

The Real Cost of Oil

by Erica Swisher

The low fuel light just turned on and you immediately begin the search: “Which gas station has the lowest prices today?” As you pass by station after station, you grumble about today’s outrageous gas prices - after all, you’ve been paying well over \$2.00 a gallon for far too long now. “When will filling up my car become affordable again?”

This scenario plays itself out each time the gas gauge nears empty. However, the grumblings of American motorists would be much louder if all the costs associated with the extraction, transportation, and use of gasoline were included in the price at the pump. How would consumers react to a local service station price sign reading \$9.45 per gallon? When faced with spending \$65 to \$180 for a single fill-up, the concept of researching and developing alternative fuels is not just an interesting thought, but a necessity.

For decades, ethanol opponents have argued against increasing ethanol use in America’s fuel supply, asserting that ethanol would not be competitive without its federal government subsidy. Those opponents seemingly ignore oil’s myriad of direct and indirect costs to the consumer, paid primarily by increasing taxes, insurance costs, and retail prices in other sectors. Tax and program subsidies, defense of oil interests, and environmental and health costs carry the weight of the external costs of gasoline usage. Even the most

conservative estimates peg these costs at 20 to 70 cents per gallon of gasoline, while some sources argue that the real cost of oil is more than \$7.00 higher than the pump price.

Last year, ethanol’s “subsidy” - the blender’s tax credit - amounted to just over \$1.7 billion dollars. The majority of that subsidy was returned to taxpaying consumers in the form of lower pump prices for high octane ethanol-blended gasoline. Five years ago, a United States General Accounting Office (USGAO) report showed that ethanol had received \$11.6 billion in tax incentives since 1968, while the oil industry had received over \$150 billion in tax benefit over the same period.

The U.S. government has, for decades, given the oil industry preferential treatment afforded virtually no other business sector. The petroleum industry has the luxury of U.S. military protection of its international interests, while American taxpayers fund the warehousing of emergency inventory in the form of strategic petroleum reserves. The oil industry reaps the benefits of the U.S tax system, receiving preferential tax treatment on its costs for exploration, more attractive depreciation rules, and even credits for paying taxes to Middle Eastern governments. What’s more, the environmental, health, and social costs that Americans bear are rarely paid by the oil industry - rather, much of the reparations are hidden within bills funded by taxes.

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In an effort to more clearly examine this issue, four research studies have been chosen to further explain the intricacies of determining the real cost of oil. Bear in mind that each study is current to that specific time period, therefore it is essential to take into account the effect that time and global events have upon prices.

Tax and Program Subsidies

The dreaded “s” word: subsidy. This word conjures up a flurry of positive and negative reactions, especially within the ethanol industry. It is often a point of dispute when discussing the merits of ethanol. However, when it comes to the oil industry, the topic of subsidies often manages to become lost within “more important” issues. Yet most people are unaware that the oil industry is the recipient of massive amounts of government tax and program subsidies.

These petroleum tax breaks are implemented in an effort to ensure that domestic companies are able to compete with international producers. In addition, the subsidies are intended to contribute to lower gasoline prices for American consumers.

According to a 1998 study by Greenpeace, “Subsidies to oil are provided to producers, transporters, and consumers in varied and often subtle ways. These subsidies not only cost taxpayers billions of dollars per year, but they often exacerbate environmental damage. They can also reduce oil prices, suppressing market signals to oil consumers to decrease consumption and begin shifting to alternatives.”

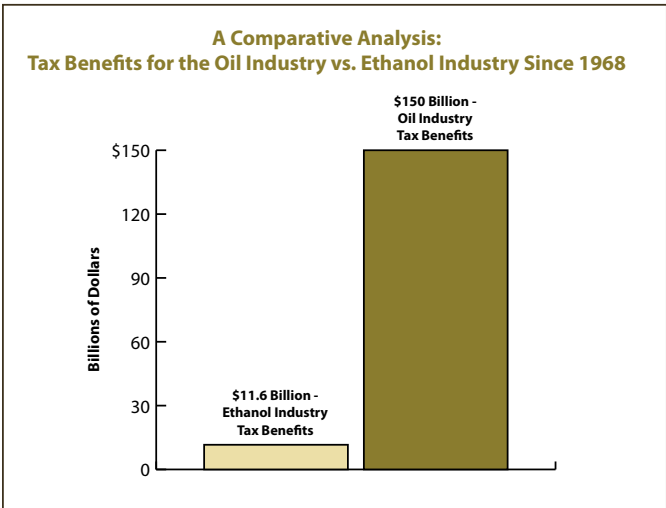
The International Center for Technology Assessment (CTA) released a study in December 1998 quantifying the true costs of oil. The study identified the following federal tax breaks as directly benefiting the oil industry:

- Percentage Depletion Allowance: \$784 million - \$1 billion per year
- Non-conventional Fuel Production Credit: \$769 million - \$900 million
- Immediate expensing of exploration and development costs: \$200 million - \$255 million
- Enhanced Oil Recovery Credit: \$26.3 million - \$100 million
- Foreign tax credits: \$1.11 billion - \$3.4 billion
- Foreign income deferrals: \$183 million - \$318 million
- Accelerated depreciation allowances: \$1.0 billion - \$4.5 billion

Also, the Taxpayer Relief Act of 1997 has recently added new rules, thus increasing the likelihood of supplying the petroleum industry with an additional \$2.07 billion per year in tax subsidies.

In addition to federal subsidies, the oil industry receives substantial subsidies on the state level. Many state income taxes are rooted in oil firms’ deflated federal tax bill resulting in undertaxation of \$125 million to \$323 million per year. Gasoline retailers and users benefit from state-imposed fuel taxes which are lower than regular sales tax, resulting in a \$4.8 billion per year subsidy.

The Real Facts
Last year the ethanol blender’s tax credit amounted to just over \$1.7 billion, the majority of which was passed on to consumers in the form of lower pump prices.



Source: U.S. General Accounting Office

“U.S. dependency on oil from countries that are either politically unstable or at odds with the U.S. subjects the American economy to occasional supply disruptions, price hikes, and loss of wealth, which have cost us more than \$7 trillion present value dollars over the last 30 years. That is more than the cumulative cost of all of the wars fought by the U.S. since the Revolutionary War.”

CTA’s research estimates that the American taxpayers fund \$9.1 billion to \$17.8 billion annually in tax breaks for gasoline production and use.

In conjunction with tax subsidies, the U.S. government provides the oil industry with program subsidies. These subsidies support the extraction, production, and use of petroleum and petroleum fuel products. The CTA study cites totals approximating upwards of \$38 billion to \$114.6 billion every year.

Some of these expenditures include:

- Research and development subsidies: \$200 million - \$220 million
- Export financing: \$308.5 million - \$311.9 million
- Support from the Army Corps of Engineers: \$253.2 million - \$270 million
- Department of Interior’s Oil Resources Management Programs: \$97 million - \$227 million
- Government expenditures on regulatory oversight, pollution cleanup, and liability costs: \$1.1 billion - \$1.6 billion

A great downfall of these subsidies is that oil exploration, production, and consumption decisions become distorted, with the American public virtually unaware of the true state of the oil supply situation. This ignorance in leads to a reduced sense of urgency in developing alternative fuel sources, intensifies environmental degradation, and leads to billions of dollars annually at taxpayer expense.

Oil Defense

The U.S. Department of Energy estimates that the U.S. will import as much as 68 percent of its oil demand by the year 2010. This startling figure begs the question: Are oil dependency, astronomical gas prices, and war in the Middle East going to be the norm over the next five years and beyond?

As past and current events have shown, it is clear that securing and defending U.S. oil interests have caused the American government to take dramatic spending measures. Even in peacetime, the U.S. Defense Department allots \$55 billion to \$96.3 billion per year alone toward protecting the world’s petroleum resources.

Holding approximately two-thirds of the world’s known oil reserves, the Persian Gulf region currently supplies the United States with about 25 percent of its petroleum. According to the National Defense Council Foundation, “Taken together, the economic losses, the defense costs, and oil supply disruption costs bring the total cost of imported oil to approximately \$250 billion per year, or close to \$4.00 per gallon over the current purchase price of gasoline.”

The complexity of America’s foreign oil dependency translates into multiple factors that influence the country’s security and economic stability. A 2003 study by the Institute for the Analysis of Global Security (IAGS) explains, “U.S. dependency on oil from countries that are either politically unstable or at odds with the U.S. subjects the American economy to occasional supply disruptions, price hikes, and loss of wealth, which, according to a study commissioned by the U.S. Department of Energy, have cost us more than \$7 trillion present value dollars over the last 30 years. That is more than the cumulative cost of all of the wars fought by the U.S. since the Revolutionary War.”

