Why Is Price-Gouging Bad?

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Covid-19 has led to a number of shortages. It has also, as a consequence, produced an epidemic of price-gouging. Crucially, the Trump administration's refusal to make serious use of the Defense Production Act has left states competing with each other for critical medical supplies, from ventilators to personal protective equipment, leading to soaring prices.

But is price-gouging in the wake of a disaster a bad thing? Most people instinctively feel that it is — that those who happen to be in possession of crucial supplies in a time of extreme shortages shouldn't be allowed to make a killing by selling those supplies at very high prices. To the extent that economists have thought about it, however, they tend to argue that we should let markets work, that putting a lid on price increases is counterproductive.

There seem to have been very few attempts to think through why, exactly, most people feel that price-gouging is bad; Snyder 2008 is one of the few examples I've been able to find. But this is a case, I'd argue, in which the public is right and many (most?) economists are wrong.

The piece linked above makes the case in terms of the morality of the seller's actions: is it right to take advantage of peoples' distress? Without disagreeing that this is a relevant question, I find it helpful to think in terms of distributive justice.

The classic argument here is, of course, that of Rawls, whose 1971 "A Theory of Justice" argued that we should evaluate social arrangements by imagining ourselves having to choose institutions and policy behind a "veil of ignorance": what society would you prefer if you didn't know who you would be?

If you assume that we're going to need to rely on a market economy, a Rawlsian approach doesn't prescribe complete equality: in reality, people do know who they are, and must be given incentives to produce. But it does suggest that you want a redistributive welfare state, with progressive taxation and a strong social safety net, Suppose, however, that we already have progressive taxes and a safety net — that we have, in effect, made our choice about how much inequality to have — and then disaster strikes. How does this change things?

The answer is that if disasters are followed by a market free-for-all, with suppliers of essential goods selling them at very high prices to those who can afford to pay, the stakes of inequality suddenly become much higher. Those who can't afford the high prices face extreme privation, even death, while those with sufficient wealth face no more than inconvenience.

Compare this with a regime in which disasters are followed by temporary suspension of free markets, in which essential goods are subject to price controls and rationing, allocated on the basis of need.

If you had to decide between these regimes ex ante, behind the veil of ignorance, which would you choose? The answer, it seems clear, is that you'd choose rules of the game in which profiteering and price-gouging in the aftermath of disaster are prohibited. Yes, there might be some reduction in incentives to supply needed goods, but you really don't want a society in which low income means death in times of disaster.

In short, even if you believe that the best system for normal times is to let markets rip and soften the impact of inequality with taxes and transfers, it makes sense to temporarily move to price controls and rationing in the face of disaster. Maybe rules against price-gouging hurt economic efficiency in the sense that they reduce the sum of consumer and producer surplus. But economics is about people; and human welfare sometimes requires looking beyond dollars and cents.