

Price Gouging and the Pandemic: An Economic Perspective

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During declared states of emergency, sellers that raise prices may face allegations of price gouging, leading to civil suits, state enforcement actions, and in certain circumstances, federal enforcement actions. The current state of emergency is no exception: the coronavirus pandemic has already begun to generate price gouging complaints, such as allegations that retailers and retailer platforms such as Amazon and eBay charged excessive prices for a range of items, including face masks, toilet paper and cleaning products.² Grocery retailers and egg producers have been targeted by a California class action alleging illegal price gouging related to egg prices after a state of emergency was declared.³ Meanwhile, consumers across the country have experienced shortages of certain goods. Economists recognize that rising prices and shortages represent two sides of the trade-off inherent in considering price gouging laws. This article discusses how economics can be useful in navigating the line between recognizing the market realities of a crisis and running afoul of price gouging laws.

Economists debate whether price gouging laws help or harm consumers

Many economists argue that permitting sellers to raise their prices during an emergency actually makes consumers better off.⁴ Charging higher prices during an emergency may seem intuitively unfair (particularly if the seller's margins increase), but when prices are permitted to rise during an emergency, the "price signal" helps to limit hoarding or over-consumption by consumers who do not value the scarce commodity enough to pay the higher price.⁵ According to economists who espouse

this view, shortages of products like hand sanitizer and toilet paper may not have occurred during the pandemic if retailers had been able to raise the prices of these products rather than instituting belated and easily circumvented purchase limits.

Other economists point out that the argument against market intervention through price gouging laws ignores two key issues: the potential for market failures during an emergency, and the possibility that when the price of necessary goods rises, lower-income households will be unable to afford them. As to the first issue, an emergency may create market failures that give some sellers temporary market power. Such temporary increases in market power might result from the shut-down of some of their competitors or from consumers' reduced willingness to comparison shop during an emergency. The reduction in competition might allow some sellers to raise prices in response to the crisis-related demand increase by more than they would have been able to if they faced greater competition.⁶ Imposing temporary price limits might mitigate this issue. As to the second issue, economists who support price gouging laws point out that charging higher prices for necessities during an emergency will magnify issues associated with income inequality. While higher prices can help to prevent or reduce hoarding, they may also result in greater consumption of goods by the consumers who can easily afford them, rather than by those with the greatest need during the emergency.⁷ For this reason, some economists argue that anti-price gouging laws may be worthwhile from a policy perspective if they reduce the unequal impact of an emergency on lower-income consumers' access to necessary goods, even at the cost of reducing market efficiency.⁸

Pricing and cost considerations involved in assessing price gouging

Enforcement against price gouging related to consumer goods typically occurs at the state level—there is no federal anti-price gouging law, although some federal enforcement has taken place during the pandemic under the authority of the Defense Production Act ("DPA").⁹ The fundamental element

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² Lauren Berg, *Amazon Price-Gouged Amid Pandemic, Calif. Consumers Say*, Law360, Apr. 22, 2020, available at <https://www.law360.com/corporate/articles/1266266/amazon-price-gouged-amid-pandemic-calif-consumers-say>; Dave Simpson, *eBay Hit with Virus-Related Price-Gouging Class Action*, Law360, May 4, 2020, available at <https://www.law360.com/articles/1270342/ebay-hit-with-virus-related-price-gouging-class-action>.

³ John R. Wilke, *Federal Prosecutors Probe Food-Price Collusion*, Wall St. J., Sept. 23, 2008, available at <https://www.wsj.com/articles/SB122213370781365931>.

⁴ IGM Forum, *Price Gouging*, May 2, 2012, available at <http://www.igmchicago.org/surveys/price-gouging/>.

⁵ Donald J. Boudreaux, *"Price Gouging" After a Disaster Is Good for the Public*, Wall St. J., Oct. 3, 2017, available at <https://www.wsj.com/articles/price-gouging-after-a-disaster-is-good-for-the-public-1507071457>; Jeffrey Dorfman, *Price Gouging Laws Are Good Politics*

⁶ Matt Zwolinski, *The Ethics of Price Gouging*, Business Ethics Quarterly 18(3) (Jul. 2008), pp. 347-378 at p. 364.

⁷ Michael Hiltzik, *Column: Memo to Economists Defending Price Gouging in a Disaster: It's Still Wrong, Morally and Economically*, L.A. Times, Aug. 28, 2017, available at <https://www.latimes.com/business/hiltzik/la-fi-hiltzik-price-gouging-harvey-20170828-story.html>.

