BY SEAN HEATHER & CURTIS DUBAY[1]

1 Respectively Senior Vice President, International Regulatory Affairs & Antitrust, U.S. Chamber of Commerce; Chief Economist, Economic Policy Division at the U.S. Chamber of Commerce.

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THE COST OF PRICE REGULATION

By Sean Heather & Curtis Dubay

The Biden Administration is using recent inflationary pressure as an excuse to push a progressive price regulation agenda that would harm consumers, businesses, and ultimately the U.S. economy. Although decades of economic study and experience confirms that market pricing is a pillar of a functioning free market, the Federal Trade Commission is proposing a "Trade Regulation Rule on Unfair or Deceptive Fees" that would impose an economy-wide rule to regulate and prohibit so-called "junk fees." If adopted, this rule would unduly burden business, confuse consumers, reduce product offerings, and, worst of all, raise prices for many consumers by forcing them to pay for services that they neither want nor need.

Prices are a pillar of functional markets. As any economist knows through study, and any business knows through experience, prices send signals to all market participants – businesses, and consumers – about what to make, how much to produce, and how much to buy. It sounds simple in practice, but properly set prices set off an invisible set of intricately coordinated activities that result in the right amount of production of all the goods and services in an economy, as well as providing signaling where to invest in new products.

Study and experience also teach that, when governments interfere in the market's setting of prices, those intrusions can cause enormous harm. When allowed to function freely, prices are the mechanism that allows for the greatest possible expansion of standards of living because they lead to the best-possible allocation of a society's scarce resources. When governments interfere with the setting of prices, they limit how much the economy can expand, and taken too far, can drive an economy to ruin.

In recent months, there has been a growing push across the administration and from some in Congress to have the government exert more control over prices and pricing practices routinely used in the economy. We have seen efforts to politicize inflation, supply chain shortages, energy prices, and food prices. There have also been misleading attempts to blame industry concentration for a supposed decline in competition and higher prices. Others want to revitalize the disastrous Robinson-Patman Act.

Against a backdrop of inflation that U.S. consumers haven't seen since the 1970s, some policymakers are turning to price regulation as a way to shift blame to the private sector. As the Washington Post's Editorial Board explained,

> President Biden is facing mounting criticism for inflation's rise to its highest level since 1982. Unfortunately, the White House's latest response is to blame greedy businesses. Economists across the political spectrum are rightly calling out the White House for this foolishness. Even some within the White House are questioning this approach.
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> Inflation, which was relatively low for years, did not suddenly rise in recent months because businesses decided now was the ideal time to squeeze their customers. What actually happened is that demand soared for many products as the economy recovered. Often, there were not enough products to meet it, thanks to supply chain hiccups and labor shortages, so prices went up.[2]

During the past two years the White House, against the advice of its economists, has repeatedly and cynically blamed so-called "corporate profiteering" for high prices[3]. As part of this effort, the White House issued an *Executive Order on Promoting competition in the American Economy*[4]. The order references "price" no less than 18 times, targeting multiple sectors of the economy and baselessly claiming that prices are too high, wages too low, and profits too big. Since the executive order, the White House has announced "new actions" and "fact sheets" to address the price of rent,[5] food,[6]ocean shipping,[7]meat and poultry,[8] drug prices,[9] and broadband services.[10]

In late October 2022, less than two weeks ahead of the general election, the White House announce a new initiative to combat "junk fees."[11] In concert, the Consumer Financial Protection Bureau, the Federal Trade Commission ("FTC"), the Department of Transportation, and the Federal Communication Commission are now moving to put in place new regulatory controls and enforcement measures to combat legitimate pricing practices that use fees.

2 Wash. Post, "The White House again offers a bizarre explanation on inflation" (Jan. 10, 2022), at https://www.washingtonpost.com/opinions/2022/01/10/white-house-again-offers-bizarre-message-inflation/.

3 Inflation strategy at White House fuels debate - The Washington Post.

4 Executive Order on Promoting Competition in the American Economy | The White House.

5 https://www.whitehouse.gov/briefing-room/statements-releases/2023/01/25/fact-sheet-biden-harris-administration-announces-new-actions-to-protect-renters-and-promote-rental-affordability/.

6 https://www.whitehouse.gov/briefing-room/statements-releases/2022/05/11/fact-sheet-president-biden-announces-new-actions-to-address-putins-price-hike-make-food-more-affordable-and-lower-costs-for-farmers/.

7 https://www.whitehouse.gov/briefing-room/statements-releases/2022/02/28/fact-sheet-lowering-prices-and-leveling-the-playing-field-in-ocean-shipping/.

8 https://www.whitehouse.gov/briefing-room/blog/2021/09/08/addressing-concentration-in-the-meat-processing-industry-to-lower-food-prices-for-american-families/.

9 https://www.whitehouse.gov/briefing-room/presidential-actions/2022/10/14/executive-order-on-lowering-prescription-drug-costs-for-americans/.

10 FACT SHEET: President Biden and Vice President Harris Reduce High-Speed Internet Costs for Millions of Americans | The White House.

