# Addressing Proposition 87 Criticisms

Posted by Robert Rapier on September 5, 2006 - 11:55am
Topic: Policy/Politics
Tags: alternative energy, california, oil companies, politics, proposition 87, vinod khosla [list all tags]

**Background**

Voters in California will go to the polls in November to decide the fate of Proposition 87, also known as the Clean Energy Initiative. However, the ramifications of this proposition have the potential to be felt nationwide. I have previously written a pair of essays on Proposition 87 that you can find here and here. My position is not so much that I am against Prop 87, and I am certainly not against the intent of Prop 87. But I do have concerns about the proposition, which are explained in my previous essays.

In response to my essays, Dr. Ana Unruh Cohen, former Rhodes Scholar and the Director of Environmental Policy at the Center for American Progress, asked if I would mind posting a rebuttal from her. Ana is certainly no stranger to the Peak Oil debate; her father was the person who got me seriously interested in the subject. I think most of us share a desire that we pursue responsible energy policy, and I believe that through a civil airing of diverse ideas we can better determine just what constitutes responsible energy policy. One of the things I find most enjoyable about debating these issues is that it gives me an opportunity to learn from others, and my views can evolve as a result of the things I learn. With those things in mind, I am happy to offer up her rebuttal to my previously mentioned essays on Prop 87.

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**Disclaimer:** To my knowledge, my company has donated no money to the Prop 87 opposition group (I don't believe we extract oil from California). I have nothing to gain financially by supporting or opposing this measure. So, consider me an unaffected party. I will offer my own take on Prop 87 in a few days, after which Ana will have the opportunity to have the final word with a concluding essay if she wishes.

Without further commentary, here are Ana Unruh Cohen's views on Proposition 87.

**Introduction**

Thanks for the opportunity to respond to your post about California's Proposition 87. As way of introduction and full disclosure for your readers, I am Ana Unruh Cohen, the Director of Environmental Policy at the Center for American Progress in Washington, DC. My boss, John Podesta, is on the Leadership Council for Prop 87. I have been involved the initiative for over a year now when a group of concerned Californians, mostly with environmental or academic backgrounds and months before Vinod Khosla was involved, approached Podesta to participate. (More about the early history of Prop 87 is here [RR edit: Requires registration].) He agreed, appointed me his liaison, and it's been an interesting experience ever since.

(For really full disclosure, I met Robert through my father. They worked together for many years and are good friends. I have asked Robert many questions about energy issues over the past few years and try to read his blog regularly.)

But why should a DC-based policy analyst or anyone outside of California care about Prop 87? As the most populous state and the largest gasoline market in the nation, success in reducing oil consumption there could have national repercussions. The new technologies that get kick-started and the lessons learned from deploying them through Prop 87 will have benefits far outside the borders of California. This is also the first time voters are going to have the opportunity to vote for reducing oil consumption.

Robert outlines a number of concerns in his post that in my mind fall into two distinct areas policy - what the initiative would do and what the impacts would be in the future - and politics. For clarity, I will address the two types of concerns separately as best I can, although in some cases they are very closely intertwined.

I'll start with policy issues and their future impact. I will place references to the initiative language in parentheses (pg. x) at times. You can download a pdf of the initiative language here.

**Support for Ethanol**

One of Robert's primary concerns is that Prop 87 would funnel money to corn ethanol. Ethanol, of all kinds, would be one option that the California Energy Alternatives Program Authority could consider as a way of meeting the goal of saving 10 billion gallons of petroleum transportation fuels between 2007 and 2017, including 4 billion annually starting in 2017 (pg. 3). The initiative language does not designate any technologies to be used but leaves that to the Authority to determine. The Authority - a reinvigorated existing California entity - will consist of 9 members, 3 state officials and 6 citizen experts appointed by various senior elected officials. No member of the Authority will be eligible to apply for any of the initiative programs (pg. 5-6), and they will be bound by all of California's ethics laws. I expect the Authority to continue in the long tradition of excellence in public service seen in other Californian boards of this kind.

