11-12-2020

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ABSTRACT
Pricing a product is considered an important component of the marketing mix that induces consumer behavior. During the 2020 Covid-19 pandemic, price gouging emerged from obscure rarely litigated business law to sensational above the fold headlines. $79.99 hand sanitizer went from a ridiculous pricing decision to an abuse of power and a criminal offense.

This paper will begin with an overview of common pricing strategies and then examine the limits placed on pricing in the form of laws which prohibit price gouging. While many of the jurisdictions which make short term increases in the price of certain goods and services illegal, the laws vary as to the definitions and requirements of the necessary elements of a price gouging violation.

The political reasons for price gouging laws albeit seemingly obvious, will be examined. The safety and consumer protection arguments will be discussed in the context of almost universal opposition by economists of price gouging regulation.

Finally, if price gouging does not protect consumers and if artificial legal parameters of prices actually intrude on healthy appropriate market forces, why do price gouging laws exist in 34 states and in the federal law? What alternatives to price gouging laws would yield a more efficient marketplace and concurrently meet the government's duty to protect consumers and citizens' health and safety during a state of emergency?

Keywords
Price gouging, surge pricing, dynamic pricing

1 PRICING STRATEGY

An overarching decision essential to the success of all businesses is what price to charge for their product. (Kienzler, 2017) A thoughtful strategic pricing decision is critical to the creation of perceived customer value and business profitability. Developing an appropriate pricing strategy is both crucial and highly complex. (Gijsbrechts, 1993) This complex, important business decision, however complex, is exclusively within the purview of the business.

There are several factors both internal and external that influence a business when making pricing decisions. Internal factors, usually under the control of the business may include a set return on investment objective, a cash flow requirement, profit maximization goal, and a market share objective. The external factors often not in the control of the business could include competitor pricing, government regulation, and the prices of complementary goods. (Haron, 2016) As businesses consider these factors and establish a price, it is rare that this decision is constrained by law. Each business has the legal right, with few exceptions, to set a price that is too high or too low and ultimately fails to accomplish their strategic business objectives.[1]

The main goal of any for profit business is profitability. Revenue must be greater than expenses. Since most businesses' revenue is primarily dependent upon what customers pay for the product the pricing strategy is crucial. The most common pricing strategies are penetration pricing, price skimming, value-based pricing, competitive pricing, and cost-plus pricing.

Penetration pricing is usually employed to by businesses willing to absorb losses to gain market share, involves charging a very low price to lure away competitors' customers and later build brand loyalty and allow you to raise prices to a level that yields a profit. (Liu, 2010)

[1] Cigarettes are a notable example. Presently 25 states and the District of Columbia have minimum price laws for cigarettes. Courts have generally held these minimum price laws and similar restrictions are within a state's police powers. See, e.g. Simonetti v State, 132 So.2d 252 (Ala. 1961). However, a few statutes have been held to violate due process or constitute price fixing. See, e.g. Strickland v Rio Stores, Inc. 255 S.E.2d 714 (Ga. 1979) These few reversals have been the exception.

Price skimming is a strategy where a business sets a comparatively high price for a short period of time to skim off customers willing to pay the higher price, usually for a new or improved product. The price is later lowered as demand decreases and competitors introduce a comparable product with similar improvements or innovation. (Zare, 2013)

Value-based pricing sets prices according to some formula that measures the value of the product to the customer. Various strategies and microeconomic models attempt to measure actual, perceived and realized value to arrive at a value-based price. (Hinterhuber, 2004)

Competitive pricing is using the competition's pricing as a benchmark to establish a price. This strategy may be used as an initial low risk entry into a market with a short-term orientation that should be adjusted as the business more effectively data mines product differentiation and relevant consumer behavior. (Ying-Ju Chen, 2018)

Cost-plus pricing is the seller applying a markup percentage to the aggregate cost incurred manufacturing the product. The markup varies industry by industry and is an additional component strategy the business must consider. (Dholakia, 2018)

Each of these approaches to a pricing decision has advantages and disadvantages. While the industry and academic debate may become heated, parochial, and at times financially life altering, rarely is this pricing strategy illegal. The rare exception is when the pricing decision interacts with a state of emergency and the priced product falls within a category of products that the public perceives as too important to leave pricing and thus availability to the unilateral whim of the seller.