11 https://www.whitehouse.gov/briefing-room/blog/2022/10/26/the-presidents-initiative-on-junk-fees-and-related-pricing-practices/.

Setting aside legal concerns with these proposed controls, the ideas would needlessly burden both business and consumers, prevent prices from scaling with the cost of the goods or services purchased, and paradoxically result in higher prices for many consumers.

I. BACK TO BASICS: WHY PRICES MATTER

Prices are the mechanism that makes an economy function efficiently, and they do that by sending signals. The countless interactions between businesses and consumers, businesses and businesses, and businesses and financial markets that occur each day send just as many signals to all those market participants about what the market demands and at what prices. Those signals then tell all those participants how to act accordingly. The more signals that prices are able to send, the more information the market has to work on, thereby increasing efficiency and the well-being of consumers and businesses. The Biden administration wants to interfere in the market and decrease the number of signals it sends.

To better understand why more price signals, help consumers, and how limiting their transmission would hurt them, let's look back at the humble widget from Econ 101 textbooks. The price consumers are willing to pay for a certain number of widgets, for instance, tells a retail store whether it is worth stocking the widgets, given that they will take room on the retailer's shelves that would otherwise go to a different product. If retailers stock the widgets, that sends a signal to the widget producers that there is a market for widgets.

Just because there is demand for widgets at a certain price point that makes sense for the retailer to sell them does not ensure on its own a supply of widgets will come to market. For that, the widget maker needs to determine if it can make an acceptable return on making widgets, given that it can make other items instead. In other words, it needs to consider the *opportunity* cost of producing widgets.

Further, prices determine whether the business makes widgets at all. Prices could tell it that it can make a profit making them, but if that profit does not equate to an adequate return for the risks involved, including its fixed costs, then the business will hold on to its capital for a more promising venture in the future. This process, which happens countless times every day in a modern market-based economy, is dependent on an enormous number of different prices and the information they transmit to all the various market actors. Each of those prices incapsulate the preferences of countless individuals, businesses, and other market participants.

The old textbook example of how important price are to widgets can be applied to the Biden administration's attempt to limit certain fees and other variable pricing mechanism used by some businesses. If this effort were to go into effect, it would decrease the number of price signals sent throughout the economy. This would prevent consumers from telling businesses the types of products they want and what they are willing to pay for them. This in turn would reduce the number of products and offerings from businesses, which would reduce the well-being of consumers and the profitability of businesses.

Fees are often a business's attempt to unbundle the price of their product. For certain types of offerings, there are multiple components that make up the cost. Not all consumers want to pay for all those various components though. In this scenario, businesses have two choices: 1) they can bundle all the components into a one-size-fits-all product; or 2) they can break the product down to its various components and offer consumers the ability to purchase the components they want. Businesses use fees to offer product choices to consumers.

It is the later scenario that the Biden administration wants to stop when it proposes to outlaw certain fees. However, this approach yields considerable benefits for consumers and businesses when those fees are visible and known. Hidden fees are bad, but those that are upfront can make the market work better.

For consumers, they can buy those parts of a service they want the most and not pay for those they are not interested in. For instance, some flyers are willing to pay extra fees to check more bags, or to sit in preferred seats, or to board early. The market would function less efficiently if these flyers couldn't pay more for the services that they want. Similarly, in the banking sector, consumers may opt for a credit card that requires them to pay a fixed annual fee in exchange for the right benefits, whether that is cashback rewards or discounts at their favorite retailers.

This market dynamic ultimately makes everyone better off by growing the number of products in the economy and allowing customers to pay for what they want. How much customers buy and how much they are willing to pay for the various services sends signals to businesses. These signals tell businesses what different customers want and allows them to further expand their product offerings to match their customers' preferences. This increase of product offerings expands the well-being of customers because there are more things they desire, at prices they are willing to pay, in the market.

Businesses can also compete based on how they unbundle and charge for their respective services. Customers will gravitate to the businesses that offer the combinations they like the best. This will simultaneously bring the best mix of offerings to the market at the best price.

Unbundling can also be good for businesses because it allows them to better target their products to a fragmented market. This can improve profitability because they can target services to customers most willing to pay for them.

For this process to be beneficial to everyone, fees and what they apply to must be fully known to everyone. A hidden price cannot send a signal. But the Biden administration is not looking to make fees more visible. It is seeking to eliminate some altogether.

If the Biden administration gets its way, all businesses would essentially be forced into option 1, which is bundling all their offerings. This would cause many consumers to pay higher prices for an array of services they do not want. It would curtail competition among businesses because it would cut off an avenue for business to compete on. And by suppressing more price signals in the economy, it would lessen the growth of products that consumers could benefit from.

II. FEES & THE FEDERAL TRADE COMMISSION

Among the agencies, the FTC is leading the charge toward more widespread price regulation. The FTC has proposed a "Trade Regulation Rule on Unfair or Deceptive Fees" that would impose an economy-wide rule to regulate and prohibit so-called "junk fees" and "hidden fees." The FTC claims, without evidence, that "junk fees . . . facilitate inflation." What are those fees? A more neutral term is "variable pricing." The Commission defines "junk fees" as any fees "that have little or no added value to the consumer," but rather one might say that such a "junk fee" is anything that *the Commission* deems offers little or no added value, regardless of what consumers think or how they behave.

