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#NeverNeeded Price Gouging Laws Would Harm COVID-19 Response

"Do Something" Policy Makes Shortages Worse and Does Not Decrease Prices

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Price gouging becomes a hot topic during every crisis. It has become especially topical during the COVID-19 crisis. Almost overnight, the need exploded for goods essential to responding to the crisis. Frontline workers suddenly needed far more hand sanitizer, face masks, and personal protective equipment (PPE). Many people stockpiled household essentials such as frozen foods and toilet paper to get through an extended lockdown. For the first several weeks of the emergency, grocery stores and online retailers were unable to keep up with demand. Some sellers raised prices in response, sometimes sharply. Many people, understandably upset at having to pay more for the same products when they need them most, have called for action against such price gougers.

Policy makers have been listening. On March 9, U.S. Attorney General William Barr announced: "The Department of Justice stands ready to make sure that bad actors do not take advantage of emergency response efforts, health care providers, or the American people during this crucial time."[1] In addition to federal warnings, 36 states have price gouging legislation already on the books.[2] Other states are considering similar legislation as part of their coronavirus responses. There have also been calls for federal price gouging legislation from private businesses, most prominently from Amazon Vice President of Public Policy Brian Huseman.[3]

Such legislation is a bad idea for several reasons. These go well beyond the typical "price controls make shortages worse" argument taught to every first-year economics undergraduate—and forgotten by most policy makers.[4]

This paper differs from other entries in the Competitive Enterprise Institute's #NeverNeeded series in that it does not suggest specific policies to enact. It urges only restraint and humility on the part of policy makers. Those who wish to fight against price gouging are better served by evolving private responses than by one-size-fits-all government regulation.

Moreover, price increases, while unpleasant, can play a positive role during a crisis. They can sort out those who are in need from those who are not. Prices encourage people with non-urgent needs to hold off on buying certain items, leaving more available for those most in need. Producers also gain an incentive to get supplies to people who need them. And they can do so without fallible, potentially corruptible politicians doing the sorting.

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The next section offers specific examples of how private responses to price gouging are more effective than government ones. These include the various ways companies address price gouging, as well as social norms regarding such behavior. The paper then looks at unintended consequences of price gouging legislation. These include rent-seeking, which occurs when established companies lobby for antitrust regulation that can raise smaller competitors' costs, and shortages that are made worse, as businesses are barred from adjusting prices to reflect actual demand. It then gives an often overlooked explanation of how prices work during a crisis.

Many people, even trained economists, often forget that prices have both money- and non-money components. Price gouging legislation aimed at preventing *money* prices from increasing will make *non-money* price increases worse. That means worse shortages, longer wait times, higher search costs, and in some cases, people resorting to potentially dangerous black-market activity. These effects disproportionately harm the people in most urgent need.

Non-Regulatory Responses. Calls for price gouging legislation show a lack of creativity. Companies that wish to give their consumers a price gouging-free option have already developed effective ways to do so without government regulation.

Amazon Vice President of Public Policy Brian Huseman writes: "We deploy dynamic automated technology to proactively seek out and pull down unreasonably priced offers, and we have a dedicated team focused on identifying and investigating unfairly priced products that are now in high demand, such as protective masks and hand sanitizer." Amazon uses a similar model in its other business under its Amazon Web Services branch.

This should be a competitive selling point for Amazon, not a reason to call for more regulation. Price gouging is unpopular, and companies that fight it can earn customers' favor.

In fact, anti-price gouging technology could be a profitable business opportunity. If Amazon is not already doing so, it could license or sell its anti-price gouging technology to competitors for a profit. And a startup that develops a killer app for online retailers to use could make a lot of money.

Moreover, these technologies and policies are improving over time. Company-level policies are also more adaptable than federal policies as technology and circumstances change.

Advocates for more regulation need to remember that regulations are made by the government we have, not the government we want. Amazon's in-house technology and seller policies are almost certainly more effective than what Donald Trump, Nancy Pelosi, or Mitch McConnell would enact during an election year that also features a pandemic and civil unrest. The legislation would be enforced by a thoroughly politicized Justice Department and Federal Trade Commission, which are overseen by a president who frequently threatens legal action against Amazon and other high-profile businesses.

Social Norms. Calls for legislation also ignore the power of social norms. Early in the pandemic, when it was becoming clear that people would need lots of hand sanitizer, brothers Matt and Noah Colvin drove around Tennessee and Kentucky and bought up 17,700 bottles of it to try to sell on Amazon for as much as $70 each. Amazon barred them within a day. eBay went further, forbidding all sales of hand sanitizer and masks on its site.[5] Tennessee state authorities got involved, but their actions were likely never needed. The Colvins managed to avoid being charged and donated all of their stockpiled supplies to nonprofit organizations.[6] The public shaming that ensued serves as a warning to other would-be price gougers. The Colvin brothers violated community norms, lost their money, and now their name is mud. Few people are eager to star in a sequel.

