The current issue and full text archive of this journal is available at
www.emeraldinsight.com/0306-8293.htm

Price gouging in the Katrina aftermath: free markets at work

Dreda Culpepper
Economics Department, College of Business Administration, Loyola University New Orleans, New Orleans, Louisiana, USA, and
Walter Block
College of Business Administration, Loyola University New Orleans, New Orleans, Louisiana, USA

Abstract
Purpose – The concept of "price gouging" during times of emergency, such as in the aftermath of Katrina, often evokes quite an emotional and reactive response from people who are outraged that stores and companies would increase their prices during a time of emergency. The problem is that people do not realize that, in times of emergency, the market price they knew before is no longer adequate. Government intervention is not the answer to this "problem." The purpose of this paper is to explore basic concepts of economics, to glean a better perspective of the justification for raising prices during times of emergency, as well as what would happen if there were not laws preventing this very necessary practice.

Design/methodology/approach – The paper addresses some "basic concepts" of economics and applies them to emergency situations, preeminently the dire plight of New Orleans and the Gulf coast after Katrina.

Findings – The paper finds that a government passes legislation preventing price gouging based on the implicit premise that it can allocate resources more efficiently than the market. By doing so, it alleges that it knows what the people want better than entrepreneurs who sink or swim based on their ability to anticipate matters of this sort. The paper voices the view that government regulation is nothing short of a disaster as far as satisfying customers is concerned.

Originality/value – The paper is of value in offering the forthright view that during times of disaster, prices must be allowed to adjust as a signal to producers and consumers alike. Consumers will utilize less of these goods, and producers will increase their output. As the supply adjusts following the price increase, goods and services will get to those who want them the most and are willing to pay for them. The paper posits the view that this will undoubtedly be a more effective way to distribute supplies to hurricane victims – price controls must be repealed, and the free market must be allowed to work via the beneficent invisible hand, not by the stultifying hands of the bureaucrats and politicians.

Keywords Free market economy, Price positioning, Disasters, Economic theory, United States of America

Paper type Research paper

International Journal of Social Economics
Vol. 35 No. 7, 2008
pp. 512-520
© Emerald Group Publishing Limited
0306-8293
DOI 10.1108/03068290810886911

1. Introduction

The concept of "price gouging" during times of emergency, such as in the aftermath of Katrina (Block, 2006; Block and Rockwell, 2007; Rockwell and Block, n.d.), often evokes quite an emotional and reactive response from people. The vast majority are outraged that stores and companies would increase their prices during a time of emergency.

JEL classification – L0, L11, R32, R48

How could firms be so cruel as to take advantage of those needy people in such a desperate situation?

The problem is that people do not realize that, in times of emergency, the market price they knew before is no longer adequate. They view price gouging as opportunistic pricing on the part of the "evil" capitalists in order to enrich themselves at the expense of the consumer. Legislation has even been passed to prevent entrepreneurs from raising their rates (National Conference of State Legislatures, 2004). Government intervention is not the answer to this "problem." Upon exploring basic concepts of economics, one might glean a better perspective of the justification for raising prices during times of emergency, as well as what would happen if there were not laws preventing this very necessary practice.

In Section 2 we address these "basic concepts" of economics. Section 3 is devoted to applying them to emergency situations, preeminently the dire plight of New Orleans and the Gulf coast after Katrina. We conclude in Section 4.

2. Basic concepts

Prices are to the economy as street signs are to the urban geography, as are the moving baton and the sheet music to the orchestra. They are signals, they convey vital information. If street signs were taken down, and the conductor and the score removed from the musicians, chaos would ensue. Something close to a real world example occurred in the early days of the Soviet Union, when prices were all but banned. Such pandemonium took place that even the died-in-the-wool Communists, the true believers, had to pull back from this particular abyss. They instituted the New Economic Plan, which brought back some semblance of market prices (Rothbard, 1971; Richman, 1981).

