

## **Our View: Windfall Taxes – Down the Rabbit Hole**

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Boris Johnson's government has finally caved to calls for a windfall profit tax on energy company profits. His finance minister, Rishi Sunak, just announced a 25% surcharge on the "extraordinary profit the oil and gas sector is making." The taxes will likely be extended to electric generators and other energy providers shortly.

For a few of us, this is, to quote the great philosopher and baseball catcher Yogi Berra, "Deja vu all over again." In 1979, US President Jimmy Carter was finally convinced to remove price controls on crude and petroleum products. At the time, I was an adviser to US Secretary of the Treasury Michael Blumenthal. Blumenthal had pushed aggressively for price decontrol at a time when the dollar was under extreme pressure due to US inflation.

Today, the UK faces similar pressures. Huw Pill, the Bank of England's chief economist, told the Association of Chartered Certified Accountants this week that the Bank expects inflation to reach more than 10% by October.

Higher energy prices are one of the causes. A recent survey reports that one in five Britons struggles to pay bills today. Revenues from the windfall tax will finance grants of £650 to more than eight million households in the country. Pensioners will also receive payments and energy bill subsidies.

The UK tax will do nothing to slow inflation. It may, though, help strengthen the pound in the short term, just as the US decontrol contributed to a short-term strengthening of the dollar.

Many believe the UK tax will suppress investment in oil and gas there, just as some asserted that the 1980 US windfall profits tax and the 1974 version of the British Petroleum Revenue Tax (PRT) did.

The PRT features a "ring-fence" that prevents the profits earned on one field from being transferred to another. The rate peaked at 75% under Prime Minister Thatcher's regime, but firms could get some relief by reinvesting earnings in specific fields. Many claimed at the time that the excessive tax would stop investment.

The UK's new Energy Profits Levy, which takes effect today, May 26, includes provisions similar to the PRT's. While it provides incentives to reinvest, the law prohibits companies from offsetting previous losses or deducting decommissioning expenses in their tax liability calculations. The limitation on decommissioning costs may be significant, given the accelerating decline of old fields in the North Sea.

The oil industry has a perfect record of opposing these types of taxes. In 1979, industry executives repeatedly told us that the taxation of profits associated with decontrol would suppress US oil and gas exploration investment. UK officials heard the same story. When Minister Sunak announced the Energy Profits Levy, BP's immediate response was that it would "look again" at its UK investment plans.

This is a very old story for BP. The company, which claims to be concerned about global warming and the good of society, has always complained about any taxes imposed on it. Perhaps BP should change its signature color from green to black.

The data refute the “investment killer” assertions. Fewer than 2,000 rigs were in operation when decontrol was announced in the United States. Two years later, the rigs in operation peaked at 4,500, a record that remains unbroken. Capital expenditures on exploration rose from \$18 billion in 1978, the year before decontrol, to \$50 billion in 1981, according to a 1983 Chase Bank survey.

The same survey shows that capital expenditures in Europe rose from \$6 billion in 1978 to more than \$10 billion in 1983. (Note that the study does not separate data for Norway and the UK.)

In retrospect, the evidence confirms a line from Shakespeare quoted by a senior official in the Carter administration when rebuked in 1979 by an oil company official: “The lady doth protest too much, methinks.”

Investment in UK oil fields will likely proceed at planned rates despite the new taxes if prices remain high. History demonstrates that price uncertainty, not taxation policy, has the greatest impact on exploration activity.