Testimony from:
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In SUPPORT of SF 1868, to eliminate Minnesota's below cost sales of gasoline prohibition

March 2, 2023 Hearing
Senate Commerce and Consumer Protection Committee

Chairman Klein, Vice Chair Seeberger, Ranking Member Dahms, and members of the Senate Commerce and Consumer Protection Committee,

Thank you for considering this testimony. The R Street Institute ("R Street") is a nonprofit, nonpartisan public policy research organization. Our mission is to engage in policy research and outreach to promote free markets and limited, effective government in many areas. Part of that work includes analyzing and supporting marketplace policies that respect individual freedom, free enterprise and the public well-being.

One of my areas of research at R Street includes minimum markup or minimum pricing laws, such as Minnesota's minimum markup for gasoline. As you are aware, the current law requires gasoline retailers to add the lesser of 6 percent or 8 cents onto the wholesale price they pay for gas. Both the history and theory of minimum pricing laws, as well as modern-day evidence, show that the negative consequences of these rules far outweigh the benefits.

Minimum pricing laws trace their heritage to the Great Depression as states sought to react after the Supreme Court struck down the National Industrial Recovery Act. Facing pressure to do something that could be seen as helping small businesses—and that would prevent monopolies from forming—during the severe economic downturn, some states turned to minimum pricing rules.[1]

The idea behind such laws was to prevent so-called "predatory pricing," in which a marketplace participant cuts prices to below the cost of production in an effort to drive competitors out of the market. Then, with the field cleared, they could theoretically be free to raise prices with impunity to achieve outsized profits.[2]

The last part of this chain—raising prices to reap massive gains—is called "recoupment" and is the key indicator of whether a cost-cutting practice can be deemed predatory or not. As a former Federal Trade Commissioner has noted, it is easy to conflate mere competition with predatory pricing, which is why, without any evidence of recoupment, the consumer is "an unambiguous beneficiary" via the lower prices.[3]

For recoupment to occur, not only must a marketplace participant's price-cutting scheme clear the field of current competitors, but the conditions of the market must be such that there are high barriers to entry for *future* competitors as well. Otherwise, new competitors would simply enter the market and ruin the ability of the potential monopolist to raise prices with impunity. Given these various criteria, economists have noted that true examples of predatory pricing are extremely rare.[4]

This backdrop is important in analyzing Minnesota's minimum markup law for gas. While the original purpose of the law may have been to thwart predatory pricing, the features of modern-day gasoline retailing make it nearly impossible to envision such a scheme taking hold in today's marketplace.

Not only are most gas stations owned by independent operators who only own a single station, thus making the marketplace highly fragmented, but consumers are highly responsive to changes in gas prices.[5] The idea that a monopolistic gas station owner would be able to undercut competitors, clear the field and then aggressively raise prices simply lacks credulity in the modern economic landscape.

To the extent such behavior somehow did take hold, however, it is important to recognize that federal antitrust law already protects against predatory pricing schemes, thereby ensuring that consumers do not lack protection.[6]

In addition, real world evidence of the impact of minimum pricing laws demonstrates that these rules fail to achieve their intended effects. While proponents of minimum pricing and markup laws suggest that they function to protect small businesses, there is no empirical evidence to support this claim.

For example, researchers in Wisconsin studied the state's own version of a minimum markup law for gasoline, and concluded:

> 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.[7]

In fact, the main impact of the Wisconsin's minimum markup law has likely been to increase the price of gas in the state.[8]

These results are not confined to a single state either, as the Federal Trade Commission (FTC) has noted the "growing body of empirical economic research" from the past two decades, in which "[m]ost studies find these laws raise gasoline prices or leave them unchanged."[9] As a result, numerous FTC commissioners have voiced criticism about state minimum pricing and markup laws.[10]

Because of the differences in how minimum markup and pricing laws are constructed, it can be difficult to get a precise count of how many states have them. The best estimates suggest that 20 to 24 states have general below-cost laws, while nine to 11 states have gas-specific minimum markup laws.[11] This means that the majority of states operate without minimum markup rules for gas and there is no evidence suggesting that these states have fewer small and independent gas retailers.

Although minimum markup laws may have stemmed from sympathetic concerns about protecting small businesses from entrenched economic interests, both the theory underpinning them and the real-world

evidence tells a different story. Reforming Minnesota's minimum markup for gas would benefit consumers while still allowing the state to have a healthy gasoline marketplace in the years ahead.

Thank you for your time and consideration, and please do not hesitate to contact me if I can be of further assistance.

Respectfully submitted,

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[1] C. Jarrett Dieterle, The Case Against Minimum Pricing Laws, *R Street Shorts* No. 66, January 2019, p. 3. https://www.rstreet.org/wp-content/uploads/2019/01/Final-Short-No.-661.pdf.
[2] Ibid., p. 1-2.
[3] Ibid.
[4] 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.
[5] Zachary Crockett, "Why most gas stations don't make money from selling gas," *The Hustle*, April 15, 2022. https://thehustle.co/why-most-gas-stations-dont-make-money-from-selling-gas; Lutz Kilian and Xiaoqing Zhou, "Gasoline Demand More Responsive to Price Changes than Economists Once Thought," Federal Reserve Bank of Dallas, June 16, 2020. https://www.dallasfed.org/research/economics/2020/0616.
[6] Susan A. Creighton 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.
[7] Will Flanders and Ike Brannon, "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://will-law.org/wp-content/uploads/2021/01/2017-MML-Final.pdf.
[8] Ike Brannon, "The effects of resale price maintenance laws on petrol prices and station attrition: empirical evidence from Wisconsin," *Applied Economics* 35:3 (2003), pp. 343-349. https://ideas.repec.org/a/taf/applec/v35y2003i3p343-349.html.
[9] Creighton et al. https://www.ftc.gov/system/files/documents/advocacy_documents/ftc-staff-comment-honorable-shirley-krug-concerning-wisconsin-unfair-sales-act-applied-gasoline/031015wisconsinunfairsalesact.pdf.
[10] Dieterle, p. 3. https://www.rstreet.org/wp-content/uploads/2019/01/Final-Short-No.-661.pdf.
[11] Ibid., p. 4, n. 46.