R STREET SHORTS NO. 66
January 2019

THE CASE AGAINST MINIMUM PRICING LAWS

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INTRODUCTION

In an era of nearly unprecedented competition and consumer choice, there is seemingly no end to the array of discounts and deals retailers are willing to offer. Black Friday, Cyber Monday, two-for-one deals and rewards programs are just some of the many mechanisms through which sellers of goods offer steep discounts to customers. Similarly, the options for where to buy items is also as diverse as ever, with the modern marketplace featuring everything from high-end boutiques to chain stores to online retailers—all competing for consumer dollars.

Given this backdrop, it may come as a surprise to learn that retailers and wholesalers often face significant—and woefully outdated—restrictions on how deeply they can discount certain products. Yet this is precisely the case in many states across America, which continue to have antiquated laws on their books that dictate the price of many goods. Specifically, prohibitions against selling products below cost, or laws that mandate a certain level of markup, directly undercut the ability of sellers to offer the lowest prices possible to consumers.

As this paper discusses, one of the most prominent examples is Wisconsin's Unfair Sales Act. This law directly forbids pricing products below production costs and mandates myriad markups for products such as gas, tobacco and alcohol.[1] The Unfair Sales Act is one of many state minimum pricing laws that lawmakers enacted during the Great Depression as a means of protecting small businesses from the alleged evils of larger firms using predatory pricing schemes to form monopolies. Ultimately, however, these laws fall short both as a matter of economic theory and in their real-world application, as they fail to enhance competition and result in higher prices for consumers. Accordingly, lawmakers should prioritize their repeal.

PREDATORY PRICING

Minimum pricing laws are primarily justified on the grounds that they prevent large firms from engaging in unfair business practices that could drive smaller competitors out of the marketplace—ultimately to the detriment of the consumer.[2]

For example, the preamble of Wisconsin's Unfair Sales Act states:

> The practice of selling certain items of merchandise below cost in order to attract patronage is generally a form of deceptive advertising and an unfair method of competition in commerce. Such practice causes commercial dislocations, misleads the consumer, works back against the farmer, directly burdens and obstructs commerce, and diverts business from dealers who maintain a fair price policy.[3]

In other words, minimum price and minimum markup laws are intended to stop the practice of so-called "predatory pricing,"[4] which occurs when a marketplace competitor lowers prices below production costs in an effort to drive its rivals out of the market. Once this objective is achieved, the competitor raises its prices back up to above-market levels in order to reap outsized profits.[5]

Unsurprisingly, it is often difficult to distinguish situations of predatory pricing from healthy below-cost pricing. After all, as former Federal Trade Commissioner Terry Calvani notes: "[L]osing business to a rival that has slashed prices is consistent with both aggressive competition and predatory pricing."[6] So how does one tell them apart?

According to the Federal Trade Commission's (FTC) antitrust guidance, the last step described above—raising prices after other competitors have been eliminated, which is often referred to as "recoupment"—is the key component for differentiating between merely aggressive price-cutting and actual predatory pricing. In other words, the worry is that a firm would price below cost temporarily to clear the field of competitors, only to then dramatically raise its prices once it

has become a monopoly. This allows the firm to reap outsized profits but also hurts consumers in the long run.

Recoupment is only possible if future would-be competitors face high barriers-to-entry into the marketplace. Otherwise, even if a firm temporarily clears the field of competitors through ultra-low pricing strategies, the moment it raises its prices to monopoly levels, a new wave of competitors reenters the marketplace, setting prices at below monopoly levels.

Without recoupment, modern antitrust theory finds nothing wrong with below-cost pricing strategies. As Calvani explains: "If there can be no 'later' in which recoupment could occur, then the consumer is an unambiguous beneficiary even if the current price is less than the cost of production."[7] Put another way, lower prices *help* consumers; it is only when a firm eliminates competitors through low prices and then later raises those prices after competitors have been eliminated that consumers are potentially *harmed*. The FTC thus requires that below-cost pricing strategies must have a "dangerous probability of creating a monopoly" in order to be considered predatory.[8]

Most observers—including economists at the FTC—view true instances of predatory pricing as incredibly rare.[9] Some economists, such as Thomas DiLorenzo, have even referred to the practice as a "myth:"[10]

> [R]esearch over the past 35 years has shown [...] that there has never been a single clear-cut example of a monopoly created by so-called predatory pricing, and that claims of predatory pricing are typically made by competitors who are either unwilling or unable to cut their own prices.[11]

