduce the amount of goods and services that could be sold. This loss of sales volume, and the mounting unemployment that goes with it, would soon put an end to such price increases.

_______10. An increasing quantity of money raises aggregate demand and thus prices by virtue of being spent and respent so long as it continues in existence and thereby raises the level of aggregate spending.

_______11. The author holds that the quantity theory of money—viz., the increase in the quantity of money—is
a. the only valid explanation of the phenomenon of generally rising prices
b. one among several equally valid explanations of generally rising prices

_______12. Once the truth of the quantity theory of money is recognized, the government's responsibility for rising prices follows immediately, because under the conditions of the last seventy years, the government has had virtually total control over the quantity of money and has deliberately brought about its rapid increase.

_______13. Since 1933, the quantity of money in the United States has increased from approximately $19 billion to more than $2.5 trillion, an increase well in excess of a hundredfold.

_______14. The imposition of price controls to combat inflation is analogous to an attempt to deal with expanding pressure in a boiler by means of manipulating the needle in the boiler's pressure gauge, or to reduce a patient's fever by means of manipulating his thermometer reading.

_______15. Price controls

a. stop inflation

b. combine with inflation to produce a different and worse set of consequences than inflation alone would produce, namely, shortages and the consequences of shortages

_______16. A shortage is an excess of the quantity of a good buyers are seeking to buy over the quantity sellers are willing and able to sell. An example of a shortage is the case of eager buyers of gasoline who are unable to find gasoline.

_______17. The concept of a shortage

a. is the same as

b. differs from

that of scarcity.

_______18. In a free market scarcities do not result in shortages but in prices sufficiently high to reduce the quantity demanded to within the limit of the supply available.

_______19. Gold and diamonds are widely desired and are extremely scarce. As a result,

a. their prices are extremely high—high enough to limit the quantity of them demanded to the supply of them that is available

b. they are in a state of shortage, with supplies being unavailable to buyers willing and able to pay the market price

c. both (a) and (b)

_______20. Scarcities can result in shortages only when they are accompanied by price controls, because in the absence of price controls the effect of scarcity is simply to drive the price to whatever point is required to limit the quantity demanded to the supply available.

_______21. Price controls can create shortages even when supplies of goods are at record-high levels, by bringing about an increase in the quantity of the good demanded to a point that exceeds the record-high-level of the supply available. For example, a record-high-level of wheat production could be accompanied by a severe shortage of wheat if the government imposed a price control low enough to make it profitable to use greatly increased amounts of wheat as animal feed.

_______22. The oil shortage of the 1970s in the United States existed despite the fact that the supply of oil in the United States was still large enough to make possible per capita oil consumption far greater than that of practically any other country and far greater than that of the United States itself not many years earlier.

_______23. The combination of inflation plus price controls easily results in large and growing shortages of practically everything, because the increase in the quantity of money, and thus the increase in the willingness and ability to spend money, that inflation represents, serves to increase the demand for virtually everything. As soon it succeeds in increasing the quantities demanded beyond the supplies available, shortages come into existence.

_______24. Inflation

a. in the absence of price controls results in higher prices

b. in combination with price controls results in shortages

c. is wiped out of existence by price controls

d. all of the above

e. (a) and (b) but not (c)

_______25. Shortages cause scarcities by allowing supplies to be diverted to less important uses at the expense of more important uses, with the effect of undercutting production. For example, diverting part of the supply of oil required to keep oil wells in operation to such uses as providing the gasoline for shopping trips that would be avoided at a higher price of gasoline. Such outcomes occur because the price controls prohibit the more important uses from outbidding the less important uses for the supply of the item.

_______26. In a free market, so far from there being shortages, the typical case is that a seller is in a position to supply more than his present number of customers, even when the overall supply of the item is strictly limited for the time being.

_______27. The situation described in the preceding question results from the price being high enough to hold the quantity demanded to a point somewhat below that of the full supply available, thus leaving the sellers with a stock capable of serving additional customers.

_______28. When accompanied by inflation, which drives up costs, price controls cause industries to become progressively less profitable and more and more unprofitable and thus to produce less and ultimately go out of existence altogether.

_______29. Rent controls first destroy the housing of the poor, because such housing starts out with operating costs closer to rental revenues than is the case with higher quality housing.

_______30. Price controls

a. in a local market operate to deprive that market of supply by making it impossible for it to compete for supplies with other local markets

b. in the natural gas crisis of 1977 served to prohibit areas such as New York and New Jersey from obtaining additional supplies by virtue of preventing them from matching gas prices in Texas and Louisiana

c. caused the agricultural export crisis of 1972–73 by prohibiting Americans from bidding up the price of agricultural commodities and thus restraining the quantities demanded by foreign buyers

d. all of the above

_______31. Price controls foment international hostility and thus serve to promote wars, because
a. they create conditions in which the citizens of a country (or region) are prohibited from competing for supplies with foreign buyers and thus can be deprived of urgently needed supplies by the foreign buyers
b. because of (a) can lead to prohibitions on exports, i.e., embargoes
c. countries that have price controls and which are the target of embargoes, such as the US during the Arab oil embargo, suffer economic devastation as the result of embargoes, since price controls deprive them of the ability to take the necessary actions to respond to the embargoes
d. all of the above

_______32. Price controls that are expected to remain in force for several more years reduce the supplies of goods held in storage.

_______33. Private hoarding is responsible for the existence of shortages whether price controls exist or not.

_______34. In cases in which suppliers withhold supplies, in anticipation of the relaxation or repeal of a price control in the near future, the resulting intensification of the shortage is due to the fact that the existing price control prohibits those seeking to buy in the present from freely competing with prospective future buyers.

