Our View: Repeating History – California's Coming Gasoline Catastrophe

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California politicians have just enacted legislation that guarantees the state's residents and visitors will pay higher gasoline prices this year than in 2022, even if crude oil prices fall. In doing so, they are repeating a mistake made by price control advocates fifty years ago.

The new legislation limits the margins California refiners can earn for producing gasoline. The theory is that retail prices will be lower because the refiners cannot collect "excess profits."

The US government introduced an identical program on March 6, 1973, that became an economic disaster. Consumers paid much higher prices because those crafting the price controls then, like the economists and California legislators today, did not understand petroleum industry basics.

Charles Owens described the government's miscue in a 1974 US Treasury publication. He explained that the US imposed controls on crude oil prices oil and refining margins in March 1973 on firms with annual sales of more than $250 million.

He added that the rule failed because "it was not universally applied." It affected only the twenty-four largest companies. He observed that those writing the regulation believed those companies dictated price competition at all levels. Indeed, the firms were thought to rule ninety-five percent of the business.

According to Owens, the regulation also failed because the integrated companies owned no retail stations. He concluded, "The fallacy in the Phase II premise was the belief that the 24 companies actually controlled industry pricing." He pointed out that such companies lost control when shortages occurred.

California's rule will fail for the same reason. Much of the gasoline consumed there is produced by refineries within the state. However, these refiners can also ship their production to Arizona, Nevada, Washington, or Oregon. To avoid margin controls, the firms will increase their out-of-state shipments. They can also export their products to Canada or Mexico and will do so when the economics dictate it.

The increased movement of California-refined gasoline out of state will force marketers there to import products from other states or countries. These volumes will not be subject to the margin controls, and prices could shoot up if markets are tight. Most of these imports will be sold to independent marketers rather than dealers connected to the refinery owners in California. Those buying the high-cost imported fuel will pass that expense on to consumers, who may pay as much as $10 per gallon.

Amoco and other "branded" marketers in California set their prices based on those posted by other stations. Thus, the price hikes implemented by independent marketers will spread to all stations. Retail margins and profits will set new records.

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Mark Twain is credited for writing that history does not repeat but does rhyme. In this case, though, history is on replay. Margin controls did not work in an open economy fifty years ago and will not work today.

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