

# Price Gouging

BY HELEN FESSENDEN

As travelers and locals alike tried to get out of Hurricane Irma’s path over Florida last fall, social media buzzed with reports of “price gouging.” One of the best known was a call to boycott Delta Airlines by comedian Chelsea Handler, who told her nearly 8 million Twitter followers about a passenger who saw her quoted airfare suddenly jump from \$547 to over \$3,200 as she tried to lock it in. Although Delta and the passenger resolved the fare dispute amicably, the fact that this story lit up social media speaks to the broad public outrage over the practice of extreme price shocks during an emergency. To date, 34 states have laws that prohibit what they term “exorbitant” or “unfair” movements in price, and in Florida, more than 8,000 complaints were filed during and after Irma. To these consumers, the common thread was that these firms exploited dire circumstances to reap higher profits.

“Price gouging” is not, however, a technical term in economics. Even in those states where it’s illegal, the definition is often not quantified, and the penalties vary widely. Still, in popular parlance, cases of “price gouging” usually have several things in common. They typically occur during an unforeseen disaster or natural emergency that causes a supply shock, and they often involve essential goods such as food, water, or gas. Demand can spike as well, as people try to stock up on basics or find transportation out of the affected area. A well-known case with national scope was Hurricane Katrina in 2005, which crippled almost all of the Gulf’s refining and pipeline infrastructure, causing oil and gas disruptions thousands of miles away.

An opposing view from many economists is that such price hikes — while painful — actually make allocation more efficient during emergencies. They can compel consumers to conserve goods more carefully, and they allow firms to recoup any jump in transportation or production costs that might result from the disaster, encouraging them to maintain supply under difficult conditions. If the government were to cap prices, it might distort those incentives, exacerbate shortages, and encourage black-market activity. Furthermore, some examples suggest that it’s in fact quite difficult to distinguish excessive price markups from the standard market response to reduced supply and higher demand.

Hurricanes Katrina and Irma provide some insights into how complex this last question can be. In the case of Irma, the widespread outcry over airfare hikes prompted some airlines to set price caps, increase capacity, and

tap into additional help from extra workers sent by the Transportation Security Agency. There was a clear public stigma they wanted to address. Yet airfares, like most online prices, are set by algorithms rather than people, and one post-Irma study of airfare data suggested that the price movement of tickets showed a typical response to the shifts in supply and demand — similar to what would happen if you tried to book a flight on short notice before a major holiday. While the public viewed these fare hikes as “price gouging,” there may have been nothing unusual going on.

In the case of Hurricane Katrina, the supply effect on oil and gas was vast due to the Gulf’s position as a pipeline and refining hub. More than 90 percent of crude oil production was knocked out of operation, and gas prices at the pump jumped by an average of 40 percent, and more in some cases, especially in the Midwest and South. While one widely cited estimate concluded that a disproportionate retail markup of gas prices did occur (by around 40 percent), another analysis, issued by the Government Accountability Office, suggested that the rise in prices at the pump might have also reflected longer-term and external factors, such as foreign demand, in addition to the post-Katrina shortage. “The wide-ranging effects of Hurricane Katrina on gasoline prices nationwide are a stark illustration of the interconnectedness of our petroleum markets,” noted the report.

These examples point to the difficulties in determining the causes of extreme price movements. What’s clearer is that consumers still broadly support “anti-price gouging” laws, even if they know that price caps can lead to shortages. Some scholars have looked to behavioral economics to explain why these laws are popular. One explanation is that the perception of “fairness” has a market value of its own. For example, Harvard University’s Julio Rotemberg has suggested that whether consumers are directly affected by shortages or not, they derive satisfaction from knowing that firms can’t exploit affected customers by allowing prices to spike — even if price caps increase the risk of shortages. Looking at the seller’s side, Nobel laureate Richard Thaler of the University of Chicago argues that even in cases when a firm knows that capping prices isn’t optimal for its bottom line in the short term, it might balance those forgone profits against the risk of long-term costs of negative publicity that could result from becoming known as a “price gouger.” This calculation, in the firm’s view, might make self-restraint the better alternative. Or, as Thaler put it in a radio interview, “If you [tick] people off, you pay a price.” **EF**



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