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Commentary

Title:

"The Economics of Emergency Pricing: Immoral Behavior by Buyers when Prices Fall?"

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In a market economy, prices are determined by the interplay of supply and demand. Supply and demand are nothing more than summaries of the willingness and ability of sellers and buyers to voluntarily trade a good. Over time, as supply or demand change, market prices will adjust upward or downward in systematic and predictable ways. During times of emergency (e.g., following a natural disaster or in the wake of a global pandemic, such as COVID-19), there can be rapid changes in supply (or even demand) for particular goods which would lead to drastic changes in market equilibrium price and quantity.

For example, if a hurricane disrupts oil refining capacity in the Gulf of Mexico, this would lead to a large decrease in supply of gasoline in the United States, causing a sudden increase in price. We can easily envision similar sudden increases in prices of other essential consumer goods – such as drinking water, food, and toilet paper – as supply chains are rapidly disrupted. Any such increase in price brought about by a decrease in supply will also result in fewer units of the good being purchased and consumed. This change in market outcome would be unequivocally bad for consumers, since they would experience a decrease in benefits from consuming fewer units and having to pay a higher price for the units they do consume.

To lessen the negative impact on consumers, many people support prohibitions on "price gouging" during such emergencies.[1] In fact, 34 states have anti-price gouging laws in place, including the six most populous states of California, Texas, Florida, New York, Pennsylvania, and Illinois, plus my home state of Georgia. However, as is the case with many matters, economists view the issue of emergency pricing differently than the general public. The results of a 2012 poll of a panel of expert economists conducted by the University of Chicago's IGM Forum on proposed legislation that would prevent price gouging in Connecticut begin to illustrate this point. Only 8% of economists agreed or strongly agreed that the restriction on price gouging should be passed, while 51% disagreed or strongly disagreed with the proposed restriction.[2]

Some of the common arguments put forth by economists *against* restrictions on allowing prices to naturally adjust in response to large, quick changes in market conditions during times of emergency are along the following lines:

- High prices discourage "overbuying" by consumers. This reduction in overbuying will help ensure that the people who need the item the most are the ones who actually get to purchase and consume the item. For example, suppose that in "normal times," I like to buy spring water at the grocery store for $1 a gallon to water my houseplants. My neighbor needs clean spring water to mix formula for her baby. Suppose there is a natural disaster and the supply of bottled spring water to grocery stores is disrupted (and additionally municipal water supplies are contaminated). If the price of water at the grocery store is restricted to not rise above $1, I might still choose to buy an available gallon at the store for my plants (unintentionally preventing my neighbor from getting the water for her infant). If the price of water is allowed to increase to $5 per gallon, I won't buy it and the fresh drinking water will still be available for my neighbor to purchase for her infant.
- On the supply side of the market, if prices are allowed to adjust upward, sellers will be able to earn large profits from supplying the good. This is actually a good thing, as it encourages more productive resources to be devoted to the production of the currently

[1] I used the term "emergency pricing" in the title instead of "price gouging," since – as suggested by economist Steven Horwitz (http://www.sghorwitz.com/) – the phrase "price gouging" is in no way objective, whereas "emergency pricing" is more accurate and less loaded.
[2] See http://www.igmchicago.org/surveys/price-gouging/.

scarce good. Continuing with the fresh drinking water example, following natural disasters which disrupt water supplies, Anheuser-Busch regularly produces canned water for affected areas (diverting this resource away from the production of beer).[3] Similarly, in response to the unprecedented need for ventilators created by COVID-19, Ford has committed to produce 50,000 ventilators in the next three months, in lieu of making more cars – and several other manufacturers are stopping production of what they normally make in order to produce valuable medical supplies as well.[4] Each of these responses was brought about by benevolence and altruism as opposed to "profit," but even more productive resources would be switched to the production of goods in short supply during times of emergency (which would clearly be a good thing) if prices were free to adjust upward to natural levels.

