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The Economics and Politics of Oil Price Regulation, Joseph P. Kalt

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THE ECONOMICS AND POLITICS OF OIL PRICE REGULATION

JOSEPH P. KALT
Cambridge: MIT Press. 1983. Pp. 372. $12.50

This volume, subtitled "Federal Policy in the Post-Embargo Era," is one of the MIT Press Series on the Regulation of Economic Activity. It was published over two years ago; the present review is of the paperback edition issued in 1983.

As the subtitle indicates, the book is concerned with regulation of oil prices during the period 1973–80, with a retrospective glance at 1971 when price regulation began, but not much at the period of promotion, protectionism and prorationing of oil before that. It is unfortunate that the analysis could not have included the post-deregulation era from early 1981 to the present. The behavior of prices and the distribution of gains since 1981 would have provided a useful additional comparative test of some of the author's findings—particularly of his strongly felt conviction that the multi-level Windfall Profits Tax perpetuates regulation on the supply side of the market by substituting tax-based regulation for price controls.

The study originated as a Ph.D. dissertation, but it is remarkably free of the clutter of unnecessary detail that frequently mars published theses. Kalt's major findings are clear, concisely expressed, and supported by analysis that is deft and thorough, making use of the best theoretical and quantitative methods available to the specialist in industrial organization. His estimates of the net transfers of economic rent and of the deadweight losses associated with price controls are pioneering applications of the methodology, and are entirely convincing. This volume should be—and probably has already become—a standard addition to every energy economist's library. Among other things, its catalogue of federal oil regulations during the decade of the 1970s is highly useful.

Professor Kalt's findings on the central issues of allocation efficiency and redistributive effects are:

(1) U.S. oil policy in the 1970s was largely a response to conflicts over distribution of income and the redistributive effects of very large price increases of petroleum, not to any "massive failure of domestic markets to allocate energy resources optimally" (p. 293).

(2) Multi-tier crude oil price ceilings combined with the entitlements program which redistributed surpluses did hold domestic crude prices below levels that they would have attained without controls, but at the same time they reduced domestic crude oil output in a range of 0.3 to

1.4 million barrels per day and subsidized crude oil imports to the extent of 10 to 20 percent of their cost.

(3) Controls diverted huge amounts of economic rent from domestic crude producers to others; over the decade, about 60 percent went to refiners, and about 40 percent to refined-product consumers. However, the deadweight losses resulting from the controls extinguished some of these rents. For example, Kalt estimates that in 1979 some $32.6 billion was transferred from crude oil producers, of which $21.8 billion went to refiners and $8.3 billion to consumers, while the economy suffered deadweight losses of $2.5 billion (p. 216).

(4) The Windfall Profits Tax will probably reduce domestic production of crude by some 1 million barrels per day, and produce deadweight losses of $1–2 billion per year.

The author includes an analysis of the political economy of oil price controls, which is interesting though somewhat convoluted. The voting behavior of members of the Senate on petroleum regulations shows that they have not always voted for the economic interests of their constituents; some votes have been motivated by what Kalt calls "altruism" or alternatively "ideology"—the conception of the "public interest" held by the legislator. Whether such controls really have been in the public interest by any meaningful standard for that phase is, of course, what every reader of the book will have to decide for himself. There is no way to judge the actual redistributions by any objective test, but the author shows that if distributive "justice" was the aim of the policy it was bought at considerable cost in allocative efficiency (lost income and output), and implies that its actual redistributive effects have not been entirely in the direction of greater equity. These inferences once more affirm the view held by most economists that price controls on commodities are poor instruments for "improving" the distribution of income.

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