But only market driven not any old prices can serve in this capacity. If they are to do their job, they cannot be arbitrary. Prices must reflect the importance people place on the items to which they refer and their relative scarcities, in the eyes of the economic actors. If street signs were randomly switched with each other, or if the notes and movements of the conductor became haphazard, they would do no good at all. It is exactly the same with prices. Arbitrary ones are no better than none at all. Here, again, the economy of the USSR serves as a baleful illumination. Owing to their Communist ideology, markets in raw materials and capital goods were legally forbidden. If it were not for black markets in the Second World, and their knowledge of prices in the Free World[1], they would have been flying completely blind[2]. They would not have known, for example, whether to use wood, plastic or metal for their row boats. They would not have been able to determine whether the resources that went into the construction of a building were worth more, less or the same amount as the final good itself.

It is only through the free interplay of supply and demand, which incorporates the comparative evaluations of all market participants, that meaningful prices can be constructed. It is no accident that to the degree that an economy has been free in this way, it has also been prosperous (Gwartney *et al.*, 1996). Thus, paradoxically, introducing a bit of arteriosclerosis into the economy by enacting anti "gouging" laws will reduce economic welfare, not increase it.

3. Applications

During a natural disaster, the demand for batteries, gasoline, milk, candles, bottled water and ice among other things generally increases. Simultaneously, the supply of

these goods often decreases due to damage from storms, forest fires, tornadoes or earthquakes. Even without the "evil" capitalist getting explicitly involved[3], the natural market price will automatically increase beyond its pre-disaster status. Most people do not take this into account when complaining about the "fairness" of post-disaster pricing. The increase in price as a result of shifts in supply and demand is the market's way to allocate scarce resources. When the market is prevented from doing so (most often[4] due to government regulation), scarcity in the form of shortages of vital resources is augmented[5].

In an article discussing the "gouging" of gas prices Lieberman (2006) illustrates this point:

> But high prices lead to solutions. They encourage producers to increase supplies and consumers to cut back on unnecessary driving. Over the longer term, they may even create opportunities for alternative fuels. This explains why oil and gas prices fluctuate and why no increase ever has proved permanent. Now, some have lost patience with this process and seek to short-circuit it. But that only leads to demand outstripping supply at the mandated price – which, in turns, leads to shortages, gas lines and rationing. The temptation is great. Consumers paying $3 or more for a gallon of gas may like the idea of government stepping in and reducing it to $2. They are less likely to appreciate passing gas station after gas station with "closed" signs in the window.

When government intervenes in the market by passing legislation that prevents sellers from adjusting their price to what it should be after a disaster, the situation is worsened. Business owners are treated as criminals, while the "anti-gouging" enthusiast consumer gets to rob them of money that is rightfully theirs, according to the market. The government is a co-conspirator to and main proponent of this economic crime. Consumers who truly believe that the government is helping them in such situations are sadly mistaken. Anti-gouging legislation reduces incentives for stores to open or outside sellers to come to the disaster area. Sellers do not want to enter a market in which there is little or no opportunity to earn a profit. It is price that rations the scarce resources and calls forth supply. All other things being equal, production increases as a result of price increasing. Implicit in this is that if prices are not allowed to increase due to government regulation, production will not increase. In times of emergency, when the demand for certain goods increases, this "helpful" government regulation is the very reason that the resources are not available to those who need them. Outside firms and entrepreneurs are naturally reluctant to enter such a tumultuous "market." This is perfectly rational and does not imply some absence of a conscience on the firm's part.

Anti-price "gouging" activists have manipulated people into thinking that there is some moral flaw surrounding the natural fluctuations in price that occur in post-disaster situations. By doing so, they are transforming basic economic theory into an issue of what is just and unjust. It should not be an issue at all. If the market were manipulated to make sure that everything was "fair" for its participants, there would be many conflicts within it. It would hardly be a market (perhaps a better term for this would be socialist regime). It would be flooded with businesses that are not needed. Firms that, under normal conditions, should not be in business would stay in operation, wasting precious resources that could be better used in some other endeavor. Government subsidies would be rampant. Simultaneously, firms that should prosper if general economic welfare were to be promoted would be forced out by taxes and price ceilings. That is "fair," is not it? High prices are not an issue. They are the market's way of allocating

resources among all those who wish to use them. The media creates these "issues" for ratings purposes. Politicians use anti-gouging legislations as a means to get re-elected or increase campaign donations.