2 SURGE PRICING VERSUS GOUGING

Why is surge pricing and dynamic pricing accepted but price gouging is not? Conceptually they are nearly all the same. Economist believe when demand is highest suppliers should charge more/raise the price so that more supply enters the market or demand is discouraged/reduced. The end result for gouging, or these more palatable pricing techniques, is the same. Supply and demand achieve equilibrium at a market price due to shift of the supply/demand curves or an increase/decrease in quanity due a change in price. Economists and management consultants discuss these pricing strategies as a positive for the market without fear that they are providing a guide to gouging.

For example, surge pricing is a way to achieve equilibrium by adjusting the prices for a ride on apps such as Uber or Lyft to match driver to supply. (Dholakia, Government Tech, 2016)When there are periods of excessive demand for a taxi/ride in an area (after a concert, rush hour, rain, etc) prices surge or multiply to draw in more supply of drivers to the location. Rather than having fixed cab fares, or static pricing, the change balances the basic forces of a compeititive market.

Dynamic pricing is slightly different in that the price of a good is constantly pricing to meet the demand. The goal of dynamic pricing is to make " pricing policies palatable, better for consumers, improve consumer welfare and also make the firm better (Veeraraghavan, 2016). As consumers we see this in many transactions. For example, if in March of 2021 you are willing to book a non refundable December 22, flight to Boca Ratton you may only pay $300 but as it gets closer to departure the price will likely go up as consumers who are inelastic and need to be on that flight could pay triple the fair. Business customers who need to meet a client on a certain day at the last minute may not care about price.

Dynamic pricing for airlines and hotels may fluctuate dramatically because of both fixed supply (airlines and hotels cannot add near term supply)and inelasticity of the consumer. Surge pricing is more normally used to boost and reallocate supply/drivers. There is almost no increase in fixed cost for Uber or the drivers.There maybe a modest increase in marginal cost but that is easily met by the increase in marginal revenue.

So far airlines have not been able to add supply quickly to match demand. Airbnb, like Uber/Lyft, seems to be able to draw in supply to an industry that viewed fix supply as key to profitability. For example, in September, New York City hotel demand gushes during Fashion Week and the United Nations opening.Even though the hotel industry knows there will be a flood of demand during this period they can't build an extra hotel tower to meet it which leads to massive price increases/gouging. However, Airbnb can add more capacity by getting potential landlords off the sidelines. Static capacity during peak demand for hotels does not exist to the same degree with Airbnb in the market.

3 LAW OF PRICE GOUGING

If a local pizzeria advertised their slices for $100 each, consumers would laugh, pity the owner's stupidity, or walk 50 feet down the street to the next pizzeria (we live on Long Island) to buy lunch. Filing a complaint with the state Consumer Protection Office would probably not come to mind or be worth their time. However, if instead of one possible dining option the desired product is within the definition of "basic goods and services including medical supplies" (California Penal Code 396) or "essential goods and services" (Arkansas Code Sec. 4-88-301 2018) and a State of Emergency (e.g. Kentucky, Massachusetts, New Jersey), "Disaster Emergency" (e.g. New York, Rhode Island, Hawaii), or some similar altered legal state due to extraordinary circumstances such as Hurricanes Katrina and Sandy or the current Covid-19 pandemic the public perception, rights of businesses, and role of the government and legal system changes. A pricing decision once only questionable strategically resulting in unprofitability becomes actionable legally resulting in liability.

In New York, the state price gouging statute (N.Y. Gen. Bus. Code Sec. 396-r) was triggered on January 31, 2020, when the U.S. Secretary of Health and Human Services declared a national public health emergency. The declaration of the emergency changed the rights of businesses with regard to unilaterally and without potential legal liability to price certain products.

