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Price signals, not price gouging

No matter how you pronounce it, it doesn't exist

By Vance Ginn | September 2024

There is no such thing as price gouging. During crises, we see price signals that help allocate scarce resources to those who need them most.

But some Michigan lawmakers are proposing new laws to prevent "price gouging" during emergencies, an approach that misinterprets how markets work. Suppressing these signals, as the proposed laws intend, will result in shortages and ultimately harm consumers.

"In times of crisis — a hurricane, blizzard, or pandemic — demand for certain goods and services soars while supplies become constrained."

For example, after the March 2017 windstorm that left many Michigan residents without power, hotel prices surged from $59 to $400 per night. Critics called this gouging, but the price increase wasn't about greed — it ensured that limited hotel rooms went to those who urgently needed them rather than being snapped up by people with less immediate needs. Higher prices, in this case, helped ensure resources were available for those who needed them most.

In times of crisis — a hurricane, blizzard, or pandemic — demand for certain goods and services soars while supplies become constrained. In a functioning market, prices rise to reflect these changes. This serves two key purposes. First, it encourages consumers to buy only what they truly need, preventing hoarding. Second, it motivates businesses to increase the quantity supplied, so shortages are only temporary. These price signals are essential in ensuring that goods flow where they are most needed.

The proposed legislation in Michigan, such as SB 954 and SB 955, would cap price increases at 10% during emergencies. While this might sound like a consumer protection measure, it sets the stage for greater problems. Price caps prevent businesses from responding effectively to surges in demand. If prices are kept artificially low, consumers have no reason to limit their purchases, which leads to empty shelves and shortages. The result is that the people most in need may be left without essential goods.

Moreover, these price caps discourage businesses from entering the market. When prices rise, new suppliers are incentivized to meet the demand. But if businesses know that prices are capped, they may

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decide it's not worth the effort or cost to increase supply during a crisis. This means fewer goods are available, harming consumers.

Critics often argue that businesses raise prices unfairly during emergencies to exploit consumers. While prices may rise, this doesn't mean businesses are being greedy. Temporary price hikes are often a natural response to increased costs. Even if a business temporarily becomes the sole supplier of a product, new competitors will eventually enter the market, bringing prices back down. Markets correct themselves quickly when competition is allowed to flourish.

We saw this dynamic play out during the COVID-19 pandemic. Demand for products like hand sanitizer and masks surged, but price controls prevented the market from adjusting. As a result, stores ran out of stock because prices couldn't rise enough to reflect higher demand. If prices had been allowed to increase, this would have signaled to producers to ramp up production and encouraged new suppliers to enter the market.

But will these proposed laws matter if a company can demonstrate that its costs increase to produce or deliver a good during an emergency? No. The laws create a mechanism where government officials can investigate and second-guess their price and cost increases after the fact and punish the company for perceived abuses. Not many companies will look at Michigan in a temporary crisis and try to find solutions for Michigan residents if they're going to get dragged through the mud and penalized for their good deeds.

Price caps also limit vulnerable consumers' access to goods. Wealthier or quicker buyers often purchase large quantities when prices are held artificially low, leaving fewer resources for those without. In contrast, when prices rise, consumers think more carefully about what they need, ensuring that goods are more widely available for everyone.

Michigan's proposed price-gouging laws are based on a misunderstanding of how markets work. Price signals are essential in balancing supply and demand, especially during emergencies. Instead of capping prices, which will only create shortages and inefficiencies, Michigan should trust the market to function effectively. When prices rise during a crisis, they help allocate goods to those who need them most, encourage conservation, and motivate suppliers to increase production.

Price increases during an emergency are a rational marketplace response to changing conditions. By allowing higher prices, Michigan can ensure that goods are available during emergencies as businesses are incentivized to meet demand. Price signals matter for bringing goods to the people who need them. Making them illegal will harm consumers.

Available online at: www.mackinac.org/v2024-26

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