_______35. In contrast to the case of most goods, price controls on natural resources in the ground are likely to result in a withholding of supplies.

_______36. A control on the wage rate of any particular type of labor operates to reduce the supply of that type of labor to the extent that workers who perform that type of labor have the ability to perform other types of labor whose wage rates are rising.

_______37. A price control on any particular product of a factor of production, such as milk, operates to reduce the supply of that product even if the price of the factor of production, in this case raw milk, is also controlled. This is because the uncontrolled prices of other milk products, such as butter, cheese, and ice cream make them relatively more profitable uses for raw milk and cause milk supplies to be diverted to them at the expense of milk for drinking.

_______38. If rent controls are placed on apartments, it should be a source of shock and outrage when landlords start converting their apartment buildings to co-ops and condominiums.

_______39. Government bodies that enact rent controls have every right to expect that their action will not cause a decrease in the supply of rental housing.

_______40. Price controls are tantamount to a prohibition of supply insofar as they amount to saying that businessmen are allowed to produce something, indeed, that their production of it is earnestly desired, only that they will not be allowed to profit from producing it.

_______41. The likely effect of the combination of price controls and inflation on electric utilities and other regulated industries is that
a. these industries will simply continue to prosper and grow
b. will be unable to keep up with rising demand and potentially could go into decline

_______42. The general level of knowledge concerning the cause of shortages is in accord with the teachings of economic science.

_______43. The statement presented in the previous question is confirmed by the New York City law declaring that rent controls could not be lifted until the vacancy rate in the City had first climbed to a certain substantial level.

_______44. Inflation raises nominal profits while reducing real profits.

_______45. Inflation reduces real profits because it increases the replacement prices of assets. In order to pay those higher replacement prices, it would be necessary to use most of the higher nominal profits that inflation creates. However, those profits are unavailabe to the extent that they have been taxed away.

_______46. Inflation
a. proves the need for price controls, because while the average wage earner suffers from rising prices, wealthy businessmen earn record profits
b. leads economically ignorant people, who are misled by false appearances, to urge price controls

_______47. According to the author, the claim of the city government of New York that in refusing to keep up their rent-controlled buildings landlords were ‘milking’ their properties was an attempt of the guilty to prosecute the innocent.

_______48. The expression “destructionist mentality” refers to a mindset that is hostile to business profits and which is based on a combination of economic ignorance, envy, and resentment.

_______49. If the landlords, electric utilities, and the oil companies were richer, the effect on tenants and consumers of electricity and oil products would be that they would be
a. poorer
b. have a more abundant and lower-priced supply of rental housing, electric power and oil products available to them

_______50. The fact that the greater wealth of producers means a greater supply of products is a point that is widely understood and accepted.

_______51. In an inflationary environment, the upward repricing of inventories already on the shelves is in the long-run interests of the consumers as well as the producers in that it is necessary to provide the funds to make possible the purchase of replacement inventories at their higher cost.

_______52. In the press and media campaign against the profits of the oil companies in the early 1970s, the claim was repeatedly made that the rise in the profits of the oil companies was the cause of the rise in the price of oil. Sixty and seventy percent increases in oil company profits were repeatedly reported in connection with inceases in the price of oil and oil products of similar relative magnitude.

_______53. Essential facts omitted in the above-mentioned campaign against the profits of the oil companies were

a. the higher profits of the oil companies were not earned on domestically produced oil or oil products but were the result of inventory profits earned abroad, higher profits on other operations, such as chemical production, and profits earned on foreign exchange holdings
b. higher profits could not have been earned on domestically produced oil or oil products because of the combination of government controls on their selling prices and a dramatic increase in their costs of production due to the rise in the world price of crude oil and thus in the cost of imported crude oil
c. the higher profits of the oil companies could not have contributed significantly to the rise in the price oil and oil products in the United States even if, contrary to fact, they had been earned on domestically produced petroleum or petroleum products, inasmuch as oil industry profits the year before were typically only on the order of 5 or 10 percent of sales revenues, and thus a 60 or 70 percent increase in profits could at most explain an increase in prices of between 3 and 7 percent, not 60 or 70 percent
d. even with the 60 or 70 percent increase—from whatever sources—the profits of the oil companies were only restored to the same level in relation to sales revenues at which they had existed in 1968
e. the actual rate of return on capital of the oil companies, rather than the percentage increase in their profit margins, was little more than the rate of increase in the consumer price index and sometimes less than the rate of increase in the consumer price index, with the result that their real rate of profit ranged from modest to negative
f. all of the above

_______54. In the 1970s, the oil companies were widely blamed for having caused the oil shortage. Given the fact that a shortage results only from a price being held too low, it follows that in order to be responsible for causing the oil shortage, the oil companies would have had to charge too low a price for their oil.

_______55. The accusation that the oil companies were responsible for the oil shortage by charging too low a price for oil is logically consistent with the almost daily repeated accusation that their behavior is "monopolistic" or "oligiopolistic" and strives to keep the price of oil artificially high.

_______56. In order to be responsible for a high price of oil as distinct from a shortage of oil, the American oil companies would have had to be responsible for artificially holding down the supply of oil.

_______57. The American oil companies have been responsible for holding down the supply of oil and thus for causing its price to be higher than necessary. This has been demonstrated repeatedly, in their efforts to prevent the environmental movement from expanding oil production on the North Slope of Alaska, from establishing new offshore wells on the continental shelf, and from finding and developing new oilfields in the areas they (the oil companies) have succeeded in setting aside as wildlife preserves and wilderness areas.

