

# Chapter 7

## Raising Taxes May Harm Energy Supplies

*Ben Lieberman*

We will energize America by achieving energy independence, and we will begin by rolling back the multi-billion dollar subsidies for Big Oil.

—INCOMING HOUSE SPEAKER NANCY PELOSI (D-CA)

In response to continued high oil and natural gas prices, the House of Representatives has pledged to “begin by rolling back the multi-billion dollar subsidies for Big Oil.” Although it is not yet clear what this entails, Congress will likely try to amend or repeal several tax code provisions with the goal of raising the overall taxes paid by the energy sector. This is the wrong approach to meeting the energy needs of the American people because it will likely lead to reduced energy supplies and higher prices.

### **No Solution**

Specifically, the House may consider changes to the treatment of so-called intangible drilling costs, the manufacturing deduction under the American Jobs Creation Act of 2004, the amortization of geological and geophysical costs under the Energy Policy Act of 2005, or other tax-related measures. The effect of these changes would be to reduce deductions against income and thereby raise taxes on energy companies.

This is not a solution to high energy prices. Simply put, the current tax code has absolutely nothing to do with the recent increase in energy prices, so tinkering with the code will at best accomplish nothing and at worst could prove counterproductive over the long term.

For one thing, the underlying assertion that the domestic energy sector is undertaxed is erroneous. By some measures, the sector’s overall effective tax rates are actually higher than the market average. Furthermore, increasing taxes on U.S. companies would only give a comparative advantage to OPEC and other foreign suppliers that are not subject to such provisions.

### **Unintended Consequences**

Worst of all, higher taxes may cause harm in the long run by discouraging investment in new domestic production of oil and gas. America’s demand for energy is growing with its economy, so it needs more domestic oil and natural gas production in the years ahead, not less. However, higher taxes would move America in the exact opposite direction because they would leave the industry with less after-tax revenues to reinvest in new exploration and production. Higher taxes would also make new projects less economically attractive.

The bottom line is that the proposals to raise energy taxes would lead to lower domestic supplies of oil and gas, increased imports to fill the void, and ultimately higher prices for consumers.

Indeed, the lesson of the infamous windfall profit tax on oil imposed under the Carter Administration in 1980 and repealed under the Reagan Administration in 1988 is that energy tax increases can backfire and end up hurting consumers by reducing domestic energy supplies. In 1980, anger at “Big Oil” over high prices led to this punitive

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measure, but America learned the hard way that this approach does not benefit the American people. The new Congress should not repeat the mistakes of the Carter Administration.

### **Expand Domestic Energy Supplies**

The answer to high energy prices is not to raise the effective tax rates on existing domestic energy supplies, but to expand domestic energy supplies so that more oil and gas is available. Recent Department of the Interior studies, conducted pursuant to the 2005 energy bill, confirm that the United States has substantial oil and natural gas deposits. These studies also show that much of these onshore and offshore resources are off-limits due to legal and regulatory constraints. In fact, America remains the only nation on earth that has restricted access to a substantial portion of its domestic energy potential. Streamlining or eliminating these restrictions on domestic exploration and drilling—not rewriting the tax code—will allow for greater supplies and lower prices in the years ahead. This should be the main focus of any genuinely pro-consumer energy policy from Congress.