‘Gouging’ a Misleading Term for Supply and Demand

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Eric D. Dixon

Every time a natural disaster occurs or terrible weather settles in, we hear a litany of warnings about price gouging. The recent ice storm precipitated similar alerts. This is understandable — after all, an emergency situation is when most people are least able to afford quickly rising prices for essential goods. However, laws that curtail gouging inevitably hurt the people they’re designed to help.

Prices are not arbitrary numbers, set by whim, or by the greed of the seller. In competitive markets, prices measure intersecting supply and demand — in the same sense that the size of your shadow is determined by your height and the position of the sun. When a good becomes more scarce, or more difficult to provide, this constriction of supply naturally causes an increase in price. Similarly, if demand for a good suddenly outstrips its supply, this also causes an increase in price. Emergencies tend to produce both of these phenomena, causing market prices to jump as more people clamor to buy goods that are suddenly in short supply.

Laws outlawing gouging don’t actually prevent higher prices — they only alter the type of price customers have to pay. If sellers can’t adjust pricetags, increased demand leads to long lines and shortages, which are a form of price increase that people pay for through time and effort rather than with dollars. This first-come-first-served scenario means that people who are quick, well-connected, or lucky get what they want, but latecomers pay the highest price when nothing is left for them.

There are plenty of people in Missouri who were driving during the 1970s, in the days of gasoline price controls — which led to corresponding shortages, sales caps, and interminably long lines at the pump. There was no economic mystery there. Because gasoline prices were set below market level by legislative fiat, people had no reason to limit their own purchases. The people who needed gasoline more — those willing to pay a higher price for it — were less likely to get what they needed. If prices had been allowed to rise to their natural levels, they would have provided an incentive for many people to buy less.
Prices also act as a signal to producers. When the price of a good suddenly rises, the profit motive spurs entrepreneurs to produce more. This increased supply is exactly what's needed in times of crisis. It not only keeps stores adequately stocked, but an expanded supply helps bring those high prices back down again. The more flexibility prices have to fluctuate, the sooner supply can meet demand and prices can return to normal. In contrast, when legislative price caps cause shortages, the unfortunate are left to depend solely on the good will and charity of others — which, unfortunately, are also often in short supply.

The economist Steven E. Landsburg illustrated this principle in his book "Fair Play," in a section that gives economic advice to his young daughter: "Cayley, if you are ever in the position to sell water for $7 a gallon I want you to charge $7 a gallon and not a penny less. That's not because I want you to make a lot of money. ... It's because it's your social responsibility to get that water to those who need it most desperately, and if you charge less than the market will bear then the wrong people will claim the water." Which is worse during an emergency: expensive water, or no water at all?

The word "gouging" is a misleading, loaded term. Ultimately, real market prices allow people to plan and prioritize their needs in a rational way. Price gougers ensure that markets continue to function in times of crisis, curbing careless purchases of crucial goods and giving businesses a practical incentive to continue fulfilling real demand when it's most needed. If prices aren't allowed to rise, though, and the "wrong" people buy up all the necessities, everybody else's needs and priorities are undermined.

In times of crisis, maintaining access to necessary supplies is more important than worrying about rising costs. Correct market prices ensure that resources are allocated efficiently and that shortages don't occur. This can't be stressed enough, especially during emergencies.

_Eric D. Dixon is the editor for the Show-Me Institute, a Missouri-based think tank._
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Show-Me Institute

5297 Washington Place
Saint Louis, MO 63108
Phone: (314) 454-0647
Fax: (314) 454-0667

3645 Troost Avenue
Kansas City, MO 64109
Phone: (816) 287-0370

Email: info@showmeinstitute.org

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