



## Episode 987: “Price Gouging” Is Urgently Necessary

Guest: David Henderson

**WOODS:** I had a lot of requests for this topic, and I looked over the other 986 episodes and couldn't find anything on price gouging. I think I had mentioned it in passing a couple of times, but this seems like as timely a moment as ever given the disastrous flooding going on in Houston. These before-and-after pictures are really devastating, very difficult to look at. And a lot of us know people in Houston and it's very sad to see.

So let's talk about, though, what happens in these situations, when people suddenly find themselves in quite desperate straits and they need a great many supplies, but of course the emergency occurs so rapidly and out of the blue, there's no way physically to create all the supplies everybody would need, and the result is very high prices that we refer to sometimes as price gouging. I don't think there's a technical definition. I think it's one of those things that you know it when you see it, when prices are abnormally high in situations of emergencies. So let's start right there with that. A lot of people see this going on. They say, "Look at the price that water is being sold at. Water is necessary for life. This is taking advantage of helpless people in an emergency. Only a coldhearted economist could defend something like that." What is it about what's happening that people who criticize the free price system are not seeing, in your view?

**HENDERSON:** They're not seeing the unseen, to us Bastiat's term, and the unseen is two things. The main one I think is the resources that will be sucked in from the rest of the country if prices are allowed to go up. It's not the case that there's a fixed amount. There will be a fixed amount if the government imposes price controls. But if the government avoids price controls, those prices will shoot up. There'll be people in other parts of Texas and Louisiana and so on who will then say, "Hey, it's worth it to put a truckload of these supplies together and get this premium price," and you get a lot more resources. So that's the first thing I think people don't understand. They just see it as a fixed supply issue.

The second thing they don't understand is: one of the neat functions of a price is to allocate resources to those who are most willing to pay. And you might think that's just rich people. I'll say in a couple minutes why that's not so. But if resources get allocated to people who are most willing to pay, another way of saying that is they go to their highest valued uses. So there'll be people who say, if the price is controlled and they can get access, the price is not allowed to go up, "I'll use this plywood for this thing that doesn't matter to me much because I've got access." If the price is

allowed to go up, they're more careful in their uses of plywood, and therefore, the plywood will go to someone who wants it even more.

**WOODS:** Okay, so these are the sorts of things that get lost in a lot of the moralizing commentary that we see not just in the press, but all over social media. Even in my Facebook feed, which I thought, David, I had properly pruned up to now or that everybody was reading all the reading recommendations I've been putting out there. And I was devastated to find that's not so. And I probably should have waited a couple of hours before responding [laughing]. I get a little hotheaded. Because I feel like if you are actively preventing people from entering into voluntary exchanges in situations like this, you really are threatening people's lives.

**HENDERSON:** That's true.

**WOODS:** And that it's not enough to say that these people who often are making themselves out to be morally superior to the economists — it's not enough for their feelings to be satisfied. I really want people's lives to be saved, and I feel like that's not happening. But these people kept saying, *Look, I understand economics. I get what you're saying about supply and demand. But at times like this, you've just got to do the right thing morally, and the right thing morally cannot be that you have a supply of water, this desperate family needs it, and you're selling it for whatever inflated price it happens to be.* And that I think resonates with a lot of people. Forget about your supply and demand graphs. Here is a family that needs water. Here's you with some water. Why don't you sell it to them at a price they can afford?

**HENDERSON:** Ah, because there are lots of people who can afford it, and then suddenly I don't know who wants it more. So that gets to the issue of allocation to people who want it most. And the other one of course is it is not a fixed amount of water. So when they say, "Forget about supply and demand curves," I'm happy to forget about supply and demand curves, but I'm not happy to forget about supply and demand. And they do forget about it, and that's in fact when it's most important to have prices be free to go up, in order to suck in those resources from other parts of the country. I gave this example in my class once of an actual bunch of people in Georgia lining up, renting semitrailers and buying plywood and waiting to see if the governor of Florida was going to impose price controls on plywood. And when he didn't, those trucks came down. They were going to make serious money and they were going to help a lot of people.

