

Does energy price regulation benefit national economy?

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Abstract:

Liberalizing of energy prices has been recognized as a necessary step to build an integrated East Asian energy market. However, national government may still want to keep the price regulation on the ground that such management will help migration the price volatility of oil imports. This study hypothesizes that price distortion due to the regulation of energy pricing in the domestic market will hurt economic output. To test this hypothesis, this paper demonstrates how energy (gasoline) price distortion will worsen the negative impact of oil price shocks on the national economic output through a two sector economic growth model. Based on the model, the paper identifies an empirical model and uses China's data for estimation. The paper contribute to the literature by innovatively incorporate energy price distortion in the existing studies on oil price-macroeconomy nexus. It demonstrates that oil price distortion indeed hurts industrial growth in the short run and the negative impact from domestic oil price distortion persists to the long run. The negative impact of oil price distortion appears to be robust to different measures of industrial production and oil price distortion. This study provides an additional justification for energy price deregulation: any policies and interventions, such as subsidies and price regulations, that may distort domestic energy prices, should be removed.

Key words: price regulation; macroeconomy; price distortion; China

JEL classification: C02, E23, Q43

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