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11/15/11

Honors 211 H01

Debate Position Paper

Personally, I do think that the United States should place a tax on oil drilling in the Gulf of Mexico. There are many negative production externalities involved in coastal drilling, such as the destruction of coastal areas to create tanker shipping lanes and the multitude of oil spills over the last twenty five years. Since these costs are not considered in the calculations of supply done by companies, there should be a Pigouvian tax to shift production to socially efficient levels. It is very likely that major oil companies have potential tax increases in their financial forecasts, and with the current prices of oil it will still be profitable for them. An increase in U.S. oil drilling would not have a major effect on prices. Finally, I feel that for energy companies to invest more money into alternate energy resources it has to be more efficient than going after oil and other non-renewables, and taxing oil drilling will help steer them in that direction.

It should be obvious to anyone who has lived through recent history that offshore oil drilling has large externalities involved. A chart showing negative production externality at the end of the paper. The BP oil spill had a total cost of anywhere from $25B to $60B depending on who you ask.[1] This only considers the short term costs of the cleanup such as compensation payments and the direct clean up of the oil, and not longer term costs like the destruction of natural habitats for animals and decreased revenues for businesses such as fishing and hotels. In addition, there are other externalities that don't make good 11 o'clock news soundbites, like the destruction of coastal areas to make pathways for oil barges and pipelines as well as potential

1 http://www.telegraph.co.uk/finance/newsbysector/energy/oilandgas/8106034/BP-in-recovery-mode-as-spill-costs-hit-40bn.html

disruptions of natural habitats by the offshore platforms. Oil companies should be taking these costs into consideration when deciding how much oil to drill for. To make them do this, there should be a Pigouvian tax on oil drilling in the Gulf of Mexico. In my research, I found that there is an 8 cent tax on oil in general and that after the BP spill there was discussion about upping that to 32 cents. I could not find whether this passed though, but I do not believe it did since it was tied to a continuation of tax breaks that would increase the deficit by $134B.[2] In particular, there should be a tax specifically on oil drilling in the Gulf, levied on the oil drilling companies and perhaps on companies supplying the oil rigs and pipelines and other such products required for offshore drilling. The revenues from these taxes should be primarily bookmarked for increasing the rainy day fund created after the Exxon Valdez spill from 1989 and for combating the externalities caused by offshore drilling.

As of 12:03 AM on 11/15/2011, the price of crude oil is at $97.82. At just under $100, the oil business is an extremely profitable one at the moment, with ExxonMobil and Apple being the top two most valuable companies in the world depending on the price of oil that day. This means that even with a substantial tax increase, it will still be incredibly profitable to drill for oil. It is likely that the major companies already have tax increases calculated into potential forecasts, given the current political environment and the recent BP oil spill. Speaking of BP, by the third quarter of 2010 they had a replacement cost profit of $1.85B. In Great Britain earlier this year, a 12% increase on profit tax of North Sea oil producers was passed. For the larger companies, this resulted in anywhere from $190M to $400M in extra tax a year.[3] ExxonMobil earned $30B in profits last year. This would be a less than 1% profit decrease, assuming that the tax increase was something large like 12%. Under their tax scheme, the tax amount is based off profits and is not

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2 http://www.consumerenergyreport.com/2010/05/25/congress-seeks-to-quadruple-oil-barrel-tax-to-32-cents/

3 http://www.telegraph.co.uk/finance/budget/8402612/Budget-2011-10bn-oil-industry-tax-grab-wipes-2bn-off-shares.html. Used the current exchange rate on 11/15/2011 of 1 pound = 1.5878 US dollars.

a static cost, so if the oil market goes back down in the future the tax amounts will be shifted back down accordingly. The tax is not viewed as a regular tax like a tax on socks or computers, but almost like a royalty tax. "The Petroleum Revenue Tax is simply the way the oil company pays the Crown for the right to take away and sell that oil. It's an alternative to a royalty, and can be thought of in much the same way.[4]"I think that if a similar tax scheme were to be implemented for drilling in the Gulf of Mexico, it would work just as well.