**WOODS:** That's the key thing, because we're getting back to your earlier point about increased supply. There are different ways you can get people to come in in a situation like this and bring their own supplies to alleviate the shortages. Now, let's bear in mind it's very easy to get on social media and write about how torn up you are about the flooding in Houston and how much you wish you could help. It's quite another to actually put your shoes on, hop in the car, and drive 10 hours with some supplies. So how do you get people to actually do that? Well, there are two ways. You can either make it worth their while to go all that way at a great personal sacrifice in their own right, or we can conscript them into doing it.

**HENDERSON:** [laughing] Right, right. And of course, conscription has all its own problems. It is a form of slavery. But it's also, once you've conscripted them, who

conscripts? And what do they conscript? What do they make people supply? The nice thing about a market is that price is a piece of information. The price is communicated to potential suppliers what people value most. And I can tell you it is not used clothes and teddy bears. I don't know if you saw that picture – it was on Facebook – of all these people, goodhearted people wanting to get rid of their used clothes and teddy bears, and people saying, *No, please, please, don't do that. Send us money.* And by the way, if you send them money, they have more money to buy these supplies.

**WOODS:** Let's talk also about the way that temporarily high prices encourage conservation of the limited supply that exist. And let's bear that in mind also. Limited. Supplies are limited. And the demand is very high, but supply is limited. It's not like, if only we could get the economists out of the way, everybody could have his need satisfied. That is a false dichotomy. So let's first address that, that dichotomy there that, on the one hand, everybody could be happy, but on the other hand, we have these economists making excuses for greedy people.

**HENDERSON:** Right. So let's think back to my plywood example with people lined up at the border between Georgia and Florida, which was a real example some years ago. Where were they getting that plywood? They were getting that plywood that otherwise would have gone to uses in Georgia, uses that people valued less. And so it made people in Georgia say, *How much do I want that plywood? Am I willing to pay double the price I was willing to pay last month? No, I'm not.* So they don't pay. They get outbid by people in Florida, and that's great. That's what we economists would like to see.

Also, let me go to the issue of whether poor people get these resources. Here's an example I give my students when I talk about this plywood example in Florida. You might say, *Well, if we have price controls, those poor people are going to get it because they can afford it.* And there's something to that. But there's less of it to get. And now imagine there are price controls on plywood. Who's likely to be friends with the local lumberyard dealer? The rich guy with the mansion or the poor guy with the single-wide trailer? I submit it's probably the rich guy with the mansion. And so he might actually have an advantage going to his friend who owns the lumberyard and he gets all he wants.

Now, will the rich guy with the mansion outbid the poor guy? Let's do another thing economists do, which is called thinking on the margin. Sure, the rich guy will get all the plywood he wants at the high price, if there are no price controls, to fix his mansion. But maybe he has a toolshed in the back, and you know what? That's not as high a priority. At a controlled, regulated price regulated by the government so the price doesn't go up, he might persuade his lumberyard friend to sell him lumber for that too. But at that higher price, believe it or not, it could be the single-wide trailer guy who outbids the rich guy with the mansion, not for fixing the mansion, but for fixing that little toolshed. And then the poor guy with the single-wide trailer gets to fix his trailer. I think that's a very plausible case.

And let me just say another reason it's plausible. We don't see poor people not being able to bid for food. Poor people and low-income people buy food every day. So it's not true that rich people outbid them on everything for everything.

**WOODS:** So there are two ways then that we can deal with a situation like this when we suddenly have a small supply compared to the demand of whatever the good is. It could be water, food, replacement parts, whatever it is. All of a sudden, these things are much more expensive. Now, we can cope with that either by getting more supplies in or, in the meantime, we can conserve the supplies we currently have. So let's talk about that angle of things and how high prices encourage that.

**HENDERSON:** Right, so let's say price controls are imposed on water in Houston. If the people selling the water think those price controls are going to remain, they have very little reason to hold off selling them. Why not sell out and get the heck out of the building with everyone else? However, if the prices are allowed to go up, they face this interesting tradeoff over time. Economists call it an intertemporal allocation problem. They can say, *Well, maybe I'll hold something of the water off the market for when people want it next week*, assuming in case it's actually really bad next week. So the price does that too.

