"Why Some Prices Should Rise"

by Milton Friedman

Newsweek, 19 November 1973, p. 130

"When the price of a thing goes up," wrote the British economist Edwin Cannan, in 1915, "a good many people … abuse, not the buyers nor the persons who might produce it and do not do so, but the persons who are producing and selling it, and thereby keeping down its price … It certainly would appear to be an extraordinary example of the proverbial ingratitude of man when he abuses the farmer who does grow wheat because other farmers do not … But have we not all heard the preacher abuse his congregation because it is so small?"

This ancient article, from which I have taken my title, has been brought to mind by the oil crisis.

Time and again, I have castigated the oil companies for their hypocrisy, for loudly proclaiming their allegiance to free enterprise yet simultaneously undermining free enterprise by seeking and getting special governmental privilege (percentage depletion, prorationing of oil, import quotas, etc.). Yet we shall only hurt ourselves if we let resentment at their past misdeeds interfere with our adopting the most effective way to meet the present problem.

The current oil crisis has not been produced by the oil companies. It is a result of governmental mismanagement exacerbated by the Mideast war. The price of natural gas at the wellhead has been held down for years by government edict. Since Aug. 15, 1971, the price of retail gasoline and of fuel oil has been held down by the successive phases. The result has been to encourage consumption and discourage both current production and the expansion of capacity. It took the Mideast war to bring these evil effects of price-fixing to a boil.

If all Mideast oil is shut off, we shall have to do without some 10 per cent of our present oil supplies. That is no tragedy. It means going back to the rate of consumption of 1970 or 1971—when no one thought we had a catastrophic shortage of fuel.

The most effective way to cut consumption and encourage production is simply to let the prices of oil products rise to whatever level it takes to clear the market. The higher prices would give each of the 210 million residents of the U.S. a direct incentive to economize on oil, to find substitutes for oil, to increase the supply of oil.

How much will the price have to rise? No one can tell. But if consumption must be cut by 10 per cent, it is hard to believe the price would have to rise by more than, say, double that percentage. A 20 per cent rise in oil and gasoline prices would not be nice—but consider the alternative.

The only alternative is exhortation backed by compulsion: artificially low prices accompanied by governmental rationing. This method induces each of us to oppose the general interest rather than to further it. Our separate incentive is to wangle as much as we can from the rationing authorities. And they can have only the crudest criteria to know how to distribute the limited supplies. They have no way to know whose "need" is genuine and whose is artificial—even if we put to one side, as experience warns us we cannot, special influence, corruption and bribery.

Two hundred and ten million persons each with a separate incentive to economize; or 210 million persons dragooned by men with guns to cut down their use of oil—can there be any doubt which is the better system?

But, you will say, rationing by price hurts the poor relative to the rich. What of the poor man with his old jalopy as the only way to get to work? The answer is straightforward. If high oil prices impose special problems on some, let us provide funds to mitigate their problem. Let us not impose compulsion and waste on 95 per cent to avoid special measures for 5 per cent.

Note that what is called for is higher prices for oil products *relative* to other products—*not general inflation*. Only some prices should rise.

The oil problem offers a particularly clear illustration of how the price system promotes both freedom and efficiency, how it enables millions of us to cooperate voluntarily with one another in our common interest. It brings out equally why the only alternative to the price system is compulsion and the use of force.

It is a mark of how far we have gone on the road to serfdom that governmental allocation and rationing of oil is the automatic response to the oil crisis. This will not prevent higher prices, which will in fact do the job—but you may be sure that the rationing authorities will take the credit.

Reprinted in Milton Friedman, *There's No Such Thing as a Free Lunch*, pp. 310-312. LaSalle, Illinois: Open Court Publishing Company, 1975.

Compiled by Robert Leeson and Charles Palm as part of their "Collected Works of Milton Friedman" project.

Reformatted for the Web.

10/25/12