ENERGY & NATURAL RESOURCES

Tax Holidays, Feebates, Price Gouging Laws?

Are proposals for gas price relief good policy?

BY STEVE G. PARSONS

This May, the U.S. House of Representatives passed an anti–price gouging bill that would give the president authority to declare an energy emergency and make it unlawful to increase gasoline and home energy fuel prices in an "excessive" or exploitative manner. The Senate Commerce Committee then deadlocked on the bill, making it unlikely to become law. But this year's persistent high gas prices—coming just before a pivotal election—is pressuring elected policymakers to "do something" to show their concern for consumers, whether in the form of anti–price gouging laws (APGLs), gas tax holidays, or something else. Politics aside, just how sensible are these ideas?

ANTI–PRICE GOUGING LAWS

Economists almost universally disdain any form of government price control, which is what APGLs are. Price is the mechanism that mediates between supply and demand; it rations scarce goods. A higher price encourages consumers to conserve and look for alternatives and it encourages suppliers and potential suppliers to produce more.

Accordingly, economic theory and substantial empirical evidence indicate that APGLs make society worse off by:

- encouraging hording and shortages,
- not sending the correct price signal to consumers to conserve and search for alternatives,
- not directing goods to their highest-valued use and users, and
- not providing the proper price signal for current and potential suppliers to increase supply.

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If price can't perform the critical rationing function, then other mechanisms must do so. These could include consumers waiting in long gas lines, employing special knowledge or contacts to get deals on gas that other motorists are not privy to, using technology to scour suppliers for better prices, or relying on luck. Such non-price rationing was typical in old-style Soviet economies or in modern Venezuela where the average shopper spends 35 hours a month waiting in line for price-controlled goods. It was also part of the rationing process when President Richard Nixon imposed price controls on gasoline in 1973, triggering customers to spend up to three hours in lines at gas stations while gas retailers reduced the quality of their services.

During World War II, federal price controls triggered shortages for which ration cards and federal coupons were required to purchase many goods. This led to black markets and other rule-breaking such as selling or giving coupons to friends.

Recently in these pages ("Anti-Price Gouging Laws: Why a Pandemic Is Different from Other Emergencies," Summer 2022), I described how a pandemic differs from other emergencies (such as a hurricane) in which APGLs can be triggered. These differences include:

- A pandemic is worldwide scope.
- It has a much longer duration than typical emergencies.
- There is no physical destruction wrought by a pandemic.
- A pandemic is driven by infection.

The first three of these characteristics are also present in the current energy price spike. Gas prices are soaring around the globe and price controls implemented in the United States will only redirect supply elsewhere. These prices are likely to persist for months if not longer because the potential to increase supply is greater in the long run. And the lack of physical destruction makes it easier for consumers to horde—and they will be more tempted

to do so if an APGL is instituted, a hallmark of price controls.

Policy recommendations / High American gasoline demand (4.5 times more than China's) is the largest economic factor driving world gasoline prices. On the supply side, the petroleum industry is a fundamentally high-risk industry; price and revenue swings over time are consistent with this risk. And industry risk has been accentuated by a variety of government policies. Because U.S. oil companies have a low level of market concentration (none have more than 5% of the U.S. market and far smaller percentages worldwide), they don't have much control over prices in a fundamentally global market.

Given those facts, my policy recommendations regarding APGLs in a gas price spike are very similar to my recommendations for them in a pandemic. The costs and unintended consequences of any APGLs make them bad policy; however, if political concerns lead policymakers to believe they must implement or trigger an APGL, they should do the following:

First, tone down the rhetoric with respect to APGLs. It can send the wrong signal to businesses that are contemplating expanding supply. Raising prices is not "fraud" nor a "scam." Government threats also reduce the good will companies hope to obtain from voluntarily limiting prices.

Second, APGLs should have specific percentage price increase caps (perhaps with reference to a cost component such as the price of crude oil) and not rely on vague language about increases that are "excessive," "exploitive," or "exorbitant." Vague language heightens business risk and will raise the costs of "litigating" price gouging claims.

Third, the specific price increase cap should not be 0%—that is, APGLs should not prohibit *any* increase. Such limits are inconsistent with normal business; market prices must react to shifts in supply and demand—especially shifts as dramatic as we have seen in both the waxing and waning of the pandemic.

Fourth, the standard for declaring an emergency should be established; otherwise, every consumer inconvenience becomes an "emergency" in search of government intervention. If an APGL is triggered (via an emergency declaration), policymakers should either state with specificity when the emergency will end or provide additional upward price flexibility over time.

Policymakers must also recognize that consumers will make judgments about the prudence of price changes by suppliers. Unfortunately, this can trigger unintended supply responses. In the wake of Hurricane Ike in 2008, for instance, Texas Tech economist Michael Giberson reported:

> Over 4,300 [gasoline] price gouging complaints were received by the [South Carolina] Attorney General's office in the post-Hurricane Ike period. ... At the same time, a number of [gas] station owners reported that, to avoid bad publicity, they simply shut their doors instead of purchasing gasoline at elevated prices.

For a highly regulated and intrinsically risky industry, one of the best ways to keep companies from re-investing in petroleum product supply is to threaten invoking APGLs.