- Allowing prices to adjust upward reduces the "non-monetary costs" of acquiring goods in short supply. "Dollars paid" is only one cost incurred when purchasing a good. Search costs (e.g., time spent driving from store-to-store to find the good) and time spent waiting in line to buy a good are also real costs that should be accounted for when measuring the "price" of acquiring a good. If price is allowed to adjust upward during a time of emergency, then stores will still have the good in stock. I may have to pay $5 for a gallon of milk that typically costs $2, but I can be confident that it will be available at the Publix near my house and I won't have to drive to five different stores before I find it in stock. It is very reasonable to think that the savings of not spending an hour driving around town to five different stores to find the milk is larger than the cost savings of $3 if I happen to be one of the lucky consumers who is able to purchase the item at the artificially low price of $2. The point is, if I am willing to pay more than $5 for a gallon of milk, I'd rather be able to purchase the good for $5 than have a store claim that milk costs $2 but they don't have any in stock. The true price of a good that is not available for purchase is infinity, and a price of infinity is clearly much more than a price of $5. Mandating low prices doesn't magically ensure that goods are available – it would be nice if it did, but it doesn't.
- If prices are not allowed to adjust, other mechanisms must be used to ration access to the good. As just discussed, these other mechanisms could be things like people spending an hour driving around to five stores before they find one that actually has milk in stock or long lines at the gas station. Keeping price artificially low where quantity demanded far exceeds quantity supplied also creates the possibility for "well connected individuals" to be the ones who get access to the good. For the past two weeks I have not been able to find toilet paper for sale anywhere in Canton, GA. However, when I drove past the Publix near my house as they were closing the other day, I saw multiple employees leaving the store with large packs of toilet paper in hand.

Many of these (and additional) common arguments *against* restrictions on price gouging have been noted by others. See, for example:

- *'Price Gouging' During Crisis a Good Thing* by Antony David and James Harrigan (4/1/20) https://triblive.com/opinion/antony-davies-james-harrigan-price-gouging-during-crisis-a-good-thing/
- *Price Controls and Anti-gouging Laws Make Matters Worse* by Steven Horwitz (3/27/20) https://www.fraserinstitute.org/blogs/price-controls-and-anti-gouging-laws-make-matters-worse

[3] See https://money.cnn.com/2015/05/29/news/companies/anheuser-busch-drinking-water-flood-victims/.
[4] See https://media.ford.com/content/fordmedia/fna/us/en/news/2020/03/30/ford-to-produce-50-000-ventilators-in-michigan-in-next-100-days.html.

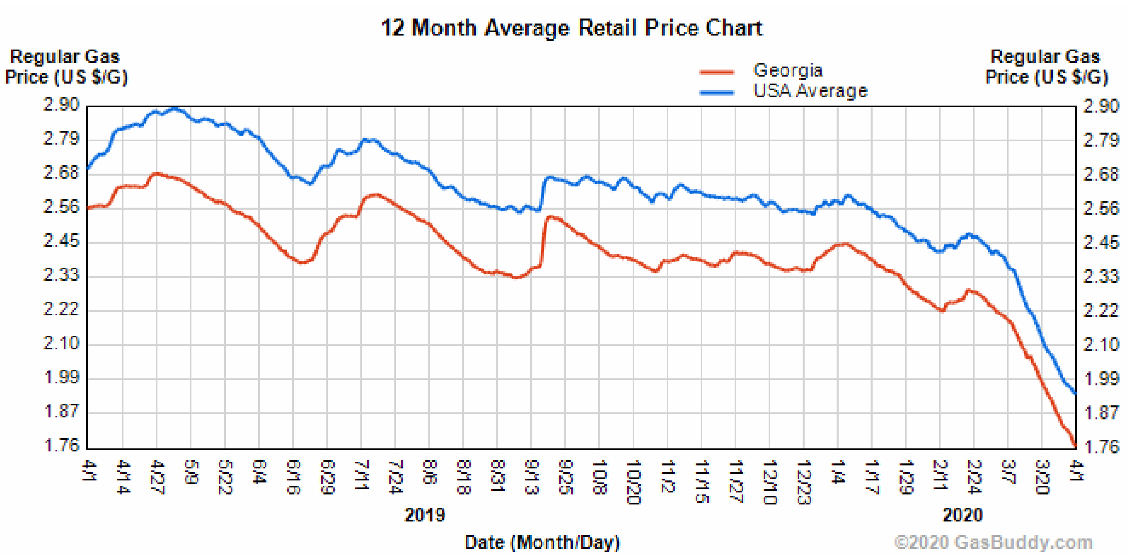
- *Coronavirus Economy: Reports of an Economic Crash have been Greatly Exaggerated* by Vernon Smith (3/23/20) https://www.usatoday.com/story/opinion/2020/03/23/coronavirus-economy-lives-suspense-not-wall-street-crash-column/2898448001/
- *Why Price Gouging Laws are a Bad Idea* by John Stossel (3/18/20) https://reason.com/2020/03/18/why-price-gouging-laws-are-a-bad-idea/
- *It's Time to Fill Out the 'Fill-in-the-Blank Price Gouging Form' for the COVID-19 Panic Buying* by Mark Perry (3/17/20) https://www.aei.org/carpe-diem/its-time-to-fill-out-the-fill-in-the-blank-price-gouging-form-for-the-covid-19-panic-buying/
- *New Light On Price Gouging* by Donald Boudreaux (9/9/19) https://www.aier.org/article/new-light-on-price-gouging/
- *Repeal Gouging Laws Before the Hurricane Hits* by Art Carden (8/31/19) https://www.aier.org/article/repeal-gouging-laws-before-the-hurricane-hits/
- *Price Gouging Laws Are Good Politics But Bad Economics* by Jeffrey Dorfman (9/23/16) https://www.forbes.com/sites/jeffreydorfman/2016/09/23/price-gouging-laws-are-good-politics-but-bad-economics/#6034650664d3
- *They Clapped: Can Price-Gouging Laws Prohibit Scarcity?* By Michael Munger (1/8/07) https://www.econlib.org/library/Columns/y2007/Mungergouging.html

