

A look at the positive side of price-gouging and greed

Price controls and lawsuits only work against consumers

By JOHN R. LOTT JR. and SONYA D. JONES

Understanding economics has never been a requirement to be a politician. With gas prices reaching \$70 per barrel on Monday and hotels outside of the disaster area raising rates, "price-gouging" seems to be politicians' favorite phrase these days. In the coming weeks, as people living in the disaster area try to get everything from fallen trees removed to food, the outcry against higher prices will only get worse. Yet, if political threats of price controls and price-gouging lawsuits prevent prices from rising now, it is the consumers who will suffer in the long run.

In Illinois on Monday, Democratic Gov. Rod Blagojevich started pressing to prosecute gas companies that profit from the recent price hikes brought on by the hurricane, and he is concerned that some of these increases occurred even before the hurricane hit the oil fields in the Gulf. In Hawaii on Sept. 1, the state government is supposed to begin imposing price controls on wholesale gasoline. Michigan, Oregon, California, New York and Connecticut have also debated regulating gas prices.

Even the Bush administration has gotten in on the act by having the Justice Department and the Federal Trade Commission look for evidence of price-gouging and believes retail and wholesale gasoline prices are "too high." Congress is planning on holding hearings on oil company "price-gouging."

In Texas, Attorney General Greg Abbott is threatening legal action against what he called "unconscionable pricing" by hotels that took advantage of desperate people fleeing the chaos in nearby Louisiana. In Alabama, Attorney General Troy King promises to vigorously prosecute businesses that significantly increase prices during the state of emergency.

You would think that people had learned their lessons about price controls during the 1970s, though memories have surely faded. Price controls didn't stop the cost of gasoline from rising. They just changed how we paid for them. Instead of prices rising until the amount people wanted equaled the amount available, chronic shortages of gasoline had Americans waiting in lines for hours. Yet, the supposedly permanent shortages disappeared instantly as soon as price controls were removed.

The free advice being offered by politicians is that it was improper for prices to start rising before Hurricane Katrina disrupted production in the Gulf of Mexico. But waiting to raise prices means that consumers will end up paying even higher prices when the reduced oil flow out of the Gulf is finally felt.

Higher prices today reduce consumption and increase inventories and thus reduce how much prices will rise tomorrow. The overall increase in price will actually be less.

The possibility of higher prices when disasters strike also gives oil companies an incentive to put aside more gas to cover those emergencies. Storing gas is costly, and if you want them to bear those costs, you had better compensate them. The irony is that letting the companies charge higher prices actually reduces customers total costs when you include such things as having to wait in long lines because there will be more gas available when the disaster strikes.

The American oil industry is no more concentrated when prices started rising immediately before Hurricane Katrina hit than it was two weeks earlier, and oil companies possess no sudden increase in monopoly power. Neither have they suddenly become greedier.

Stamping out "price-gouging" by hotels merely means that more of those fleeing the storm will be homeless. No one wants people to pay more for a hotel, but we all also want people to have some place to stay. As the price of hotel rooms rises, some may decide that they will share a room with others. Instead of a family getting one room for the kids and another for the parents, some will make do with having everyone in the same room. At high enough prices, friends or neighbors who can stay with each other will do so.

There is another downside to price regulations. Companies in states all across the country, hoping to make a few dollars, are thinking of loading up their trucks with food, water and generators and heading down to Louisiana, Mississippi and Alabama. The higher the prices, the faster these "greedy" companies and individuals will get their products down to desperate customers. But their greed means less suffering. The more products delivered, the less prices will rise. Political grandstanding today means future disasters will turn out even worse.

What about the poor?

Making the companies pay for others' altruism not only creates the wrong incentives, it is also unfair. If we need to help out, make everyone pay.

Bashing companies may be profitable short-term political behavior, but the discomfort will be over far sooner and less severe if markets are left to their own.

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