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Minimum Markup: The Price is Not Right

By Ken Wysocky



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A P R E F A C E T O

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Why would a citizenry want its government to require, by law, higher prices?

At any time, it's a good question but, as veteran journalist Ken Wysocky points out, at a time of raging inflation, it takes on a new urgency.

And why would a government, such as Wisconsin's state government, go on requiring, by law, higher prices even though there is a broad bipartisan consensus that it should stop? And shelves of research showing it to be pernicious?

The Badger Institute has been asking this question for a long time, and Wysocky here reviews the findings — because our state is *still requiring*, by law, higher prices.

— *Badger Institute*

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Like wings on birds that can't fly, Wisconsin's minimum markup law is a vestigial remnant — a well-intended but no longer needed government intrusion enacted during a bygone economic era. In short, it's a policy in search of a problem that no longer exists, according to numerous researchers, studies and reports that decry its impact on consumers.

The fact that there's been long-standing bipartisan support to repeal the law, originally passed by the Wisconsin Legislature in June 1939, speaks volumes about its relevance today.

The Law's History

To understand why the law no longer makes sense requires a short history lesson.

Technically known as the Unfair Sales Act, the law was enacted to help stymie the tsunami of small business failures during the Great Depression of 1929 through 1939. It originally called for a mandatory 2% markup on wholesale prices and a 6% markup on retail prices on all merchandise sold in Wisconsin.

The legislation was based upon a model State Unfair Sales Act prepared by the National Food and Grocery Conference Committee. The committee, in turn, was made up of representatives of associations from various branches — retail, wholesale and manufacturing — of the food and grocery trade, according to 1939 drafting files.

Why would state government meddle in product pricing? Because of concerns that larger retailers could use so-called predatory pricing tactics — drive down prices so low that smaller businesses would fail. In essence, the law was designed as a protective measure to create at least a somewhat level playing field for both smaller businesses and their larger competitors.

The law underwent minor changes during the ensuing decades. But a major shift occurred in 1986, when the state Legislature removed most merchandise from under the yoke of markup requirements, creating a more free-market economy.

But lawmakers kept the law in place for a select number of goods, such as motor vehicle

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fuel, tobacco and alcohol. And in 1997, the minimum markup on gasoline was raised to 9.18% of the “average posted terminal price,” which many consider a proxy for wholesale costs.

The end result: Even though the Great Depression ended more than 80 years ago and economic dynamics have changed considerably since then, gas, alcohol and tobacco still cannot be sold at below-cost prices in the Badger State without violating the law.

This dictum seems especially egregious in light of significantly higher prices for gasoline.

The Research

Cost to Consumers

As explained in a 2016 report¹ by the Badger Institute, it’s exceptionally difficult to estimate the aggregate impact of minimum markup laws on Joe and Jane Consumer, given variables such as fluctuating gasoline prices and widespread circumvention of the law.

But a 1999 study² by two professors at Marquette University in Milwaukee estimated the law cost consumers an additional two to three cents per gallon for gasoline — or a total of at least \$50 million a year. And that was when gas prices ranged from a mere \$1 to \$1.50 per gallon. (The study was published by the Badger Institute, then called the Wisconsin Policy Research Institute).

More recently, Will Flanders of the Wisconsin Institute for Law & Liberty (WILL) pointed out that because the minimum markup is tied to the wholesale price of gas, it’s difficult to pin down exactly how much more consumers pay because of the markup. But in an interview,³ he estimated the law adds 32 cents to the price of a gallon of gas.

The Federal Trade Commission (FTC) supported the 1999 study’s findings. In a 2003 letter⁴ to then-state Rep. Shirley Krug (D-Milwaukee), who supported repealing the law, the FTC said that the study “was consistent with a growing body of empirical research from the past two decades that has assessed the impact of ‘sales-below-cost’ laws on retail gasoline prices” and that “most studies find these laws raise gasoline prices or leave them unchanged.”

Wisconsin’s law, which the FTC said features one of the steepest minimum markups on retail fuel sales in the country, likely leads to significantly higher prices for consumers, discourages pro-competitive price cutting and — given federal antitrust laws — simply is not necessary.

The FTC emphasized that the federal government, state attorneys general and private parties all have the ability to fight “predatory pricing” without minimum markup laws. The

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U.S. Supreme Court defines predatory pricing as “pricing below an appropriate measure of (a defendant’s) cost for the purpose of eliminating competitors in the short run and reducing competition in the long run.”

But the FTC also stated that “predatory below-cost pricing happens infrequently” and that “anti-competitive, below-cost sales of motor fuels are especially unlikely.”

Finally, the FTC questioned the logic behind the 9.18% markup in particular, noting that it appears “completely arbitrary.”

More Incentives to Repeal

There’s also evidence that the law doesn’t even accomplish its intent.

In 2017, WILL partnered with Ike Brannon to examine the extent to which minimum markup laws⁵ protected small businesses. (At the time, Brannon was a visiting fellow at the Cato Institute and now is president of Capital Policy Analytics, a consulting firm in Washington, D.C., and a Badger Institute visiting fellow.)

After comparing states that had both a gasoline-specific minimum markup law and general minimum markup law, Brannon found no difference in the number of per capita small businesses in those states.