Similarly to the argument made in class that an individual corn farmer can not affect world corn prices, the US does not have enough oil (both currently being drilled and estimates of natural stocks in the Gulf, ANWR, etc) to create a large decrease in oil prices by increase drilling. The politicians say it will change, but people who actually study oil markets for a living say things like "It's not going to change the price of oil overnight, and it's probably not going to have a huge impact on the price of oil ever.[5]" The decrease in oil prices in 2008 can be attributed more to the fact that of this little recession we have been in, since there was a decrease in overall demand there was a decrease in supply and therefore a decrease in price. In optimistic scenarios, over five to six years we could add 2M barrels a day to world production if we greatly expanded oil drilling in all places not already at max capacity. We import about 12.1M a day and use about 21M, [6] so in the most optimistic case we could replace 16% of the oil we import. At the same time though, the US produced 7% of world supply, so even with a 2M increase in supply that would increase our amount of world supply by ~1.5% to 8.5%. This is not enough to drastically change the price.

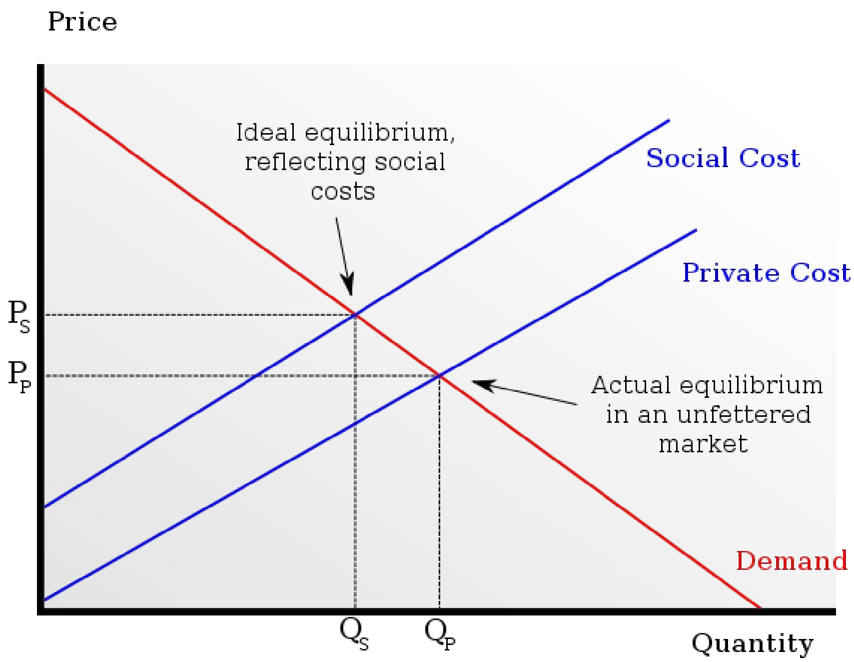
As a young teen, I read a sci-fi/alternate history novel series in which a technologically advanced species called the Race (anthropomorphic lizards basically) invades Earth in the

4 http://blogs.telegraph.co.uk/finance/andrewlilico/100010172/the-extra-oil-tax-wont-shut-down-the-north-sea/
5 http://www.huffingtonpost.com/2011/05/06/more-us-oil-drilling-wont-help-gas-prices_n_858473.html
6 http://www.infoplease.com/science/energy/us-oil-imports.html

