Why price controls and windfall taxes do not work

Let me begin by making it clear I do want government to ensure everyone has sufficient money to be able to keep warm and do their cooking this winter. That is best done by allowing people to keep more of their income through tax cuts , or by giving people more in benefits to cover the bills who cannot earn. This blog is about the underlying problem of high prices and how you solve them.

Most people want there to be an easy answer to the ultra high prices of energy. Some say just stop any price increase for any energy sold to anyone. Some say control the prices of oil and gas that producers from UK reserves can charge us. Some say stop the renewable producers charging the same price for their electricity that the gas based producers have to charge now the gas price has gone up. Maybe there is a way to do the latter that the industry would accept, but they do need to be able to make a profit on their investments and need some long term visibility on contracts. The first proposal would stop all price rises. The second and third would stop some of the price rises, but would leave us paying the new high prices for all imported fuels and for the items of domestic production they leave out.

All these schemes mean government to a greater or lesser extent stops price doing what price will always do, balancing available supply with available demand. Higher prices now surging if left in place will solve the imbalance. All those in business or on better incomes who can economise on their power use will now do so, reducing demand. The state will need to rein in its extravagant use of energy by reviewing its over night street lighting, its heating and lighting of little used offices and the rest. Better off households will reach for the thermostat or timers to slice a bit off their past use. So demand will fall.

More importantly the price signal will incentivise businesses to put in more capacity to produce energy. Oil and gas producers will be encouraged to bring forward marginal new prospects that used to be uneconomic for development. Renewable investors will have more profits to plough back into additional capacity or into all important storage. In the short term energy companies will sweat their current assets more to maximise output. In the medium term they will add to their stock of producing assets and in the longer term the whole industry stands a better chance of achieving major commercial throughs with nuclear, battery, hydrogen and other technologies.

If you stop the energy industries in the UK earning the extra revenue from high global prices you will divert profit and investment capital away to countries that do allow them the benefits. If you stop them charging world prices they will divert as much of their current product as possible to markets where they can charge more. Anyway you look at it, price controls prevent more supply and impede lower demand from energy saving. It is no accident that the countries that have relied most on price controls are often those in the lower income bands worldwide, short of domestic supply. I will deal with those who think that means the answer is nationalisation in a later blog. That too would make the position worse.