Furthermore, the initiative language instructs the Authority to assess fuels based on their full fuel-cycle and greenhouse gas emissions (pg. 22), which will lead to a rigorous evaluation of petroleum reduction and climate impact on which the Authority can base its decisions. The initiative programs must also compliment ongoing California environmental programs, like the greenhouse gas tailpipe standard and the governor's climate program (pg. 3, 18, 21, 223). Ethanol might get some support, but I expect many other technologies and programs that will help reduce oil consumption will also receive robust funding. Despite Robert's fear, I believe the funds raised will be deployed in an efficient way.

**Impact of Oil Royalty**

While you are about to read more than a few paragraph on prices, I would like to say at the beginning that the goal of Prop 87 is to reduce the use of oil, which I believe will ultimately benefit the people of California economically and environmentally no matter where the market takes the price of oil.

Another big concern of Robert's was the oil royalty the initiative would put in place and its impact on the industry and the price of gasoline. Robert argued that the royalty would ultimately raise the price of gasoline and also that California's current gasoline tax ensures the state is receiving adequate compensation for the oil companies' use of its natural resources. I will take each of these points in turn.

On the issue of passing on the assessment to consumers, there are legal precedents, right up to the U.S. Supreme Court in Exxon vs. The State of Alabama (1983), upholding the consumer protections that prevent the fee being passed on directly to consumers. The California Attorney General has confirmed that the initiative prohibits producers from passing taxes on to the consumers.

But what about the more indirect way that Robert suggests? In the near term, California will remain the largest gasoline market in the country and an important market for the oil companies. In a world where supply and demand for oil are so closely matched, it is hard to imagine any company reducing production because of the imposition of a small royalty. Robert quotes a 1990 Congressional Research Service report about a decline in domestic production from a windfall profits tax, but the landscape of oil supply and demand was very different in the 1980's than it is today. With almost no excess production capacity in the world now and rising global demand, oil producers will continue to pump what they can. In this instance, I don't think the past is necessarily prologue.

Robert also does a quick calculation of the royalty's cost per barrel. He uses a price of $75 per barrel, which I assume he is taking from the NYMEX future prices, but the royalty is based on the wellhead (gross value) price of oil (pg. 28). In California, wellhead prices typically run $10 to $20 below the futures prices. The royalty is also graduated so that when the price per barrel is low, the royalty is at its lowest. California imports 40% of its oil from foreign sources and 20% from Alaska with the remaining produced in California. With the current problems in Prudhoe Bay, the recent change in Alaska's oil tax law and the increasingly competitive nature of the global oil market, it appears oil from California - compared to imports from Alaska or abroad - will remain attractive to refineries looking to purchase the cheapest crude.

And, yes, oil companies will have to pay $4 billion over 10 years to the new trust fund for clean energy. Because I believe oil prices and oil company profits will stay high over that time, I think they will be able to find the money. After all, the oil companies have to deal with royalties in all the other large oil producing states and on federal lands when they make their financial decisions. And at the moment, they seem to be favoring their shareholders, since the six majors spent more on share repurchases and dividends ($74 billion) than on capitol investment ($71 billion) in 2005 according to a *BusinessWeek* story. Moreover in 2005, ExxonMobil was able to compensate their retiring CEO, Lee Raymond, $400 million, roughly the same amount California would collect annually from all oil companies pumping crude from California's natural resources when Prop 87 passes.

Robert also argues that oil companies are paying their fair share in California because of the high gasoline tax, but a gasoline tax serves a fundamentally different purpose than an oil royalty. Drivers pay gasoline taxes. Gasoline retailers just collect them. Typically tax on a gallon of gas serves as a proxy for road usage and the revenue is used for transit funding. Oil royalties on the other hand are a way to return some of the value of natural resources to the government for allowing oil companies to extract material from the public commons. They are paid for by the producers who are profiting from the extraction of oil from the state. Because they serve two different purposes, almost all other states and the federal government impose both a gasoline tax on drivers and an oil royalty on producers. Why should California be any different?

Robert quotes California's gas taxes at $0.32/gallon. Here's the breakdown that the California tax board provides. You will see that California charges sales tax on motor fuels - another public policy decision and another tax borne by drivers, not oil companies.