The New York statute applies to "consumer goods and services vital and necessary for the health, safety, and welfare of consumers." It defines consumer goods and services broadly and covers a broad range of parties in the supply chain. Manufacturers, wholesalers, suppliers, and retailers are all limited by the statute from price gouging. (N.Y. Gen. Bus. Code Sec. 396-r(2))

The statute prohibits parties from pricing the aforementioned consumer goods at an unconscionably excessive price. The New York approach provides the court with factors to consider when determining if the price is unconscionably excessive.

- The amount of the excess in price is unconscionably extreme;
- There was an exercise of unfair leverage or unconscionable means; or
- A combination of:
    - The amount charged represents a gross disparity between the price of the goods or services which were the subject of the transaction and their value measured by the price at which such consumer goods or services were sold or offered for sale by the defendant in the usual course of business immediately prior to the onset of the abnormal disruption of the market; or
    - The amount charged grossly exceeded the price at which the same or similar goods or services were readily obtainable by other consumers in the trade area.

If the accused party can prove the increased price charged was outside of its control the price increase may not constitute a violation. (N.Y. Gen. Bus. Code Sec. 396-r(3)(b)(ii)) Whether the evidence provided by the defendant is sufficient to rebut the evidence of price gouging is left up to the court.

Texas' prohibits price gouging under the state's Deceptive Trade Practices Act. Similar to New York, the courts are given broad discretion to determine what constitutes price gouging. Unlike New York, the Texas statute provides a private cause of action. Individuals may also bring a claim against the business.

The Texas statute prohibits price gouging during a designated disaster period. While the statute does prohibit demanding an exorbitant or excessive price in connection with the sale or lease of fuel, food, medicine, lodging, building materials, construction tools, or another necessity, it does not define exorbitant or excessive. Like the New York statute the courts are left to consider what prices rise to the threshold of illegal activity. (Texas Commerce Code Sec. 17.46(b)(27))

California's anti-price gouging statute is an example of a jurisdiction taking a more quantitative approach. California law prohibits charging excessive and unjustified increases in prices once a state of emergency has been declared. The statute defines an excessive increase as more than 10% above the price charged by that person immediately prior to the proclamation of a state of emergency. (Cal. Penal Code Sec. 396(a))

Price gouging laws vary from state to state and jurisdiction to jurisdiction. While at least 35 states have specific price gouging statutes or are currently considering them, the public outcry during trying periods of financial, emotional, and economic distress cries out for government intervention. This opportunity is strategically not missed by many leaders/politicians even those without state price gouging statutes. Arizona Governor Ducey, and Minnesota Governor Waltz both issued Executive Orders prohibiting price gouging. Delaware Governor Carney and Montana Attorney General Fox issued statements that existing consumer protection laws would be interpreted to prohibit price gouging and be aggressively enforced immediately. Arizona, Minnesota, Delaware, and Montana are four of the states without specific statutes defining and prohibiting price gouging. (Ondeck, 2020).

In nearly all of the examples of surge or dynamic pricing both the consumer and supplier feel satisfied. Nonetheless, government sometimes steps in, thwarting the "invisible hand". (Foster, 2020)of economic participants to find this equilibrium. It is not just fines that we see government intervention to thwart gouging during peak periods. There are regulations that inhibit competition. For example, New York City has one of the more aggressive laws that makes it "illegal to have paying guests for less than 30 days--unless, of course, the property is a licensed hotel, bed-and-breakfast, or other similar business. (Fishman, 2020). By not allowing short term rental it takes supply off the market. During Fashion week this will keep existing hotels filled and prices high. But what about during a natural disaster? If parts of Brooklyn were damaged during a hurricane this law would also prevent inviduals from renting out their Mantatten apartments for a few weeks to people who need housing. There are so many similar laws and regulations that Airbnb has pages of its website devoted to the issues (Airbnb, 2020)

During COVID we have not seen price gouging for hotels in part because travel has declined dramatically that occupany is down to under 30%. However, as an example of how regulations can once again impact another busines that uses surge pricing to balance demand is Uber. Riders in the Boston area there are reports that wait times are now of 2-3X greater then before the pandemic.The number of drivers out on the road is down because Massachusetts bans surge pricing for all industries during state of emergencies.Regulations that were put in place to reduce explotation of consumers is instead leading to a reduction in consumer welfare.