In any event, a proposed rule could affect wide swaths of the economy. It would broadly cover all types of "fees, interest, charges or costs" and comprehensively regulate the advertising of all prices. According to recently departed FTC commissioner, Christine Wilson, the rule could "regulate the way prices are conveyed to consumers across nearly every sector of the economy" and impact "billions or even trillions of dollars in commerce, as well as millions of consumers and companies."[12] For example, the proposal would affect the timing and placement of pricing disclosures and displays of all-in pricing in economic sectors as diverse as

As a matter of economic theory, this proposed rule offends basic notions of a free market. A company's strategy for setting, advertising, and marketing prices is a core component of a functioning market and encompasses nearly every aspect of consumer-facing economic activity. Although a free market assuredly requires pricing transparency so that consumers know how much they are paying and for what, courts have not held that disclosing fees "later" in the shopping and purchasing process, but before purchasing, is unfair or deceptive. Nor have courts required companies to provide all-in pricing in all transactions.

In practice, this proposed rule would harm both business and consumers. Widespread government-mandated disclosures would impose a significant burden on businesses and prove confusing and burdensome for consumers. Think of all the paperwork associated with a mortgage, an auto loan, or a trip to the doctor – how many consumers would want to wade through a pile of paperwork for every routine purchase? And would such requirements serve any effective purpose or merit the costs?

The FTC provides no reason to think that variable pricing is necessarily deceptive or unfair across all industries and sectors of the economy. The proposed rule gives short shrift to the many contexts in which such variable pricing policies may benefit consumers, such as by allowing ultimate prices to scale with the price of the goods or services purchased. For instance, airlines charge more for a variety of things that consumers value, such as early seating and preferred seats, including seats in first class or in the exit row. Movie theaters may soon charge different prices for different seats. These sorts of pricing strategies allow customers to pay for what they value and provide businesses with useful information about what to sell and where to invest.

In contrast, the proposed rule would have significant downsides. Charging everyone the same fee, regardless of how much or how little they purchase, would misallocate resources and mute those critical price signals. It could also be considered "unfair" – an important term of art thus providing the FTC the means to prohibit it. With one price, some consumers would receive windfalls (e.g. the most popular seats) even

12 Wilson dissent, at https://www.ftc.gov/system/files/ftc_gov/pdf/commissioner-wilson-dissenting-statement-junk-fees-anpr.pdf.

as other consumers pay for more than what they actually receive (e.g. the least popular seats). In fact, consumers today expect that their end prices will reflect the volume or quality of goods they have purchased. As a result, regulatory proposals that would require businesses to disclose, upfront, all-in pricing likely would be difficult to implement and unclear to consumers in many contexts.

Such a rule would also prove expensive. Extensive upfront fee disclosures would impose prohibitive costs on many businesses. Those burdens would pass to consumers through higher fees (to recoup costs) or through the downstream consequence of fewer goods or services. In some cases, an upfront fee requirement could prove unduly burdensome or entirely unworkable, so some companies could abandon certain goods or services altogether if the regulatory costs render the venture unprofitable or impractical.

Finally, there are significant practical issues with the FTC's attempt to impose a one-size-fits-all directive to all industries and companies about how they must present prices to consumers. For instance, the rule also does not distinguish between fees that are fixed and determinable upfront versus fees that vary based on consumer choice. Any rule of this scope will necessarily impose unintended consequences on legitimate business practices, and in many cases reduce consumer choice. When it comes to online orders, consumers often have several shipping and delivery options, which may vary in price due to speed, delivery date, and other factors. Until the consumer has finalized their product selection, the company will not know the amount of the fees, and in some cases, whether they apply at all.

Perhaps worst of all, the proposed rule could start an avalanche of federal efforts to control prices. Already, the FTC is looking to revive a dormant law, the Robinson Patman Act, that effectively discourages price cuts in the name of fairness for small retailers.[13] Other policymakers are calling for federal intervention to control the price of housing[14] and other necessities.

Instead of moving toward price controls, policymakers should explore other avenues to encourage competition and lower prices for consumers. Policies that make it easier for markets to increase supply could ease inflation: reducing tariffs, and relaxing regulations would allow the business community to serve the needs of consumers more efficiently.

History has conclusively shown, and economic theory has confirmed, that government attempts to regulate price reduce investment, cause shortages, and harm consumers. Prices should be transparent, but market competition, coupled with existing consumer protection laws, are the best ways to protect consumers while ensuring that businesses retain the necessary incentives to provide the goods and services that consumers want – and to invest in new ones.

13 See https://www.uschamber.com/finance/antitrust/antitrust-legislation-the-robinson-patman-mistake-all-over-again.

14 See https://www.wsj.com/articles/nationwide-rent-control-congress-democrats-progressives-housing-president-biden-11674233540.