The Price of Price-Gouging Laws

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American consumers are used to having instant access to a wide variety of choices of products. Consumers can typically compare price and quality between online and brick-and-mortar stores. Companies are generally free to sell their products at any price they choose. The COVID-19 outbreak rapidly changed all of this. American consumers and healthcare providers saw widespread supply shortages. Demand for consumer products such as hand sanitizer, cleansing wipes, and toilet paper suddenly spiked as households began disinfecting frequently and stocking up on supplies to limit trips to stores. It became difficult to find many previously ubiquitous products for sale in either retail stores or online. Demand for personal protection equipment (PPE) and related medical supplies also increased drastically, causing dire shortages. Protective face masks in particular have been in short supply, and tragically there were reports of front-line healthcare workers unable to obtain face masks.

Amid the surging demand for and dwindling supply of these products, prices jumped where these items were still available for purchase. Before the first COVID-19 case was detected in the United States, outrage and allegations of price gouging quickly filled the internet over prices for products like hand sanitizer and toilet paper. Some who could afford it paid the high prices and stocked up in anticipation of shortages to come. Those who could not afford it went without. Those early allegations of price gouging were based on moral outrage, but price-gouging laws typically require a trigger, usually a state of emergency declaration, and many were not yet in effect. As the COVID-19 crisis reached U.S. soil, states of emergency were declared by the President of the United States and by every state and the District of Columbia. The declarations of these states of emergency triggered price-gouging laws on the books in at least 38 states1 and the District of Columbia; many of these laws carry criminal penalties as high as $10,000 per violation and one year in prison. States and local governments quickly jumped into action, issuing cease and desist orders and bringing enforcement actions for alleged price gouging on essential products as COVID-19 became a larger threat.2 And on March 23, 2020, President Trump signed an execu-

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1 At least 38 states have price-gouging legislation. In some states without price-gouging laws, such as Minnesota, governors have targeted price-gouging activities with executive orders. And in other states without price-gouging laws, attorneys general have threatened to prosecute price gouging under state consumer protection laws. See, e.g., Press Release, Montana Attorney General Tim Fox, Attorney General Fox Warns of Potential Coronavirus Scams, Price-Gouging (Mar. 13, 2020) (reminding Montanans that “state law protects them from unfair or deceptive trade practices and price fixing”), https://dojmt.gov/attorney-general-fox-warns-of-potential-coronavirus-scams-price-gouging/.

tive order triggering the Korean War-era Defense Production Act (DPA), temporarily making price gouging and hoarding of crucial medical supplies a federal crime.³

As the world has witnessed, COVID-19 infections can spread widely throughout the population. With no clear end in sight and the expectation that outbreaks will continue to flare up at different times in different places across the globe, sudden spikes in demand for and shortages of critical products like N95 masks are likely to occur frequently over the next year and perhaps beyond. The widespread state law prohibitions, federal and state enforcement actions, and media coverage of price gouging suggest prohibiting price gouging is a no-brainer policy. But price-gouging laws influence the speed and size of supply responses to affected areas. And because supply responses will have an impact on the number of lives lost, the reasons for and impacts of price-gouging laws need to be carefully considered. Additionally, if price-gouging laws are good policy, as at least 38 states and the Trump administration have decided they are, the laws should be structured and enforced with an eye toward prohibiting the most egregious behavior while allowing for the largest and quickest possible supply responses.

Case for Price-Gouging Prohibitions

Price gouging is generally the sale of a product for an excessive price during an emergency. There are several reasons underlying the outrage over price gouging and the laws prohibiting it, all of which seem to be moral in nature.

First, every element of a transaction viewed as a price gouge seems grossly unfair. Price gouging occurs in the wake of economic shocks, typically natural or man-made disasters. The victims of the disaster are one and the same as the victims of price gouging. This is because disasters cause spikes in demand for certain essential products—products needed to mitigate or respond to the harm caused by the disaster (e.g., protective face masks) or to meet basic needs that have become more difficult to meet as a result of the disaster (e.g., food, water, electricity, ice). So the people hardest hit by the disaster have an immediately increased demand for the same essential products at the same time. Those most affected by the disaster thus see the sharpest demand spikes and resulting supply shortages, and are most likely to become the victims of price gouging.

On the other side of the price-gouging transaction is the seller. The seller is typically (though not always) an individual or company not devastated by the disaster who has access to or the ability to produce the products in high demand. The unharmed seller is the one who gains financially from the transaction and is often seen as an amoral profiteer.

So, in the eyes of many, price gouging involves an amoral profiteer selling a vital good to a twice victimized person in dire circumstances.