DiLorenzo further explains that predatory pricing is largely irrational. This is because few certainties exist as to how long a potential price war between rivals must last before a competitor fully eliminates other firms from the marketplace. In view of this reality, the practice is likely to be very costly.[12]

Given the rarity of predatory pricing and the difficulty of distinguishing it from legitimate business practices, laws that bluntly prohibit below-cost pricing are particularly poor mechanisms for addressing predatory-pricing concerns. Additionally, most states and the federal government already have antitrust laws in place that protect against true cases of predatory pricing—in other words, they require the key component of recoupment. This makes minimum-pricing laws largely unnecessary.[13]

Given that below-cost pricing often enhances competition and benefits consumers, laws that forbid it—or that fail to adequately distinguish it from predatory pricing—have fallen out of favor among antitrust legal scholars and economists.[14] For example, famed federal judge and antitrust scholar Frank Easterbrook has gone so far as to suggest that the antitrust offense of predatory pricing "should be forgotten."[15] Accordingly, over the past several decades, antitrust doctrine has evolved to reflect current understandings of economics and to protect *competition* in the marketplace rather than specific *competitors*. But while some progress has been made, far too many of these laws continue to exist.[16]

A LEGITIMATE AND TIME-HONORED RETAILING PRACTICE

To the uninformed observer, the concept of below-cost pricing might seem counterintuitive, as there appears little reason why a legitimate businesses would want to price its products below its cost of production However, below-cost pricing is actually a commonly accepted and time-honored retailing tradition.

As economists have long recognized, below-cost pricing is an effective retailing strategy for several reasons. First, it can give upstart businesses a way to enter into an already-established marketplace and gain new customers. Economists like DiLorenzo have used the example of a new pizza parlor running two-for-one specials as a way to gain recognition in the neighborhood and to differentiate itself from older competitors.[17]

Second, below-cost pricing allows businesses to engage in what is often referred to as "loss-leader pricing," which occurs when businesses purposefully sell certain products below cost in the hopes that customers will then buy other items above cost. In other words, businesses use targeted below-cost pricing to get customers in the door, at which point they are likely to purchase other products.[18] Such a strategy makes particular sense for products like gasoline, as it has long been recognized that gas stations make most of their profits on convenience store sales rather than the gas itself.[19]

Other common examples of loss-leader pricing strategies include: cell phone carriers offering customers a new phone on the assumption that subscription revenues for data and phone service will make up for any losses over time; printing companies selling printers below cost and then deriving the bulk of their profits from selling ink cartridges; and movie theaters accruing profits from concession sales rather than movie tickets.

Yet notwithstanding the utility of such strategies, many states retain minimum pricing laws for gas and other products that make below-cost pricing virtually impossible to implement legally.

CASE STUDY: WISCONSIN'S UNFAIR SALES ACT

During the 1930s, all levels of government in the United States faced pressure to do something about the wave of business failures that followed the 1929 stock market crash.[20] As law professor Michael Waxman has noted, these years were "a time of falling prices," which raised fears of "a cascading chain of events culminating in depression."[21] The fear was that "through various improper acts," mass retailers would lure consumers away from merchants who maintain a "fair price," and that the latter would be driven out of business.[22]

Accordingly, Congress passed the National Industrial Recovery Act (NIRA), but the United States Supreme Court eventually held it unconstitutional.[23] After the NIRA was struck down, states began passing their own versions of laws designed to address the nation's various economic ills. Echoing portions of the NIRA, lawmakers pushed state-level Unfair Sales Acts as a means of "protecting small business from mass-merchandising economic power."[24] One of the prime examples of these laws was Wisconsin's Unfair Sales Act.[25]

The Wisconsin Unfair Sales Act considers below-cost pricing to be a form of unfair competition. Thus, the text of the Act forbids the "sale of any item of merchandise" by a retailer or wholesaler "with the intent or effect of inducing the purchase of other merchandise or of unfairly diverting trade from a competitor," "impair[ing] and prevent[ing] fair competition" or "injur[ing] public welfare."[26] In turn, any evidence of selling "at less than cost" is "prima facie evidence of intent or effect to induce the purchase of other merchandise, or to unfairly divert trade from a competitor."[27] The law also mandates minimum markups that retailers and wholesalers must impose on certain products, such as gas, tobacco and alcohol.[28]

As penalties, the Act allows for forfeiture and injunctions against retailers and wholesalers that are caught selling below cost. It also creates a private right of action that competitors can use to bring enforcement actions against other sellers. If these are successful, the law allows the aggrieved firm to recoup up to three times the amount of any monetary loss it suffered as a result of its competitor selling below cost.[29]

As with other predatory pricing laws, Wisconsin's law is overbroad in addressing a rare economic phenomenon, is redundant in light of federal antitrust laws, and undermines a useful and legitimate business practice. The Unfair Sales Act therefore makes little economic sense for both sellers and consumers in the Badger State. Perhaps most egregiously, however, the law fails on its own terms. As described, its intent is to protect small mom-and-pop stores by ensuring that they cannot be undercut by larger retailers. But, according to an analysis by the Wisconsin Policy Research Institute (WPRI), there is no evidence that the law actually works as intended.