Who Benefits? Looking at price gouging legislation from Amazon's perspective, but without the public relations filter, the company, and others like it, stand to gain three things from a federal price gouging law:

1) **Regulatory certainty**. One federal standard is easier to comply with than dozens of state standards.
2) **Liability protection**. Amazon will face fewer price gouging lawsuits if it cooperates with legislators or has a hand in crafting the rules.
3) **Rent-seeking**. Rent-seeking is economists' term for using government for unfair advantage.[7] Price gouging legislation would allow Amazon to raise rivals' costs without having to improve its own offerings. Amazon already has invested both in artificial intelligence (AI) algorithms and in enforcing guidelines for its third-party sellers. Many of Amazon's competitors, especially smaller ones, have not.

There is something to be said for the first two items, though there are also arguments against them. But rent-seeking is anti-competitive behavior at its worst. One of the strongest arguments against antitrust regulation, for example, is that it creates major rent-seeking opportunities.[8] Big companies routinely game regulations to thwart competitors. Price gouging legislation is another example of this same rent-seeking process.

Anti-Competitive. Amazon's call for a price gouging bill might be part of a larger effort to get itself out of antitrust crosshairs. Ironically, a federal price gouging bill would make the retail sector less competitive. Not only would Amazon potentially raise rivals' costs, binding standards would prevent companies from competing to offer price gouging policies their customers most prefer.

The timing is as bad as the idea itself. Retail sales declined by 16.4 percent in April 2020—the worst drop ever recorded—for the second month in a row.[9] Healthy bouncebacks in May and June brought spending close to pre-pandemic levels, but a still-active virus and continuing high unemployment mean the economy is by no means recovered.[10] Retailers have enough to worry about without having to spend resources complying with new rules that a competitor potentially helped to write.

There is a federalism angle, as well. A federal rule would impose standards on more than a dozen states that intentionally refuse them.

Prices Are More than Money. As any good economist will tell you, money isn't everything. Prices are more than money. Every good has a mix of both money and non-money prices. Price gouging legislation is ultimately ineffective because it only reduces *money* prices during a crisis. Tamping down on those means greater increases in *non-money* prices. These cannot be legislated away.

What are non-money prices? One illustration is to imagine two stores next door each other. They both sell the same item, for the same money price, and are identical in every respect except one. One store has an hour-long line going out the door, while the other store has no such wait. They don't really charge the same price, do they?

A high money price causes people who do not urgently need toilet paper or hand sanitizer to buy less or hold off until later, when the money price goes back down. That leaves more left over for people who need those items immediately. This matters a great deal during an emergency. On the other side of the equation, that same money price increase also induces producers and distributors to go the extra mile, often literally.

Just like money prices, non-money prices can also go up sharply during an emergency. High-demand items like non-perishable foods, paper products, and PPE become much harder to find. You might have to drive to a store further away or do some deep digging online, even looking at some potentially shady sources. Queuing and waiting lists emerge. Shipping times might take longer. Maybe only lower-quality goods are available. These inconveniences do not necessarily cost money, but they are still part of the crisis price increase. These prices are measured in wasted time, extra hassle and stress, and lost opportunities. More time searching for low-money-priced but scarce hand sanitizer leaves less time left over for job searches, homeschooling, or even taking a little break for some peace of mind during a difficult time.

Some Things Are Subjective. Price gouging is not a subject most people treat with nuance. When anecdotes like the one about the Colvin brothers and their 17,700 bottles of sanitizer come out, most people's responses are instant and emotionally charged. This is in part because the unspoken price theory model people use in their heads is essentially "one evil mind determining the quantity supplied and the price, altering the price at its pleasure," as economist Deirdre McCloskey describes it.[11] The Colvin brothers found out the hard way that this folk theory is wrong. Nobody was willing to pay their high prices. They had as little power in setting the price of hand sanitizer as a mouse does in moving a mountain. Legislators have a similar lack of power.

Simply put, tradeoffs exist. During a crisis, shortages will happen and prices will go up. There is no way around it. This is especially true on crises that hit with little or no warning, such as the coronavirus. But there is more than one way for those prices to rise. Not all of those ways involve money. Price gouging legislation not only ignores non-money prices, it is incapable of regulating them. Just as pushing down on a balloon does not change the amount of air in it, pushing down on money prices will only make the non-money price rise more severely to compensate. Policy makers should be more modest about what they claim they can accomplish.