_______58. In a free market, the oil companies' profit motive is tied to achieving as great a supply and as low a price as possible because

a. the interests of the firms that are predominantly petroleum refiners, and whose capital is invested primarily in refineries, pipelines, tankers, delivery trucks, and the like, rather than in deposits of crude oil in the ground, lie with the greatest possible supply and lowest possible price of crude oil, which price is their cost
b. the interests of the producers of crude oil lie with the greatest possible efficiency of refining operations and the lowest possible price of refined petroleum products, because the lower the prices of refined products, the greater the quantity of them demanded and therefore the greater the quantity demanded of crude oil, which means that the price of crude oil can benefit by part of any cost savings in refining
c. the mutual tension between the interests of refiners and producers of crude oil makes it necessary for each group to try to improve its own production, because if the existing producers of crude oil lag behind, they can expect competition from the refiners, who can develop their own supplies of crude oil or expand their existing crude oil operations; if the existing refiners lag behind, they can expect competition from the producers of crude oil, who, for their part, can undertake refining operations or expand their existing refining operations
d. both groups can expect competition from total outsiders if they fail to exploit any significant opportunity for improvement
e. within each group, whichever individual firm succeeds in improving production ahead of its rivals will almost certainly gain at their expense
f. all of the above

_______59. In contrast to the oil companies, the U.S. government, acting largely under the influence of the ecology movement, restricted the supply of oil in the following ways:

a. it prevented exploration for and development of oil reserves in vast areas of territory arbitrarily set aside as “wildlife preserves” or “wilderness areas”
b. it prevented the development of offshore wells on the continental shelf
c. it prevented the construction of oil and gas pipelines, of new refineries, oil storage facilities, and facilities for handling supertankers
d. it imposed price controls on oil
e. it acted further to restrict oil company profits, and thus oil industry investment, by punitively increasing their rate of taxation through first reducing and then totally abolishing the customary depletion allowance on crude oil
f. it deterred investment in the oil industry through threats of antitrust actions forcing the breakup of existing companies, and even through threats of nationalization
g. all of the above

_______60. Over the years, the U.S. government has been responsible for increasing the demand for oil, and thus for raising its price, by means of

a. its policy of inflation of the money supply, which serves to increase the demand for and raise the price of virtually everything
b. controlling the price of natural gas, thereby undermining the growth of that industry and causing the demand for fuel that normally would have been supplied by natural gas to overflow into an expanded demand for petroleum, which is its closest substitute for most purposes
c. preventing the construction of atomic power plants and restricting the mining of coal, which serve to force the demand for fuel to rely more heavily than necessary on oil supplies
d. all of the above

_______61. In restricting the supply of oil and expanding the demand for it, the policies of the U.S. government have been responsible for the success of the OPEC cartel, because in their absence, in order to achieve the prevailing price of oil, OPEC would have had to reduce its own production of oil by an amount equal to the reduction in supply and increase in demand that the U.S. government has achieved for it, an amount so substantial that the rise in price probably would not have been worthwhile to OPEC.

_______62. In a free market, the achievement of a higher price by a cartel which does not control all the available sources of supply, which is and was the situtation of OPEC, serves to enrich its competitors more than itself, since they too receive the higher price but without having had to restrict their own production.

_______63. To the extent that the competitors of a cartel are in a position to expand their production in response to the higher price it achieves, it must progressively further curtail its own production in order to maintain that higher price.

_______64. Price controls and restrictions on production imposed on the American oil industry by the U.S. government served to insulate the OPEC cartel from competition by preventing major competitors from profiting from the rise in prices it achieved and expanding their production.

_______65. In the absence of the U.S. government’s destructionist policies, the Arab cartel would probably never even have been formed in the first place, because the conditions required for its success would have been lacking.

_______66. To argue that the oil companies were responsible for the oil shortage of the 1970s is an absurdity compounded by a triple injustice in that it

a. implies that the oil companies charged too low a price for their oil
b. evades the fact that it was the government’s price controls that kept the price too low and so created the shortage
c. ignores the fact that by the nature of the profit motive the oil companies have always worked to expand the supply of oil and reduce its price
d. evades the fact that the government and the ecology movement did practically everything they could to restrict the supply and expand the demand for oil
e. all of the above

_______67. Price control means

a. the setting of prices, whether by private businessmen, in the interest of private profit, or by government officials, in the public interest; either way prices are controlled, just as there is censorship whether by the decisions of private publishers about what to publish or not to publish or by government officials about what should be published or not be published
b. the setting of prices by the government

_______68. The claim that in setting their prices private firms are engaged in a process of price control, with the result that the only choice left is between selfish, private price controls and benevolent, government price controls ignores the fundamental and radical distinction between private action and government action, which is that private action is voluntary and proceeds by mutual consent to mutual advantage, while government action is based on the threat of physical force and proceeds against the will and the interests of one or more of the parties involved.

_______69. When prices are set by private firms, they are set with regard to the mutual self-interest of the buyer and seller, including the need to take into account the threat of competition or potential competition. Thus, a seller must ask prices that are not only high enough to enable him to stay in business and make the best possible profit he can, but, simultaneously, that are low enough to enable his customers to afford his goods and too low for other sellers or potential sellers to try to take away his market.

