Why a $100/barrel oil price and various petroleum taxes don't mix

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Oil price, like the price of any other commodities and services, is driven mainly by the dynamics of supply and demand. High demand relative to supply means prices will go up. High supply relative to demand means prices will go down. And there are dozens of factors that determine both supply and demand. For instance, when millions of newly-riched Chinese and Indians, plus other people around the world buy new cars, then demand goes up. When oil producing-countries (OPEC or non-OPEC member-countries alike) pump more oil, and there are no supply disruptions (meaning no oil refinery or oil pipeline is blown up by bombs or knocked down by hurricanes), then supply goes up. But even if crude supply increases but oil pipelines are blasted, like the attack on pipelines in Yemen the other day, then supply can still go down, adding fears to oil consumers and traders, which further push prices up.

Yesterday, world oil prices hit $98 a barrel, or just $2 away from the symbolic 3-digit level of $100 a barrel. This is partly due to the fact that despite continuing world oil price hikes in the past few months, world demand does not decline, staying at 85 million barrels a day on average.

Should oil prices finally reach $100 a barrel and stabilize there for say, one month, if not rise further, then it should be the right time for governments to cut petroleum taxes. In the Philippines there are at least 3 direct taxes slapped on petroleum products -- import tax (3%), excise tax (more than P5/liter for gasoline), and value-added tax (12%). Not included here are taxes slapped on companies that refine, distribute, and sell (wholesale and retail) oil.

The Philippine government says it is lukewarm to reduce or abolish the import duties. The DOE and DOF leadership say doing so will deprive the state of some P450 million/month in revenues while the people will only save around P0.23/liter. But what if a motorist, say a taxi driver, is consuming 60 liters a day or more, that's a savings of around P14 a day. And there are more than 35,000 taxi units in Metro Manila alone. Another way of looking at this is that if the government will abolish the import duties, then the Filipino people will have P450 million/month of additional money in their pockets.

The continued imposition of excise tax on petroleum products is a callous decision. Excise tax is slapped on so-called "public bads" – petroleum (causes pollution), tobacco and alcohol products (can cause diseases to people). But is petroleum a "public bad"? People who do not want pollution from petroleum products should ride carabaos, horses or bicycles. A few people do this, but the majority can not. The use of petroleum to power vehicles that move people and their goods and services over far away places, is as necessary as food, clothing and shelter. Thus, abolition, or at least drastic reduction, of excise tax on petroleum products should be another measure that government should consider if it is honest in saying that it cares for the people.

The 12% VAT on oil products is possibly the only tax that can be retained. A zero import tax, zero excise tax, and 12% VAT, should be the best compromise between the public and the state to cushion an ever-increasing world oil prices without depleting the state's coffers.

Oil taxes and horses

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In a society of abundance and freedom, people have lots of options and choices of what to do and what to consume, when, where, by how much, and so on. In moving themselves and their goods and services for instance, there are plenty of horses and carabaos, bicycles and skateboards, motorcycles and cars, boats and planes, to choose from. People who are very environment-sensitive will ride bicycles or skateboards to transport themselves, and they may opt to use horses and carabaos to transport their goods or their young kids. While less physically-able people will ride cars or motorcycles or planes.

When governments around the world began expanding to huge bureaucracies, they naturally needed huge taxes and fees, plus huge loans and debts, to sustain themselves. And among the compulsory collections they invented were various taxes on petroleum products. Oil products, after all, cause pollution, which contribute to global warming; hence, consumption of oil products should be "discouraged" whenever possible. In the Philippines, at least 3 different taxes are slapped on oil products: import tax, excise tax, and value-added tax (VAT). In addition, there are various taxes on companies that refine or import or retail petroleum products.

After imposing various oil taxes, some governments also regulated oil prices. This way, they play heroes twice: first they raise the price of oil products through various taxes to "limit pollution", and second, they control oil prices so that they will not rise as often or as high as the "profit-hungry" oil companies would want them to be. And there are many people who clap their hands with this "twice hero" acts of governments.

At the start of 2008, world oil prices have touched the symbolic 3-digit level of $100 a barrel. After that, there were moves and proposals among Philippine government officials and politicians to remove the import tax and/or the VAT on oil products. Other groups and politicians wanted more, to re-regulate the oil industry and oil prices. That is, before any increase in the pump-price, there should be public hearings first, then get the nod and approval of government energy bureaucrats second. Local oil prices therefore, will not be a function of world oil prices, but of bureaucrats' approval or disapproval of price adjustments.

Removing the VAT on oil products violate the "rule of law" principle. The law should apply to all or none at all, right? If the state continues collecting the 12% VAT on medicines despite government's pronouncements to have "cheaper medicines", then there is no logic in exempting oil products from VAT.

What should be cut or removed instead, aside from the import tax, is the excise tax on petroleum products. Excise tax is slapped on three so-called “public bads” – petroleum (causes pollution), tobacco and alcohol products (causes diseases). But petroleum is not a “public bad”. Try using thousands of horses and carabaos to reduce pollution, in transporting rice, fruits, vegetables, fishery and meat products from the provinces 100+ or 200+ kilometers away from the urban consumers. We will not only have tons upon tons of animal manures on the roads and public plazas, we will also have tons upon tons of those spoiled and rotten food products. And then we will have high food prices, which will worsen poverty. And what’s next, tax the owners of those horses and carabaos and use the tax proceeds to subsidize the food consumption of the poor?

Perhaps a better way to stabilize oil prices since petroleum products are public goods anyway, is a reduction, if not abolition, of the bureaucracy in the Department of Energy. This way, there can be real “twice hero” function of government: less bureaucracy could translate to less taxes, and less regulation could translate to less oligopolies and more competition.