“Indeed, in the modern era, the law may protect the same big retailers that it was designed to restrict,” an article⁶ on WILL’s website reports. “In general, bigger gas providers like these laws because they guarantee a profit on gas sales while severely restricting the ability of alternative retailers to undercut them on price. This has made the repeal of this law, which almost indisputably harms consumers, all but impossible in the (Wisconsin) legislature.”

Furthermore, the 2017 study points out that the profit margins on gasoline sales already are extremely slim. Gas stations typically rely on sales of ancillary items, not fuel, for profits, just as restaurants typically rely on alcohol sales for profits while making little money on food.

Gas stations in states without a minimum markup requirement don’t perceive narrow margins on gasoline as an existential threat, the report notes. Why not? Because modern gasoline stations make most of their money on ancillary sales of convenience store items such as soft drinks and snack foods.

This, the report goes on to say, is a primary reason supermarket chains such as Walmart, Kroger and Woodman’s have been so keen to enter the gasoline market in recent years.

Effects Beyond Gas Prices

The law affects more than just gas prices. A 2020 Badger Institute article⁷ provides a telling example of how the law can penalize consumers.

Years ago, Walmart began selling an array of generic prescription drugs for just \$4 for a 30-day supply and \$10 for a 90-day supply. The retailer surmised that while some of the

prices may have been a little below cost, charging a uniform low price across such a wide array of drugs would encourage shoppers to get all of their prescriptions at Walmart — and make other purchases at the same time.

It was a great deal for consumers, and other large pharmacy operators such as Costco, Walgreens and Kroger eventually followed suit with similar pricing programs.

However, because some of the generic drugs on Walmart's list cost the retailer more than \$4 and violated the state's Unfair Sales Act, Wisconsin prevented Walmart from offering the deal. In the name of protecting Badger State consumers, Walmart was forced to charge higher prices in Wisconsin than in other states.

The fact that this discounting program has survived for years and years elsewhere belies any notion that Walmart's low prices will drive its competitors out of business. Besides, these days its biggest competition comes from online sellers.

"If this is predatory pricing designed to drive competitors out of business, then Walmart is really, really bad at it," the article concludes.

No Enforcement

There's at least one more compelling reason to repeal the law: It's rarely enforced. During the past 25 years or so, Wisconsin has effectively adopted a go-easy, look-the-other-way approach to violations, according to research compiled for the 2016 Badger Institute report.

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In fact, the Wisconsin Department of Agriculture, Trade and Consumer Protection (DATCP) employs just two full-time staff members whose duties include, but aren't restricted to, handling complaints and issuing warning letters when alleged violations occur. Furthermore, since 2005, the state has referred just one case for prosecution, according to the agency.

Pointedly, DATCP takes action only when someone files a complaint. During the past five years (2017 through 2021), the state received 6,907 complaints about pricing violations, with almost 99% of them (6,822) stemming from gas prices. That's an annual average of 1,364 complaints about gas prices, according to the agency.

Alleged violators receive an informational letter with an educational packet that explains the law. If violations continue, the state then issues a warning letter. During the past five years (2017 to 2021), the state sent out an average of 115 warning letters, mostly pertaining to gas price disputes, according to DATCP. The agency was unable to timely provide information on the number of complaints it received during that period.

Conclusion

Wisconsin has an estimated 3,000 gas stations so, generally speaking, minimum markup violations for gas prices don't appear to be a big concern for the state's station owners.

There's some debate over the exact number of states with similar minimum markup laws. In a 2018 article,⁸ *The Wall Street Journal* reported that 26 states have minimum markup laws. As of 2016, the Wisconsin Legislative Reference Bureau stated there were 21 states with general restrictions on retail sales below cost and 11 with laws specific to motor vehicle fuel. Also as of 2016, the National Conference of State Legislatures said Wisconsin was one of 16 states with minimum markup laws.

Whatever the exact number, there's no doubt the Badger State is a member of a distinct minority of states that still have this relic of Depression-era economics on their books. It's a membership that state legislators should terminate as quickly as possible.



Badger Institute takeaways

- Wisconsin lawmakers should immediately repeal the state's minimum markup law.

About the Author



Ken Wysocky is a Milwaukee-area freelance journalist and editor published in many national magazines and other media. His 40-plus years of journalism include reporting at daily newspapers in Milwaukee and the Chicago area, managing communications for a former Milwaukee-based Fortune 250 company and editing a magazine.

Endnotes

¹ badgerinstitute.org/BI-Files/Special-Reports/Minimum_Markup_SpecialReport_2016.pdf

² wpri.org/BI-Files/Reports/Vol12no7.pdf

³ thecentersquare.com/wisconsin/wisconsin-s-minimum-mark-up-law-not-helping-with-gas-prices/article_ecb663a2-a0b3-11ec-a0a9-9730f4be7374.html

⁴ ftc.gov/news-events/news/press-releases/2003/10/ftc-staff-wisconsins-unfair-sales-act-likely-raises-gas-prices

⁵ will-law.org/wp-content/uploads/2021/01/2017-MML-Final.pdf

⁶ will-law.org/repeal-minimum-markup-law/

⁷ badgerinstitute.org/News/2019-2020/State-law-inflates-prescription-drug-costs.htm

⁸ wsj.com/articles/these-prices-are-a-steal-and-in-some-states-thats-illegal-1517007867