The Daily Dish

Price Controls – an Economic and Political Trap

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The Financial Times has a nice piece on electricity rates and the affordability debate in the United States. Eakinomics thinks there are two main takeaways. The first is that industrial policy has bigger costs than just backing the wrong horse in the chosen industry. In the United States, artificial intelligence (AI) is the national priority/industrial policy target of the moment. That means it is important to keep the costs of development down, and electricity is a key input to that development. In short, in Eakinomics' experience, there are spillovers from the industrial policy. In this case, the focus on AI generates a need for electricity rates to be kept (artificially) low for data centers and other AI infrastructure.

The second takeaway is that it is proving impossible to shift those electricity costs to households. The president campaigned on energy abundance (if not dominance) and the promise to bring prices down. While a global oil glut has made gasoline cheaper, other energy costs – especially electricity – are on the rise. As noted above, the AI supply chain is hands-off, and passing costs along to industrial customers is at odds with the promise to re-shore and expand domestic manufacturing. By process of elimination, that leaves households. And they don't like the idea.

What happens? In Pennsylvania, price controls are the solution, with a price: "…independent power producers say that price caps, introduced by Pennsylvania's Governor Josh Shapiro to protect consumers, disincentivise the building of new generation capacity." But price controls don't just fail. They actually make the problem worse. Generators not only fail to add new capacity, they have incentives to skimp on maintenance and upgrades, and service suffers. Nobody – not AI, not manufacturers, not households – gets the power they want and policymakers have decided they need. This is the economic trap.

It is also a political trap. The industrial policy pursuit turns out to be a failure, undercut by the absence of reliable AI infrastructure. The affordability issue morphs into a broader economic malaise due to the poor innovation and manufacturing incentives – and the jobs that fail to materialize.

The bottom line is that the cure for high prices is, in fact, high prices. Only prices high enough to incentivize new supply have any impact. Unfortunately, that process simply does not happen overnight. But it should be allowed to occur.