_______70. When the government sets prices, its prices are backed by the threat of physical force, and are necessarily against the mutual self-interests of buyers and sellers. The government invariably sacrifices either the seller to the buyer (by forcibly imposing lower prices), or the buyer to the seller (by forcibly imposing higher prices). The government's price, imposed by force, is the controlled price.

PART B. FURTHER EFFECTS OF PRICE CONTROLS AND SHORTAGES

_______71. The shortages that result from price controls represent a situation in which

a. the excess of quantity demanded over supply available means that there are waiting lines and waiting lists of customers hoping to be supplied
b. if a dissatisfied customer were to leave any given supplier, he would have to go to the end of the waiting line or waiting list of some other supplier and might not be supplied
c. if a customer does leave a given supplier, that supplier suffers no economic loss because the customer is immediately replaceable by the next customer on the waiting line or waiting list
d. buyers are deprived of economic power over the sellers
e. sellers are placed in a more powerful position with respect to ignoring the wishes of the buyers than if they (the sellers) were protected legal monopolists
f. producers can reduce their costs by reducing the quality of their products and at the same time not lose any business and thus have a powerful motive to do so
g. all of the above

_______72. Price controls and shortages launch a spiral of mutually reinforcing hatred between buyers and sellers

a. in which buyers experience themselves as economically impotent and the sellers as all powerful tyrants, with their (the buyers) only recourse being resort to the power of the state
b. in which sellers experience buyers as petty chislers seeking to live at their (the sellers) expense
c. which is confirmed by the relations between tenants and landlords living under rent controls in places like New York City and by relations between motorists and service stations in the oil shortage
d. all of the above

_______73. Shortages lead sellers to regard customers not only as valueless, but as a positive nuisance—as a source of trouble and expense, not a source of livelihood. This occurs because, in fact, under a system of shortages and waiting lines, that is just what customers become. Under such a system, when a seller renders a customer some service or goes to some expense on his behalf, he is no longer doing it for the sake of gaining or keeping the customer's business and thereby earning his own livelihood, because having the customer's business no longer depends on performing the service or incurring the expense. The seller can have the customer anyway, or, if not that customer, then any one of ten or a hundred or a thousand other customers. If the seller is to continue to provide the service or incur the expense for the sake of the customer, he can only do so out of a sense of altruistic duty, not out of the sense that in serving the customer he serves himself.

_______74. Repeal of rent controls would restore harmony between landlords and tenants because

a. free markets rents would rise to the point of reducing the quantity of rental housing demanded somewhat below the supply available, with the result of establishing a significant vacancy rate
b. in the face of vacancies available at rents comparable to those they were presently paying, tenants would feel free to leave if they were dissatisfied with their present landlords
c. the absence of waiting lists would mean that landlords who lost tenants would experience an actual economic loss and be motiviated to please tenants so as to avoid such loss
d. all of the above

_______75. Price controls and shortages bring about the disappearance of lower-priced models and a decline in the quality of higher-priced models as a disguised way of raising prices.

The following is a three-part question.

_______76. Under a severe shortage, quality and service are cut to the point that buyers are offered models that would never appear in a free market in any price range. What happens is that sellers are led to cut corners in order to make relatively small savings to themselves and which have a great impact on the buyers. For example, situations can exist in which it is advantageous to a seller to save a few cents in manufacturing costs that later imposes many dollars in repair costs on the buyer. The harm inflicted on the buyers does not cause the sellers any economic loss, because at the controlled price there is a surplus of buyers eager to buy even a very inferior product.

_______77. In the same way that price controls and shortages make it impossible for a consumer to select his model on the basis of cost, they also make it impossible for a businessman to select his methods of production on the basis of cost. For one or more of the factors of production he requires may simply be unobtainable, because a price control has created a shortage of it. Under price controls, businessmen must select those methods of production for which the means happen to be available, and not necessarily those which have the lowest costs.

_______78. The inability to find the right factors of production as the result of shortages, frequently results in a decline in the quality of products as well, and should be viewed as a further and major cause of declining quality.

_______79. The deterioration of quality and service that results from shortages is itself a powerful source of higher costs both to businessmen and consumers. If, for example, a machine is produced or serviced in an inferior way, then even if its price remains the same, it will cause higher costs of maintenance and repair and may have to be replaced sooner.

_______80. Shortages of supplies and the mere threat of shortages themselves directly raise the costs of production. The effect of a shortage of a factor of production is to delay production. This causes the capital invested in all the other, complementary factors of production that depend on it, to have to be invested for a longer period of time than would otherwise be necessary. For example, a shortage of building-nails causes capital to be invested in half-finished houses and in piles of lumber for an unnecessary period of time. Since interest must be paid on capital for the full time it is invested, the effect of all such delays is to raise the interest cost of production.

_______81. The mere anticipation of shortages of supplies leads businessmen to hoard supplies of all types. This requires that production be carried on with a larger capital investment—in the additional stocks of supplies and in facilities for storing them, which, in turn, means extra interest costs and extra costs on account of the storage facilities.

_______82. Price controls and shortages also raise costs because of the loss they cause of the valuable time of executives in searching for sources of supply and in performing all the paperwork required to comply with the government's price controls and any associated regulations, such as rationing.