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FEEBATES

In a June 22, 2022, *USA Today* op-ed, University of Massachusetts, Amherst economist James K. Boyce proposed the federal government adopt a "feebate" program financed in part by a "windfall profits tax" on American oil companies. The proceeds would be distributed to Americans on either a family or individual basis.

This proposal raises some questions. Would corn farmers and ethanol refineries also be subject to this tax, as they also provide motor fuel and are benefiting from the current gas price spike? Would petroleum companies receive a government kickback in the future if their profits drop to low levels or they incur losses and bankruptcies like in 2020 (causing U.S. refinery capacity to fall 4.5%)? Moreover, imposing such a tax would require the defining of "windfall profit," and that would be fraught with legal, accounting, and administrative problems. And it would increase risks for petroleum product suppliers.

Concerning foreign suppliers, which seemingly would not be subject to a U.S. windfall profits tax, Boyce suggested the United States should "auction permits for fuel suppliers," by which he seemed to mean that foreign oil companies should be required to bid for access to the American market. But the market already performs such an "auctioning" function: the lowest-cost provider (at any specific location) is the one

that is utilized. In some instances, this involves product crossing international borders.

To evaluate this idea, some important facts should be kept in mind about U.S. oil imports and exports. In 2019, the country imported 9.14 million barrels of oil a day and exported 8.47 million barrels. Further, the United States was a net exporter of refined petroleum products. Why would the United States both import and export oil? One reason is that oil is not a homogenous substance; different types of oil are easier or harder to refine for different products. Another reason is that in a geographically large country like the United States, foreign supplies may be cheaper on net in some areas than domestic supplies. Moreover, the country's chief sources of foreign supply are Canada and Mexico, which in 2019 accounted for nearly five times as much imported oil as more nefarious suppliers like Russia and Saudi Arabia.

With commodities like petroleum products, attempts to punish particular suppliers such as the Saudis and Russians are doomed to failure unless the vast majority of countries in the world simultaneously engage in the same punishment. Restricting imports or increasing tariffs on one exporter will cause other importers (such as India or South Korea) to simply buy more of the Saudi supply, while the United States buys from other sources (that likely previously supplied India and South Korea). This would increase exchange complexity and transport costs for oil but would mete out little punishment on the targeted exporters.

Petroleum and petroleum distillates are a world market. Any attempts to increase taxes within the United States will cause product to be diverted elsewhere in the world. If one wishes to redistribute sudden, new oil company profits, there are far less complex methods to do so than windfall profits taxes, foreign supplier permit auctions, and "feebate" checks. And without reverse compensation to petroleum companies in times of "windfall losses," a windfall profits tax may be tantamount to confiscating property without due process, is fundamentally unfair, increases risk in the industry, and reduces domestic supply. All told, by penalizing domestic supply and complicating foreign supply, Boyce's effort to redistribute income in the United States so that "low-income households come out ahead" would be a costly and cumbersome way to benefit those households.

GAS TAX HOLIDAYS

Some policymakers have called for—and even adopted—temporary suspensions of gas taxes that are used to fund road construction and maintenance. Is this a good idea?

Consider a basic principle: people should pay for the goods and services they use. For example, the U.S. Postal Service should charge prices for its services sufficient to pay its costs. For some services, this is more difficult. Infrastructure investments in roads and bridges provide transportation services to the businesses and individuals that use them. As a theoretical matter, one could charge tolls for this infrastructure, but as a practical matter fuel taxes (and vehicle registration fees as electric vehicle penetration increases) can act as a decent proxy for tolls where tolls are administratively costly.

The Tax Foundation suggests that "states should attempt to fund infrastructure through user taxes and fees as much as possible, internalizing the costs associated with using the state's transportation systems." However, in the United States in fiscal year 2019, state and local gasoline and license fees accounted for just 40.4% of state and local road expenses, while tolls and user fees contributed an additional 12.6%. This left 47% of state and local road expenses to be recovered via other sources such as income or sales taxes. (In contrast, federal fuel taxes and transportation fees do a good job of financing federal highway spending.)

What happens when user fees and fuel taxes are not sufficient to pay for transportation costs? First, it's not fair. People who decide to work from home or locate closer to work end up subsidizing (through other taxes) people driving longer distances. Second, subsidizing roads sends the wrong signal to users (and producers): they think use of the road system is cheaper than it actually is. In contrast, user fees (fuel taxes, tolls, and vehicle registration fees) cause the users of roads and bridges to bear the costs of their decisions. It also encourages vehicle manufacturers to respond with more fuel-efficient choices and may even trigger broadband investments (and higher telecommute rates) as consumers search for alternatives.

A gasoline tax "holiday" is obviously counter to the goals of infrastructure construction and having users pay for the services they use (in this case roads). It also sends a slightly more distorted price signal to consumers, encouraging continued high gasoline consumption.

CONCLUSION

Gas price spikes grab the attention of consumers and elected policymakers, and the current spike is even more significant because of the 2022 midterm elections. Policymakers badly want to do *something*—or, at least, *be seen* as doing something—to help motorists. Proposals such as APGLs, redistribution of oil company profits, and suspension of gas taxes certainly seem to be good things: helping (voting) Americans while punishing apparent villains.

But the market signals being sent by the current price spikes are important: incentivizing consumers to conserve and oil producers and refiners to invest in output. Obstructing these signals and breaking the connection between road use and road funding will ultimately not make Americans better off. *R*

READINGS

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