WPRI's study compares the number of retailers in states with minimum markup laws (like the Unfair Sales Act) with states that lack such laws. If such laws were effective in protecting retailers, one would expect more retailers in states like Wisconsin. But, as WPRI's report shows, the data does not support such a supposition:

> Our econometric analysis shows that the theory underlying these laws is wrong. There is no statistically significant relationship between such laws and the number of small businesses or gas stations. As a result, there is no evidence that Wisconsin's minimum markup law has affected the concentration in the retail market.[30]

The Act has also been heavily criticized by economists at the FTC—the agency charged with enforcing federal antitrust laws. In accordance with its advocacy powers, state lawmakers often ask the FTC to analyze state laws to determine their effects on competition.[31] With respect to the Unfair Sales Act, the FTC has written numerous letters to Wisconsin lawmakers who requested such analysis; each time, the FTC has voiced significant concerns about the law.

For instance, the FTC has noted that there is a "growing body of empirical research" suggesting that minimum pricing laws, particularly in the gasoline marketplace, either raise prices or leave them unchanged.[32] As the FTC points out, if a Wisconsin vendor has a lower cost of doing business than the minimum markup percentage required under the Act, the law prevents the vendor from passing on those savings to consumers.[33] The FTC has also concluded that the Act is "unnecessary" given that federal antitrust laws already protect against predatory pricing. Additionally, over the years, several FTC commissioners themselves have criticized state minimum pricing laws.[34]

In addition to the economic problems with Wisconsin's Unfair Sales Act, the law has significant flaws from a purely legal perspective. For example, the Act states that merely selling below cost is "prima facie evidence" of an intent to engage in unfair competition.[35] This means that the law has no *mens rea* requirement—e.g., a requirement that there be at least some evidence to indicate that a seller *intended* to sell below cost in a way that broke the law. Instead, as Waxman has concluded, the Act merely "presume[s] the purpose of the below cost selling is to destroy competition."[36]

In other words, if a retailer or wholesaler is found to be selling below cost, courts automatically assume that the retailer/wholesaler meant to break the law. The burden then falls on the seller to prove that it either did *not* sell below cost or that

it qualified for an exemption under the law (such as by demonstrating that the product in question was damaged or that the sale was part of a liquidation of the business). Under the law, gas stations can also file a notification that their below-cost pricing was merely an attempt to match the price of a nearby competitor that was selling below cost.[37]

Traditional Anglo-American law requires at least *some* indication that a lawbreaker intended to commit the act in question, lest innocent actors find themselves in unwitting violation. In contrast, Wisconsin's Unfair Sales Act merely assumes illicit intent, which makes little sense given that, as discussed above, many businesses have legitimate reasons for offering products below cost.

In addition to its weak *mens rea* requirements, the way the Unfair Sales Act operates in practice also raises concerns. The government does not enforce the law rigorously or consistently. According to the Wisconsin Institute for Law and Liberty, Wisconsin's Department of Agriculture, Trade and Consumer Protection (DATCP)—the agency charged with enforcing the law—received 2,373 complaints alleging violations of the Act's minimum markup requirement in 2014.[38] While this may seem like a large number, DATCP only pursued enforcement action—in the form of sending warning letters—in 60 cases.[39] And, in the past decade, the state has not referred a single case to local prosecutors to pursue fines for violating the law.[40] Furthermore, at present, only two employees at DATCP are assigned the task of enforcing the Unfair Sales Act, which helps explain its inconsistent implementation.

