PROFITS AND PINK SLIPS

HOW BIG OIL AND GAS COMPANIES ARE NOT CREATING U.S. JOBS OR PAYING THEIR FAIR SHARE

NATURAL RESOURCES
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A Natural Resources Committee Democratic staff review of recent earnings reports for the five largest investor-owned oil companies -- ExxonMobil, Chevron, BP, Shell and ConocoPhillips – demonstrates how high oil prices are translating into huge profits for these companies.

Together, the Big Five oil companies:

- Recorded **$36 billion in profits** in the second quarter of this year.
- **Repurchased nearly $10 billion worth of their own stock** in the second quarter alone, thereby boosting the value of remaining shares.
- Distributed more than **$7 billion in dividend payments** to their investors in the second quarter.
- Paid their executives a total of nearly $220 million in 2010.

Despite these massive profits, oil companies are not creating jobs in the United States or globally.

- Despite generating **$546 billion in profits** between 2005 and 2010, ExxonMobil, Chevron, Shell, and BP combined to **reduce their U.S. workforce by 11,200 employees** over that time.
- Just in 2010 alone, the big 5 oil companies **reduced their global workforce by a combined 4,400 employees**, while making a combined **$73 billion in profits.**[1]

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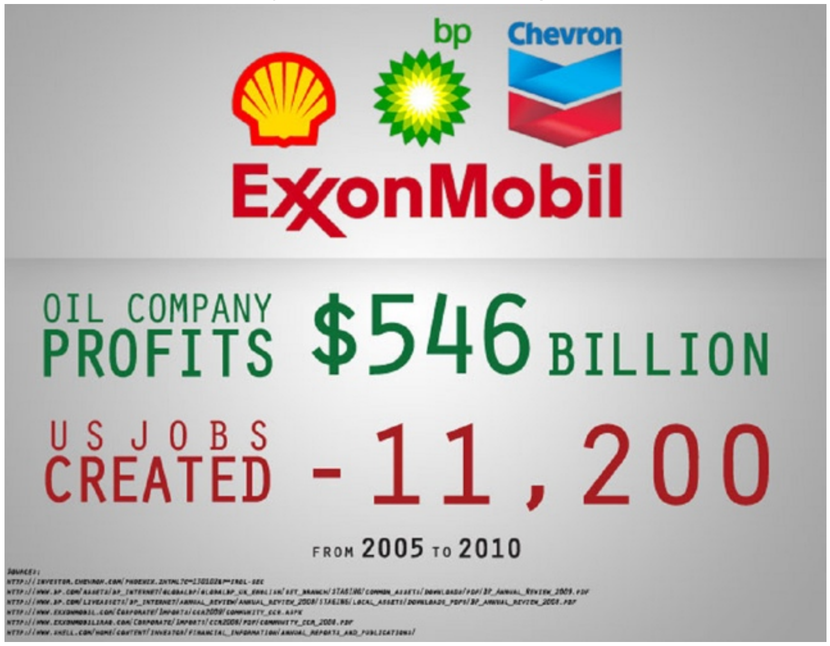
[1] BP recorded a $40.9 billion pre-tax charge for costs associated with the Deepwater Horizon disaster. Without this charge, Big Oil's profits would have been even greater.

Chart 1: Oil Company Profits and Changes to U.S. Workforce



Charts Compiled by Natural Resources Democratic Staff using data from earnings reports

Oil prices increased significantly during the first half of 2011. The price of Brent Crude is currently above $110 per barrel and regular gasoline currently averages $3.67 per gallon across the United States. High oil prices have given a huge boost to the Big 5 oil companies. The oil and gas industry has generated massive profits that undermine the necessity for continued taxpayer funded subsidies and royalty-free drilling that these companies currently enjoy.

While many American businesses and consumers are tightening their belts and Congressional leaders in Washington are looking at options to reduce the federal deficit, the hugely profitable oil and gas industry is set to receive **nearly $100 billion in unnecessary taxpayer subsidies in the coming decades**.[2] This includes $43.6 billion in taxpayer subsidies that oil companies are expected to receive over the next decade,[3] as well as an additional taxpayer funded windfall of up to $53 billion in royalty free drilling on public lands offshore in the Gulf of Mexico over the next 25 years.