**WOODS:** I'm not sure, David, that I've heard this proposed, but I could imagine somebody proposing it. What if somebody said, *All right, we get that obviously prices can't be exactly where they were the day before a historic flood hit. I mean, some of us do get at least that. But some people are just taking it way too far. Couldn't we meet in the middle and say suppliers are allowed to sell goods in an emergency at a price that's 20% higher than they were the emergency? And then that way we get some of these good effects that you're talking about with the price system, but we don't get the moral offense of \$100 water and whatever. We have less human suffering this way. We'll just put a cost-plus pricing system in effect.* What's wrong with that?

**HENDERSON:** Well, you do get less human suffering than you would with total price controls that don't allow the price to go up even a percent, but you'd probably get more suffering than you would get by allowing the price to go up. Because it goes up only 20%, then you don't give much of an incentive for people to bring in those supplies on some pretty wet roads. And so it just is a way of kind of stopping the kind of progress you could have had by letting the price go up more. It's better than not allowing the price to go up at all; it's just not nearly as good as allowing the price to go up to whatever price equilibrates the amount of supply demanded.

Let me also point out, by the way, that one nice thing about allowing prices to go up is it also allows people not to raise prices. So you hear these stories – I think it happened with Katrina, a few other things – where you had Wal-Mart anticipating these issues, bringing in various electric generators and so on in advance, not raising the prices on them, but just having anticipated and brought in those things. That was a goodwill gesture on their part. So you kind of get the best of both worlds. You get people who just want to raise the price and that serves that very useful function we've talked about. You also get people who don't want to raise the price and generate a lot of goodwill. And so we've got both forces working when the prices are not regulated by the government.

**WOODS:** Let me say a quick thing about conservation, which I asked you about before, just because I'm trying to think of examples that I've used. I've sometimes used the silly example of: let's suppose it's raining and there are people outside and they want

umbrellas. The price of umbrellas, let's say, goes up when it's raining, and this is a terrible outrage. But of course, it means that maybe a family of five chooses not to buy five umbrellas. Maybe they buy two umbrellas and the three little kids are under one and the mom and dad are under the other, and that way, instead of buying five, they buy two, and that leaves three umbrellas available for another person.

**HENDERSON:** Yes.

**WOODS:** This is I think a factor that a lot of people don't think of. Or I've given the example of, again, a way that you could conserve even at a distance, would be kind of like the example you gave. If there's a lot of demand for lumber to rebuild people's homes, well, I bet 100 miles from there, they're still feeling that demand has pushed prices up, and that will make people who even weren't affected by whatever the disaster was say, *Well, maybe now's not the time for me to start my project, or, Maybe I don't need that dog house immediately. I could keep the dog in the house for a while or something.* And that frees up lumber for more urgent uses. This is — really, it's a miracle, frankly, what the price system does.

But even when it comes to something like water, which is necessary for life, there are a lot of uses for water that are not urgently necessary to preserve your life. I gave the example before we went on of using it to cook pasta with, or I might use it to wash my dog or something. Well, when it's urgently necessary and you know it's urgently necessary because you've paid an arm and a leg for it, you're going to make darn sure you use it to drink and stay alive with rather than waste it on stuff that's not necessary. And if you wasted it on that, then other people don't have that water to use for drinking.

**HENDERSON:** That's right.

**WOODS:** So again, it makes you put the existing stock to its most value-productive use. So in these arguments that we've made, these are really the standard arguments against price controls during emergencies, and yet, in every single emergency, we keep having to make these arguments that I think are really compelling. Do you have any insight as to why we can't seem to make this stick?

**HENDERSON:** Let me try. First of all, I think it's important to look at the fact that we're looking at it in a very gross sense, so maybe on the margin we have made it stick. In other words, maybe there's a little less pressure for these price controls. Maybe there's a little more pushback against price controls because of past arguments and past experience. And so you're always going to find, especially if you go on places like Facebook, you're going to find people just emoting and reacting and they don't know much. And that doesn't mean that the argument didn't persuade — it's the unseen, the people who didn't emote, who didn't just kneejerk, "Let's have price controls," and maybe five years ago they did have that kneejerk. But it's an argument we have to make every time, and I'm willing to make it. And if I can persuade one little city not to have price controls, I've done my job.