⁸ IGM Forum, *Price Gouging*, May 2, 2012, available at <http://www.igmchicago.org/surveys/price-gouging/>.

⁹ Although there is no federal anti-price gouging law, the Department of Justice has taken enforcement action during the current pandemic against alleged hoarding of medical supplies under an Executive Order pursuant to the DPA, in cooperation with the Department of Health and Human Services ("HHS") and Federal Emergency Management Agency ("FEMA"). See

of a price gouging allegation under state statutes is the claim that the seller's prices rose excessively after a declared state of emergency.¹⁰ State price gouging laws typically presume that sufficiently large price increases during an emergency are evidence of price gouging, placing the burden on the retailer to present mitigating factors.¹¹ Sellers that typically exhibit fluctuating margins or seasonal pricing may be at particular risk of price gouging allegations if they raise their prices during a declared emergency. Low prices and/or margins in the period preceding the emergency may heighten the mistaken impression of intentional price gouging.¹²

One unusual feature of the current crisis may be relevant in distinguishing the pandemic from the sort of emergencies envisioned in price gouging laws. The pandemic has introduced new products into daily life, like cloth face masks and home coronavirus testing kits, as well as introduced new sellers of these products.¹³ With these new products and sellers may come challenges in applying state price gouging laws. The relevant price comparisons may be hard to establish for products that did not exist before the pandemic, as in the case of home coronavirus testing kits. In these cases, historical price data to establish the prevailing price before the state of

Department of Justice, *Combating Price Gouging & Hoarding*, May 5, 2020, available at <https://www.justice.gov/coronavirus/combatingpricegouginghoarding>; HHS.gov, *DOJ and HHS Partner to Distribute More Than Half a Million Medical Supplies Confiscated from Price Gougers*, Apr. 2, 2020, available at <https://www.hhs.gov/about/news/2020/04/02/doj-and-hhs-partner-to-distribute-more-than-half-a-million-medical-supplies-confiscated-from-price-gougers.html>; Ballard Spahr, LLP, *Understanding Price Gouging Laws During COVID-19*, JD Supra, Apr. 6, 2020, available at <https://www.jdsupra.com/legalnews/understanding-price-gouging-laws-during-98583/>.

¹⁰ Note that in many states, price gouging laws apply only to retailers. In some cases, upstream wholesalers or distributors may also be subject to price gouging laws. See Lawrence D. Silverman & Carmen M. Ortega, *The Reach of Price Gouging Laws: Why Wholesale Distributors Are Not Exempt*, Akerman, Apr. 6, 2020, available at <https://www.akerman.com/en/perspectives/the-reach-of-price-gouging-laws-why-wholesale-distributors-are-not-exempt.html>.

¹¹ Richard Lawson & Shoshana Speiser, *Cloudy with a Chance of Price Gouging*, Law360, Aug. 28, 2018, available at <https://www.law360.com/articles/1076395/cloudy-with-a-chance-of-price-gouging>.

¹² For example, during an FTC investigation into possible gasoline price gouging after Hurricanes Katrina and Rita, the FTC noted that fluctuating margins created a spurious impression of price gouging in some cases. See Federal Trade Commission, *Investigation of Gas Price Manipulation and Post-Katrina Gasoline Price Increases*, 2006, at 140-41, available at <https://www.ftc.gov/sites/default/files/documents/reports/federal-trade-commission-investigation-gasoline-price-manipulation-and-post-katrina-gasoline-price/060518publicgasolinepricesinvestigationreportfinal.pdf>.

¹³ Darrel Etherington, *LabCorp's At-Home COVID-19 Test Kit Is the First to Be Authorized by the FDA*, Techcrunch, Apr. 21, 2020, available at <https://techcrunch.com/2020/04/21/labcorps-at-home-covid-19-test-kit-is-the-first-to-be-authorized-by-the-fda/>; Anna Hecht, *These 3 Etsy Shop Owners Have Each Sold Hundreds of Cloth Face Masks since the Pandemic Started*, CNBC, May 7, 2020, available at <https://www.cnbc.com/2020/05/07/etsy-shop-owners-sell-hundreds-of-cloth-face-masks-during-pandemic.html>.

emergency may be scarce. Even for goods like cloth masks that did exist prior to the pandemic, the entry of new sellers may make it challenging to determine whether a particular seller is engaging in price gouging, or simply has higher costs to supply the product. Or, conversely, the new sellers may have costs that are not subject to the same shocks as the costs of larger producers, thereby distorting cost comparisons.