Despite lax enforcement of the Act, the law still creates perverse incentives in the form of excessive paperwork burdens on businesses. Because it allows gas station owners to file a notification that they only priced below cost in an effort to match a competitor's price, gas stations often flood DATCP with complaints to ensure that they can price as low as possible without risking legal liability. In fact, over 99 percent of the more than 2,000 complaints received in 2014 for violation of the law came from gas station owners against other stations—and the majority of these came from a single gas station operator.[41]

Filing notifications requires time and manpower, of course, which raises compliance costs for businesses like gas stations. One station operator in Wisconsin estimated that filing notifications cost him nearly $100,000 each year.[42] He also noted that he had four people in his office who managed his company's Wisconsin-based gas stations versus less than one full-time employee dedicated to his Michigan-based ones.[43]

CONCLUSION

While Wisconsin's Unfair Sales Act is probably the most notorious, other states have their own versions of minimum pricing laws. Some of these apply generally to retail and wholesale products, while others target specific markets, such as gas, tobacco or alcohol. Tennessee stands out for its prohibition against below-cost sales of "frozen desserts."[44] These laws vary in their function enforcement. As former FTC Commissioner Calvani has noted:

> Construction and enforcement of state [minimum pricing] law is also diverse. Some states, like their federal counterparts, require proof of sales below an economically informed measure of costs and proof of probable recoupment. Others have adopted a more "populist" view reminiscent of the federal treatment in an earlier age and focus on injury to competitors rather than injury to competition.[45]

Given this variation, it is difficult to determine the exact number of states with minimum pricing or markup laws, although estimates have suggested that anywhere from 16 to 24 states have such laws.[46] The penalties for violations also vary from state to state. Some states use fines, while others strip business licenses from violators.[47] States like Nebraska even go so far as to treat violations of minimum markup laws as felonious.[48]

Ultimately, these laws lack economic sense by running counter to modern economic theory. Examples of true predatory pricing are exceedingly rare and federal antitrust laws are already available to address the issue. Furthermore, minimum pricing laws unduly restrict commonly accepted retailing practices and often result in higher prices for consumers. Worse yet, they create burdensome compliance costs and perverse incentives for businesses.

Accordingly, lawmakers in Wisconsin and across the country should prioritize their repeal. It is far past time they did so.

ABOUT THE AUTHOR

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ENDNOTES

1. Wisc. Stat. 100.30.

2. See, e.g., Will Flanders and Ike Bannon, "A Policy in Search of a Problem: A Study on the Impact of Minimum Markup Laws on Small Businesses and Gas Stations," Wisconsin Institute for Law and Liberty, May 2017, p. 5. https://www.will-law.org/wp-content/uploads/2017/05/2017-MML-Final.pdf; and Terry Calvani, "Predatory Pricing and State Below-cost Sales Statutes in the United States: An Analysis," Competition Bureau Canada, 2001. http://www.competitionbureau.gc.ca/eic/site/cb-bc.nsf/eng/01292.html#sec02.

3. Wisc. Stat. 100.30(1).

4. Larissa Price, "Minimum-Markup Laws Gouge Gasoline Buyers," Foundation for Economic Education, Aug. 21, 2006. https://fee.org/resources/minimum-markup-laws-gouge-gasoline-buyers.

5. See, e.g., U.S. Federal Trade Commission, "Predatory or Below-Cost Pricing," *Guide to Antitrust Laws*. https://www.ftc.gov/tips-advice/competition-guidance/guide-antitrust-laws/single-firm-conduct/predatory-or-below-cost; and Calvani. http://www.competitionbureau.gc.ca/eic/site/cb-bc.nsf/eng/01292.html#sec02.

6. Calvani.

7. Ibid.

8. U.S. Federal Trade Commission. https://www.ftc.gov/tips-advice/competition-guidance/guide-antitrust-laws/single-firm-conduct/predatory-or-below-cost.

9. Ibid.

10. Thomas J. DiLorenzo, "The Myth of Predatory Pricing," Cato Institute, Feb. 28, 1992, p. 1. https://www.cato.org/publications/policy-analysis/myth-predatory-pricing.

11. Ibid., p. 1.

12. Ibid., pp. 2-3.

13. See, e.g., Susan A. Creigton et al., "Letter to Rep. Shirley Krug Re: Wisconsin's Unfair Sales Act," U.S. Federal Trade Commission, Oct. 15, 2003. https://www.ftc.gov/system/files/documents/advocacy_documents/ftc-staff-comment-honorable-shirley-krug-concerning-wisconsin-unfair-sales-act-applied-gasoline/031015wisconsinunfairsalesact.pdf; and Michael P. Waxman, "Wisconsin's Unfair Sales Act – Unfair to Whom?", *Marquette Law Review* 66:2 (1983), p. 305. https://scholarship.law.marquette.edu/cgi/viewcontent.cgi?referer=https://www.google.com/&httpsredir=1&article=1970&context=mulr.