**WOODS:** Yeah, that's true. That's absolutely true. Is there anything in this — By the way, I appreciate that, because I get so down in the dumps sometimes. And this is another thing that's sort of unseen, the town that never established laws like this or

that never clamped down. The people who realized, *Hey, it is better for us to just have voluntary transactions after all*. I don't necessarily ever get to know about those.

**HENDERSON:** Yeah.

**WOODS:** But no doubt they are out there. And plus, on social media, I think because of our arguments, there are probably fewer people who dare to stick their heads up and say, "Hey, we better clamp down on this," because they know we're going to come in there and let them have it [laughing].

**HENDERSON:** Right. And there's another thing too – and we won't know this. It'd be very hard to know this. But what if, because they want to cater to a certain viewpoint, various officials who understand this advocate price controls, but then they put almost zero police resources into enforcing it? And so that's good news too. It's not as good news because then there's this kind of mixed, noisy information out there. Will I be nailed or not? But I wonder to what extent that happens, that it's just this statement so people feel morally good about themselves, whereas in fact, they understand the vicious consequences of price controls, and so they kind of hold back on enforcement.

**WOODS:** Yeah. Yeah, yeah, that's also a good insight. Is there anything we've left out? Any major portion of the argument that I've overlooked?

**HENDERSON:** No, but there's an analogy that I like to use, and I'd like to use it here. There's the old joke about the pastor who sees a very small congregation in front of him and gets really upset at them because the congregation is so small. Why is that funny? Because they're there. They're exactly the wrong people to get upset at. So people who are getting upset at people who are pricing are getting upset at the people who are doing them a favor. If they want to get upset at someone, they should be getting upset at the people who are not bringing us water, who are not bringing us plywood. But once they have that thought, maybe they could open themselves up to: don't even get upset at them; give them an incentive.

**WOODS:** That reminds me of something, again, I saw on – I do do other things other than look at Facebook all day, contrary to the impression you get from this particular conversation we've been having. But somebody was saying something like, "If you don't like the price somebody's offering you for a good in Houston, let's say, then go get it from the next person."

**HENDERSON:** Yeah.

**WOODS:** Which is a way of saying, "I bet there is no next person." So again, in a way, I'm not sure the analogy works completely, but I always had a hard time understanding why people get so upset at – it's not a perfect example, but at McDonald's for not paying enough to their cashiers, when it seems to me that, given that the person chose the McDonald's job, that means McDonald's is paying either more than anybody else would be willing to pay or was the only institution willing to hire them. It seems like McDonald's is the last place you should be upset at.

**HENDERSON:** That's right. That's right. And also, there's another joke I like to tell that kind of applies in this case. This guy runs into a butcher shop and says, "How much is your filet mignon?" And the butcher says, "\$9 a pound." And the guy says, outraged, "\$9 a pound? I can get it across the street for \$7 a pound." And the butcher says, "Well, then why don't you go across the street?" And he says, "Oh, he doesn't have any."

**WOODS:** [laughing] Yeah, exactly.

**HENDERSON:** And he's like, "Well, when I don't have any, I charge \$5 a pound."

**WOODS:** Yeah, that's right. I think I even heard that on *The Honeymooners*. [laughing] Yeah, that one's been around for a long time. That's great. I knew exactly where that joke was going.

**HENDERSON:** [laughing]

**WOODS:** Yeah, sure, when you don't have any, you can have super low prices [laughing]. All right, David, do you have a website we can send people to?

**HENDERSON:** Well, I blog a lot on EconLog. If you do a search on EconLog, you come up with the right thing. So go to EconLib.org and then click on "EconLog," and you'll see my various blog posts along with those of Bryan Caplan and Scott Sumner and some other bloggers we have.

**WOODS:** Okay, I'll actually link directly to that on the show notes page, TomWoods.com/987. All right, that is the last time we ever need to talk about price gouging, because these are the arguments. If you're not satisfied with them, that's all we've got. But that basically is it. There's no need to keep revisiting this. It doesn't matter if it's an earthquake somewhere, if it's a flood, or whatever it is, the arguments are going to be the same, so it's just our responsibility to make them as compelling as possible so as to minimize as much human suffering as we possibly can. Thanks again, David R. Henderson. I appreciate it.

**HENDERSON:** Thanks, Tom.