President Obama has called for the elimination of the tax breaks for oil and gas companies and House Democrats have offered legislation that would repeal these unnecessary giveaways. However, the Republican Majority in the House has repeatedly voted down Democratic

[2] This estimate of taxpayer subsidies provided to the oil and gas industry is conservative. The tax breaks given to the industry are estimated to cost $43.6 billion over the next 10 years by the Office of Management and Budget. However, these tax breaks will continue for the oil and gas industry beyond 10 years, absent Congressional action. While the cost of continuing the oil industry's tax breaks will depend on factors like production and earnings, it could certainly be as large as it will be over the next 10 years.

[3] Office of Management and Budget, Budget of the U.S. Government, Fiscal Year 2012, p. 185-186. Available at: http://www.whitehouse.gov/sites/default/files/omb/budget/fy2012/assets/budget.pdf

legislation that would repeal these tax breaks for the largest oil companies.[4] Republicans also refused to eliminate these tax breaks for the largest integrated oil companies as part of any attempt to reduce the federal deficit and raise the debt ceiling. The Republican Majority has also opposed legislation authored by Ranking Member Markey on the House Floor that would end the oil industry's $53 billion free-drilling loophole.[5] The Republican Majority in the House has also opposed a package of reforms proposed by the Obama Administration that would close other oil and gas loopholes and generate nearly $1 billion in additional revenue for the federal government over the next 10 years.[6]

The oil and gas industry is a mature and highly profitable sector that is no longer in need of generous tax breaks or royalty-free drilling. The $43.6 billion in tax subsidies that the industry is set to receive over the next decade will not help consumers with rising energy prices. These subsidies will not strengthen America's energy independence or help to develop alternatives to oil. Eliminating these unnecessary tax breaks to Big Oil and closing the $53 billion royalty free-drilling loophole would allow us to reduce the federal budget deficit by nearly $100 billion.

Big Oil's Earnings

As oil prices remained high, the Big Five oil companies reported a combined $36 billion in profits for the second quarter of 2011. Shell saw its profits climb by 97 percent from the second quarter of 2010. ExxonMobil saw its quarter over quarter profits increase by 41%. Together, these five companies have made a combined $71.3 billion in profits during the first half of the year.

4 U.S. House of Representatives roll calls number 153, 293.

5 U.S. House of Representatives. Roll calls 109, 313.

6 The Obama Administration has proposed establishing a fee on nonproducing oil and gas leases, increasing inspection fees paid by oil and gas companies and permanently eliminating a prohibition on charging oil companies fees for processing permits.

Figure 1. Big Five Oil Company Profits in 2011[7]

	2011 Profits (billions)			
	Q2	% change	YTD 2011	% change
ExxonMobil	$10.7	↑ 41%	$21.3	54%
Chevron	$7.7	43%	$13.9	40%
ConocoPhillips	$3.4	39%	$6.0	29%
BP	$5.6	---	$12.7	---
Shell	$8.6	97%	$17.4	77%
Total	**$36.0**	---	**$71.3**	---

Charts Compiled by Natural Resources Democratic Staff using data from earnings reports

And these massive oil company profits are largely going to stock repurchases, investor dividends and executive compensation. In the first half of 2011, ExxonMobil, Chevron and ConocoPhillips spent nearly $18 billion on stock buybacks, which prop up their stock prices by reducing the outstanding shares of stock in the company. Exxon alone spent more than $11 billion repurchasing its stock in the first half of the year.

Figure 2. Oil Company Stock Repurchases

2011 Stock Buybacks (billions)		
	Q2	YTD 2011
ExxonMobil	$5.5	$11.2
Chevron	$1.0	$1.8
ConocoPhillips	$3.1	$4.7
BP	N/A	N/A
Shell	N/A	N/A
Total	**$9.6**	**$17.7**

Meanwhile, oil companies are also handing out billions in dividends to their investors. The five largest oil companies have doled out more than $14 billion in dividends during the first 6 months of 2011. ExxonMobil issued $4.5 billion in dividend payments to investors during the first half of the year. Chevron and Shell have both issued more than $3 billion in dividends thus far in 2011.