_______83. Shortages and the threat of shortages also directly raise costs to consumers because

a. they must buy goods that do not last as long or need more frequent repairs as the result of the decline in quality that shortages create
b. consumers too suffer effects analogous to wasted investment—for example, consumers who could not obtain gasoline could not use their cars or enjoy their country homes until such time as they could obtain gasoline, and to that extent, the money they had spent for these complementary consumers' goods represented a kind of wasted investment
c. consumers too suffer effects analogous to the need for more investment—namely, they too are led to hoard supplies and thus to tie up larger sums of money in stocks of goods and, quite possibly, incur additional costs on account of acquiring extra storage facilities—for example, extra home freezers, if there should be the threat of a food shortage
d. of the wasted man-hours spent in waiting lines during every shortage, which, while not a money cost, are nonetheless a real hardship and burden and can well be at the expense of actual working time
e. all of the above

_______84. Under price controls and shortages, normal cost reductions, based on improvements in efficiency, cease to pay, even if they are still within a firm's power to make, because their effect is merely to postpone the day that the firm is permitted to obtain relief by raising its prices on the basis of demonstrating higher costs. The only cost reductions that pay under price controls are the ones that can be made effortlessly, namely, cost reductions at the expense of quality—the kind of cost reductions that would not pay in a free market.

_______85. The willingness of the government to allow higher controlled prices on the basis of demonstrated higher costs of production leads to

a. multiple controlled prices of the same good in cases in which different parts of the supply are produced at different costs of production
b. a system of transfer payments from sellers obtaining supplies at a lower controlled price to sellers obtaining supplies at a higher controlled price in conditions in which both sets of sellers are required to make their sales at the same controlled selling price
c. both (a) and (b)

_______86. Price controls and shortages

a. mean that consumers who get to stores when supplies of goods arrive can snap them up to the point of leaving nothing for latecomers
b. prevent consumers with greater wealth or income from benefitting from it by being able to outbid consumers with lesser wealth or income
c. prevent consumers of equal wealth or income but with greater need or desire for particular goods or services from outbidding consumers with lesser need or desire for those goods or services
d. introduce chaos into the distribution of consumers' goods to individuals
e. make government rationing appear necessary
f. all of the above

_______87. Price controls and shortages create chaos in the geographical distribution of goods among local markets by creating a situation in which

a. supplies can be taken away from any given area and the area is prohibited by price contols from calling them back by offering higher prices and greater profitability

b. supplies can be brought into an area and not reduce price or profitability but merely the severity of the local shortage until the local shortage is entirely overcome, at which point the price must drop to find buyers of additional units

c. the movement of supplies between geographical areas is made arbitarary and random within the limits of what is required to totally overcome a local shortage, because only then will considerations of price and profitability again become operative

d. all of the above

_______88. The severity of shortages in particular localities can depend on the time of year in which the price controls are imposed—for example, price controls imposed on gasoline in summer time will favor resort areas in the following winter, while price controls imposed in winter time will strangle resort areas in the following summer.

_______89. Minor events, like the washout of a bridge, or small bureaucratic adjustments in the controls can cause sudden, major swings in supply between different geographical markets.

_______90. Price controls and shortages introduce chaos into the distribution of factors of production among their various uses and make it possible for some products of a price-controlled factor of production to be faced with extremely severe shortages, while other products are faced with only minor shortages.

_______91. The position of the various products in the preceding question can suddenly be reversed by minor changes in the uncontrolled prices of complementary factors of production, by small bureaucratic changes in the price controls, or by anything that results in the slightest changes in the relative profitability of the various products of the factor of production.

_______92. The season of the year in which price controls are imposed is relevant to the extent to which different products of a factor of production are faced with shortages. For example, price controls imposed on oil and oil products in the winter time, when gasoline prices are low relative to heating oil prices, will result in an especially severe shortage of gasoline the following summer, because of the freezing of that price relationship. For the same reason, if the controls were imposed in the summer time, the heating oil shortage would be especially severe in the following winter.

_______93. Price controls and shortages create tremendous instability in supply. The supply of everything subjected to controls becomes subject to sudden, massive, and unpredictable shortages.

_______94. Hoarding

a. comes into existence in response to the existence of shortages and the fear of shortages; it is the attempt to secure supplies when they are available in preparation for their being unavailable

b. represents a new and additional demand that under price controls operates to increase the severity of the shortages

c. both (a) and (b)

_______95. Under price controls, the most vital and urgent employments of a factor of production are prevented from outbidding not only its most marginal employments, but, from the standpoint of a free economy, employments that could not even qualify as submarginal, namely the accumulation of hoards as a safeguard against shortages.

_______96. The abolition of price control puts an end to hoarding by allowing the price of a good to rise sufficiently high to limit the quantity demanded, including the hoarding demand, to the supply available. At that point, the good is available to whoever is willing to pay the market price and the need to hoard is eliminated.

_______97. It follows from the preceding question that following the repeal of price controls and prices rising to levels high enough to cope with the desire to hoard, prices will actually decline somewhat, in response to the disappearance of the hoarding demand.

_______98. The effect of a shortage of any particular commodity is to cause the unsatisfied demand for that commodity to spill over and add to the demand for other commodities.

_______99. "Selective" or partial price controls, that is, price controls imposed merely on certain goods only, are contrary to any rational purpose the government might have in imposing them. This is because their effect is to inhibit the profitability and thus the production of the goods the government deems important while leaving uncontrolled the profitability of the goods the government considers unimportant. At the same time, the profitability and thus the production of the goods the government considers unimportant is positively stimulated by the spillover of demand into the markets for the uncontrolled goods that results from the shortages of the controlled goods.

