In Hugo's Path, a Man-Made Disaster

By David N. Laband

In the wake of the devastation wrought by Hurricane Hugo in Charleston, stories of a different sort of "hardship" have appeared.

For days now, tens of thousands of people have been without power. Food, fresh water, gasoline and other commodities are in short supply. Not surprisingly -- to economists at least -- prices of certain commodities rose to alleviate the imbalance between individuals' desires and local availability. Bags of ice that normally sold for $1 were being sold for $10. A post-hurricane chain saw was in the $600 range, plywood was available at $200 a sheet.

To many, price gouging is unconscionable, especially when someone else profits at your expense. Indeed, on Saturday (two days after Hugo it), emergency legislation was passed making the charging of higher prices post-Hugo than pre-Hugo a crime, punishable by a fine of up to $200 and/or a 30-day jail term. Give the politicians credit for being politically astute. Give them all an F in economics. Government-mandated restrictions on price levels will slow the cleanup effort as much as another Hugo. High prices are the free market's mechanism for ensuring that economic resources flow to their most highly valued uses. On the demand side, high prices guarantee that scarce goods are allocated to those buyers who place the highest value on them.

Consider the effect of requiring that ice not be sold for more than $1 a bag. Smith, whose time in the cleanup effort is valued at $10 per hour, wants ice to ensure that the groceries in his refrigerator, worth $50, do not spoil. Jones, whose time in the cleanup effort is valued at $75 per hour, wants ice so that the $300 worth of meat in his freezer does not spoil. At $1 a bag, so many people want ice that a huge line forms outside any store where it is available, and the average buyer has to stand in line for four hours to buy it.

The real price of ice to Smith is $41 ($1 price tag on the ice plus $40 worth of lost time). Similarly, the real price of ice to Jones is $301. Smith gets ice because the value of the ice ($50) exceeds the real price he has to pay ($41); Jones does not get ice because the cost ($301) exceeds the value ($300). Note, however, that Jones would gladly have paid $50 plus 10 minutes' time for the ice, while Smith would not. The ice gets allocated improperly -- i.e., to the person who values it less. Moreover, society loses four hours of productivity from Smith, slowing the recovery. On the supply side, high prices motivate producers to increase production. At $200 per sheet of plywood, $10 per bag of ice and $600 per chain saw, contractors nationwide will rent planes to ship plywood, ice and
chain saws to Charleston. At artificially low, restricted prices, no one will bother and demand will continue to exceed supply.

So why were price controls embraced so fervently by Charleston? Almost certainly it is because every individual has an incentive to alter the distribution of income in his favor and most individuals have a distorted understanding of prices.

No economist is surprised that an individual prefers paying $1 per bag to paying $10 per bag. We suspect these are the prices Smith thinks are the relevant prices of ice. But they are not. The relevant prices are $10 (the nominal price before the restrictions were imposed plus no lost productivity from waiting in line) vs. $41 (the $1 nominal price after the restrictions were imposed plus $40 lost productivity from waiting in line). The Smiths of this world do not squeal about paying real prices of $41 for ice, but they scream bloody murder about paying nominal prices of $10.

And, as with virtually all redistributive fights, the screaming occurs only when the redistribution threatens to hit home. When the Boston Celtics' star forward, Larry Bird, goes down with an injury and the Celtics are desperate to trade for a forward to fill the gap, everyone expects other teams to take advantage of the Celtics' temporary misfortune by demanding higher-caliber players in trade than they might otherwise have requested.

When there is a temporary imbalance in the labor market, such as with high school math and science teachers, nurses, and computer security personnel, those available are in a position to "gouge" employers for high salaries. Politicians are not deafened by squealing from the constituents about profiteering.

The redistributionist incentives underlying price controls imply that specially interested parties will always attempt to subvert the efficient working of prices to quickly solve temporary demand-supply imbalances. Taking advantage of the AIDS situation was, no doubt, the motive that spurred Burroughs Wellcome, the manufacturer of AZT, to develop the only known effective drug against that disease. Victims made it clear that they were willing to pay high prices for such a drug, and that spurred the drug's development. Politicians even contemplating helping AIDS sufferers who ask for relief from Burroughs Wellcome's monopoly prices severely damp the incentive for entrepreneurs to develop other such drugs.

For fast, efficient reaction to problems caused by natural disaster, the price system can't be beat.

---

Mr. Laband is an associate professor of economics at Clemson University.