[7] The change in Second Quarter and Year to Date profits from 2010 is not listed for BP, which incurred the large costs associated with the cleanup and aftermath of the Deepwater Horizon disaster, which began in April 2010, in the second quarter of last year. BP reported a loss of $17.15 billion for the second quarter of 2010 and a loss of $11.1 billion for the first half of 2010 as a result of the oil spill, which ultimately became the worst environmental disaster in our nation's history. BP's 2010 earnings report is available at: http://www.bp.com/liveassets/bp_internet/globalbp/STAGING/global_assets/downloads/B/bp_second_quarter_2010_results.pdf

Figure 3. Big Five Dividend Payments

And while millions of Americans are out of work or seeing their earnings reduced, oil company executives are continuing to rake in millions of dollars a year in compensation. Last year, these five oil companies paid out nearly $220 million in compensation to their executives. ExxonMobil's executives made, on average, nearly $15 million last year. The average salary in 2010 for an oil company executive at the five largest oil companies was nearly $8 million.

2011 Dividend Payments (billions)		
	Q2	YTD 2011
ExxonMobil	$2.3	$4.5
Chevron	$1.6	$3.0
ConocoPhillips	$0.9	$1.8
BP	$0.8	$1.6
Shell	$1.8	$3.3
Total	**$7.4**	**$14.2**

Figure 4. 2010 Executive Compensation

Oil Company Executive Compensation		
	2010 (millions)	Average Executive Compensation (millions)
ExxonMobil	$72.1	$14.4
Chevron	$56.6	$9.4
ConocoPhillips	$69.6	$8.7
BP	$4.7	$1.6
Shell	$15.0	$5.0
Total	**$218.0**	**$7.8**

Old Habits Die Hard

> "Historically, Federal energy tax policy was focused on promoting the development of oil and gas, at the expense of the commercialization of alternative and nonconventional energy technologies."[8]
>
> --Congressional Research Service

Most oil and gas subsidies have been on the books in the United States for many decades (Figure 3). They represent an era when the oil and gas exploration was in its infancy, and when resources were plentiful but remained largely unexplored. However, while the industry has now become the most profitable in the world, its legacy of U.S. tax subsidies remains alive and well. Some of the subsidies have been on the books for nearly 100 years.

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[8] Congressional Research Service, Salvatore Lazzari, *A History of Federal Energy Tax Policy: Conventional as compared to Renewable and Nonconventional Energy Resources*, 1988.

Figure 5. Date of Initial Enactment of Targeted Oil and Gas Tax Provisions

Tax Incentive	Year Added to the Tax Code
Excess of Percentage over Cost Depletion	1926(a)
Expensing of IDCs	1916(b)
Credit for Enhanced Oil Recovery Costs	1990(c)
Expensing of Tertiary Injectants	1980(d)
Reduced G&G Amortization Period	2005(e)
Election to Expense 50% of Refinery Costs	2005(e)
Credit for Production from Marginal Wells	2004(f)
Oil and Gas Exemption from Passive Loss Limitation	1986(g)

Source: U.S. Congress, Senate Committee on the Budget, *Tax Expenditures: Compendium of Background Material on Individual Provisions*, committee print, prepared by Congressional Research Service, 111th Cong., 2nd sess., December 2010.

Notes:

(a)An allowance for depletion was added to the tax code in 1913. Percentage depletion replaced discovery-value depletion in 1926 (The Revenue Act of 1926).

(b)1916 Treasury Regulation, Number 45, Article 223.

(c)The Omnibus Budget and Reconciliation Act of 1990.

(d)The Crude Oil Windfall Profit Tax Act of 1980.

(e)The Energy Policy Act of 2005.

(f)The American Job Creation Act of 2004.

(g)The Tax Reform Act of 1986.

Source: Congressional Research Service memo to Natural Resources Democratic Staff, February 3, 2011.

