The Oil Drum: Europe
DISCUSSIONS ABOUT ENERGY AND OUR FUTURE

A Tuppence Extra?

Posted by Chris Vernon on October 2, 2007 - 8:00pm in The Oil Drum: Europe
Topic: Economics/Finance
Tags: duty, fuel, petrol, taxation, united kingdom [list all tags]

On Monday the 1st October 2007 the UK government increased the ***duty*** on a litre of petrol and diesel by two pence taking the duty to 50.35 pence per litre (ppl). This is the first of three increases announced in the last budget. Duty will be increased by a further 2 ppl on 1st April 2008 and 1.84 ppl on 1st April 2009 (Duty Rates .pdf).

The increase has been almost unanimously criticised by the UK motorist, not just because it's a tax but because it takes UK fuel prices perilously close to the psychological barrier of £1 per litre. On the www.petrolprices.com site a survey receiving 80,000 votes in just a few days indicated 90% in favour of the following statement:

> Should the government do a U turn and scrap the extra 2.35p tax on fuel because of unexpectedly high oil prices already hitting motorists hard?

Despite everyone talking about petrol prices it seems that many people don't understand how that price comes about and certainly have no awareness of the approaching decline in global oil production.

There are three components to the price at the pump:

- Price of the product
- Excise duty
- Value Added Tax (VAT) - a percentage

The price per litre at the pump is simply:

Price of the product + Excise duty + VAT

In September 2007 the UK national average price stood at 95.2 pence for unleaded 95 octane petrol (AA fuel price reports). With an exchange rate of $2.04 to a pound that is equal to $7.39 per US gallon. Working backwards we can see how the UK price is arrived at:

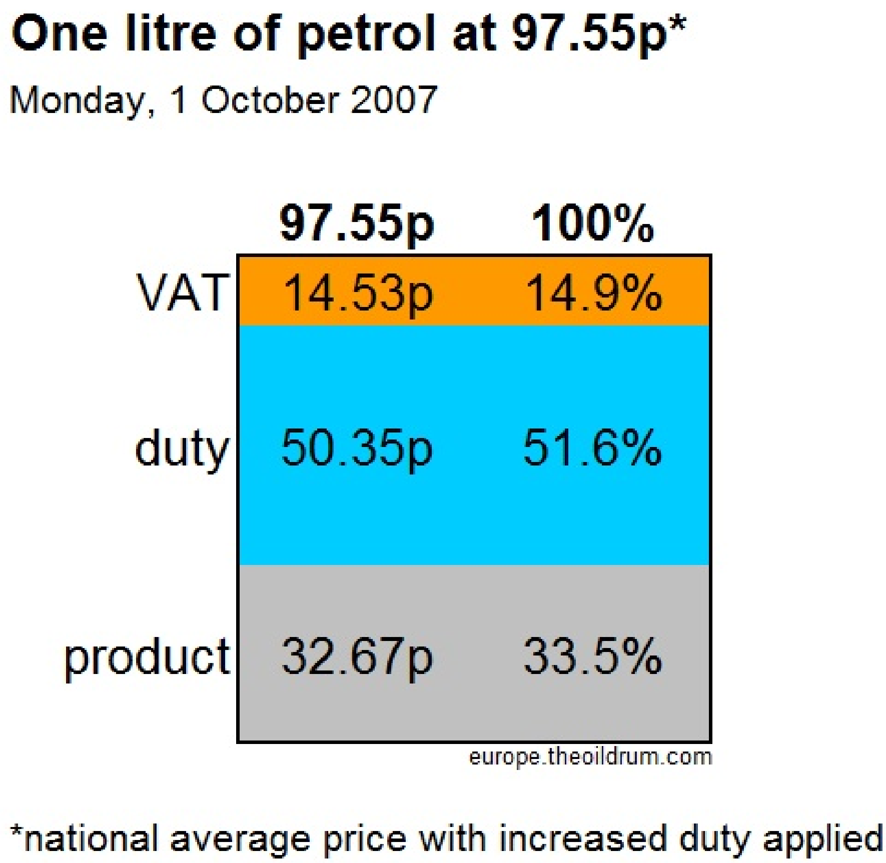
First the VAT at 17.5%, which on 95.2p is 14.2p.

Second the duty, which until 1st Oct 2007 stood at 48.35 ppl.

Subtracting the two forms of taxation from the sticker price leaves a product price of 32.67 ppl or 34% of the sticker price. The taxation therefore accounts for 62.53 pence or 66%.

Increased Duty

With the recent 2p (2.35p with the additional VAT) increase taking the duty to 50.35 ppl and assuming the product price remains the same the breakdown will look like this:



Response to Product Price Change

If the product were to increase in price by 30% (approximately $100 oil) from 32.67 ppl to 42.47 ppl what would happen?

The sticker price would become 42.47 + 50.35 + 17.5% = 109.06p. An increase of only 11.8% and the rate of tax would fall from 66.5% to 61.1%, albeit increasing by 1.71p per litre.

A feature of a high fixed taxation, the excise duty, is this damping effect of product price variations on the sticker price. In countries with little or no element of fixed duty such variation in the product price would have a much greater effect at the pump.

The petrolprices.com Survey

It's fair to say the vast majority don't like this duty increase, despite it only keeping up with inflation. I on the other hand welcome it and the subsequent increases already announced (yes I do drive a car, albeit a relatively efficient diesel).

It is clear that the UK will have to use less oil in the future. In 1999 the UK was the 9th largest oil producer in the world. A third of the country's North Sea oil production was exported delivering billions to treasury coffers each year. Since that peak year, production rates have fallen dramatically. So far in fact, that in 2006 the country was a net importer of oil for the first time since 1980. The treasury receipts have been replaced with a growing trade deficit, a trend only expected to continue and to be exacerbated by any increases in the price of oil.

Increasing reliance on imported oil against a backdrop of tightening global supplies and in competition with the rapidly expanding economies and healthy trade surpluses of India and China presents the UK with a problem. Maintaining the current oil consumption of 1.7 million barrels per day into the future will become increasingly expensive and ultimately no longer viable.

High and increasing levels of duty on fuel are certainly not the whole answer, but they provide a degree of price control, damping future volatility and providing a strong price signal in advance of that delivered by the actual price of oil. This advanced price signal has two advantages, it reduces consumption from what it would otherwise have been by encouraging more efficient vehicles and reduced vehicle-miles travelled and also delivers revenue to our government in the form of tax receipts rather than wealth transfer to oil exporting nations.

It can be argued fuel duty is regressive, affecting the poor to a greater extent. However this can be mitigated whilst maintaining the benefits, through a tax credit.

So why is the majority opinion against the increase? Because, in my opinion, they are thinking only about the direct and immediate impact on their wallet and are simply unaware of the structural changes oil depletion will force upon the country in coming years.

What does The Oil Drum think? Should the fuel duty in the UK, already with some of the most heavily taxed fuel in the world, increase further?