Bearing great interest in the Persian Gulf’s oil supply, the U.S. has found itself amid the political instability of the region, entangling itself in costly military actions. The oil dispute between Iraq and Kuwait led to the 1990-91 Gulf War. According to IAGS, the cost to the international community reached almost \$80 billion. The cost of the 2003 Iraq war and the following occupation of the country are estimated at \$200 billion.

Along with contributing to the nation’s oil defense, taxpayers find themselves paying an additional \$5.7 billion per year toward the Strategic Petroleum Reserve. Created in 1975 by the U.S. government, the petroleum reserve was started after oil supplies were stopped during the 1973-74 oil embargo. The U.S. economy experienced severe shock, therefore convincing policymakers that America should never be put in that situation again. The reserve’s purpose is to supplement regular oil supplies should disruptions due to military conflict or natural disaster occur.

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Studies Cited:

Fueling Global Warming, 1998, Prepared for Greenpeace by Industrial Economics Incorporated

The Real Price of Gas, 1998, International Center for Technology Assessment

Petroleum and Ethanol Fuels: Tax Incentives and Related GAO Work, 2000, United States General Accounting Office

The Hidden Cost of Imported Oil, 2003, National Defense Council Foundation

Charts courtesy of the Ethanol Fact Book, published by the Clean Fuels Development Coalition www.cleanfuelsdc.org

The CTA study sites that, in addition to traditional military support and the petroleum reserve, federal protection services also include the Coast Guard and the Department of Transportation’s Maritime Administration. Such protection tacks on an additional \$566.3 million per year in external oil costs.

Along with federal protection services, state and local governments fund approximately \$27.2 billion to \$38.2 billion in police, fire, and emergency services for oil industry companies and gasoline users.

Environmental, Health, and Social Costs

Hospital visits, oil spills, ozone depletion, urban sprawl - the list goes on and on. It is difficult, if not nearly impossible, to place a price tag on the damages that the oil industry has placed upon the world and its inhabitants.

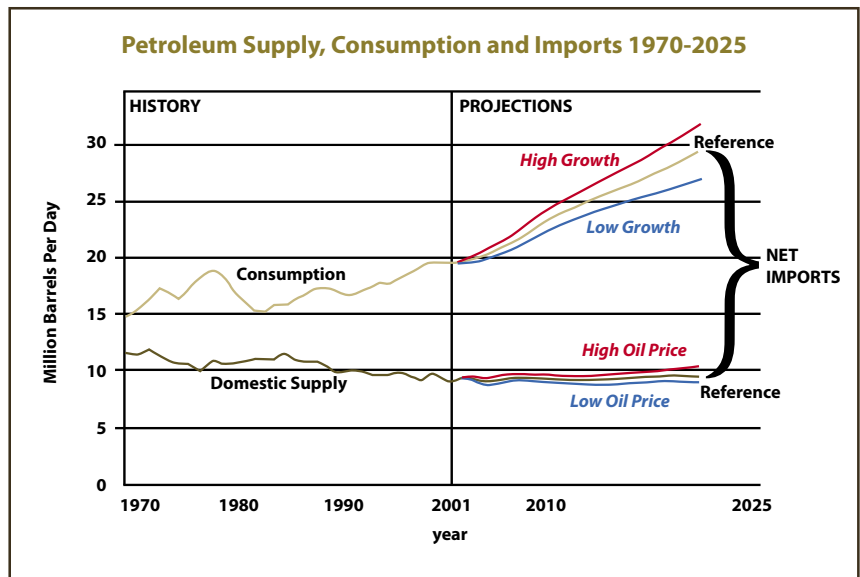
Yet the reality of such destruction is clear and has come at a cost. According to the American Lung Association, “Over the last decade, the death rate for lung disease has risen faster than that of any of the top leading causes of death. Tens of millions of Americans live in areas not meeting at least one federal air quality standard. The health costs of air pollution are estimated to be \$50 billion each year.”

The CTA study has estimated that the externalized price Americans pay for their gasoline reliance amounts to about \$231.7 billion to \$942.9 billion annually in environmental, health, and social costs. Bear in mind that such costs are difficult to quantify, thus explaining the large gap in estimated costs. Among these costs are: decreased agricultural yields, reduced visibility, building and material damage, global warming, water pollution, noise pollution, and improper disposal of batteries, tires, engine fluids, and junked cars.

Social costs are also among the “difficult to quantify” categories that the petroleum industry affects. Among the social implications is urban sprawl. As Americans are becoming increasingly dependent upon their vehicles, they are living farther and farther away from where they work and socialize. CTA researchers have determined that costs of urban sprawl total at \$163.7 billion to \$245.5 billion per year. The costs include: additional environmental degradation, aesthetic degradation of cultural sites, social deterioration, additional municipal costs, additional transportation costs, and the barrier effect.

