The Daily Dish

Beware the WPT

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"Exxon made more money than God this year." That was the president of the United States complaining that the oil company was somehow at fault for the current state of global oil supply, global oil prices, and global gasoline prices. (Emphasis on global.). It was also a prelude to "…start paying your taxes," which Eakinomics interprets as a leading indicator of the president calling for a windfall profits tax (WPT).

Gordon Gray and Keith Bray anticipated this development months ago, noting that high gas prices were a political invitation for tax policy meant to punish oil companies – that is, a confiscatory tax on their "windfall profits." We've seen this movie before in the United States. As Gray and Bray noted:

> In 1980, President Jimmy Carter signed into law the Crude Oil Windfall Profit Tax Act. It would be repealed eight years later by a bipartisan coalition. Fundamentally, the tax was repealed because it was eventually recognized as a demonstrable policy failure. It was not a windfall profits tax. Rather, it was simply a 70 percent excise tax on the difference between the market price for domestically produced oil and a statutory threshold. But irrespective of any statutory price, the price of oil is set by global markets. The excise simply made U.S.-produced oil more expensive. In 2006, the Congressional Research Service estimated that the WPT reduced domestic oil production between 1980–1988 by anywhere from 1.2–8.0 percent, or about 320–1,269 million barrels. At the same time, reliance on imported oil grew from somewhere between 3–13 percent. Not coincidentally, revenue collected by the tax similarly disappointed. An August 1987 Congressional Budget Office report found that the WPT collected $34.7 billion less than it was expected to between 1980–1987.

In short, the WPT did not lower the demand for oil, did not raise the supply of oil, did not reduce the price of oil, and did not deliver a political win. As noted, however, it also did not tax profits. An alternative would be to apply a tax to the excess of adjusted taxable income in the "high oil price" year over taxable income in a "normal" year. Or, the tax could be on profits above a legislatively determined rate of return. In either case, it taxes higher profits regardless of the source of the increase, thus disincentivizing profit-making opportunities outside of those delivered by higher global prices. The end result would be the same – less supply and no price relief.