4 GOOD POLITICS, BAD ECONOMICS, AND A PROPOSAL

Defending consumers from short term windfall profiteering businesses is a political opportunity and wonderful optic for election season. When voters are, through some unforeseen disaster of no fault of their own, financially disadvantaged, government leaders coming to the rescue of their constituents by prosecuting the businesses and publicly decrying these opportunistic price gougers is public relations gold. Unfortunately, while some people benefit in the short-term from anti-price gouging prosecution, economists argue many other people will be disadvantaged by such a policy. (Dorfman, 2016)

Artificially restricting prices with anti-price gouging statutes or Executive Orders, holds prices lower than it would take to balance supply and demand. While some people will be able to purchase the goods at lower prices because of the artificial legislative restrictions, other people will do without when supply is exhausted. The inability to raise prices will remove the economic incentive for businesses to manufacture and supply additional goods. If the opportunity to charge higher prices legally existed, businesses who ordinarily did not manufacture those goods, sell to that region, or target that market would be motivated to increase the market’s aggregate supply.

Economists also argue anti-price gouging laws encourage hoarding. Consumers who happen to purchase the protected good early are motivated by the anticipated shortfall in supply to buy more than they need. This purchasing decision exacerbates the shortage by increasing demand in a market without any motivation to rush to increase supply. (Mohammed, 2013)

A hybrid solution proposed to satisfy politicians desire to be perceived as the defender of consumer/voters and the economists’ market impact concern is a combination of price limits and market subsidies. During states of emergency, price gouging laws go into effect, but concurrently suppliers of essential goods are subsidized by government payments, tax credits or other similar financial supplement to incentivize entrepreneurial augmenting needed supply. This hybrid approach will remove the motivation to hoard essential goods. The balance between encouraging timely supply increases and still allowing politicians to have their photo op, will motivate both sides to accomplish their primary goals of profit maximization and constituent appeasement.