Then Congressman (now Senator) Bernie Sanders believes that companies charging "high" prices need to be stopped for the sake of the consumer. Throughout his article, "Stop oil company price gouging", Sanders explores the supposed wretchedness of profits and big business. While the concept of Big Oil raising its prices in response to market forces and the concept of businesses doing so during times of emergency are not exactly the same, the argument against such organic practices follows the same logic. Businesses are taking advantage of consumers. Government must protect the consumers. Government must regulate, i.e. punish, businesses. Sanders (2005) refers to businesses as "corporate behemoths," describes price adjustments by them as "company greed" and "market manipulation," and classifies the benefits enjoyed by Big Oil as "huge windfall profits" made "on the backs of consumers." This is the anti-gouging attitude[6].

Sanders is clearly not a supporter of the free market. He demonstrates this through his condemnation of corporations and market prices as well as his urging of consumer aid in the form of government regulation. By implying that profits made by these companies are made at the consumers' expense, Sanders is blatantly ignoring the fact that the consumers engage in these transactions willingly. Clearly the price, although higher than they may have liked, was one at which they benefited from making the purchase; otherwise they would not have willingly done so. Through engaging in transactions, consumers are demonstrating that they prefer the good or service more than they prefer the amount of money they must pay for it. As long as neither party was coerced, both parties benefit from exchange. Congressman Sanders further illustrates his neglect for this concept by labeling the prices "anti-consumer." Very much to the contrary, legislation that prohibits price adjustments is the anti-consumer measure. Companies earn profits by satisfying the wants of customers. People want these products and are willing to pay for them. If these companies are not allowed to earn profits due to price controls, they may not develop the technology needed to increase supply to the maximum extent possible. They could even go bankrupt. How will the demand for oil and gas be satisfied if companies are no longer in operation or cannot afford to produce at capacity levels due to out-dated technology? If Sanders wants to reduce the price of oil and gas, he should explore ways to reduce demand, such as urging his constituents to use these resources in lesser amounts[7].

The main flaw in the anti-gouging argument is its lack of logic. Consumers and politicians want "fair" prices, but have not thought much past that point. They are so consumed with the actual price that they neglect to think about the implications of such regulations. In the face of disaster, people panic. It is human nature to do so. Prices lower than otherwise indicated by supply and demand conditions, combined with panic, result in hoarding. People flock to stores and buy as much as they can. Even with quantity limits, supplies run out before most people can get to them. This is where the government is supposed to step in and take care of its people, at least as far as the pundits are concerned; the state has stepped in, alright, but it is not helpful. A good example of this is federal and state response (or rather lack of same) to Hurricane Katrina:

> From Wal-Mart's satellite-based communications systems to FedEx's aircraft, US business has in some cases managed to provide a swifter response to the initial impact of hurricane Katrina than the federal and state authorities.
>
> But critics of the handling of the crisis by government agencies said they were slow in accepting offers of help.
>
> Mary Landrieu, the Democratic US senator from Louisiana, accused the Federal Emergency Management Agency of having "dragging its feet" when Amtrak offered trains to evacuate victims.
>
> "Offers of medicine, communications equipment and other desperately needed items continue to flow in, only to be ignored by the agency," she said.
>
> Wal-Mart, the largest US retailer, with over 100 stores and distribution centers in the affected areas, sent in trucks carrying water, food and other emergency items in response to calls from local relief groups in the first days after the hurricane hit (Birchall *et al.*, 2005; Block, 2006; Block and Rockwell, 2007).

While the concern is often that monopolies and oligopolies[8] might arise, free market prices would have the opposite affect. When the market is allowed to adjust without the "help" of the government, resources will flood into an area. It will now be profitable for out-of-towners to move supplies and services to places such as New Orleans, where disasters have struck. The now legal increase in market price will serve as a signal to the suppliers of goods that the demand has increased. In turn, these suppliers will produce more in order to accommodate the shift in demand. This is the efficient way to get resources to those who want and need them the most. Markets will be saturated with entrepreneurs and competition. The increase in supply will eventually bid down the price of these resources. Market forces will stamp out the "gouging" that solved the problem in the first place far more effectively than government intervention. Both firms and consumers will get valuable information from prices. They will ration the resources temporarily undergoing shortages (batteries, candles, milk, water, etc.) and call forth new supply. If so-called price gouging is allowed by law, it will not last for long; it will vanish when its rationing and incentive effects on entrepreneurs are no longer needed.

