Centre for Competition Law and Economics

Comment:
Empirical challenges when assessing excessive pricing during Covid-19 national disaster period

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The South African Competition Commission has indicated that it has received multiple complaints of excessive prices against retailers and suppliers relating to hand sanitizers and face masks, toilet paper, flu medications and related Covid-19 essential products[1].

These complaints relate to new excessive pricing regulations, published in the Government Gazette, which deem a price excessive if price changes do not align with cost changes or if there is a change in the mark-up compared to the mark-up over the three months December 2019 to February 2020[2].

The empirical challenge in such an excessive pricing case is to determine whether prices have behaved materially different against a benchmark period, and by how much. To do so, economists typically estimate what the relevant price would have been during the period of investigation (in our case, the national disaster period) if prices had continued to respond to demand and cost in the same way as during the benchmark period.

For example, if a 10% increase in cost typically gives rise to a 10% rise in prices during the benchmark period, then a 40% rise in prices during the national disaster period would be justified if cost had risen by 40%: economists would not identify a material change in price behaviour, even if prices did rise during the national disaster period.

The key to assessing 'normal' behaviour is the benchmark period. In the South African context, the new regulations define this period as December 2019 to February 2020. Presumably, the window is defined sufficiently short to allow a direct comparison of prices for the two periods. Unfortunately, it is not so simple.

[1] Media release on 31 March 2020: http://www.compcom.co.za/2020-media-releases/

[2] See my earlier comments on how these regulations set a stricter standard, and the difficult issues surrounding this standard: https://ccle.sun.ac.za/2020/03/20/excessive-pricing-regulations-under-the-covid-19-crisis/

The empirical methods typically used by economists to study price behaviour require a sufficiently long period. If 'normal' behaviour is 'average' behaviour, a sufficiently long history of pricing behaviour is required to assess how prices usually respond to cost and demand changes. The length of the historical period required may differ by case, but it would be odd not to consider at least the past three years and, where applicable, longer periods that include sudden demand and cost shocks.

A sufficiently long history ensures that economists avoid committing two types of error. Firstly, it ensures that economists do not consider the price responses to a particular demand or cost shock (or the total absence of such shocks) during December to February as indicative of general behaviour. Secondly, it ensures that economists do not take a short-term view of price adjustment. It is well established in the economics literature that demand and cost shocks take time to fully feed into prices. Estimating how pricing typically adjusts to demand and cost shocks is therefore critical.

The type of analysis that economists would have to undertake does not necessarily require significant resources – at least not in the case of national chains. In fact, the data requirements for economic models of price behaviour are not onerous – and relates to information that the Commission would have to collect in any event. The cases highlighted in the press release relate to retail prices of selected products. For such products, econometric models of price behaviour may require the relevant retail price, wholesale cost and a proxy for demand over a sufficiently long period.

The standards for excessive pricing may well be stricter during the national disaster period, but a continued commitment to an ex-post competition policy regime – as signalled in the regulations – also implies a commitment to rigorous analysis. The Commission has indicated, in its press release, that it is sensitive to some of problems discussed here, acknowledging, for example, the impact of seasonality on price behaviour. Even so, an appropriate understanding of price behaviour is of key importance, and should be carefully considered by both potential respondents and the Commission.