Second, because price gouging typically has to do with necessities at times when those items are exceedingly scarce, price-gouging transactions can be seen as coercive. A justification for allowing sellers to charge whatever price they choose under normal circumstances is that transactions are voluntary—buyers can simply choose to walk away from prices that are too high. But in price-gouging situations, buyers are seen as not having a choice. The products are often necessary to meet people’s basic needs—health, safety, food, or shelter. The coercive rather than vol-

The voluntary nature of price gouging is seen as a justifiable reason for the exception to the general rule that sellers are free to set their price.

Another objection has to do with the distribution of critical goods. By allowing sellers to charge high prices, some argue that those with the most money, or only those with a lot of money, are able to acquire the products. The argument is that life necessities should not be distributed according to ability to pay.

Last is the notion that price gougers do not add any value to the products they sell to justify the high prices charged. Often price gougers are seen as “middlemen” who make windfall profits out of circumstance—often tragic circumstances—rather than because of useful production. The middleman seizing on an opportunity to make a buck during a crisis is often the disdained profiteer that price-gouging laws seek to punish, while in a nonemergency situation that same person might be viewed as the type of scrappy entrepreneur Americans often applaud for seeing and seizing on an opportunity.

Supply Case for Letting Prices Rise

The counter to this moral case for price-gouging laws is primarily an economic one, namely that price-gouging laws set artificial caps or ceilings on prices and profits, resulting in lower total supply of products that victims of disasters need the most. In our market economy, prices act as both incentives and instantaneous signals to both buyers and sellers. A market price that is much higher than the cost to supply the product is an incentive for and a signal to potential sellers to supply that product to the market. Conversely, a high price is a signal to and incentive for buyers to either reduce their consumption or substitute away from that good.

In economic terms, prohibitions against price gouging are price ceilings. They set a maximum price allowed by law. That price ceiling sets a profit cap as well. When laws prohibit prices from rising to the level that buyers would be willing to pay, prices lose some of their ability to function as an incentive for and a signal to buyers and sellers.

Unfortunately, price ceilings do not solve the underlying market condition of excess demand for limited supply. But price ceilings do suppress the price signal, limit the incentive to supply, and, as a result, reduce the total level of supply as compared to the level that would be supplied if prices were allowed to rise. This is because producers (individuals and companies) are willing to undertake more actions, make more investments, take on more costs, and take on more risk when the payoff, the price, is higher. In economics, this fundamental principle is known as an upward sloping supply curve. Even during a global pandemic when government orders and travel restrictions might limit the number of suppliers (a “shift the supply curve” in economic terms), the total quantity supplied to a market by the more limited set of suppliers is likely greater at higher prices.

Practically, new sellers who might otherwise enter a market may not do so because price caps limit or eliminate their profit incentive. In the COVID-19 crisis, this concept has very real implications. Those who have an inventory of, or access to, vital PPE and medical supplies, or who work in adjacent lines of business and have the ability to shift production to these products may be less likely to bring those products to markets with price ceilings in place. Selling products into markets with price ceilings limits sellers’ pricing and profit and comes with a risk of being prosecuted, a risk many will not be willing to take, particularly if the price ceiling is unclear. This barrier to would-be entrants worsens the supply gap that is typically filled by the promise of profits.

We are seeing this dynamic play out during the current pandemic. Perhaps the product in the shortest supply—and that which has been the source of most price-gouging prosecutions—has been respirator or surgical face masks. While demand for such masks has increased everywhere
for both medical workers and nonmedical consumers, the level of need for face masks is different in different places, and the need for face masks in a given place can change quickly. In the United States, New York has been an epicenter of the COVID-19 spread. There are certainly, on the margins, producers of face masks, or people who have inventory or access to producers of face masks around the world, who face the choice between (a) continuing business as usual, selling to the customers they already have relationships with in places in which they typically sell, and (b) shifting those sales to somewhere like New York City. While the second choice might be what is best for public health, as well as the moral thing to do, shifting those sales has significant costs and risks. There are costs associated with finding buyers, vetting buyers, and arranging logistics to deliver product to new buyers. There also are risks associated with diverting sales from other customers with which the supplier might already have long-term contracts. Ideally suppliers would make this shift despite those costs and risks, but many will not unless the reward encourages them to do so.

Why should suppliers need a higher price to incentivize the shift to helping others? Shouldn’t they increase their output or shift their sales because it is the right thing to do? Some do. During the COVID-19 pandemic, for-profit companies have donated millions of face masks to those in need.4 Others have promised to keep their prices the same5 and expand output. But these are primarily charitable actions, perhaps made with a long-term focus on brand and reputation protection. The charitable actions of some should not be confused with broader market behavior. Maybe many or even most suppliers and owners of products in short supply are willing to take similar actions. The most relevant question when evaluating price ceilings from a policy perspective, however, is whether there would be even more incentive and therefore even more supply absent price ceilings. While some noble individuals and companies are willing to undertake investments, costs, and economic risk to aid those in need, even more individuals and companies would be likely willing to do so if they could expect a greater financial return.

