

On Tax Subsidies for Oil Companies

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The U. S. Senate voted on 17 May 2011 against a bill that would have abolished about \$20 billion over the next ten years in various tax subsidies to the major U. S. oil companies. Most of the Democrats favored ending these subsidies, but the bill failed 52-48.

There was a hearing before the Senate on 12 May, in which politicians berated several oil company executives, ostensibly for reporting large profits in the last quarter. Exxon-Mobil, for example, posted a quarterly profit of approximately \$11 billion. The politicians get away with this nearly-annual grandstanding because \$11 billion is a lot of money, and oil companies are easy targets for those looking to score easy points with the public. After all, the public is not particularly pleased with the price of gasoline at about \$3.85 per gallon of regular. But as usual, in all this posturing, most of the facts about the price of gasoline are left out. It turns out that a significant fraction of the price paid at the pump is actually federal and state excise taxes. While the federal excise tax is about 18 cents per gallon (14 cents for the ethanol mixed types), the amount of state excise tax varies by state from 26 cents per gallon in Alaska to 66 cents per gallon in California. Here is the approximate breakdown of the components that go into a price of a gallon of gas at today's prices, using a median value of 48 cents per gallon for state excise taxes.

63.5%: the total price of crude oil, including exploration, leases, research and development, production, logistics, royalties, and income taxes on gross profit

12.5%: federal and state excise taxes

8%: transportation (from mining site to refinery, and refinery to gas station)

9%: refining crude into gasoline (or diesel)

0.5%: gross profit to retailer (out of which he must pay his income taxes)

6.5%: net profit to oil company

We see here that the total taxes imposed by the federal and state governments exceed by a margin of about 2:1 the profit to the oil companies. Likewise, the oil companies have considerable expenses: they have to pay for the leases, and then the royalties; then they pay income taxes on the gross profit, all of which is of course built into the price of the raw material.

Keep in mind that the U. S. consumption of gasoline is about 140 billion (140,000,000,000) gallons of gasoline per year. When you think of it, this is a lot of work. The oil companies and the others in the supply chain have to locate it, drill it, transport it in special ships or pipelines, refine it, then store it and ship it again in special containers. If gas is \$4.00 at the pump, the oil company net profit is about 26 cents. But it comes to seemingly big oil company profits; 26 cents on 140 billion gallons is \$36 billion annual (on sales of gasoline alone).

Senator Harry Reid admitted that repealing these \$4 billion annual subsidies will have little short term effect on the price of gas, which seems certain. It seems to me that these tax subsidies should be repealed, but not out of envy at oil company success or some nebulous populist sentiment that the Democrats continue to advance. I favor a repeal of these simply because in the long run, they serve to distort the true price of a gallon of gas. First, they no doubt come with a long series of conditions and regulations, which may serve to distort the priorities of the oil companies. It is no secret that many decisions are made with a view to how a corporation's tax position will be affected, even if those decisions are contrary to what is in the long-term business interest. If the long-term interest of the oil companies is to provide reliable energy at a sustainable profit, it seems that the interest of the people coincides with the oil companies, since a profitable economy depends on energy. Second, a general support by the taxpayer distorts the true return on investment; it may affect the allocation of research and development, which in turn may cause the oil companies, experienced in many aspects of energy production, from developing alter-

nates. Third, these subsidies politicize the basic function of capitalism; if the taxpayers end up subsidizing corporations, their representatives (Congress) will assume powers to inordinately regulate their businesses; I refer to the political game of what public leases can and cannot be developed. It is not certain that such meddling benefits the taxpayer (witness the present price of gas). Last, I am opposed to any corporation using its influence to weasel special favors from the politicians at taxpayer expense; why should a corporation receive welfare payments from the taxpayer? But I make this statement in general for all corporations, not just the oil companies.

I mentioned "grandstanding" earlier, and now I give an example. At one point in the 12 May 2011 hearings, Senator Jay Rockefeller told the oil company executives that they were "out of touch": that although they were "good people", flying around on Lear jets and the like resulted in those oil executives becoming too isolated from the sentiments of his constituents, namely the average folk of West Virginia. This is a rather odd charge from the great-grandson of John Rockefeller of Standard Oil fame. But in his defense, at least he did not accuse the oil company executives of engaging in every kind of corrupt practice and driving all the honest competitors out of business the way his great-grandfather did.