The Oil Drum
DISCUSSIONS ABOUT ENERGY AND OUR FUTURE

Getting Even with ExxonMobil

Posted by Robert Rapier on May 4, 2011 - 10:33am

It is no secret that consumers are suffering from very high gasoline prices. And as a result of these high prices, ExxonMobil just reported a first-quarter profit of $10.7 billion — 69 percent higher than a year ago. The national level of disgust and anger is approaching record levels as we watch the loss of our hard-earned dollars become Big Oil's gain. The question is, what are we going to do about it?

Before discussing how to deal with this, we should first discuss what it is that we are actually trying to do. I believe the very simplistic view is that by going after the oil companies, they are going to relent and lower gas prices. Thus, their profits will return to 'normal' levels along with our gas prices. We want a return to the good old days of sub-$2/gallon gasoline. But most of the proposals that are being floated won't do anything to relieve high gas prices, although they may have an impact on oil company profits. If that's the case, then what is the point? I would say that it is simply feeling like justice was served. We want to get even with Big Oil.

Take Their Subsidies

It seems preposterous that an industry as profitable as the oil industry receives subsidies. But does anyone know what they actually are? CNN just did a story breaking them down, and you might be surprised at some of the other companies that benefit from these 'Big Oil' subsidies.

But we should also ask "What is the the subsidy supposed to accomplish, and what is the impact of removing it?" It isn't a question of whether a company making billions in profits "needs" a subsidy. Even companies that make billions of dollars evaluate projects on a case-by case-basis. Some of those projects may have poor economics, and companies won't use their billions to subsidize projects with poor paybacks. So the question is, "Is the subsidy encouraging the company to do something that we would like them to do, and that they otherwise would not do? Is the net impact to create more jobs and tax revenues?" Those are the questions that should be asked, and if the answer to those questions is "No", then that subsidy would appear to be a waste of money.

Section 199 – The Biggest Subsidy

The biggest 'oil company subsidy' — amounting to $1.7 billion per year for the oil industry — is a manufacturer's tax deduction that is explained in Section 199 of the IRS code. This is a tax credit designed to keep manufacturing in the U.S., but it isn't limited to oil companies. It is a tax credit enjoyed by ethanol companies (have you ever heard anyone call it an ethanol subsidy?), computer companies (we are subsidizing Microsoft and Google!) and foreign companies that operate factories in the U.S.

One never hears of proposals to entirely do away with Section 199. Apparently, since this tax credit was designed as an incentive to keep manufacturing in the U.S., many would feel that eliminating it for all companies would provide less incentive for them to keep their factories in the U.S. Some of the same people apparently don't believe this reasoning will apply with the oil industry.

So, the proposal is to disallow a tax credit to Texas-based ExxonMobil for their U.S.-based refining operations, while leaving it in place for foreign-based firms like Mercedes, BMW, and Toshiba that operate factories in the U.S. After all, as one staffer from the Center for American Progress smugly (and naively) put it in the CNN story, *"What are they going to do, move the oil field to the North Sea?"* Exactly. They are trapped and there isn't a thing they can do about it. They can't move their oil fields, so we can tax them silly. Nor can they move their drilling rigs or refining operations. Wait, I guess they could move those, but will they? Well, this is the same model Hugo Chavez used to mismanage Venezuela's oil industry into the ground and dry up foreign investment in the oil industry there. He thought that since foreign oil companies were trapped, he could tax them at will. Instead, they just left.

If we make it less profitable for oil companies to operate here than in foreign countries, surely they wouldn't shift operations out of the U.S. as Halliburton did in 2007. OK, they might, but so what? It's Big Oil we are talking about here. Who cares if they leave the U.S.? At least if we shift those refining jobs in Texas, Louisiana, and California to the new refineries being built in Saudi Arabia, we will no longer have to listen to reports of windfall profits, since Saudi Aramco doesn't publicly disclose their profits.

Other Subsidies

Another category of subsidies is a percentage depletion allowance. It is worth about $1 billion a year for U.S. oil companies. Again, it isn't limited to oil companies; other extractive industries are able to take the percentage depletion allowance. It is similar to a depreciation allowance in other businesses. What will be the net impact of eliminating this subsidy? It will make the costs of operating a well somewhat higher, which will probably mean that wells will stop producing at an earlier stage than before. After all, over time as wells are depleted the oil becomes more expensive to extract. It stands to reason that if the costs are even higher, the wells won't produce as long. However, much higher oil prices should provide an incentive to continue producing the wells longer than if oil prices are lower. But oil prices rise and fall, and the net impact will be to make an oil well in the U.S. less competitive against an oil well in Saudi Arabia. This will impact small producers more than Big Oil, but at least it will help realize the goal of getting more of our oil from foreign countries where we don't have to read about windfall profits.

Another category is the foreign tax credit. Again, you may be surprised to find out that this 'oil subsidy' isn't limited to the oil industry. But it is worth $850 million to the oil industry, and is designed to make sure that profits that have been taxed by foreign countries aren't taxed again when they are returned to the U.S. Eliminating the foreign tax credit will provide an incentive for oil companies to keep the profits out of the U.S. and reinvest them abroad, helping to accomplish the goal of shrinking the U.S. oil industry.