14. Calvani. http://www.competitionbureau.gc.ca/eic/site/cb-bc.nsf/eng/01292.html#sec02.

15. Ibid.

16. Ibid.

17. DiLorenzo, p. 4. https://www.cato.org/publications/policy-analysis/myth-predatory-pricing.

18. Waxman, p. 299. https://scholarship.law.marquette.edu/cgi/viewcontent.cgi?referer=https://www.google.com/&httpsredir=1&article=1970&context=mulr.

19. Flanders and Bannon, p. 4. https://www.will-law.org/wp-content/uploads/2017/05/2017-MML-Final.pdf.

20. Waxman, p. 295. https://scholarship.law.marquette.edu/cgi/viewcontent.cgi?referer=https://www.google.com/&httpsredir=1&article=1970&context=mulr.

21. Ibid., p. 298.

22. Ibid.

23. Ibid.

24. Ibid., p. 296.

25. Wisc. Stat. 100.30.

26. Wisc. Stat. 100.30(3).

27. Ibid.

28. Wisc. Stat. 100.30(2)(am).

29. Wisc. Stat. 100.30(4), (5) and (5m).

30. Flanders and Bannon, p. 5. https://www.will-law.org/wp-content/uploads/2017/05/2017-MML-Final.pdf.

31. 15 U.S.C. § 46(a), (f).

32. "Letter to Rep. Shirley King Re: Wisconsin's Unfair Sales Act." https://www.ftc.gov/system/files/documents/advocacy_documents/ftc-staff-comment-honorable-shirley-krug-concerning-wisconsin-unfair-sales-act-applied-gasoline/031015wisconsinunfairsalesact.pdf.

33. Ibid.

34. See, e.g., Wisconsin Policy Research Institute Staff, "Federal Trade Commission slammed markup law over the years," *Wisconsin Policy Research Institute Special Report*, 2016, p. 18. http://www.wpri.org/BI-Files/Special-Reports/Minimum_Markup_SpecialReport_2016.pdf; and Calvani. http://www.competitionbureau.gc.ca/eic/site/cb-bc.nsf/eng/01292.html#sec02.

35. Wisc. Stat. 100.30(3).

36. Waxman, p. 303. https://scholarship.law.marquette.edu/cgi/viewcontent.cgi?referer=https://www.google.com/&httpsredir=1&article=1970&context=mulr.

37. See, e.g., Wisc. Stat. 100.30(6)-(7); and Waxman, p. 300.

38. Ken Wysocky, "Krist Oil owner says markup law hampers his ability to compete in Wisconsin," Wisconsin Policy Research Institute Special Report, 2016, p. 11. http://www.wpri.org/BI-Files/Special-Reports/Minimum_Markup_SpecialReport_2016.pdf.

39. Dave Daley, "Wisconsin does little to enforce markup law," *Wisconsin Policy Research Institute Special Report*, 2016, p. 24. http://www.wpri.org/BI-Files/Special-Reports/Minimum_Markup_SpecialReport_2016.pdf. The number of enforcement actions in 2013 was only 27 and in 2012, it was 50.

40. Ibid.

41. Wysocky, p. 11. http://www.wpri.org/BI-Files/Special-Reports/Minimum_Markup_SpecialReport_2016.pdf.

42. Ibid., p. 13.

43. Ibid.

44. Tenn. Code. Ann. § 53-3-201-202.

45. Calvani. http://www.competitionbureau.gc.ca/eic/site/cb-bc.nsf/eng/01292.html#sec02.

46. According to Calvani's paper, 24 states have a general below-cost law and nine have gas-specific laws. States with general laws include: Arkansas, California, Colorado, Hawaii, Idaho, Kentucky, Louisiana, Maine, Maryland, Massachusetts, Minnesota, Montana, Nebraska, North Carolina, North Dakota, Oklahoma, Rhode Island, South Carolina, Tennessee, Utah, Washington, West Virginia, Wisconsin and Wyoming. States with gas-specific laws include: Alabama, Colorado, Florida, Massachusetts, Missouri, New Jersey, North Carolina, Tennessee and Utah. Meanwhile, Wisconsin's Legislative Reference Bureau has estimated that 21 states have general below-cost laws, while 11 have gas-specific laws. See Daley, p. 23. http://www.wpri.org/BI-Files/Special-Reports/Minimum_Markup_SpecialReport_2016.pdf. Finally, the National Conference of State Legislatures has estimated that 16 states have minimum markup laws.

47. Flanders and Bannon, p. 8. https://www.will-law.org/wp-content/uploads/2017/05/2017-MML-Final.pdf.

48. Neb. Rev. Stat. 59-805.