Congress has allowed oil and gas companies to deduct "intangible drilling costs" since 1916 – only 3 years after the 16th amendment to the Constitution established the power of the federal government to levy income taxes.[9] Intangible costs of exploration generally include wages, costs of using machinery for drilling, and the costs of materials like drilling muds, chemicals, and fuel that get used up during the process of building wells. While most businesses must write off these expenses over the useful life of the property, oil companies can write these expenses off

[9] Congressional Research Service, Molly F. Sherlock, *Energy Tax Policy: Historical Perspectives on and Current Status of Energy Tax Expenditures,* May 7, 2010 (R41227). Available at: http://www.crs.gov/pages/Reports.aspx?PRODCODE=R41227&Source=search

immediately.[10] Since 1968, this program has cost the U.S. Treasury $78 billion.[11] Ending this tax subsidy would raise nearly $8 billion over the next decade.

Tax breaks that allow oil and gas companies to use the "percentage depletion allowance" were first put in place in 1926. Rather than writing off the actual costs of the property over its useful life, like most businesses must do, some oil companies get to simply deduct a flat percentage of gross revenues. Under this method of accounting, total deductions regularly exceed the actual capital invested to acquire and develop the reserve.[12] When this program was started, stimulating massive exploration around the geologically unknown United States was so important that oil and gas companies were allowed—through this preferable tax treatment—to recover amounts in excess of their investment. Since 1968, this program has cost the U.S. Treasury $111 billion.[13] Ending this tax subsidy would raise more than $10 billion over the next decade.

As Figure 4 demonstrates, the remnants of our 20th century energy policy remain with us today. Since 1968, six different oil and gas tax subsidies have cost us more than $190 billion in revenue losses. Figure 4 does not include the Section 199 manufacturing deduction, which allows eligible oil extraction operations to deduct up to 6% of taxable income. In 2004, the definition of "manufacturing" was amended so that oil and gas production could qualify. It is not yet clear how much this provision has cost so far, but it is estimated that closing this loophole would raise more than $17 billion over the next ten years.

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[10] Senate Budget Committee, Tax Expenditures: Compendium of Background Materials on Individual Provisions, December 2008. Available at: http://frwebgate.access.gpo.gov/cgi-bin/getdoc.cgi?dbname=110_cong_senate_committee_prints&docid=f:45728.pdf

[11] In constant 2010 dollars. Congressional Research Service memo to Natural Resources Democratic Staff, February 3, 2011.

[12] Senate Budget Committee, Tax Expenditures: Compendium of Background Materials on Individual Provisions, December 2008. Available at: http://frwebgate.access.gpo.gov/cgi-bin/getdoc.cgi?dbname=110_cong_senate_committee_prints&docid=f:45728.pdf

[13] In constant 2010 dollars. Congressional Research Service memo to Natural Resources Democratic Staff, February 3, 2011.

Figure 6. Cumulative Revenue Losses to the United States
billions of dollars

Tax Incentive	Revenue Loss in Constant Year 2010 Dollars
Excess of Percentage over Cost Depletion	$111.0
Expensing of IDCs	77.7
Credit for Enhanced Oil Recovery Costs	2.4
Expensing of Tertiary Injectants	0.4
Reduced G&G Amortization Period	0.3
Election to Expense 50% of Refinery Costs	1.6

Source: CRS calculations using GAO and JCT data.

Notes: Values are adjusted to 2010 dollars using the Office of Management and Budget (OMB)'s GDP price index.

Subsidies to Oil Companies Do Not Benefit the Public

The oil and gas industry argues that the tax breaks they enjoy encourage them to develop more oil and gas deposits, which lead to increased oil and gas supplies and lower energy prices.[14] The Natural Resources Committee Democratic Staff's analysis suggests otherwise for two primary reasons:

1. Depending on the reservoir and the physical characteristics of the hydrocarbon, the cost of producing oil can range from as little as $2 per barrel in the Middle East to more than $15 per barrel in some fields in the United States, according to the Energy Information Administration. Bringing once-expensive deepwater Gulf of Mexico oil into production can now be done for less than $10 per barrel.[15] The profit incentive to explore and produce new supplies for this lucrative market dwarfs any marginal benefit that existing federal tax breaks for oil exploration or production could provide. As President George W. Bush said in 2005, "With oil at more than $50 a barrel, by the way, energy companies do not need taxpayers'-funded incentives to explore for oil and gas."