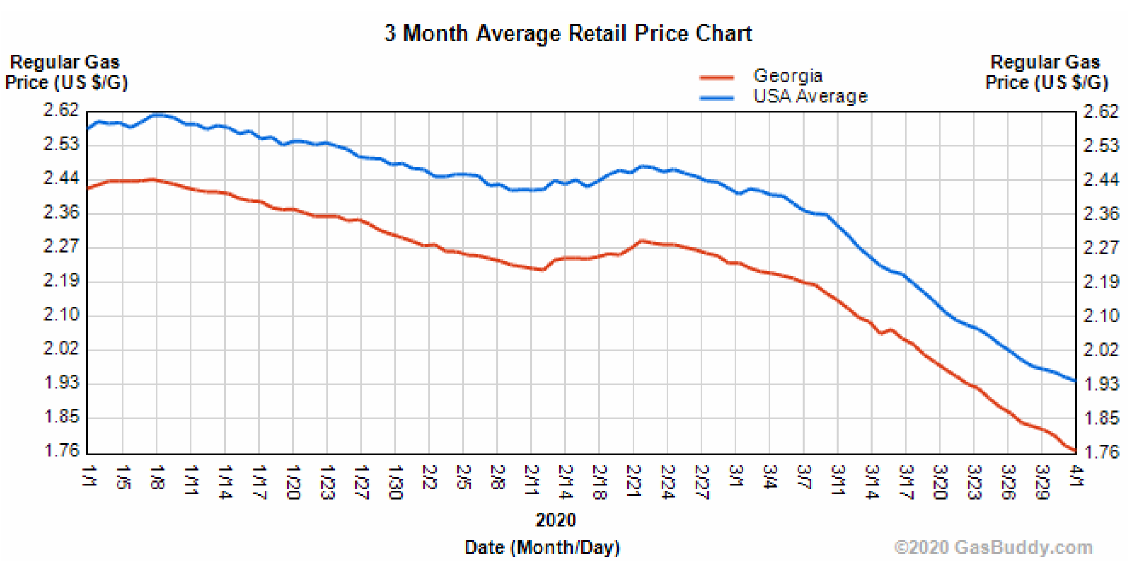
Much of the opposition to allowing prices to naturally adjust during times of emergencies is rooted in feelings of justice and ethics. Many think that it would be fundamentally unfair to have consumers pay drastically higher prices and allow sellers to realize greater profits during such abnormal times. Moreover, they view any interference with the ability of letting a consumer purchase the good in his previous pre-emergency quantity at the pre-emergency price as immoral behavior, whether the supposed violation is done by a price gouging seller or a hoarding buyer.