_______100. The effect of selective or partial price controls is to

a. raise the prices of uncontrolled goods because of the spillover of demand from the controlled goods

b. raise the general price level insofar as they apply to the production of goods on which the production of other goods depends, such as oil or electric power, and reduce their production and thus cause a reduction in the aggregate amount of production and supply

c. both (a) and (b)

_______101. Price controls
a. save people money
b. cause them to spend less money for the goods they want, but cannot obtain because of the resulting shortages, and more money for other goods that they want less

_______102. Rent control on part of the supply of rental housing has the effect of raising rents on the part of the supply that remains free of rent controls. This is because insofar as it leads to part of the supply going to tenants who could not have obtained it in the absence of rent control, it equivalently reduces the supply of housing available on the market and correspondingly raises its price.

_______103. Rent controls and housing shortages across broad regions have the potential for bringing about the compulsory assignment of boarders to homes and a system of internal passports so that it requires the government's permission to move to various places within one's own country. In such conditions, which existed in Soviet Russia, such measures appear as necessary to prevent large numbers of people from otherwise being homeless and to restrain the severity of housing shortages in areas of the country that are relatively desirable in which to live and into which large numbers of people might otherwise move.

_______104. Rent controls in the United States have not resulted in the kind of conditions described in the preceding question because the controls have applied only to local jurisdications surrounded by other jurisdictions in which there were no controls and in which housing could be found.

_______105. Rent control serves to increase the effective cost of constructing new rental housing insofar as the prospect of its later on being extended to the new housing makes it necessary to recover one's investment more rapidly and thus to crowd the depreciation of the housing into the years one can expect it to remain free of controls.

_______106. By keeping property values down, and thus the revenues that can be collected from property taxes, rent controls contribute to the imposition or increase in local sales and income taxes.

_______107. The effect of the immediate abolition of rent control would largely be that the present "beneficiaries" of rent control would simply have to change places with an equally large but generally unrecognized class of victims of rent control—those who presently cannot find an apartment they can afford to rent in the rent-controlled area but must live with inlaws, roommates, or outside the area. The repeal of rent control would place the apartments of its "beneficiaries" on the market, thereby enlarging the market supply and reducing market rents to the point of apartments becoming affordable by people who cannot presently afford them.

_______108. The "beneficiaries" of rent control would suffer far less hardship following its repeeal than the unseen victims of rent control have suffered under it, because repeal would be followed by a sharp increase in the supply of rental housing and thereafter by a progressive increase and improvement in the supply of rental housing making rental housing more and more affordable.

_______109. There are no beneficiaries of rent control in the long run because its seeming benefits in the short run are made possible by the consumption of the capital invested in rental housing, with the ultimate result being the destruction of rental housing. And in the interval, the "beneficiaries" live in deteriorating conditions, valueless to their landlords yet afraid to move out of fear of being unable to duplicate the rental "bargain" they have.

_______110. The effect of repealing rent controls in an otherwise unregulated housing market would not be to make people sleep in the streets because
a. open-market rents would fall, as the result of an expanded supply available for the market, not rise to the level of open-market rents reflecting the restricted supply that is available for the market as the result of rent control
b. those unable to afford their own apartments even with the lower open-market rents that would exist without rent control would be able to share apartments with others and in that way be able to find housing at a rent they could afford
c. both (a) and (b)

_______111. Government housing regulations that impose minimum standards too costly for poor people to afford have the potential to result in people having to sleep in the streets, in the same way, say, that government standards prohibiting automobiles more than ten years old, would serve to deprive poor people of the ability to drive cars, since such old cars are often all that they can afford.

_______112. Just as rent controls applied to part of the stock of rental housing serve to raise rents on the part that is not subject to rent controls, so price controls applied to domestically produced oil served to raise the price of oil produced outside the country, notably in OPEC countries. Like partial rent controls, the price controls on oil enabled part of the supply of oil to be consumed in submarginal uses and thus reduced the supply available for the open market and thereby raised the price of oil on the open market.

_______113. The repeal of U.S. price controls on oil reduced the price received by the OPEC cartel even before the production of oil was increased, simply by causing existing supplies to be withdrawn from submarginal uses and be made available on the market, where the effect of greater supply was to reduce price.

_______114. The windfall profits tax on the oil industry, enacted in conjunction with the repeal of price controls, contributed to subsequent widespread bankruptcies in the oil industry because it correspondingly deprived oil producers of the ability to finance expansion out of profits and made them borrow money instead. Then when oil prices plunged, as the result of expanded production, instead of merely losing back profits, producers lost borrowed money and went bankrupt.

PART C. UNIVERSAL PRICE CONTROLS AND THEIR CONSEQUENCES

_______115. Price controls tend to spread until all prices and wages in the economic system are controlled—i.e., partial price controls lead to universal price controls.

_______116. Price controls spread because
- a. price controls on products require controls on the prices that constitute the costs of production, if the production of the product is not to be made unprofitable and cease, and then on the further prices that constitute the further costs of production of materials, machinery, and the like, going all the way back in the chain of production
- b. price controls on labor (wage controls) must be extended to more and more occupations to prevent workers from leaving the already controlled occupations and taking jobs in better paying uncontrolled occupations
- c. price controls must be extended not only to the prices of the factors of production, which prices constitute the costs of production, but also, in cases in which factors of production have more than one product, to the prices of the other products of the factors of production—for example, price controls on milk for drinking and on raw milk lead to price controls on butter, cheese, and the other milk products lest they become more profitable uses for raw milk than milk for drinking
- d. all of the above

_______117. The shortages of individual goods that exist under universal price controls tend to be far more severe than the shortages that exist under partial or selective price controls because of the spillover of demand from all other goods in a state of shortage.