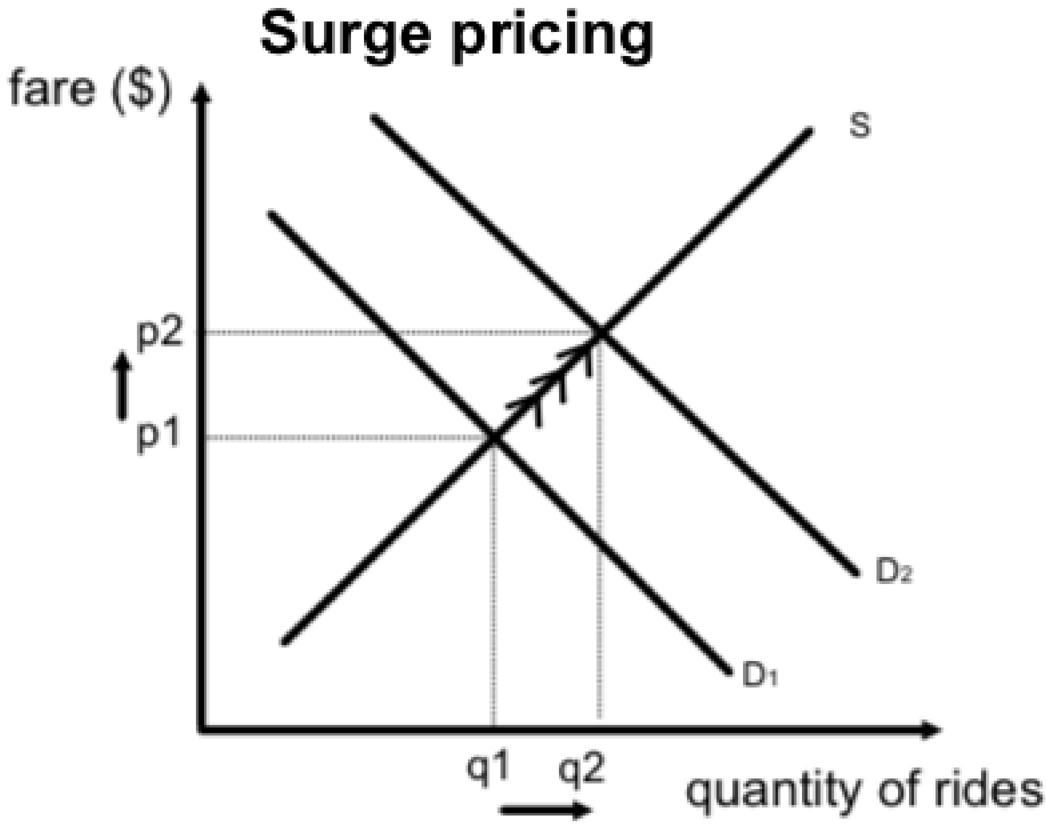

Figure 1:
Source: Tutor2U

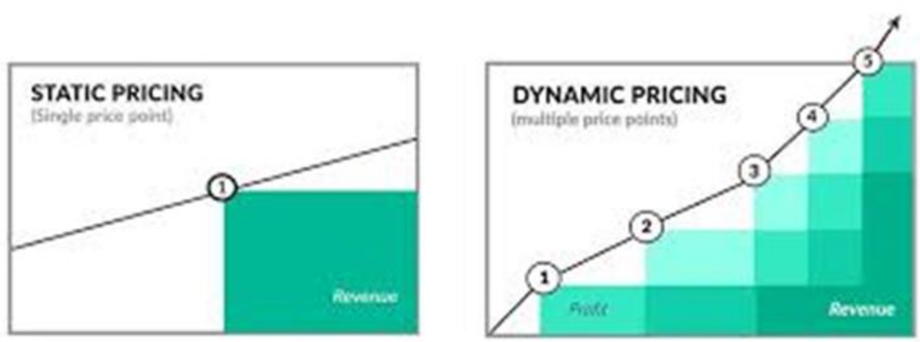

Figure 2:
Source: Towards Data Science

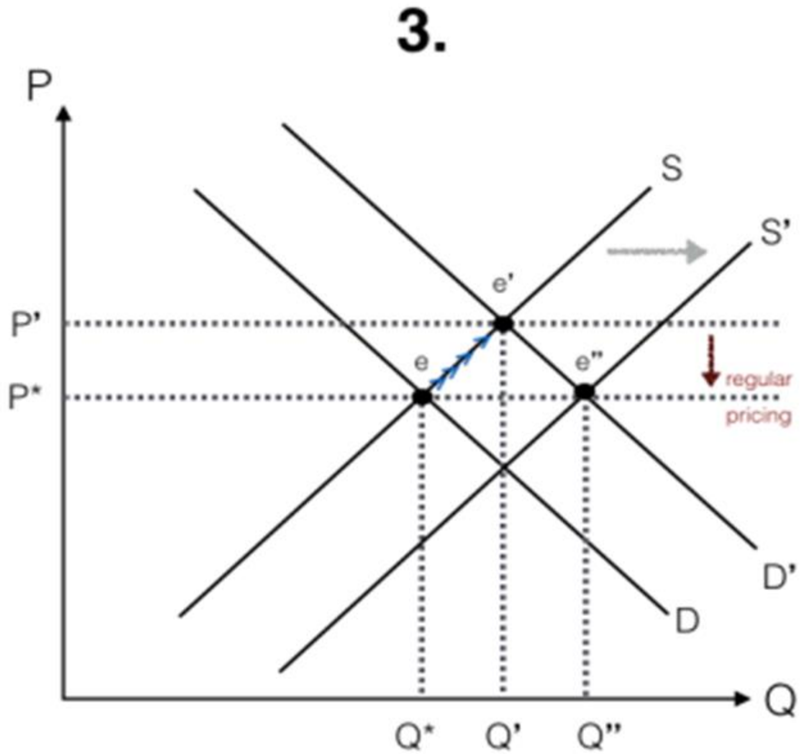

Figure 3:
Source: Wordpress

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