Robert also argues that oil companies are paying a price by not selling as much gasoline as they might otherwise with lower gasoline taxes. But this logic suggests that every public policy decision that reduces the amount of product a corporation sells would somehow count towards their contributions to the state or federal treasury. Should we compensate oil companies when the government raises vehicle efficiency standards because they will sell less gasoline? Should we compensate coal companies when the government raises air quality standards because they will sell less coal? Should we compensate utilities when building codes are improved to make houses more efficient? I don't think so, and I don't think we should consider the gasoline oil companies didn't sell when considering whether or not they are adequately compensating the people of California for access to their oil resources.

Robert also makes many allusions to Hugo Chavez (perhaps straying into a little demagoguery himself) and is concerned that Prop 87 would open the door to other economic burdens on the oil companies. We can't predict the future, but the initiative is explicit that the royalty will sunset after $4 billion has been raised (pg. 30). The legislature would have to act or another ballot initiative would have to pass to extend the royalty. In drafting the initiative, we had many discussions about what would really be needed financially to meet Prop 87's goals and feel that $4 billion used judiciously will be enough to meet the challenge.

**Will Prop 87 Work?**

Robert quotes at length an article originally from the Wall Street Journal that argues that California's past attempts to reduce oil consumption have failed. I would argue that California's programs have been at least a moderate success. Every single program may not have succeeded, but on the whole California has maintained a smaller growth of gasoline consumption over the past decade than the overall increase in gasoline consumption in the United States. That has to count for something. Even with a growing population and economy, they have managed to keep their gasoline use somewhat in check. Don't take my word for it. Check out the EIA's data for yourself. Moreover, while California might be the largest gasoline market in the United States, only six states and the District of Columbia use less gasoline per capita than California. There has to be some reason that California is doing better than most states and the United States as a whole, and I bet part of the reason is those same allegedly failed programs.

There is no denying that the goals of Prop 87 are challenging. That's why we took a comprehensive approach when writing the language. We knew that areas not usually thought of as helping reduce oil consumption -- like public education, training new workers, and partnering with entrepreneurs to bring their products to the market -- would be necessary in addition to the traditional programs used to save oil. We also wanted to compliment and enhance the public policy decisions the people of California have already made, which in some instances have not received the necessary funding to implement.

**The Campaign**

Now let's turn to the politics of the campaign. Its impact goes beyond those who work for the oil industry or might benefit financially from Prop 87 to everyone who uses petroleum in some way. It is hard for anyone to be disinterested.

So are oil companies paying their fair share in California as the Yes on 87 campaign ads ask? I would argue no. Without some royalty on oil produced from the state, I think Californians are being shortchanged. Other natural resources in California, like timber and water, are assessed a fee for their extraction. Why should oil get special treatment?

Robert is also concerned that Vinod Khosla's investments in alternative energy create a conflict of interest. There are lots of interests involved in the campaign for and against Prop 87. The oil companies have produced oil royalty-free in California for a long time, and they aren't interested in starting now. On the other side, California scientists working on clean energy technology could get an increase in their research funding. Community colleges could get new money to prepare workers for new technologies. Public health advocates could get air quality improvements. Mayors could get help converting their bus fleets to hybrids or biodiesel. Drivers could get help buying more efficient vehicles. On Nov. 7 Californian voters will have to decide which interests they want to support.

As for the campaign vilifying oil companies, vilification, much like beauty, is in the eye of the beholder. I know oil companies are made up of more than their CEOs. I have friends and family who work for the oil or related industries. They are hard working individuals trying to do a good job. They are not villains. Sometimes they are even heroes, like the workers who blew the whistle on the Prudhoe Bay leaking pipelines. But have the oil companies help fund global warming deniers? Yes. Have the oil companies helped prevent progress on federal policies to improve efficiency, support renewable energy and reduce greenhouse gas emissions? Yes. Is it fair to ask the voters of California to support Prop 87, which would impose a small royalty on oil produced in California and direct the revenue to clean energy programs in their state? I think so. (Do I wish political discourse in this country were more sophisticated and less sensational? Absolutely.)

I hope this gives everyone some new insight into Prop 87. I would be happy to answer questions on the blog or directly at aunruhcohen@americanprogress.org. More information from the campaign for Prop 87 is available at Yes on 87.