WebMemo
Published by The Heritage Foundation

No. 1469
May 23, 2007

Gasoline Price-Gouging Laws Will Not Benefit Consumers

Ben Lieberman

Sometimes the simplest solution is the best one, but not in the case of high gasoline prices. Previous federal efforts to simply outlaw high prices through gasoline price controls have a bad track record, actually hurting consumers rather than helping them. Several pending bills seek to reduce gas prices by prohibiting "price gouging," essentially making it a crime to charge too much for gasoline.[1] Any such attempt would again backfire and exacerbate the pain at the pump.

Repealing the Law of Supply and Demand. The market price of gasoline is the price at which supply and demand are balanced. Currently, that price is uncomfortably high, largely due to stubbornly high crude oil prices and barely-adequate refining capacity in the face of strong U.S. and global demand for gasoline. But high prices eventually lead to solutions because they give producers extra incentive to increase supplies and give consumers extra incentive to cut back on unnecessary driving. Over the long term, they can even create opportunities for alternative fuels. This is why oil and gas prices fluctuate over time, and no past increase has ever been permanent.

But some are losing patience with this process and want to use price controls to force the price below market levels. That only means that demand would outstrip supply at the mandated price. This is why attempts to impose price controls in the 1970s led to shortages and gas lines.

Consumers paying $3.20 per gallon may like the idea of the government stepping in and setting a limit on the price—until they realize how hard it would be to actually find gas at the below-market price.

As Bad As Price Controls. Fortunately, Congress is not seriously considering imposing price controls directly. However, there are several pending measures that would outlaw price gouging. This approach would likely cause the same problems as price controls.

These bills feed off consumer anger over high gas prices and suspicion that oil industry misconduct is somehow to blame. Existing antitrust laws already forbid oil companies from engaging in monopolistic practices or colluding with competitors to suppress supplies and raise prices. The new bills propose to add "price gouging" to the list of illegal activities.

Price gouging is a term often used but never clearly defined. The new bills use vague and arbitrary terms like "unconscionably excessive." This could include justifiable and unavoidable price increases caused by market conditions, such as the disruptions caused by Hurricane Katrina. The bills would impose civil and criminal penalties, including imprisonment. Thus, while the definition of price gouging is subjective and vague, the penalties would be severe. The chilling effect would result in

This paper, in its entirety, can be found at:
www.heritage.org/research/energyandenvironment/wm1469.cfm

Produced by the Thomas A. Roe Institute
for Economic Policy Studies

Published by The Heritage Foundation
214 Massachusetts Avenue, NE
Washington, DC 20002–4999
(202) 546-4400 • heritage.org

Nothing written here is to be construed as necessarily reflecting the views of The Heritage Foundation or as an attempt to aid or hinder the passage of any bill before Congress.

fewer market participants and lower supplies—just the opposite of what is needed—particularly in emergency situations such as post-Katrina.

Federal Trade Commission Voiced Strong Concerns. Because these bills put the Federal Trade Commission (FTC) in charge of enforcing price gouging, it is worth noting what the FTC itself thinks of the idea. Last year, the FTC published a comprehensive report, "Investigation of Gasoline Price Manipulation and Post-Katrina Gasoline Price Increases." The report was the result of the latest in a long series of congressionally mandated FTC investigations of the oil industry and looked specifically at the reasons for high gasoline prices in 2005, both before and after hurricanes Katrina and Rita. As with previous FTC reports on this topic, the report found no evidence of antitrust violations, concluding that "the evidence collected in this investigation indicated that firms behaved competitively."

With regard to the post-Katrina jump in prices, the FTC concluded that it was due to supply disruptions, not market manipulation: "In light of the amount of crude oil production and refining capacity knocked out by Katrina and Rita, the sizes of the post-hurricane price increases were approximately what would be predicted by the standard supply and demand paradigm that presumes a market is performing competitively."

Most importantly, the FTC warned against price-gouging legislation: "Our examination of the federal gasoline price gouging legislation that has been introduced…indicates that the offense of price gouging is difficult to define." The FTC adds that "the lack of consensus on which conduct should be prohibited could yield a federal statute that would leave businesses with little guidance on how to comply and would run counter to consumers' best interest."

The FTC concludes that a price-gouging law that does not account for market forces would be counterproductive. "Holding prices too low for too long in the face of temporary supply problems risks distorting the price signal that ultimately will ameliorate the problem." In other words, price-gouging restrictions could act as *de facto* price controls and cause the same problems. For example, if suppliers to the post-Katrina gasoline market feared being targeted for price gouging and so kept prices artificially low, the shortages could have been prolonged and caused even more hardship for consumers.

In fact, some of the actions that caused gasoline prices to return to pre-Katrina levels within 10 weeks of the hurricane, such as bringing in extra gasoline from unaffected areas into the shortage areas, could be considered price gouging. If price-gouging measures were enacted, gasoline suppliers would likely play it safe and forgo such actions the next time, to the detriment of consumers.

Conclusion. The FTC has made it clear that price-gouging laws have the potential to do more harm than good. At the very least, Congress should consider the opinions of the very agency it wants to enforce its misguided price-gouging policies.

—Ben Lieberman is Senior Policy Analyst in the Thomas A. Roe Institute for Economic Policy Studies at The Heritage Foundation.

1. See H.R. 1252 (Federal Price Gouging Prevention Act), S. 94 (Gasoline Consumer Anti-price-gouging Protection Act), and S. 1263 (Petroleum Consumer Price Gouging Protection Act).