The Real Facts

Increased petroleum consumption, coupled with decreased U.S. production, means net imports will continue to rise.



Source: U.S. Department of Energy Annual Energy Outlook (2003)

“The transfer of wealth to oil-producing countries - \$1.16 trillion over the past thirty years - significantly increased our trade deficit. The Department of Energy estimates that each \$1 billion of trade deficit costs America 27,000 jobs.”

Other Economic Impacts

As oil prices increase along with the volume of oil and refined product imported into the United States, the impact of a huge outflow of American dollars is becoming a much bigger concern. Importing products directly impacts employment opportunities. Currently the U.S. attributes nearly 40 percent of its trade deficit to petroleum imports. It has projected that petroleum imports may increase the American trade deficit to 60 percent or even 70 percent within the next 10 to 20 years.

In addition to money leaving the country, higher prices for oil have a drag on the economy as a whole. The NDCF estimates that the periodic “oil shocks” the U.S. has experienced over the past three decades have cost Americans from \$2.2 trillion to almost \$2.5 trillion dollars. Currently, about four percent of total U.S. household income is used to purchase petroleum products, and over 60 percent of that - 2.5 percent of all American household income - leaves the country as payment for gasoline, diesel fuel, or other petroleum products.

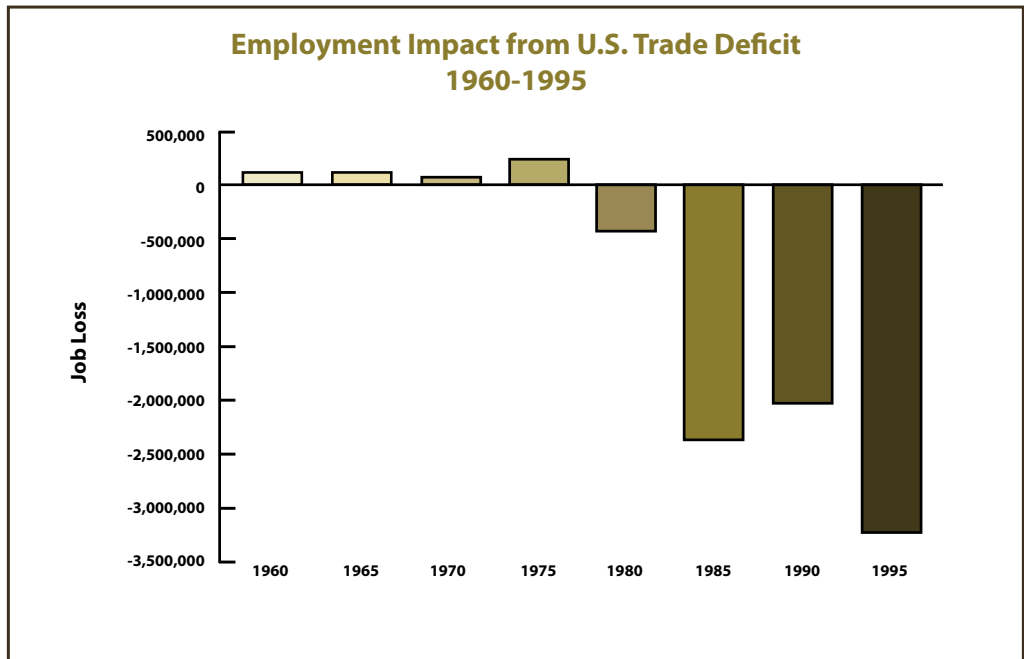
According to the IAGS, “The transfer of wealth to oil-producing countries - \$1.16 trillion over the past thirty years - significantly increased our trade deficit. The Department of Energy estimates that each \$1 billion of trade deficit costs America 27,000 jobs.” At current prices and import rates, the U.S. will take less than four years to transfer the next trillion dollars to oil producing countries. With it will go 2.7 million jobs - over 18,000 each day.

The price of gasoline may be higher today than at any time in recent history, but given all of the additional costs associated with America’s ever-increasing consumption and our reliance on oil from foreign sources, we are paying far more than the price reflected on the pump. By comparison, ethanol’s modest subsidy seems like an incredible bargain.

Ron Lamberty, ACE Vice President/Market Development, also contributed to this article.

The Real Facts

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Source: U.S. Department of Commerce