The final category of subsidies covered by the CNN story is intangible drilling costs (IDC). Once more, like all other industries the oil industry is allowed to deduct the cost of things like wages and is worth $780 million per year. The story suggests that most businesses have to take these deductions over the lifetime of an investment, but the oil companies get to take these deductions all in the first year. Someone in the oil business recently explained how the IDC works at The Oil Drum:

> "The elimination of the IDC tax credit would have a huge immediate effect. The IDC is a significant incentive to drill. About 40% of the cost to drill a well is IC (intangible costs). The IDC allows a company to deduct that amount from the taxes owed…not the earned income. So if a company owes the feds $100 million in taxes and spends $100 million in IC it can subtract $35 million (IC X 0.35) from its taxes. Defiantly a huge break. So they only pay $65 million in taxes. But take note: the ICD doesn't increase the company's revenue or profits: it allows them to spend more money drilling. If they don't spend it

> drilling new wells they lose it. That's the logic behind the IDC tax credit: instead of letting the govt spend the money the oil industry gets to drill more wells. That was once considered a good thing. The effect on drilling activity: the economics of each project is evaluated on its own merits. This evaluation includes utilizing the IDC. Eliminate it and a number of projects become sub-economic and won't be drilled."

So the IDC credit clearly provides some extra incentive to drill, but are those extra incentives needed? President Obama says no, except in his recent energy policy speech in which he said the U.S. should be "finding and producing more oil at home" and that his administration would "provide new and better incentives that promote rapid, responsible development" of oil and gas. One might think an incentive that encourages companies to offset taxes owed by drilling more wells might be just such an incentive, but apparently the Obama administration knows better.

Bottom Line – 1.8 Cents Per Gallon

In a nutshell, a large chunk of Big Oil's 'subsidies' are the same as those of Big Ethanol (which also has direct per gallon subsidies), Big Computer (Microsoft, Google, etc.), Big Auto, Big Pharmaceutical, and all the other industries large and small. They are not *like* their subsidies, they are in most cases the exact same tax deductions from the same tax code. The oil industry already pays an estimated $36 billion per year in U.S. taxes, and they have a higher tax rate than that of Microsoft or Google — both companies with higher profit margins than those of the oil industry. But those who argue that we preferentially eliminate, for instance, Section 199 and the foreign tax credit for the oil companies are in effect saying they have no problems subsidizing industries that are more profitable than the oil industry.

But let's say we follow through and eliminate the $4 billion just for the U.S. oil industry. U.S. refineries currently process about 14 million barrels of crude oil per day, and $4 billion works out to be 1.8 cents per gallon of crude oil processed through those refineries. Is that going to reduce the price you pay at the pump? Of course not. Will it cut into the profits of the oil companies, "punishing" them as we hope to do? Perhaps. Will it treat the oil industry differently than other industries, some of which enjoy higher profit margins? Definitely. Will it provide an incentive for oil companies to shift manufacturing out of the U.S.? Will it shift some competitive advantage to Saudi Arabia and Venezuela, both of which we are already highly dependent upon for our oil? Yes and yes.

The Naive and the Hopeful

I get that it doesn't seem fair that ExxonMobil's record profits are coming out of our pockets. But the current proposals won't do anything to combat what is coming out of our pockets. It will ensure that more of that profit — and the jobs that those profits support — are shifted to foreign suppliers. As much as people hate ExxonMobil, would they rather those profits were being reaped by Saudi Aramco? That is the alternative.

I understand that some believe that singling out the U.S. oil industry for punishment would help level the playing field for alternative energy companies. I think the dream of many is that if we make U.S. oil companies uncompetitive, the alternative energy sector will flourish and make up for the lost production from the oil industry. The future can be cleaner and greener and the only losers will be the oil industry. This is an incredibly naive view. In fact, look at the situation in Europe. Gasoline costs $8 to $10 a gallon, and cars are still predominantly fueled by petroleum. And it will be the same in the U.S. if gasoline rises to $10 a gallon.

There are effective ways of making renewable energy more competitive relative to oil. I have written about some of them. What the current proposals will do is to disadvantage U.S. oil companies relative to foreign oil companies. That means a shift alright, but not from U.S. oil to U.S. renewable energy. There will be a shift from U.S. oil to more foreign oil and refined products.

How to Really Get Even

It is nice to think that we can force Big Oil to sell fuel at the prices of a decade ago and limit their profits, but that isn't the way the world works. Big Oil doesn't have to sell fuel period if we single them out for punitive tax treatment. And if they don't, we will get our fuel from Big Foreign Oil. After all, refineries do close and oil companies do go out of business.

The proposals that are currently being floated for singling out the U.S. oil industry for punishment as a result of their profits simply feed on the public's anger at these companies. They don't represent good energy policy; indeed they aren't about energy policy at all. They are about revenge. We want to stick it to ExxonMobil — even though the proposals would if anything increase the price you pay at the pump and ensure that more of our oil comes from overseas.

But there is a way that every individual can stop feeding ExxonMobil's enormous profits. Stop buying their product. The reason they are so profitable is simply that the public keeps buying their product even as the price has doubled over the past few years. I understand that we are all dependent to one extent or another on oil, but most people use more of that product than we need to. Because of changes I have made in my own life, even though Big Oil is making record profits, they are profiting less from me than they were a decade ago. That is because of personal choices I made that you can make too. You can become more fuel efficient. You can use your car for fewer trips. You can carpool and use public transportation. Those things will have a real impact in reducing your contribution to Big Oil's profits.

But that would require that we make some actual changes, and our collective laziness is too great for that. We want to keep consuming as we always have, while sticking it to the companies that make that consumption possible. But if you won't make any changes in your life, then you can expect to continue transferring an ever increasing portion of your budget to Big Oil's coffers. We might be able to drive the domestic oil companies out of business — which by the way support an estimated 9.2 million jobs — but you are still going to pay more (to Saudi Arabia and Venezuela) unless you use less. Of course your other option is to buy ExxonMobil stock. If you can't help but feed your money to the beast, you could at least invest in them and get some of that money back as their stock value appreciates.