Is there a "right" mix of money- and non-money prices? There is no single correct answer. It is a subjective value judgment.[12] Different people have different preferences, and that is OK. They should be allowed to pursue them. This is another reason for policy makers to exercise restraint and humility.

Conclusion. Federal price gouging legislation would make shortages worse during a crisis. High prices tell people with non-urgent needs to hold off on stockpiling toilet paper or hand sanitizer, which leaves more available for others with more urgent needs.

Moreover, legislation is not needed to limit price gouging. Public opinion and social norms have spurred retailers like Amazon and eBay to pursue their own anti-price gouging innovations, from AI price monitoring algorithms to manually policing their third-party sellers.

Companies like Amazon still favor federal legislation for understandable reasons, such as having a single nationwide standard to comply with rather than 50 state standards, and presumably some liability protection. But one price of a federal price gouging bill is increased rent-seeking, and there is already far too much of that in Washington. Large companies that have already taken measures to fight price gouging would see their competitors' costs rise as a result of anti-price gouging legislation.

The retail market would become less competitive as sellers converge on a single federally imposed price gouging standard rather than competing with each other to provide the types of protections their customers want, and working to improve them over time.

Money is not everything, including in prices. Keeping money prices from going up means non-money prices will rise instead. As noted, non-money prices include worse shortages, more time and resources spent searching for products and comparing prices, and longer waiting and shipping times. These would have the worst impact on people with the most urgent needs.

Notes

[1] United States Department of Justice, "Justice Department Cautions Business Community against Violating Antitrust Laws in the Manufacturing, Distribution, and Sale of Public Health Products," news release, March 9, 2020, https://www.justice.gov/opa/pr/justice-department-cautions-business-community-against-violating-antitrust-laws-manufacturing.

[2] FindLaw, "Price Gouging Laws by State," updated March 24, 2020, https://consumer.findlaw.com/consumer-transactions/price-gouging-laws-by-state.html.

[3] Brian Huseman, "It's time for Congress to establish a federal price gouging law," Amazon Blog, May 13, 2020, https://blog.aboutamazon.com/policy/its-time-for-congress-to-establish-a-federal-price-gouging-law.

[4] This is not a fringe free-market argument. Even the famous Samuelson-Nordhaus introductory textbook, which takes generally interventionist point of views of public policy, is wary of price controls, noting that "they lead to numerous distortions and subterfuges that undermine the economy's efficiency." Paul Samuelson and William D. Nordhaus, *Economics, Eighteenth Edition*, (Boston: McGraw-Hill Irwin, 2005), p. 199.

[5] Jack Nicas, "He Has 17,700 Bottles of Sanitizer and Nowhere to Sell Them," *New York Times*, March 14, 2020, https://www.nytimes.com/2020/03/14/technology/coronavirus-purell-wipes-amazon-sellers.html.

[6] Caitlyn Shelton, "Settlement reached in price gouging case of Tennessee brothers with 17,000 hand sanitizers," Fox 17 Nashville, April 21, 2020, https://fox17.com/news/local/settlement-reached-in-price-gouging-case-of-tennessee-brothers-with-17000-hand-sanitizers.

[7] Gordon Tullock, (Charles K. Rowley, ed.), *The Rent-Seeking Society: Selected Works, Volume 5*, (Indianapolis: Liberty Fund, 2006).

[8] Ryan Young, "Antitrust Basics: Corruption and Rent-Seeking," *OpenMarket*, Competitive Enterprise Institute, August 21, 2019, https://cei.org/blog/antitrust-basics-corruption-and-rent-seeking.

[9] Jeff Cox, "Retail sales plunge a record 16.4% in April, far worse than predicted," *CNBC*, May 15, 2020, https://www.cnbc.com/2020/05/15/us-retail-sales-april-2020.html.

[10] Harriet Torry, "U.S. Retail Sales Rose 7.5% in June as Stores Reopened, Separate jobless claims data indicate improvement in labor market is stalling," *Wall Street Journal*, July 16, 2020, https://www.wsj.com/articles/us-retail-sales-report-data-june-2020-11594846181?mod=hp_lead_pos3.

[11] Deirdre Nansen McCloskey, *The Applied Theory of Price, Second Edition* (New York: Macmillan Publishing, 1985), p. 99.

[12] Readers interested in the subjectivity of prices are strongly encouraged to read James M. Buchanan, *Cost and Choice: An Inquiry in Economic Theory: Collected Works of James M. Buchanan, Volume 6*, (Indianapolis; Liberty Fund, 1999 [1969]). The book is difficult but short, and rewards the effort.