Price Regulation and Implicit Taxes: Let's Not Go There

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We often complain about high prices. This sometimes leads our politicians to unfortunate attempts to "do something" about it. One of the latest episodes, not surprisingly, deals with gasoline prices. Gasoline prices have been on somewhat of a roller coaster and when they are at their high point the complaints intensify. There are recent reports of refineries unwilling to expand capacity in this environment of elevated prices and many politicians crying foul. But are things really so foul? Let's look a little deeper. Then let's draw some broader lessons.

Reluctance by refiners to expand capacity suggests that it's perceived to be a money loser. Either the high price is not expected to last long enough, costs are forecasted to be too high, or other conditions are expected to occur that makes long-term investment in refinery capacity unprofitable. Oil refiners have been hammered in the press for this reluctance by various political and consumer groups. (See, as an example, http://biz.yahoo.com/ap/070617/ethanol_refineries.html.) Consider what the effects are, though, if political pressure somehow induces refinery expansion. More gasoline would be available and its price lower. Thus, refiners are induced to lose money so that gasoline consumers can obtain lower prices. In effect, refiners (actually, their stockholders) are implicitly taxed and gasoline consumers are receiving implicit charity. If it costs $2.80 per gallon to produce and market a gallon of gas but it's sold for $2.60 per gallon, $.20 per gallon is "taken" from refiners. It's as if the price were $2.80 with a $.20 per gallon tax on refiners. And it's as if consumers receive a charitable gift of $.20 for every gallon of gas that they buy. In effect, this creates a form of public charity . . . and a pretty bizarre form at that: taxing the stockholders of oil refiners to provide charity to gasoline consumers! To be sure, many consumers of gasoline are poor but most are not so the subsidy goes mainly to the non-poor.

Similar comments apply to political attempts to reduce prices by mandate, whether it's for food, housing, automobiles, health care, or most any other good you wish to name. It implicitly taxes a narrow subset of the citizenry to subsidize a group that includes poor people but is mostly non-poor. It gets worse than this, though. Keeping price low by mandate generally means that, at the mandated price, suppliers do not wish to supply all that consumers want. Thus, shortages occur . . . and they are a mess. With a market-determined price, the willingness to pay the going price is sufficient to obtain the good. This is no longer that case for price-controlled goods in short supply. Thus, other means of obtaining the good evolve. It could mean waiting in line for extended periods of time. As one who is old enough to have experienced gas shortages due to the 1970s price controls, this is not a pleasant experience. You were never sure how long the wait would be and whether you'd actually get anything when it was your turn. And this is way economies are run by tin-pot dictators and unrepentant communists, not how modern, market-based economies should operate. With other price controlled goods (rent controlled apartments are a good example), one often obtains the good in short supply through "influence." In other words, if you're a big wig you get all you want, if you're an average schmoe you'll get some, and if you're a little guy . . . good luck! Thus, owners and stockholders of price-controlled good are implicitly taxed to support persons of influence. While this may be good politics it surely is not good government policy.

On top of all this, inducing below-market pricing provides all the wrong signals and incentives. If a good is in short supply, it's sensible to give consumers incentives to conserve on its use. Yet an artificially low price signal plentiful supply and gives financial incentives to consume more. Similarly, it makes sense to encourage suppliers to produce more, but the low price signals low value by the marketplace and provides incentives to make less. The beauty of a market determined price is that is gives the correct information and incentives . . . without a government authority telling us what to do. We freedom-loving Americans (and other like-minded folks around the world) value that.

If the intent of these attempts to beat down prices is to provide relief for the poor, there's much more effective and simple ways to do so. It's though income-based welfare programs. They have their problems, but they are effective in getting resources into the hands of the poor without contravening the normal workings of markets. It's financed by general tax revenue, so a narrow group is not singled out for taxation and the subsidy goes to those who actually are poor.

Complaining about prices is normal. Political interference with prices, though, causes many problems and solves none. It generates a quagmire of implicit taxes and subsidies and spawns shortages and the associated muddle. Let's not go there.

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