2. In recent years, higher oil company profits have increasingly been redirected into dividends and stock purchases, not exploration. Among the Big 5 oil companies, less than

[14] J. Larry Nichols on behalf of the American Petroleum Institute, testimony before the Senate Finance Subcommittee on Energy, Natural Resources, and Infrastructure, September 10, 2009. Available at: http://www.api.org/Newsroom/upload/090910_Finance_Committee_Testimony.pdf

[15] EIA, *Supply*. Available at: http://www.eia.doe.gov/pub/oil_gas/petroleum/analysis_publications/oil_market_basics/supply_text.htm#Oil%20Production

> 10 percent of profits are reinvested into exploration of new oil deposits.[16] Net profits directed towards dividends and stock repurchases for the Big 5 oil companies were 58 percent in 2005, 73 percent in 2006, and 72 percent in 2007, 71 percent in 2008, and 89 percent in 2009. Dumping profits into stock buybacks drives up share prices for remaining shareholders by concentrating ownership, and, in the process, acts to increase the values of stock options for executives. It also reduces the amount of capital available for new exploration, improvements in drilling safety, and for other purposes (see below).

Current tax treatment does not incentivize oil and gas companies to diversify into clean energy alternatives. While some oil companies tout their commitment to research into alternative energy resources, a review of actual corporate investments in research and development (R&D) reveal a business model which appears wildly *averse* to innovation. While companies in high-tech sectors like pharmaceuticals and semiconductors regularly invest 15-18 percent of their revenues in R&D, U.S. energy companies invest less than one quarter of one percent of revenues in R&D.[17] Viable new substitutes for oil are a clear threat to the industry, as they would act to reduce the value of the oil industry's reserves, refineries, pipelines, and other infrastructure.

Repealing the oil industry's tax subsidies will not impact gas prices for American consumers. Oil, the main input and primary cost driver for gasoline, is traded in a global market and oil companies get paid the going market price for the oil they produce. On the oil market, there is no difference between an unsubsidized barrel of oil that costs $10 to produce and a subsidized barrel that costs $9.50 to produce. Each barrel will sell for the same price, currently more than $90 on the oil market. Oil companies that receive tax subsidies pass on that benefit to their shareholders, not to consumers.

Beyond Tax Subsidies: Royalty Relief and the $53 Billion Windfall

In addition to the tax code, there also exist other federal policies designed to incentivize drilling. Chief among these is so-called royalty relief. Oil companies pay a fraction of the value of oil produced on federal land to the federal government.

In 1995, at a time when oil prices where under $20 per barrel, the Republican Congress passed the Deep Water Royalty Relief Act (DWRRA) which allowed for royalty free deepwater production in the Gulf of Mexico when prices were low, for leases issued between 1996 and 2000. The intent of this law was to encourage deepwater production by waiving royalties until prices rose above certain thresholds. However, the oil and gas company Kerr-McGee (now

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[16] Citizens for Tax Justice, *What Oil and Gas Companies Extract—from the American Public,* July 9, 2010. Available at: http://ctj.org/pdf/energy20100709.pdf

[17] Susan Hockfield, testimony before the House Select Committee on Energy Independence and Global Warming, September 10, 2008.

Anadarko) filed suit to challenge the Interior Department's authority under the poorly drafted 1995 law to end royalty free drilling when prices were high. The courts ultimately sided with Kerr-McGee's interpretation of the law and the Supreme Court declined to hear the case.

As a result of the Court's ruling, ExxonMobil, BP, Chevron, Shell, Conoco Phillips and many other companies are now drilling for free on public land offshore and will continue to do so for the life of these leases no matter how high oil prices climb. The Government Accountability Office (GAO) has estimated that the federal government and American taxpayers stand to lose up to $53 billion in foregone royalties over the next 25 years.[18] Ranking Member Markey has authored legislation that would recover these royalties rightfully owed to the American people. The Republican Majority has repeatedly opposed legislation authored by Rep. Markey on the House Floor that would close this $53 billion loophole.[19]

[18] United States Government Accountability Office, June 5, 2008. (GAO-08-792R). Available at: http://www.gao.gov/new.items/d08792r.pdf

[19] U.S. House of Representatives. Roll calls 109, 313.