In his article about Wal-Mart's entry into the generic drug market, Devon Herrick captured the impact of competition on prices. Wal-Mart approached the market with the plan to offer these drugs at a lower price that their competitors. As a result, firms like Target and K-Mart are attempting to match or beat Wal-Mart's price. Concerning this fierce competition, Dr Robert Graboyes of the National Center for Policy Analysis is quoted as saying, "They've demonstrably driven down consumer prices nationally" (Herrick, 2007).

By enacting price controls, moreover, the government is restricting entry to the market. Firms are not legally able to realize free market rates for their goods and services. By reducing incentives for firms outside the area affected by the disaster, government is directly restricting competition. This perpetuates a misallocation of resources. Another affect of this government intervention in the market is the monetary loss to which firms in the price controlled area are subject.

The anti-gouging perspective is one of business taking advantage of the poor consumer. The businessman is "evil" for wanting to make a profit or charge a market price for his resources. The consumer is helpless and has no choice other than to pay these astronomical prices. Keeping in mind the aforementioned economic theory of mutual gains from exchange, this concept is nothing short of irrational.

By regulating and restricting business during times of emergency (or any time for that matter), the government is enhancing the economic loss suffered by the afflicted area. According to Malek, supporters of price ceilings believe that it is morally justified for the consumer to pay as little as possible and immoral for the firm to charge as much as possible. But to imply that a price is not fair (too high) is to imply that the consumer has some inherent right to that good (Malek, 2002).

4. Conclusion

Government passes legislation preventing price gouging based on the implicit premise that it can allocate resources more efficiently than the market. By doing so, it alleges that it knows what the people want better than entrepreneurs who sink or swim based on their ability to anticipate matters of this sort[9]. Government regulation is nothing short of a disaster as far as satisfying customers is concerned.

Paradoxically, the government is correct in thinking that the people want "fair" prices for goods. Were this not the case, they would not dare to oppress price "gougers." Indeed, this is a wildly popular stance for a politician to take. But, the masses of the people are entirely erroneous in supposing that these market interferences can actually be helpful to them. In the words of Caplan (2007), "the public suffers from anti-market bias."

Particularly, during times of disaster, prices must be allowed to adjust as a signal to producers and consumers alike. Consumers will utilize less of these goods, and producers will increase their output. As the supply adjusts following the price increase, goods and services will get to those who want them the most and are willing to pay for them. This will undoubtedly be a more effective way to distribute supplies to hurricane victims. The government has demonstrated on more than one occasion how ineffective it can be, and this unwarranted attack on price gouging is no exception. Price controls must be repealed, and the free market must be allowed to work via the beneficent invisible hand[10] (Smith, 1979; Childs, 1977; Diamond, 1987; Flew, 1987; Garrison, 1985), not by the stultifying hands of the bureaucrats and politicians.

Notes

1. They had access to the Sears Roebuck catalogue, and to financial newspapers of the west. There was also that slight matter of the black market, which, according to many estimates, was significant.
2. The literature supporting this statement emanates from the Austrian side of the socialist calculation debate (Boettke, 1991; Gordon, 1990; Hoppe, 1996; Klein, 1996; von Mises, 1981; Rothbard, 1991).
3. That is, unless we define, Marxist-like, any seller of anything, even labor, as a capitalist exploiter. Remember, after Katrina, wages in New Orleans catapulted.
4. Sometimes, what prevents markets from operating in this way are riots on the part of the populace, not formal governmental decrees. See on this: www.labournet.net/world/0010/zimbab1.html; http://select.nytimes.com/gst/abstract.html?res = FA0717FE3D580C738EDDAD0894D1484D81&n = Top%2fReference%2fTimes%20Topics%2fOrganizations%2fI%2fInternational%20Monetary%20Fund%20. It cannot be denied, of course, that in these cases the masses of people are acting in a governmental manner: seizing property that does not belong to them.

