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Coronavirus price hikes should be praised – not condemned

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Have you tried buying hand sanitiser this week? By all accounts, store shelves have been emptied of the stuff, in the wake of public health warnings about the coronavirus.

Social media is full of images of unfilled racks at supermarkets or chemists, with laments about how panic buyers are hoarding products away from those with compromised immune systems "who really need it". As a result of the backlash, Boots is now even rationing purchases to two per customer.

At the same time, members of the public have been attacking third-party sellers for huge price rises for the same products on the Amazon marketplace.

Face mask prices have jumped 2,000pc as the panic has taken hold, while a pack of 24 2oz bottles of Purell hand sanitiser, usually around £8 to £10 per box, have been going for over £300.

Amazon has assured users that it is doing whatever it can to eliminate such profiteering. The Competition and Markets Authority has even issued a warning, with chairman Andrew Tyrie pledging to do whatever it can to "act against rip-offs and misleading claims".

These phenomena are, of course, really two sides of the same coin. A surge in demand for face masks and sanitiser explains both the current observed shortages and some sellers hugely inflating prices. In the near term, supply of both goods is constrained.

As demand has spiked, the price the market can bear has risen dramatically. It's the inverse of prices of flights and hotels in Italy, Tenerife and Asia falling as demand for holidays has collapsed in areas of high virus prevalence.

Whereas the public has no apparent problem with firms dropping prices, sellers raising them during a global health crisis feel the heat.

The price spike in face masks has even been denounced by Amazon as "price gouging" – a term usually reserved for "greedy profiteering" on water and petrol following natural disasters.

The government in France is threatening price regulation to stamp out such spikes. Other governments will be under public pressure to follow suit.

Yet anti-price gouging laws, or even firms constraining prices now in the face of shortages, bring significant costs. Fixing prices below market rates dampens the message that price signals are telling us about relative scarcity and people's willingness to pay.

That's worrying, because price rises help people become more careful about overuse or hoarding when products are scarce. And, in the longer term — which, right now, is especially important — higher prices create powerful profit incentives for new producers or merchants to make highly demanded supplies more widely available.

In fact, anti-price gouging laws actively exacerbate the existing shortage problem, which is why economists overwhelming oppose them.

Fixing prices below what customers are willing to pay encourages people to load up on the products when they are available. Restrictions such as "two per customer" rules can easily be circumvented by, say, getting every family member to buy separately.

And such restrictions favour those who can check in on in-store availability regularly over those who value the product most.

But the more important consequence is the discouragement of new producers or even small hoarders from bringing their supply to market.

Given there's a chance that we could be in for a protracted global pandemic with restrictions on travel and transportation, or workers being sick and unavailable to produce or ship new products, imposing price controls could be extremely shortsighted.

That's because the introduction of price gouging laws even after this shortage passes could dampen supplier plans for what the economist Tyler Cowen has called "option-ready supply" for when there are future demand surges.

Consider Uber surge pricing. When it starts raining, Uber prices spike as demand rises sharply. In the near term, this acts as a rationing device such that people who really value hailing a ride can do so. But it also encourages some additional drivers onto the road.

Preventing this dynamic price adjustment has damaging consequences. Just after New Year in 2015, an experiment occurred in New York when Uber's surge-pricing algorithm suddenly stopped working. As ride demand spiked, prices stayed flat.

As a result, wait times doubled and the number of completed trips fell 80pc since drivers had no increased incentive to go out and meet the new demand.

Upwardly flexible prices do not just help supply adjust to constantly changing demand, however. They also encourage drivers to go out in future when they foresee potential surges, such as if there's rain expected or a big public event.

In the same way, allowing hand sanitiser and face mask price signals to operate now will make leading firms and merchants, who have big reputational concerns, more likely to develop robust supply chains to avoid future shortages.

This is a point made by Nobel prize-winning economist Richard Thaler. The behaviour of companies such as Amazon and others in, effectively, restraining third-party prices today may help them protect their customer-friendly reputation in the wake of a public health crisis.

But by keeping prices low or, in the case of some American retailers, actively discounting them, they are making the products harder for new customers to obtain by encouraging the very hoarding that is infuriating the public.

Price increases encourage us to find frugal ways to adapt and cope with undesirable shortage situations. Yes, ideally, everyone who needs the products would get exactly what they require to slow the spread of this virus at reasonable prices. But in the absence of that perfect world, fixing prices artificially low can lead to big problems.

We can see this already with barren shelves and complaints. Governments would exacerbate the problem with populist “price gouging” laws.

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