Supply responses triggered by high prices have another effect—in time they reduce the market price. As more supply enters the market, excess demand falls, and sellers more frequently have to compete for sales. As a result, sellers are forced to lower prices in order to sell all their product.

As long as price is able to act as a signal and an incentive, economics suggests that the market price will eventually fall to something close to what price-gouging laws demand: a price at or slightly above the price charged before the emergency (or, if costs have risen, the cost plus an ordinary profit). Prices in a world without price-gouging laws would thus eventually converge with those enforced in a world with price-gouging laws. The difference is that, in the world without, more people may be able to acquire the product, though those who acquire the product earlier in time will pay a higher price. In the state of emergency world where price-gouging laws are triggered, many are simply not going to be able to acquire the products at all because there is insufficient supply. For those people, the price of the products is essentially infinite.

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markets quickly develop to connect those willing to pay the price, and such gray market transactions leave customers much more susceptible to counterfeits and fraud.

**Price-Gouging Laws**

In the United States, the case in favor of price-gouging prohibitions has largely won the day. At least 38 states and the District of Columbia have laws against price gouging. This includes states across the political spectrum, from California to Texas. Others are considering adding them. In Ohio, a state without a specific price-gouging law, the attorney general has brought an action for alleged price-gouging conduct under both consumer protection statutes and unconscionability contract law theories. And while there is no general federal price-gouging law, President Trump invoked the DPA, a Korean War-era law provision that in effect prohibits hoarding and price gouging.

The state price-gouging laws vary, though there are a few common threads seen among many of them. Almost all are limited in time to a period following some sort of declaration of a state of emergency. Most include some sort of price ceiling that is set at a certain percentage above the average price that the relevant good sold for during a time period immediately preceding the declaration of emergency. For example, some states like New Jersey and California prohibit selling products at prices greater than 10 percent more than the average price for the same product over the 30-day period preceding the emergency declaration. Some state laws make the percentage increase an element of the law while, in others, a price increase over the prescribed percentage is prima facie evidence of a violation. Some laws are vaguer and merely prohibit sales at unconscionably high or excessive prices. Most have exceptions or defenses, the most common being that the defendant can seek to show that the price increase is directly attributable to increases in costs, though many of these defenses also require a showing that the seller’s markup did not

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11. See, e.g., [Ala. Code § 8-31-4 (equal to or in excess of 25% of the average price during the last 30 days immediately prior to the declared state of emergency); Cal. Penal Code § 396 (price of more than 10% greater than the price charged by that person for those goods or services immediately prior to the proclamation or declaration of emergency); Ky. Rev. Stat. § 367.374 (more than 10% above the price prior to the declaration)](https://www.arkansaslegis.gov/Laws/ArkansasCode/chapter488/section303). 50 U.S.C. §§ 4501–4568; [White House, supra note 3](https://www.whitehouse.gov).


increase. While there are common threads, sellers do not really have a safe harbor under which they could increase their prices at all, or begin selling a relevant product, and be completely safe.

The executive order that President Trump signed in March invokes the DPA to prevent hoarding of certain critical items as designated by the U.S. Department of Health and Human Services (HHS). For such items, including PPE and ventilators, individuals and companies are prohibited from accumulating them either (1) in excess of reasonable needs or (2) for the purpose of selling them in excess of prevailing market prices.

This is new federal territory. Outside of the authority granted to the president under the DPA, there is no general federal price-gouging law. Federal price-gouging laws have been proposed after past crises, and there have recently been renewed calls for new legislation. When price-gouging concerns arose after natural disasters like hurricanes, the disasters affected particular geographic regions, and concerns were focused on products like gas, water, and building supplies. Price-gouging enforcement was typically a state enforcement issue limited to the region and a few essential products. Under the new federal enforcement regime, U.S. Attorney General William Barr said the DOJ will prioritize hoarding and price gouging involving vital supplies needed to fight COVID-19 and created a COVID-19 Hoarding and Price Gouging Task Force. The task force quickly initiated federal investigations of hoarding and price gouging, and it has announced charges. It is unclear how far the administration will go in invoking the DPA with respect to pricing and how “prevailing market prices” may be pled and proven beyond a reasonable doubt in the criminal context.

