

Business Ethics

BUS 300

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Notes on Fair Price
(revised November 2000)

One of the fundamental rights of customers is the right to a fair price. Price is a measure of value in exchange (strictly speaking, nothing really has a price until it is offered in exchange). Price may be expressed in monetary terms (a sale) or in non-monetary terms (e.g., a barter). There are two principal theories of price that should be of concern to us in the context of customer rights, the cost theory and the market theory.

The Cost Theory of Prices

According to the cost theory, value in exchange is a function of the cost of efficient production or acquisition of the object of the exchange and the required return (profit). In other words, the fair price of something will depend ultimately on how much it costs for the seller to make the thing available to the buyer and on the calculation of a reasonable profit for the seller. For example, a retailer would receive an unfair price if buyers are unwilling to pay enough for her merchandise to permit her to recover the cost of acquiring the merchandise and offering it for sale (inventory and overhead costs) and make a reasonable profit. Similarly, farmers receive unfair prices for their crops, milk, or livestock if the prices do not cover their costs (including seed, labor, capital, and so on) and make a reasonable profit for the year.

In consideration of cost-based estimates of fair prices, much hinges on the assumptions about what constitutes a reasonable profit. Estimates considered reasonable can vary greatly from industry to industry. For instance, margins in the retail grocery or gasoline industries are rarely more than 5%, while margins in jewelry, clothing and other consumer goods may often exceed 100%.

Critics of the cost theory of prices point out that it tends to reward inefficient producers (whose costs are higher) and therefore to penalize buyers. It also takes no account of wider issues or factors, such as supply and demand. Can this be fair?

The Market Theory of Prices

According to the market theory, value is a function of utility and scarcity. That is to say, the fair price of something may vary considerably with the general context in which the thing is offered for sale. If something is offered for sale that is perceived by buyers to have great usefulness (however they may define this) its value in exchange will be

higher. And if, by the same token, this thing is offered for sale in limited quantity, its price will also be higher. Both factors influence prices.

Critics of the market theory point out that this makes prices dependent upon a variety of factors that neither seller nor buyer can readily control. A surplus of wheat in the agricultural marketplace, for example, could easily drive prices down to a point where many farmers, who have worked very hard to bring their produce to market, might not be able to obtain a price for their goods that enables them to stay in business. Similarly, the whims of buyers may this month judge some products harshly in terms of their usefulness that were quite popular last month. Or a scarcity of a product—food or medicine—could drive prices sharply higher and make it difficult for many people to obtain what they need. Can this be fair?

What Makes a Price Fair?

When all is said and done, the market theory of prices must be the foundation for judgments of fairness. Both theories can result in hardships to buyers or sellers, but this is more a reflection of the uncertainties and rough edges of real life than it is an ethical issue. (Though, to be sure, it is always possible for buyers or sellers to deceive, manipulate, or defraud one another—and these are serious ethical issues.)

A price is fair, then, when its value is determined in an exchange in which three conditions are met.

First, the buyer and seller must negotiate the terms of the exchange voluntarily. If either buyer or seller has no choice to make about some relevant term of the exchange, we cannot be sure the price is fair.

Second, both buyer and seller must agree to the exchange without unusual constraints. If either buyer or seller is under unusual pressure to buy or sell, we cannot be sure the price is fair.

Third, both buyer and seller must have adequate information about the things to be exchanged. This means, for example, that buyers must receive from sellers, or be able to get, adequate information about the thing they propose to buy. They do not have a right to know everything, perhaps, but sellers who deceive or mislead buyers about relevant details, or who conceal important information, violate their customers rights. Prices obtained under such circumstances may very well not be fair. This has far-reaching implications for advertising efforts.

When Can We Suspect that Prices Are Unfair?

- When profits are excessive (with respect to costs of capital).
- When the object is priced according to an estimate of the cost to repair the damage suffered by failing to receive the benefit.
- When an increase in price occurs to take advantage of another's distress.
- When an increase in price is due to a false differentiation of the product.