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Economics for the Citizen, Part 9

by Walter E. Williams

We're all grossly ignorant about most things that we use and encounter in our daily lives, but each of us is knowledgeable about tiny, relatively inconsequential things. For example, a baker might be the best baker in town, but he's grossly ignorant about virtually all the inputs that allow him to be the best baker. What is he likely to know about what goes into the processing of the natural gas that fuels his oven? For that matter, what does he know about oven manufacture? Then, there are all the ingredients he uses — flour, sugar, yeast, vanilla, and milk. Is he likely to know how to grow wheat and sugar and how to protect the crop from diseases and pests? What is he likely to know about vanilla extraction and yeast production? Just as important is the question of how all the people who produce and deliver all these items know what he needs and when he needs them. There are literally millions of people cooperating with one another to ensure that the baker has all the necessary inputs.

It's the miracle of the market and prices that gets the job done so efficiently. What's called the market is simply a collection of millions upon millions of independent decision-makers not only in America but around the world. Who or what coordinates the activities of all these people? Rest assured it's not a bakery czar.

There are a number of ways to allocate goods and services. They include: first-come-first-served, gifts, violence, dictatorship, or lotteries. When the price mechanism performs the allocation function, we realize efficiency gains absent in other methods. The price mechanism serves as a signaling function. Prices rise and fall, reflecting scarcities and surpluses. When prices rise as a result of higher demand, this acts as a signal to suppliers to expand output. They do so because whenever the price exceeds the costs of production, they stand to gain. They ship the goods to those with the highest willingness to pay.

Let's look at just one of the baker's needs — flour. How does the wheat farmer know whether there's a surge in demand for bakery products? The short answer is that he doesn't. All he knows is that millers are willing to pay higher wheat prices, so he's willing to put more land under cultivation or reduce his wheat inventory. In other words, prices serve the crucial role of

conveying information. Moreover, prices minimize the amount of information that any particular player involved in the process of getting flour to the baker needs in order to cooperate.

What if politicians thought that flour prices were too high and enacted flour price controls in the wake of a surge in demand for bakery products? Would wheat farmers put more land under cultivation? Would millers work overtime to produce more flour? The answer is a big fat no because what would be in it for them? The result would be flour shortages, but the story doesn't stop there because mankind is ingenious about getting around government interference. If there were flour price controls, we'd see black markets emerging — people buying and selling flour at illegal prices. That's always one effect of price controls. Another would be the corruption of public officials who know about the illegal activity but for a price look the other way.

In 302, the Roman emperor Diocletian commanded, "There should be cheapness," declaring, "Unprincipled greed appears wherever our armies ... march.... Our law shall fix a measure and a limit to this greed." The predictable result of Diocletian's food price controls was black markets, hunger, and food confiscation by his soldiers. Despite the disastrous history of price controls, politicians never manage to resist tampering with prices — that's not a flattering observation of their learning abilities.

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