5. As Hugo Chavez, the Venezuelan dictator is now discovering, price controls, of which anti "gouging" is just one aspect, is a recipe for clearing goods off of store shelves. How this will help consumers is a bit difficult to ascertain. See on this: http://blog.mises.org/archives/006271.asp
6. On May 23, 2007, the House of Representatives passed anti oil price gouging bill by a vote of 284-141: www.latimes.com/news/nationworld/nation/la-na-gasoline24may24,0,3926741.story?coll = la-home-nation; www.washingtontimes.com/business/20070524-121323-8807r.htm
7. If he does this, however, it will only underscore even the more how far we have come from constitutional principles. Can anyone imagine George Washington or John Quincy Adams acting like a nanny, and urging citizens to consume fewer apples? For a principled constitutional outlook, see Ron Paul (www.mises.org/story/2514).
8. For an Austrian economic analysis according to which such institutions are necessarily part of the system of government privilege, not free enterprise (Anderson *et al.*, 2001; Armentano, 1999; Block, 1994; Boudreaux and DiLorenzo, 1992; McChesney, 1991; Rothbard, 1970; Shugart, 1987; Smith, 1983).
9. When is the last time a government bureaucracy went broke due to its inability to serve the public? Never, that is when. It is for this reason, perhaps, that one of the most popular bumper stickers in the New Orleans area articulates this message: "FEMA happens."
10. "But the annual revenue of every society is always precisely equal to the exchangeable value of the whole annual produce of its industry, or rather is precisely the same thing with that exchangeable value. As every individual, therefore, endeavours as much as he can both to employ his capital in the support of domestic industry, and so to direct that industry that its produce may be of the greatest value; every individual necessarily labours to render the annual revenue of the society as great as he can. He generally, indeed, neither intends to promote the public interest, nor knows how much he is promoting it. By preferring the support of domestic to that of foreign industry, he intends only his own security; and by directing that industry in such a manner as its produce may be of the greatest value, he intends only his own gain, and he is in this, as in many other cases, led by an *invisible hand* to promote an end which was no part of his intention. Nor is it always the worse for the society that it was no part of it. By pursuing his own interest he frequently promotes that of the society more effectually than when he really intends to promote it. I have never known much good done by those who affected to trade for the public good. It is an affectation, indeed, not very common among merchants, and very few words need be employed in dissuading them from it" (emphasis added by present authors).

References

Anderson, W., Block, W., DiLorenzo, T.J., Mercer, I., Snyman, L. and Westley, C. (2001), "The Microsoft Corporation in collision with antitrust law", *The Journal of Social, Political and Economic Studies*, Vol. 26 No. 1, pp. 287-302.

Armentano, D.T. (1999), *Antitrust: The Case for Repeal*, revised 2nd ed., Mises Institute, Auburn, AL.

Birchall, J., Roberts, D. and Taylor, P. (Eds) (2005), "Federal Agency 'slow' to accept business help", available at: www.ft.com (accessed April 29, 2007).

Block, W. (1994), "Total repeal of anti-trust legislation: a critique of Bork, Brozen and Posner", *Review of Austrian Economics*, Vol. 8 No. 1, pp. 35-70.

Block, W. (2006), "Katrina: private enterprise, the dead hand of the past, and weather socialism; an analysis in economic geography", *Ethics, Place and Environment: A Journal of Philosophy & Geography*, Vol. 9 No. 2, pp. 231-41.

Block, W. and Rockwell, L.H. Jr (2007), "Katrina and the future of New Orleans", *Telos*, Vol. 139, pp. 170-85.

Boettke, P.J. (1991), "The Austrian critique and the demise of socialism: the Soviet case", in Ebeling, R.M. (Ed.), *Austrian Economics: Perspectives on the Past and Prospects for the Future*, Vol. 17, Hillsdale College Press, Hillsdale, MI, pp. 181-232.