_______118. The nature of shortages under universal price controls could be seen in Soviet Russia, where the shortages were so severe that when people saw a line forming, they would automatically get on it, even without knowing what goods were available, because it was better to obtain practially any good than hold otherwise unspendable money.

_______119. Universal price controls existed
- a. in Nazi Germany
- b. in the United States in World War II
- c. briefly under President Nixon, when he imposed a ninety-day freeze on all prices and wages in August 1971
- d. their equivalent exists under socialism, as for example in the former Soviet Union and its satellites
- e. all of the above

_______120. Excess demand under price controls builds up even though people's incomes are controlled and even though the sum of the controlled prices times the quantities of goods available for sale does not exceed those incomes. It occurs as the result of government spending financed by the creation of new and additional money succeeding in obtaining supplies and thus causing a part of people's incomes to back up on them, so to speak, as unspendable funds. Then, in the next year, the people may be paid the same incomes, but their available funds now equal the sum of those incomes plus the unspendable funds from the year before. If the government again makes purchases out of newly created money, then additional unspendable funds accumulate.

_______121. Shortages under universal price controls
- a. are both far more widespread and far more severe than under partial price controls
- b. destroy production in all the ways that partial price controls do
- c. destroy production in ways beyond partial price controls
- d. result in shortages of capital and labor, in which the production of any product can be randomly expanded at the expense of the production of any other product
- e. result in disproportions in the supplies of the various capital goods, which serve to undermine the ability to produce and lead to a process of continuing capital decumulation
- f. result in people losing the incentive to earn more money, and to quitting their jobs, a process which is capable of causing a cumulative, self-reinforcing decline in production
- g. all of the above

_______122. Universal price controls and the shortages they create result in chaos in the allocation of capital and labor among the various branches of production in the economic system, because price controls prohibit a rise in prices and profits when capital and labor are withdrawn from an industry and the existence of shortages prevents a fall in prices and profits when additional capital and labor are brought into an industry. Thus any industry can be expanded at the expense of any other industry, with nothing to counteract or limit the process.

_______123. Because of the spillover of demand caused by shortages, and the fact that under universal price controls the spillover into each industry is the sum of the spillovers from all other industries, the shortage facing any given industry may not be capable of being overcome, irrespective of any increase in the industry's output, and thus nothing whatever may be present to limit the relative overexpansion of an industry.

_______124. As the result of the shortages created by universal price controls, capital and labor can be withdrawn from any industry and placed in any other industry, and there is no effect on the rate of profit anywhere.

_______125. Under universal price controls and shortages, even though the consumers want more of one good and less of another, say, more shoes and fewer shirts, the producers can go ahead and do the exact opposite and yet suffer no financial penalties.

_______126. The chaos in the relative production of capital goods that results from universal price controls and shortages undermines the subsequent ability to produce, including the subsequent ability to produce capital goods. If, for example, the steel industry is unduly expanded at the expense of the coal industry, say, the economic system's subsequent ability to produce will be impaired: not only the extra steel mills, but part of the existing steel mills may be inoperable for lack of fuel.

_______127. Like a human body, whose total performance cannot exceed the power of its brain, heart, lungs, or any other vital organ, the overall performance of an economic system cannot exceed the power of any one of a large number of vital industries. If some are unduly expanded at the expense of others, the effect is to reduce the functioning of the whole.

_______128. The ability of the economic system to produce is undercut by disproportions

a. among major industries, like steel and coal

b. within the output of individual industries—for example, the production of too many trucks to haul farm products and of not enough tractors to harvest them

c. in the production of just a few key products here and there—like ball bearings, lubricants for machinery, spare parts, even ordinary screws, and so on, a shortage of any one of which or of any one special type of which, such as ball bearings of a particular size, must cause a widespread paralysis and the grossest inefficiencies in production

d. all of the above

_______129. The problem of disproportions in the supply of capital goods is further compounded by the declines that result from producers just not having to care any longer about the quality of their products or about economies in producing them.

_______130. In Soviet Russia, hydroelectric stations were built without generators and without the existence of industries to supply; wheat could not be harvested because the necessary tractors had not been built, or, if they had been built, they lacked spare parts, or were in the wrong place, or quickly became inoperable; factories could not operate because they lacked materials; new buildings and new machines were worthless, because of shoddy construction due to lack of care or lack of the necessary materials.

The following is a five-part question.

_______131. Since capital goods are continuously used up in production and must be replaced out of production, a severe reduction in the ability to produce capital goods, because of malportions among them and because of the various other inefficiencies that are caused by universal price controls, results in a smaller supply of capital goods being produced than is consumed in production.

_______132. As the result of a smaller supply of capital goods being produced than is consumed in production, the stock of capital goods falls.

_______133. Once the stock of capital goods falls, production must decline further, because it will be carried on with fewer capital goods.

_______134. If the smaller supply of capital goods is used as inefficiently as was the larger supply, because of continuing chaos in production, it will not be possible to replace the smaller supply of capital goods either. Thus, once again production will decline.

_______135. The process of less production causing fewer capital goods causing less production, can go on until the economic system is carried back all the way to the level of barbarism.

_______136. Universal price controls result in a severe labor shortage because

a. every industry is eager to employ more labor, inasmuch as whatever extra products it can produce with more labor will be snapped up by goods-hungry buyers

b. the inefficiencies in production under universal price controls imply a need for more labor per unit of output and thus intensify the labor shortage

c. shortages of consumers' goods and the accumulation of surplus unspendable funds leads workers to quit their jobs since there is no point in working to earn money they cannot spend and the funds they have are sufficient to enable them to get by for an extended period; this worsens the shortage both of labor and consumers' goods

d. all of the above

_______137. Like the process of capital decumulation, the labor shortage under universal price controls is a factor making for a self-reinforcing, cumulative decline in production, because workers quitting their jobs reduces the supply of consumers' goods and thus further intensifies the shortage of consumers' goods, which, in turn, further reduces the incentives to work and earn money and thus leads to still more workers quitting.