Given these challenges, an economic evaluation of the plausibility of price gouging allegations might start by comparing the pricing behavior of the allegedly price gouging seller to other sellers in the same market. Some state price gouging statutes explicitly adopt this approach.¹⁴ However, even such a simple comparison can produce misleading conclusions if sellers in the same market priced differently before the declared emergency. For example, retailers of different types (supermarkets, convenience stores, online retailers, etc.) might charge different prices for household goods like hand sanitizer and toilet paper even during normal times. The more similar the set of retailers whose prices are compared pre- and post-emergency, the more informative the comparison is likely to be.

The FTC's investigation into alleged gasoline price gouging after Hurricanes Katrina and Rita provides a useful example of how economists have attempted to construct informative price comparisons in past emergencies. In order to ascertain how widespread price gouging by individual gasoline retailers may have been in the aftermath of the hurricanes, the FTC adopted a three-part "screen" that considered (1) whether the gas station's price relative to the city average rose immediately after the hurricanes, (2) whether the gas station's price rose relative to other gas stations from the same brand and city and (3) whether its prices were in the top fifth percentile of prices charged in that city for at least three-fourths of the week following each hurricane.¹⁵ While the FTC emphasized that even this detailed comparison could not definitively demonstrate that retailers that failed the screen had engaged in illegal price gouging, the FTC's approach illustrates an attempt to construct an informative comparison group (gas stations from the same brand in the same city) and to flag only those gas stations whose pricing behavior particularly stood out.

¹⁴ Richard Lawson & Shoshana Speiser, *Cloudy with a Chance of Price Gouging*, Law360, Aug. 28, 2018, available at <https://www.law360.com/articles/1076395/cloudy-with-a-chance-of-price-gouging>.

¹⁵ Only 1% of retailers failed these screens, and the FTC noted that some of the station owners whose prices were flagged by the three-part test cited station-specific increases in cost. See Federal Trade Commission, *Investigation of Gas Price Manipulation and Post-Katrina Gasoline Price Increases*, 2006, at 110-13, available at <https://www.ftc.gov/sites/default/files/documents/reports/federal-trade-commission-investigation-gasoline-price-manipulation-and-post-katrina-gasoline-price/060518publicgasolinepricesinvestigationreportfinal.pdf>.

Even a seller that does raise its price relative to similar firms during an emergency may not be price gouging if the seller faced unusually high costs during the emergency. During the pandemic, retailers have already encountered significant changes to their daily operations that might well increase their costs, including an increase in remote work, new safety protocols and the pass-through of costs associated with disruption to the operations of upstream suppliers. Moreover, the entry of many new sellers during the pandemic may make variation in production costs a particularly important explanation for differences in sellers' prices for the same product. A single-employee business that begins selling cloth masks on Etsy (an online platform for sellers of handmade and vintage goods) may charge different prices than a large retailer that sources cloth masks from a factory supplier because they face different costs.¹⁶ On the one hand, these cottage industry suppliers may be less efficient than larger suppliers, but on the other, they may avoid the costs associated with adopting new factory safety precautions.

In past emergencies, economists have acknowledged additional factors that may cause some retailers' costs to rise more than others. In its investigation into alleged gasoline price gouging, the FTC acknowledged that much of the dispersion in local retail gasoline pricing could be explained by differences in retailers' relationships to upstream producers: some retailers purchased from wholesalers at the prevailing wholesale price, others had long-term purchasing contracts, and still others were vertically integrated with suppliers.¹⁷ The FTC also observed that, particularly during an emergency, sellers are likely to have different amounts of information about market conditions, which may lead to inefficient business decisions that increase cost.¹⁸ From the perspective of an economist, a seller that simply passes on a legitimate cost increase during an emergency is likely not engaging in price gouging. However, because state price gouging laws often make price increases over the legal threshold presumptively illegal, sellers may still need to demonstrate that their price increases were motivated by

¹⁶ Anna Hecht, *These 3 Etsy Shop Owners Have Each Sold Hundreds of Cloth Face Masks since the Pandemic Started*, CNBC, May 7, 2020, available at <https://www.cnbc.com/2020/05/07/etsy-shop-owners-sell-hundreds-of-cloth-face-masks-during-pandemic.html>.

