States Move to Prevent Post-Disaster Price Gouging

BY CHARLES GERENA

The remnants of Tropical Storm Gaston dumped more than a foot of rain on central Virginia in just one day in August, creating raging floodwaters that caused millions of dollars in damage and killed eight people. Within days, a few parking facilities in downtown Richmond allegedly raised their fees because many lots in the city's Shockoe Bottom district were covered in a mass of mud and wrecked vehicles.

The threat of rapid markups for goods and services after disasters like Gaston and Hurricane Isabel in 2003 is the reason why Virginia passed an anti-price-gouging law last April. North Carolina enacted a similar law in 2003 and the District of Columbia did it 11 years earlier. Lawmakers want to protect consumers from businesses deemed opportunistic.

In fact, not every post-disaster price hike is predatory. Some price increases are inevitable when a hurricane or some other calamity throws supply and demand out of whack.

After a disaster, the total supply of certain goods and services suddenly drops — there may be less gasoline due to power outages at service stations, for example. The disaster also creates a surge in demand for some items like generators. In either case, prices of those items tend to rise. Things become even more complicated when supply disruptions coincide with demand surges, for instance, when people need gas to fuel their generators.

In such situations, businesses want to increase their output, but they can't unless they take extraordinary measures. Goods producers and retailers may have to truck in fresh supplies from distant sources, while service providers may have to bring in extra help. Since these measures cost money, businesses must raise prices. Anti-price-gouging laws usually permit moderate price increases, which is why some industry groups aren't concerned about Virginia's law. It seems to them like a good compromise that both protects consumers and allows businesses to recover their added costs.

But economists like Donald Boudreaux counter that if businesses can't raise prices beyond a certain level, they may have to ration goods by limiting purchases. This prevents items from going to the people who need them most. "You have to make sure that existing supplies in the immediate vicinity of the distressed area ... are used as efficiently as possible," says Boudreaux, chairman of the economics department at George Mason University. Anti-price-gouging laws prevent this "economic triage" from taking place.

This means that even businesses with inventories on hand ought to be able to raise prices to market levels. Otherwise, "first come, first serve" becomes the standard for determining who gets what. The senior citizen who has a generator powering his respirator may end up at the back of the line for gasoline and get nothing, while the first person in line gets to refuel his generator so that he can keep his entertainment center running.

In addition, rising prices signal that an unmet demand exists. This entices new suppliers into disaster-struck communities with the promise of hefty profits. That's important because "you need to make sure that new supplies find their way into distressed areas as quickly as possible," says Boudreaux. Anti-price-gouging laws limit price increases, which "discourages suppliers from outside of the disaster area from putting forth the extra effort to get vitally needed supplies to that area."

Although higher prices boost the availability of goods and services in the medium and long run, one could argue that supply remains relatively constant in the short term. Variables that usually influence supply, such as the state of technology and the number of producers, can't change immediately. To make matters worse, flooded roads and power outages may make it impossible for new supplies to reach the market.

Therefore, higher prices won't immediately result in, say, many more bags of ice getting to many more people. Instead, only those who are willing and able to pay higher prices — no matter how outrageous they may seem — will get what they need. Some people may simply go without.

Government agencies and charitable organizations could meet unmet demand in the aftermath of a disaster. That way, the higher prices would be spread over a wider population beyond the individuals in need. However, buyers and suppliers may be less motivated to prepare for future disasters if they think a white knight will save them, and that doesn't always happen.

"No serious economist would ever claim that allocation [of goods] according to prices is perfect," says Boudreaux. Still, he argues, it is a better way to allocate resources in emergencies than the alternatives available with an anti-price-gouging law in place. **RF**

All's Fair in Love and War ... and Pricing?

There are good economic reasons for raising prices of essential goods following a natural disaster or major storm. But most people seem to think that this practice is unfair. Consider the responses to the following household survey question.

Question: A hardware store has been selling snow shovels for $15. The morning after a large snowstorm, the store raises the price to $20. Please rate this action.

Response: Unfair, 82%; Acceptable, 18%

SOURCE: Daniel Kahneman, Jack L. Knetsch, and Richard Thaler. "Fairness as a Constraint on Profit Seeking: Entitlements in the Market." *American Economic Review*, September 1986, vol. 76, no. 4, pp. 728-741.