_______138. The combination of inflation and price controls and the shortages they created promoted a delusion of prosperity in the United States in World War II, by making it extremely easy to earn money, which included finding employment; people ignored the fact that much of the money they earned was currently unspendable, that major categories of civilian goods were not being produced, and that the goods that were available were of reduced quality; they looked forward to spending the money after the war.

_______139. The government's typical response to the chaos resulting from price controls and shortages is to seize the power to determine what goods are produced, in what proportions, by what methods, and to whom they are distributed.

_______140. The U.S. government's response to the chaos that resulted in connection with price controls on oil and the resulting oil shortage was the creation of a new government agency—the Federal Energy Administration (now the Department of Energy), which had the power to tell the various oil companies how much of each of the various petroleum products they were to produce and to which industries, firms, and regions they were to distribute those products.

_______141. The meaning of ownership is the power to determine the use and disposal of property. If the government determines what a firm is to produce, in what quantity, by what methods, and to whom it is to sell its output and at what prices, then it is the government that determines the use and disposal of the firm's property. The government, therefore, becomes the real owner of the firm—the de facto owner.

_______142. The government's assumption of the further powers required to deal with the economic chaos caused by universal price controls and shortages represents the de facto socialization of the economic system, because it gives to the government all the essential powers of ownership.

_______143. Socialism on what von Mises calls "the German or Nazi pattern," in contrast to "Socialism on the Russian or Bolshevik pattern," in which the government openly nationalizes all of the means of production, is the de facto socialism that results from universal price controls and the government's response to the shortages and chaos that result.

_______144. Nazi Germany was a capitalist country only in outward guise and appearance. In it, private ownership of the means of production existed in name only. All substantive economic decisions were made by the government; the Nazi government held and exercised all the actual powers of ownership—the setting of prices and wages, the determination of what was to be produced, in what quantities and locations, and by what methods, and to whom the products were to be distributed.

_______145. While Nazi Germany was a socialist country, Sweden is not a socialist country, nor was Great Britain or Israel when they were governed by socialist parties. The great bulk of the means of production in the economy of these latter countries was and is privately owned and they did not have price controls and shortages nor, therefore, the government's de facto seizure of ownership.

_______146. Private ownership of the means of production in countries such as Sweden has, to be sure, labored under all sorts of restrictions, prohibitions, and compulsions, but still it has been private ownership—production has been carried out characteristically at the initiative of private owners for the sake of private profit.

_______147. Economies such as Sweden, and that of the United States too, are more appropriately described as "hampered market economies" or "hampered capitalist economies" rather than as "mixed economies," inasmuch as socialism, understood along the lines of universal price controls and the destruction of the price system, cannot actually be combined with a functioning price system, which last represents capitalism.

_______148. The expression "mixed economy" should only be used if it is understood that what is meant is an economy based on private ownership of the means of production but more or less severely hampered by an extensive list of socialistically motivated acts of government intervention—i.e., a hampered capitalist economy.

_______149. The existence of isolated socialized industries, such as the postal service and passenger railroad service, does not warrant characterizing a country as socialist. So long as such industries operate in the context of a market and market prices based on a foundation of private ownership of the means of production and the profit motive, they represent, in effect, merely a blemish on an otherwise capitalist body.

_______150. Examples of genuinely socialist economies are those of the Communist countries, most of which no longer exist, Nazi Germany, and those of normally capitalist or market economies for the duration of their imposition of all-round price controls, as in World War II.

Answers to Questions 1-150 on Chapter 7

Question #	Correct Answer	Question #	Correct Answer	Question #	Correct Answer	Question #	Correct Answer
1	d	39	F	77	T	115	T
2	d	40	T	78	T	116	d
3	T	41	b	79	T	117	T
4	b	42	F	80	T	118	T
5	T	43	F	81	T	119	e
6	T	44	T	82	T	120	T
7	d	45	T	83	e	121	g
8	c	46	b	84	T	122	T
9	T	47	T	85	c	123	T
10	T	48	T	86	f	124	T
11	a	49	b	87	d	125	T
12	T	50	F	88	T	126	T
13	T	51	T	89	T	127	T
14	T	52	T	90	T	128	d
15	b	53	f	91	T	129	T
16	T	54	T	92	T	130	T
17	b	55	F	93	T	131	T
18	T	56	T	94	c	132	T
19	a	57	F	95	T	133	T
20	T	58	f	96	T	134	T
21	T	59	g	97	T	135	T
22	T	60	d	98	T	136	d
23	T	61	T	99	T	137	T
24	e	62	T	100	c	138	T
25	T	63	T	101	b	139	T
26	T	64	T	102	T	140	T
27	T	65	T	103	T	141	T
28	T	66	e	104	T	142	T
29	T	67	b	105	T	143	T
30	d	68	T	106	T	144	T
31	d	69	T	107	T	145	T
32	T	70	T	108	T	146	T
33	F	71	g	109	T	147	T
34	T	72	d	110	c	148	T
35	T	73	T	111	T	149	T
36	T	74	d	112	T	150	T
37	T	75	T	113	T		
38	F	76	T	114	T		