Energy costs in Europe: economists discuss policy options

*In her September 2022 State of the Union address, the European Commission president Ursula von der Leyen called for windfall taxes on energy companies' profits. She also flagged the possibility of price caps to reduce household and business bills for gas and electricity, which have soared in recent months. **Romesh Vaitilingam** summarises the results of a survey by the Initiative on Global Markets, which invited US and European economists to express their views on the policy responses to the energy crisis.*

The survey of European economists took place in June 2022. We asked the experts whether they agreed or disagreed with the following statements, and, if so, how strongly and with what degree of confidence:

1. *A windfall tax on the excess profits of large oil and gas companies – with the revenue rebated to households – would be an efficient way to provide temporary relief for the average household in European countries from rising energy costs.*
2. *Fiscal measures putting a cap on consumer energy prices would be a more appropriate immediate response to increased inflation in the euro area than raising interest rates.*

Windfall taxes

Of our 48 European experts, 33 participated in this survey. On the first statement, there is a diversity of opinion. Weighted by each expert's confidence in their response, 4% of the panel strongly agree, 46% agree, 33% are uncertain, 17% disagree, and 0% strongly disagree.

The experts are able to include short comments in their responses, many of which add considerable nuance to their simple poll responses. For example, among those who agree, there are some notable caveats.

Ricardo Reis at the London School of Economics (LSE) states: 'Yes in principle, but highly uncertain effect on expectations of future taxes for lucky industries, subsidies when energy prices fall, etc.' Charles Wyplosz at the Graduate Institute, Geneva, says: 'It is a poor substitute for a fully-rebated carbon tax, but a better approach to raise revenues than a general tax or a deficit.' And Franklin Allen at Imperial College London comments: 'This redistribution may have some long-run effect on investment but seems appropriate given the current situation in many countries.'

Among those who say they are uncertain, several panelists note the challenges of implementing windfall taxes. Patrick Honohan at Trinity College Dublin remarks: 'The geopolitical circumstances could justify an excess profits tax, but operationalising it successfully in a multi-country world tricky.' And Nicholas Bloom at Stanford speaks from personal experience of having worked in government: 'Having been the official in charge of a windfall tax on oil firms in the UK in 2001, this is much more complex than it sounds.'

Other concerns mentioned by experts who say they are uncertain include those expressed by Jan Eeckhout at Universitat Pompeu Fabra in Barcelona: 'Tax inelastic supply (resources), by all means. Levy ad hoc taxes on ex post outcomes, not so sure. Norway example: 78% profits tax, always.' Costas Meghir at Yale adds: 'Excess profits are very hard to measure and profitability should be measured by the longer-run return to capital.' And Christian Leuz at Chicago Booth observes: 'The incidence of this tax is unclear but matters. Moreover, there are many issues with constitutionality and implementation of this tax.'

Among those who disagree with the statement, there are some strong views. Kjetil Storesletten at the University of Oslo protests: 'People invest because they think they can harvest the return. Ex post taxation infringes on property rights and kills investment incentives.' And Jan Pieter Krahnen at Goethe University Frankfurt concludes: 'Windfall profits in the energy sector and relief for poorer households are two different things that must not be connected directly.'

American perspectives

Similarly strong opinions were voiced by some members of our US panel when, in March 2022, we asked effectively the same question about policy on energy costs in the United States:

A windfall tax on the profits of large oil companies – with the revenue rebated to households – would provide an efficient means to protect the average US household from rising energy costs.

Of our 43 US experts, 36 participated in this survey; and while there was a similar diversity of opinion, they were more inclined to disagree with the statement than the European panel: nearly a half of US respondents compared with only a sixth of Europeans. Weighted by each expert's confidence in their response, 4% of the panel strongly agree, 34% agree, 16% are uncertain, 35% disagree, and 12% strongly disagree (totals don't always sum to 100 because of rounding).

Among those who disagree, some note the potential effects on the incentives of companies and consumers. Robert Shimer at Chicago replies: 'It would reduce energy costs now, but anticipation of future taxes reduces the incentive to invest in stable supply.' And David Autor at MIT objects: 'I want energy companies to invest right now. I also want consumers to reduce energy consumption. This idea discourages both.'

Others echo the view that taxing windfall profits and helping households should be thought of separately. Oliver Hart at Yale declares: 'Arbitrary taxes are bad and a windfall tax is arbitrary. Better to help poor households directly.' And Larry Samuelson at Yale suggests: 'The rebate would help households, but is a piecemeal policy. A comprehensive tax reform and coherent energy policy would be more efficient.'

Of the US panellists who agree with the statement, two refer to environmental issues. Maurice Obstfeld at the Peterson Institute notes: 'Especially in view of climate goals.' And Daron Acemoglu at MIT concludes: 'But should be motivated not as windfall but punitive tax for all of their misbehaviour on climate and clawing back of fossil fuel subsidies.'

Capping consumer energy prices

On the second statement about whether putting a cap on consumer energy prices would be a more appropriate immediate response to increased inflation than raising interest rates, a majority of panellists say that they disagree. Weighted by each expert's confidence in their response, 4% of the panels strongly agree, 11% agree, 7% are uncertain, 36% disagree, and 43% strongly disagree.

Among those who agree, Oliver Blanchard at the Peterson Institute argues: 'This is a case where a larger fiscal deficit can make the job of monetary policy easier.' But Jan Eeckhout, who says he is uncertain, objects: 'Messing with the price system leads to disequilibrium, which someone has to pay anyway. Better monetary and fiscal policy plus redistribution.'

Of the panellists who disagree, some focus on alternative ways to help poorer households. Jan Pieter Krahnen says: 'Thou shall not manipulate market prices, because of adverse allocative consequences. Poorer households may be compensated directly.' Ernst Fehr at the University of Zurich suggests: 'Instead of a cap on energy prices, poor households should receive a cash transfer to soften the burden of high energy prices.' Jean-Pierre Danthine at the Ecole Polytechnique Fédérale de Lausanne adds: 'I do not favour such a measure for ecological reasons. Direct subsidies to poorer households are preferable.'

Others are also concerned about the impact on incentives for reduced energy consumption. Franklin Allen replies: 'Such a cap would blunt incentives to reduce usage of energy and so be counterproductive.' And Charles Wyplosz observes: 'Energy prices should rise because supply is diminished (and good for the long run too). Inflation is another matter.'

Still others do focus directly on inflation and potential policy responses. Lubos Pastor at Chicago states: 'Inflation is broader-based, going well beyond rising energy prices.' Patrick Honohan says: 'The energy price shift is – and should be – unlikely to be temporary; strongly negative nominal policy interest rate hard to justify now.' Pol Antras at Harvard comments: 'Inflation is broad-based. Price controls would reduce energy costs, but would likely foster spending, aggravating inflation. Need tightening.' And Ricardo Reis explains: 'Monetary policy is the right tool to deal with inflation', linking to one of his papers on the topic.

Finally, two experts go back to history. Kjetil Storesletten observes: 'We tried price caps as an instrument to curb inflation in the 1970s. It didn't work then and it will not work now.' And Nicholas Bloom concurs: 'Price controls don't work – there is a long history of evidence on this. Indeed, not sure why this is even a question.'

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Notes:

- *This blog post summarises a survey by the University of Chicago Booth School of Business' Initiative on Global Markets. The full survey results for the European and US panels include all comments made by the experts.*
- *The post represents the views of its author(s), not the position of LSE Business Review or the London School of Economics.*
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