The existing patchwork of state and federal laws makes selling essential products during a time of crisis an uncertain and risky venture. First, it is very difficult to ensure compliance with laws that use undefined and vague standards in prohibiting “excessive” and “unreasonable” pricing. It also is often not clear whether the relevant reference “price” is the advertised price or the actual price and how discounts should be accounted for. Given the infrequent enforcement of the relevant state laws, case law defining these terms is sparse. The executive order in place under the DPA

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15 White House, supra note 3.


17 50 U.S.C. § 4512. As a result of this executive order, it is a misdemeanor to engage in this prohibited activity, which is punishable by up to one year in prison and a fine of up to $10,000.


19 U.S. Dep’t of Justice, Long Island Man Charged Under Defense Production Act with Hoarding and Price-Gouging of Scarce Personal Protective Equipment (Apr. 24, 2020), https://www.justice.gov/usaو-edny/pr/long-island-man-charged-under-defense-production-act-hoarding-and-price-gouging-scarc-0 (DOJ filed a criminal complaint charging a Long Island man with violating the DPA by hoarding personal protective equipment at a warehouse in Brentwood, New York, amid the COVID-19 pandemic, and price-gouging customers of his retail store in Plainview, New York); U.S. Dep’t of Justice, supra note 4 (Brooklyn man was arrested by FBI agents investigating hoarding and price gouging and charged with assaulting a federal officer and with making false statements to law enforcement).
falls into this category as well. It provides no guidance as to what it means for a price to be “in excess of prevailing market prices.”

Second, even with respect to laws that use a more certain standard, the laws tie the acceptable selling price to the selling price of the product in the affected area (the boundaries of which may be unclear) over a specific time period preceding the emergency. A seller, therefore, needs to compile and sort through available data to determine what the acceptable price is in any relevant area. And new suppliers—those that shift production to the needed good or have not previously sold in the area—likely do not have ready access to market data needed to determine the acceptable price ceiling under the law. As a result, in a situation where time is of the essence, sellers looking to sell critical products to buyers across many different states have to spend a significant amount of time and resources in order to ultimately get only an incomplete level of certainty that they are not in violation of one of the many different price-gouging laws. Coordination with competitors of efforts to do so may even put companies at increased risk of running afoul of federal or state antitrust laws.

Third, laws that prohibit price gouging based on the price charged during an emergency unnecessarily mandate that prices remain at the levels they were at during a rather arbitrary time (usually either in a period immediately before the emergency or at a price that is the average over a number of days before the declaration of an emergency). At the very least, standards for price gouging should be tied to profit margins, not gross prices. During crises and times of market turmoil and increased demand, it is simply unrealistic for prices to remain unchanged. For example, during the COVID-19 crisis, we see that the price many are willing to pay for N95 masks is many times higher than the price they would have been willing to pay before the pandemic, when such masks typically cost just over a dollar and were plentiful and used by painters as well as healthcare professionals. A 10 percent price cap above pre-crisis prices, which allows for only pennies in increased prices for masks, is simply unrealistic today and far out of line with what a free market would dictate. If the prevention of profiteers seeking windfall prices is the real aim of price-gouging prohibitions, the laws should be based on profit margins rather than prices. Additionally, because a complaint can cause enormous reputational harm even if the accused is ultimately successful using an increased-cost defense, the burden should be on the prosecution to show excessive profits, not merely excessive prices.

Last, states could consider adding an “increased output” defense to price gouging. This would allow a defendant accused of price gouging to rely on a defense that they would not have supplied the product had they not been able to charge the price they did. This would be akin to an antitrust “rule of reason” analysis under which the defendants are given the opportunity to show that their actions had procompetitive or output enhancing effects. In this case, defendants would have the burden, but be able to show that their actions ultimately resulted in greater aggregate output of the product sold.

The current prosecution model of price-gouging enforcement is resource intensive for enforcers and not transparent or easy to navigate for market participants responsibly trying to price essential products during the current pandemic. A more radical rethink after this pandemic could involve governments stepping in to directly sell or facilitate sales to get essential products to hos-

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pitals or customers who need them, or even temporarily communicating specific price ceilings for certain essential products so that market participants would have more transparent price limits. These alternatives could certainly raise other competition and supply concerns but may be worth considering in a post-COVID-19 world.

**Conclusion**

The reasoning that underlies price-gouging laws is straightforward and morally sound—protecting victims of life-altering disasters from having to pay exorbitant prices for ordinarily common and necessary products. Unfortunately, because they could suppress supply responses, price-gouging laws can exacerbate, not relieve, the product shortage problems that they are meant to address. The price we pay to prevent people from entering into voluntary transactions at temporarily inflated prices is that more people are forced to go without. While it is unlikely that states and the federal government will change course in the short term, lawmakers could use lessons learned from the current COVID-19 crisis to improve price-gouging laws with an eye toward mitigating the supply effect and encouraging increased output in the wake of disasters.