Boudreaux, D.J. and DiLorenzo, T.J. (1992), "The protectionist roots of antitrust", *Review of Austrian Economics*, Vol. 6 No. 2, pp. 81-96.

Caplan, B. (2007), "Special-interest secret", *Wall Street Journal*, available at: http://online.wsj.com/article_email/SB117893365787300771-lMyQjAxMDE3NzE4MjkxMzIzWj.html (accessed May 12).

Childs, R.A. Jr (1977), "The invisible hand strikes back", *The Journal of Libertarian Studies*, Vol. 1 No. 1, pp. 23-34.

Diamond, A.M. Jr (1987), "The intergenerational invisible hand: a comment on Sartorius's government regulation and intergenerational justice", *The Journal of Libertarian Studies*, Vol. 8 No. 2, pp. 269-74.

Flew, A. (1987), "Social science: making visible the invisible hands", *The Journal of Libertarian Studies*, Vol. 8 No. 2, pp. 197-212.

Garrison, R.W. (1985), "Inter-temporal coordination and the invisible hand: an Austrian perspective on the Keynesian vision", *History of Political Economy*, Vol. 17 No. 2, pp. 309-21.

Gordon, D. (1990), *Resurrecting Marx: The Analytical Marxists on Freedom, Exploitation, and Justice*, Transaction, New Brunswick, NJ.

Gwartney, J., Lawson, R. and Block, W. (1996), *Economic Freedom of the World, 1975-1995*, The Fraser Institute, Vancouver.

Herrick, D. (2007), "Wal-Mart drug discounts increase competition and lower prices", available at: www.heartland.org (accessed May 2, 2007).

Hoppe, H-H. (1996), "Socialism: a property or knowledge problem?", *Review of Austrian Economics*, Vol. 9 No. 1, pp. 147-54.

Klein, P.G. (1996), "Economic calculation and the limits of organization", *Review of Austrian Economics*, Vol. 9 No. 2, pp. 3-28.

Lieberman, B. (2006), *The Washington Times*, June 27.

McChesney, F. (1991), "Antitrust and regulation: Chicago's contradictory views", *Cato Journal*, Vol. 10 No. 3, pp. 775-98.

Malek, N. (2002), "Myths about business", available at: www.mises.org (accessed April 29, 2007).

National Conference of State Legislatures (2004), "Energy and electric utilities: state laws and regulations: price gouging", available at: www.ncsl.org (accessed April 12, 2007).

Richman, S.L. (1981), "War Communism to NEP: the road from serfdom", *The Journal of Libertarian Studies*, Vol. V No. 1, pp. 89-98.

Rockwell, L.H. Jr and Block, W. (n.d.), "Free enterprise, Katrina and the big easy", *International Journal of Social Economics* (in press).

Rothbard, M.N. (1970), *Man, Economy and State*, Nash, Los Angeles, CA.

Rothbard, M.N. (1971), "Nixon's NEP", *The Libertarian Forum*, Vol. 3 No. 10.

Rothbard, M.N. (1991), "The end of socialism and the calculation debate revisited", *Review of Austrian Economics*, Vol. 5 No. 2, pp. 51-70.

Sanders, B. (2005), "Stop oil company price gouging", available at: www.commondreams.org (accessed March 11, 2007).

Shugart, W.F. II (1987), "Don't revise the Clayton Act, scrap it!", *Cato Journal*, Vol. 6, p. 925.

Smith, A. (1979), *An Inquiry into the Nature and Causes of the Wealth of Nations*, B.IV, Chapter 2, Liberty Fund, Indianapolis, IN.

Smith, F.L. Jr (1983), "Why not abolish antitrust?", *Regulation*, January-Febreuary, 23, p. 23.

von Mises, L. (1981), *Socialism*, LibertyPress/LibertyClassics, Indianapolis, IN.

Corresponding author
Walter Block can be contacted at: wblock@loyno.edu

To purchase reprints of this article please e-mail: **reprints@emeraldinsight.com**
Or visit our web site for further details: **www.emeraldinsight.com/reprints**

Reproduced with permission of the copyright owner. Further reproduction prohibited without permission.