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OPINION

A Penny Not Saved

By

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New York and several other states (California, Illinois, Massachusetts, Michigan, New Hampshire, North Dakota, Rhode Island and sometimes in Connecticut) have an "Item Pricing Law" (IPL) requiring that, for most goods in retail stores, each item have its own individual price sticker; in other states a simple price tag on the shelf is considered sufficient. The argument for the IPL is that, without individual price tags, consumers could not tell if pricing errors are made.

How do these laws actually work in practice? In a recent paper, my co-authors and I examined the economics in detail.

Since a principal benefit of an IPL to consumers is that they can prevent overcharges, the reasonable question to ask is, How common are these pricing errors? For evidence, the most recent and comprehensive study is by the Federal Trade Commission in 1998. This study found that overcharges occurred in about 1% of the items sold, and that the average cost of overpricing for all items was less than one cent per item. (Undercharges were about equally likely.) Thus, estimates of the potential benefits of IPLs are less than one cent per item.

The IPLs also have costs, however. It is expensive and time consuming to put labels on each item. And it also makes changing prices more expensive than otherwise -- meaning that stores are less likely to have sales of covered items. In a competitive industry like grocery retailing, any cost increase will translate into a price increase. We would therefore expect IPLs to lead to higher prices.

How much higher? There is no discussion in the existing literature of the effect of IPLs on prices. This is what we studied.

In order to estimate the effect of the laws on actual prices, an area where one could compare similar stores subject to different laws is best -- and the tri-state region of suburban New York, New Jersey and Connecticut is ideal. This region has similar socioeconomic characteristics, and markets are comparable in many respects. New York is an IPL state and New Jersey is not. In Connecticut, stores must either have item prices or use electronic shelf labeling systems, so that there are some stores subject to IPLs and some stores that are not.

We gathered data on prices of identical items in grocery stores in these three states, in two rounds. In the first round, we sampled 15 products four times in four stores: two IPL stores, one store exempt because it was in Connecticut and used electronic shelf labeling, and one store in New Jersey, a non-IPL state. In the second round, we sampled prices of two categories of products in 20 stores: 12 IPL stores, three stores exempt from IPL because of electronic shelf labeling, and five non-IPL stores. In both rounds, we included stores from the same chain located in different states. Altogether we collected 3,240 price observations.

Results were consistent across both sets of data: Prices in IPL stores are 20 cents to 25 cents higher per item than in non-IPL stores. Stores in Connecticut with electronic shelf labels were in the middle, with prices 15 cents lower than in IPL stores, and 10 cents higher than in non-IPL stores -- because electronic shelf labels are more expensive than old fashioned labels but cheaper than item pricing. All results are highly statistically significant.

The maximum estimate of the benefit of avoiding overcharges to consumers through IPLs is less than one cent per item. The costs exceed 20 cents per item. The laws are a bad deal for consumers.

How significant are these price differences -- about a quarter per item? The average price of the items in our sample was about $2.50, so there is a 10% difference. This implies that prices of groceries are almost 10% higher in IPL stores. Food represents about 14% of the average family's budget. IPLs, therefore, reduce the real incomes of families by more than 1% -- a nontrivial amount.

In sum, our study shows that IPLs impose net costs on consumers much greater than any potential benefit. Jurisdictions without them should not pass them, and jurisdictions with them should repeal them. In New York City, where costs and so prices are already very high, consumers would greatly benefit from a 10% reduction in grocery prices.

Mr. Rubin is a professor of economics and law at Emory University. The study discussed in this essay was coauthored with Mark Bergen, Daniel Levy, Sourav Ray and Benjamin Zeliger and will be published in the Journal of Law and Economics.

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