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A White Paper on The Economic Consequences of Gasoline "Price Gouging" Legislation

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The Nation's drivers, the Administration, and Members of Congress are rightfully concerned about high gasoline prices and the burden high prices impose on families and businesses, particularly on those low-income households least able to adjust to high prices. All policymakers firmly oppose any anticompetitive practices perpetrated by firms. Any instances of illegal collective anticompetitive action can and should be vigorously fought by the Federal Trade Commission (FTC) and, if criminal conduct is involved, by the Department of Justice.

The problem with this legislation is that terms like "price gouging" and "unconscionable" have no economic definition. As such, there is no economic evidence that can establish or refute claims of gouging or unconscionable behavior. We agree with FTC Chairman Deborah Platt Majoras: the legislation "likely will do consumers more harm than good."

Legislation like the "Petroleum Consumer Price Gouging Protection Act" as part of S.1419 or H.R. 1252, the "Federal Price Gouging Prevention Act," will harm the economy generally and specifically will harm drivers – the very people the bills are intended to protect. The approach contradicts standard economic principles.

Such legislation is harmful for primarily two reasons:

1. "Price gouging" legislation that effectively places controls on prices exacerbates shortages and potentially increases lines at gasoline stations.

2. The difficulty in defining "price gouging" would create an unnecessary regulatory regime with potentially high litigation costs and great uncertainty for sellers, enforcement agencies, and the courts. These added costs and uncertainties would deter investment in new supply, increasing prices in the long run.

Supply Disruptions and Lines at Gas Stations

"Price gouging" legislation would reduce incentives to supply areas facing a fuel shortage. For example, in the days after natural disasters, such as hurricanes, price increases induce domestic refineries outside the affected region and foreign suppliers to rapidly ship additional gasoline to affected areas. If this legislation were implemented, it could deter retailers from increasing prices and it might not be worthwhile for suppliers to divert their shipments. Retailers in the affected region would have even less gasoline and drivers would face additional hardship. With gasoline prices kept below market levels, there would be shortages. Consumers would be forced

to line up at gas stations, but gasoline would run out before satisfying demand and many would be forced to do without.

Without the flexibility for prices to increase, supply disruptions last longer than they would otherwise. By disrupting the price mechanism, price controls make lines longer during emergencies, misallocate the available supply, and prevent those with the greatest need for gasoline from getting access. Also, by making it illegal for prices to increase when supplies are tight, price gouging legislation makes retailers reluctant to lower prices when supplies are readily available, for fear of not being able to adjust to future supply changes.

It is useful to compare the experiences of the 1970s to the present day. In the 1970s, when price controls were in effect, oil price increases were accompanied by long lines at the pump and economic recession. In recent years with flexible prices, oil price increases of similar magnitude have been accompanied by gasoline availability and strong economic growth.

Enforcement

The legislation would create an unnecessary and costly enforcement regime. Competition between suppliers ensures that they cannot take advantage of consumers by setting prices that are out of line with their cost and ensures that gasoline goes to consumers who need it most.

Existing antitrust law based on economic principles already ensures healthy competition by protecting against anticompetitive business practices both generally and during an emergency. Antitrust law prohibits sellers from explicitly colluding to impose higher prices. Retailers and refiners are prohibited from taking exclusionary actions that would create monopoly power (See the appendix for additional details).

Enforcement of and compliance with price gouging legislation, on the other hand, is costly because price gouging is not well-defined. Firms and regulators therefore would face a great deal of uncertainty, potentially leading to costly and unnecessary litigation. These added uncertainties and costs could deter future investment and increase prices in the long run.

Conclusion

For all of these reasons, "price gouging" legislation should be opposed. Excessive legislation such as this is effectively a price control and would set a bad precedent for the government's involvement in the market. A wide variety of economists have found with both empirical research and practical experience that these policies do not work. Long experience has shown that allowing the market to set prices—the principle that forms the basis of our Nation's free-market system—is the most efficient and effective method to allocate scarce resources.

Appendix: Existing Laws already prevent anticompetitive behavior by firms

Competition policy already makes it illegal for participants in the gasoline production and distribution network to conspire to restrict supply or raise prices after a disaster. The antitrust laws, as enforced by the Department of Justice's Antitrust Division and the Federal Trade Commission, prohibit actions such as the following.

- Gasoline retailers exploiting the reduced availability of gasoline by explicitly colluding on higher price levels than otherwise would have prevailed.
- Explicit collusion among refineries and wholesalers to designate exclusive territories, allowing them to charge monopolistic prices in those areas.
- Unlawful monopolization or attempts to monopolize by gasoline retailers in a relevant retail geographic market.
- The imposition of some retail price maintenance schemes in which gasoline is made available to retailers only on the condition that the retailer charges a price higher than a pre-set minimum.