The changing economic realities during the ongoing COVID-19 crisis reveal a selective disgust to drastic price changes which exposes an inconsistency in the values of many people – specifically, many individuals care about the wellbeing of others when they think about them as consumers/buyers, but do not seem to care (or at least drastically discount) the wellbeing of others when they think about them as suppliers/sellers.

As COVID-19 has swept across the United States and people have been encouraged to engage in social distancing, there have been quick and sudden decreases in demand for many goods and services (e.g., air travel, gasoline, meals at restaurants, hotel rooms, and drinks at bars), resulting in drastic reductions in the prices of these goods and services for buyers and sellers. The graphs below (created at https://www.gasbuddy.com/Charts) plot the average price of gasoline in both the United States as a whole and the state of Georgia over the last 12 months and 3 months respectively. Looking at the second graph, we observe a steady decline in price during January and February 2020 (when COVID-19) was becoming a major concern in Asia and then Europe, followed by a sharper decline in March 2020 as the disease spread domestically. The average price of a gallon of gas in Georgia was \$1.76 on 4/1/20, a decrease of 28% from the price of \$2.44 on 1/8/20 and a decrease of 34% from the price of \$2.68 on 4/27/19.

As price was plummeting during the last month, a personal friend of mine posted a photo on Facebook of a gas station selling gas for \$1.74 with the caption: "Well here's a silver lining amidst the chaos!" This post got dozens of "likes" and several comments, none of which were negative. But imagine if prices for bottled water were allowed to naturally adjust after a supply decrease, and an independent owner of a single convenience store posted a photo of water selling for \$5 a gallon with a caption of "Well here's a silver lining amidst the chaos!" Nobody would "like" that post, and the person would be ridiculed and scorned and treated like a pariah. This difference reveals a moral inconsistency in the way in which we value people's wellbeing differently when thinking about them as buyers versus sellers. Recognize that all of us who work for a living are both buyers and sellers – so if you care about people as buyers, shouldn't you also care about them as sellers?





Objections to drastic increases in prices by "price gougers" (or objections to excessive purchases by "hoarders" when prices are legally not allowed to adjust) seem to suggest that it is wrong – after market conditions have suddenly changed – to interfere in any way with the ability of a buyer to purchase a good at the previous pre-emergency price and quantity. There is a disdain for anyone (a price gouger or a hoarder) who interferes with a consumer's ability to do so. But if it is "wrong" for a seller to charge a higher price to buyers after a sudden decrease in supply, is it not equally wrong for a buyer to pay a lower price to sellers after a sudden decrease in demand?

During the last month I decreased my consumption of gasoline by about 75% below my normal consumption, and when I did buy gas I paid much less per gallon than I would have if not for the recent drop in price. When I buy gasoline, I often do so from a "76" gas station down the road from where I live; I am pretty sure that this gas station is independently owned by an almost elderly married couple who are Asian immigrants. When I drove by yesterday, gas was selling for $1.599 per gallon and I didn't buy any.

I don't think anyone would claim that I am being immoral by not continuing to buy 10 gallons of gas per week from them. And if I had bought gas yesterday, I don't think anyone would claim that I was behaving unethically if I paid $1.599 per gallon instead of offering to pay them the pre-emergency price of $2.44. But why don't people object in these ways? After all, my decision to not buy as much gas as I previously bought and my decision to not pay the higher pre-emergency price harms these individual gas station owners and decreases their wellbeing in much the same way that they would be harmed if a grocery store increased the price of toilet paper in response to a sudden decrease in supply.

Why are people indignant at emergency price increases that harm consumers but rejoice at emergency price decreases that harm sellers? I think the most reasonable explanation for the inconsistency is that people have one set of values when thinking about the wellbeing of individuals as consumers but a completely different set of values when thinking about the wellbeing of individuals as sellers. This inconsistency makes me uncomfortable, both as an economist and a human being.