¹⁷ Federal Trade Commission, *Investigation of Gas Price Manipulation and Post-Katrina Gasoline Price Increases*, 2006, at 107, available at <https://www.ftc.gov/sites/default/files/documents/reports/federal-trade-commission-investigation-gasoline-price-manipulation-and-post-katrina-gasoline-price/060518publicgasolinepricesinvestigationreportfinal.pdf>; Scott Berhang, *Pricing 101 Part 4: Demystifying Retail Fuel Prices and Players*, OPIS Blog, Sept. 12, 2017, available at <http://blog.opisnet.com/demystifying-retail-fuel-prices-and-players>.

¹⁸ Federal Trade Commission, *Investigation of Gas Price Manipulation and Post-Katrina Gasoline Price Increases*, 2006, at 107-8, 195, available at <https://www.ftc.gov/sites/default/files/documents/reports/federal-trade-commission-investigation-gasoline-price-manipulation-and-post-katrina-gasoline-price/060518publicgasolinepricesinvestigationreportfinal.pdf>.

higher costs, or relatedly, that their margins did not increase when their prices rose.¹⁹

When does price gouging become an antitrust concern?

Price gouging is not in itself a violation of federal antitrust law: as the Department of Justice explains, even a monopoly—provided that it is a lawful monopoly—may set whatever price it chooses.²⁰ However, allegations of price gouging may magnify attention on the conduct of both individual sellers and firms throughout the industry.²¹ In a time of increased scrutiny on consumer prices, retailers should be particularly cautious about conduct that could appear to violate the antitrust laws.

As noted at the beginning of this article, the disruption associated with emergencies like the pandemic may lead to temporary increases in market power for some firms. An increase in market power may heighten a firm's potential to engage in both price gouging and anticompetitive conduct. For instance, temporary increases in market power among a small number of sellers in an industry could facilitate coordinated price increases—conduct that would qualify both as price gouging and price fixing. A seller acting unilaterally in a way that preserves its emergency-generated market power might also face allegations of anticompetitive conduct. Consider a seller that, in response to an increase in market power during the pandemic, raises its markup (possibly violating price gouging laws), but offers a discount to customers that have invested in the seller's loyalty program. That seller may be accused of attempting to "lock in" customers if the loyalty program is potentially preventing efficient rivals from competing.²²

¹⁹ CA Penal Code § 396 (2017), available at <https://law.justia.com/codes/california/2017/code-pen/part-1/title-10/section-396/>; Edward J. Page & Min K. Cho, *Price Gouging 101: A Call to Florida Lawmakers to Perfect Florida's Price Gouging Law*, 80 Florida L.J. 49 (2006), available at <https://www.floridabar.org/the-florida-bar-journal/price-gouging-101-a-call-to-florida-lawmakers-to-perfect-floridas-price-gouging-law/>; Richard Lawson & Shoshana Speiser, *Cloudy with a Chance of Price Gouging*, Law360, Aug. 28, 2018, available at <https://www.law360.com/articles/1076395/cloudy-with-a-chance-of-price-gouging>.

²⁰ Directorate for Financial and Enterprise Affairs Competition Committee, *Working Party No. 2 on Competition and Regulation: Excessive Prices*, Oct. 17, 2011, at 2, available at <https://www.justice.gov/sites/default/files/atr/legacy/2014/05/30/278823.pdf>.

²¹ *Id.* at 5-6.

²² While economists recognize that loyalty discounts often represent a form of price competition that benefits the consumer, loyalty discounts that amount to a price below cost or that prevent efficient rivals from competing in the market may be found to be anticompetitive in some cases. See DLA Piper, *Your loyalty discounts and rebates may violate antitrust and competition laws*, Feb. 5, 2014, available at <https://www.lexology.com/library/detail.aspx?g=28f97281-23a9-4886-954a->



The unprecedented nature of the coronavirus pandemic has already led to challenges to retailers' pricing practices under state price gouging statutes and federal enforcement authority under the DPA. As the pandemic continues, allegations of price gouging and possibly of price fixing will likely continue to accumulate. From an economic perspective, it is important to analyze retailers' pricing behavior carefully, taking into particular account the many factors that may cause costs to increase during the pandemic, potentially leading to large price increases that do not imply proportionate growth in retailer profits.

e7de6f40be7b; Department of Justice Antitrust Division, *Competition and Monopoly: Single-Firm Conduct Under Section 2 of the Sherman Act*, Jun. 25, 2015, available at https://www.justice.gov/sites/default/files/atr/legacy/2008/09/12/236681_chapter6.pdf