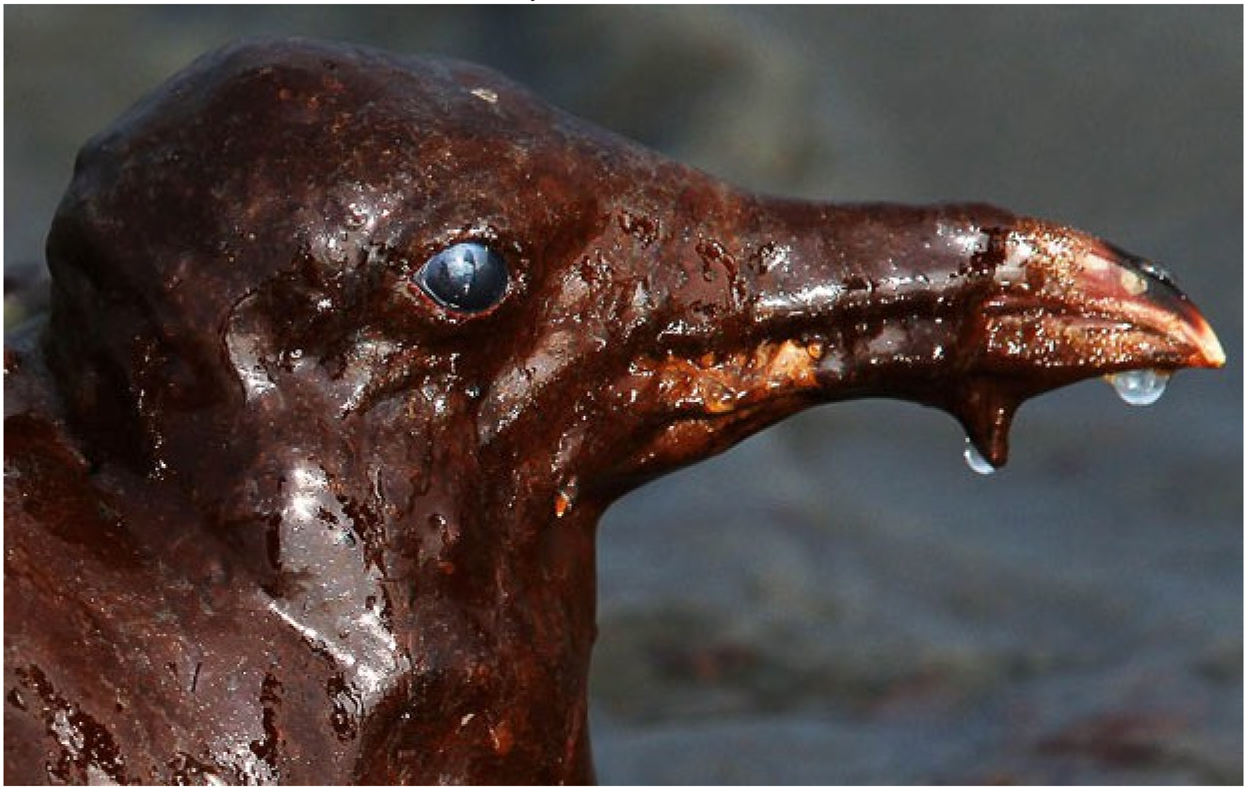
middle of WWII. Humanity captures and adapts many parts of their technology over the course of the series, and by the end everyone is using hydrogen cars and they do not have the same environmental problems as we do now. Ever since reading this, I've always pondered on the fact that if we had started heavily investing in technology such as hydrogen or electric cars, instead of filling up at the gas station when I go home next week for Thanksgiving I would be recharging my battery or filling the water tank. Unfortunately, to get from the now of point A to the hydrogen car future of point B, requires a lot of investment to bring the processed to economically efficient levels. We've made some headway with other forms of alternative energy such as wind and solar, but the technology still isn't there yet. The government can only do so much investing. A tax on offshore drilling would release some amount of funds for other purposes. Perhaps the companies would put some of those extra funds towards alternative energy research, especially if they had some sort of incentive like a reduction of the increased tax. It would be a start at least.

Drilling in the Gulf of Mexico has negative production externalities associated with it, and hence should have a tax placed upon it. These externalities include both the short term and long term costs of oil spills as well as the costs on the environment of supporting the infrastructure required to drill. With the price of oil drilling being so high, it would still be profitable for companies to drill even after taxes, so the US economy would not be largely harmed. In addition, a large increase in US oil drilling would not drop the price very much because it is a small amount of world supply. To help companies invest in alternative energy sources, it must be more efficient than oil drilling and they must be nudged along with economic incentives. In the end, ensuring that the ever fragile Gulf environment survives another day is more important than saving 15 cents at the gas pump.

Negative Production Externality Graph



The Externality, in real life instead of a chart



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