

Price Gouging Is A Bad Thing?

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People worry about price gouging during emergencies, but does it actually accomplish something good?

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There was talk about price gouging during hurricane Katrina, as there is during almost every natural disaster. People hate the idea of stores "taking advantage" of them during these difficult times. Politicians threaten to prosecute the store owners to win public praise (and eventually votes). But is it really such a bad thing?

{bot_wrgoogle}First, what is price gouging? According to one definition, it is, "pricing above the market price when no alternative retailer is available." Of course, in the context of a natural disaster people don't care if there are other retailers, especially if they all raise the prices. Just raising the price of something during these times is considered gouging. Raising the prices, however, serves an important function that most people don't understand. Let's look at that.

The Value Of Price Gouging

We'll use a plywood retailer as an example of what happens during a hurricane, and why it is actually important that prices rise.

First of all, we can probably agree that a retailer doesn't want to hurt the public. He just wants to make more money. Secondly, raising the price accomplishes this profit goal only if the retailer can still sell his goods. This means, for example, that he won't make anything on his high-priced plywood if it's priced so high that nobody buys it. He still has to price it to sell.

So typically when a hurricane is coming, all the plywood will still be sold, but at a higher price. I don't think we can call it "above the market" however, because markets change, and the "market price" is naturally higher when demand goes up, as it does before a hurricane. In any case, all that plywood will still be covering windows and protecting houses somewhere during the storm.

However, the higher price does something very useful. It allocates the plywood to the highest and best uses. To understand why, let's start at \$18 per sheet. At this price a man might buy enough plywood to cover not only the windows of his house, but the windows on his shed in the backyard. He might even buy too much and have several pieces left laying in the garage. Meanwhile some poor family has their front window uncovered because all the plywood sold so fast at this "normal" price.

On the other hand, if the retailer raises the price to \$50 per sheet, what happens? Everyone thinks more carefully about how much they need. They buy just enough, and only enough for the more important uses. This means a lot more front windows protected and fewer pieces wasted. A family that might have bought ten sheets of plywood now buys just six for the most important uses, leaving four more in the store for someone else's important uses.

There is more to this story, however. If prices are allowed to rise during emergencies, it motivates companies to be better prepared. In other words, the higher prices (if predictable and not discouraged by politicians and prosecutors) mean more supplies brought to the areas where they are needed.

In fact, Wal-Mart doesn't advertise the fact, but they monitor weather and stock their stores accordingly, bringing in an extra thousand snow shovels before a predicted blizzard, for example. This is a wonderful service to the community, of course, but the fact that they make money doing it probably makes them hesitate to let it be known. People are uneasy with companies making profits from their problems.

That sentiment is a shame, because it means we are worse off. As a consumer, I only would buy plywood at \$50 a sheet if it really was worth it to me. But I would rather have it available at that price than punish the retailer just so Joe - or whoever runs to the store the fastest - can cover his shed windows and leave extra unused plywood in his garage at the

"fair" price of \$18 per sheet.

There is yet another reason why high prices are good. By allocating supplies to their highest economic uses, the result is less monetary damage. In other words, at \$50, more people will use that plywood to cover expensive windows rather than sheds and doghouses and such. This means fewer and smaller insurance claims, which in turn means lower future rates for all of us.

All of this is something that economists know, and it applies to virtually all basic goods and services. Let prices rise and things are allocated in better ways. But politicians and others are afraid to be honest about this, even if they aren't ignorant about this. They don't think the public can understand that what we refer to as price gouging could make us all better off during emergencies.

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