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ECONOMICS

The Cost of Raising Prices Can Prove Too High to Pay

- **SLATE – MAY 11, 2007**

A serving of Coca-Cola cost a nickel for 60 years -- an example that illustrates the disadvantages of price stability, Tim Harford writes.

Low inflation helps companies and people plan their finances far into the future, but it also makes it harder for the prices of products to change relative to one another. If they can't do so, the economic consequences can be serious. Prices won't accurately reflect a product's demand and the cost of producing it. If, for example, the relative price of a car "can't fall when demand does, sales will collapse." If wages can't fall in a recession, unemployment will rise.

The case of Coke, Mr. Harford says, is an example of the main reason companies choose to keep prices constant in the face of dramatic rises and falls in costs: the hassle of changing a product's price can be very high. Coke kept its price constant from 1886 through the mid-1940s, even as the price of sugar tripled after World War I and then fell slightly, and after the product went from being taxed as a medicine to taxed as a soft drink. Part of Coke's problem was that it sold many of its bottles in vending machines that accepted only nickels. A price increase would have meant either building new vending machines or doubling the price of Coke, neither of which made financial sense.

In an age when Coke can reprogram its vending machines easily and Internet retailer Amazon can adjust its prices whenever its costs change, a few companies that are slow to adjust prices can still severely distort the prices charged by companies that are quick to do so. Even if Amazon can constantly tinker with the prices of books, it still has to reflect the less flexible prices that come further down the product chain with shipping companies and bookbinders.

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