



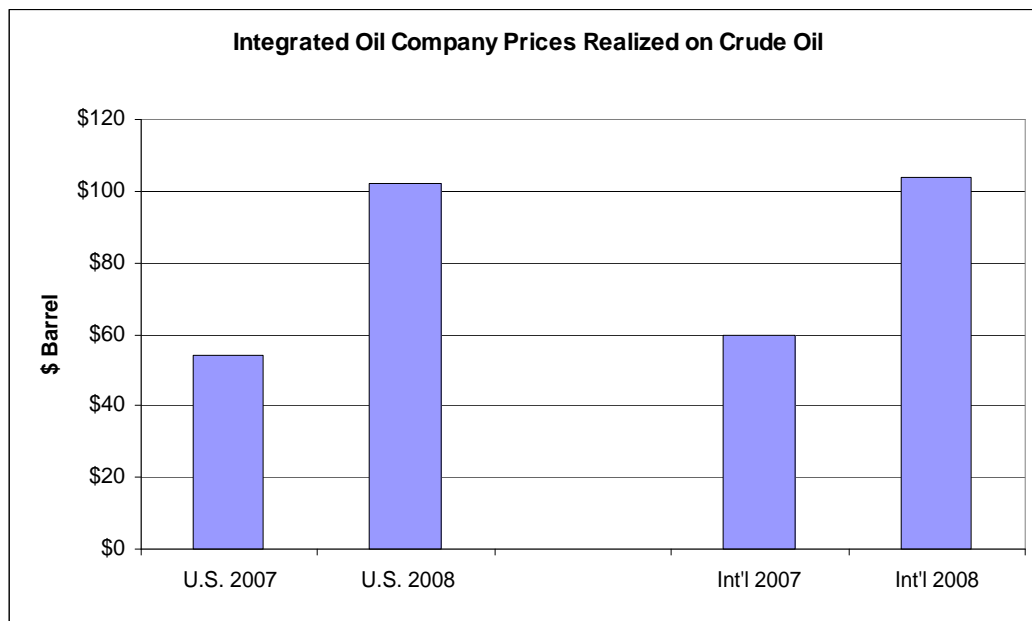
# Consumer Federation of America

## **MORE U.S. OIL DRILLING: A BOOM FOR BIG OIL, A BUST FOR CONSUMERS**

**AUGUST 5, 2008**

The second quarter profits of the major integrated oil companies have now all been reported and they shed important light on the intense debate over the expansion of leasing for drilling in environmentally sensitive areas. The financial results show why drilling for oil in pristine areas will increase oil company profits, but do little if any good for gasoline consumers.

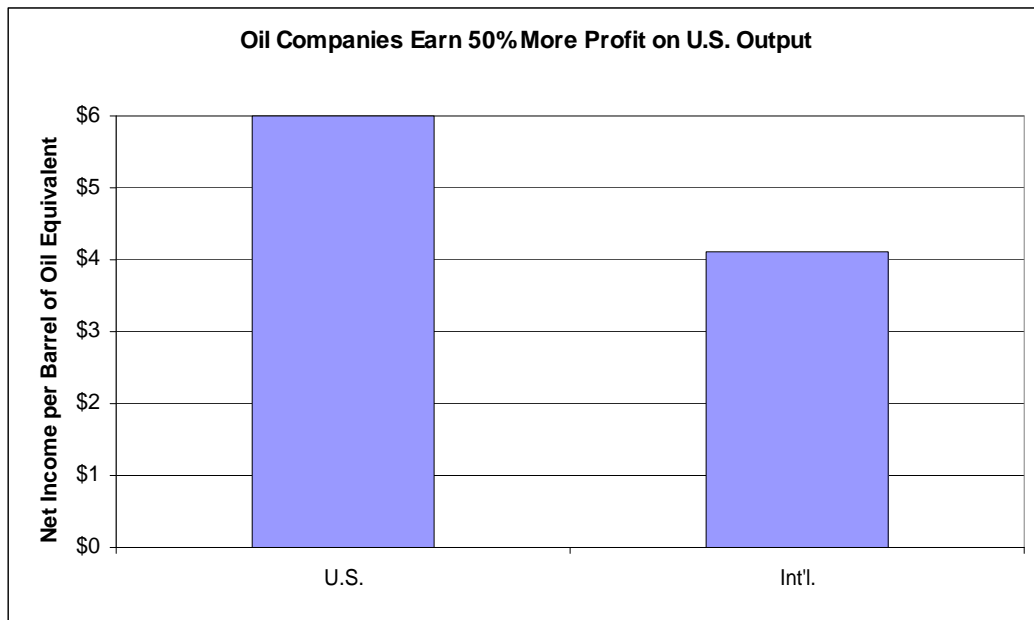
Oil companies charge the same price for oil and natural gas that they produce in the U.S. as they do for oil produced abroad. They charge the world price with minor differences for quality and transportation costs. In the first half of 2008, price was just over \$100 per barrel, about \$45 per barrel more than the comparable period of 2007. The cost of finding crude oil did not increase anywhere near that much in the past year, so oil company profits have skyrocketed.



**Source: second Quarter Press Statements, ChevronTexaco, Royal Dutch Shell, British Petroleum, ConocoPhillips, ExxonMobil.**

Indeed, oil company executives recently testified that the cost of producing crude oil is only between \$35 and \$65 per barrel at the margin,<sup>1</sup> although the average cost is about considerably less than that. Prices above that level are excessive. The oil companies pocket prices as profits.

Oil companies make much more on domestic U.S. oil than they do on oil produced in foreign countries. In the first six months of 2008, their net income on oil and natural gas was 50 percent higher on U.S. production than on international production. The reason they earn so much more on U.S. production is that the royalties, production costs, and transportation costs are lower. Or, stated another way, foreign countries collect more from oil companies in the form of higher royalties and taxes than do US and state governments on behalf of US taxpayers. Thus, the immediate effect of allowing more U.S. production will be to increase oil company profits.

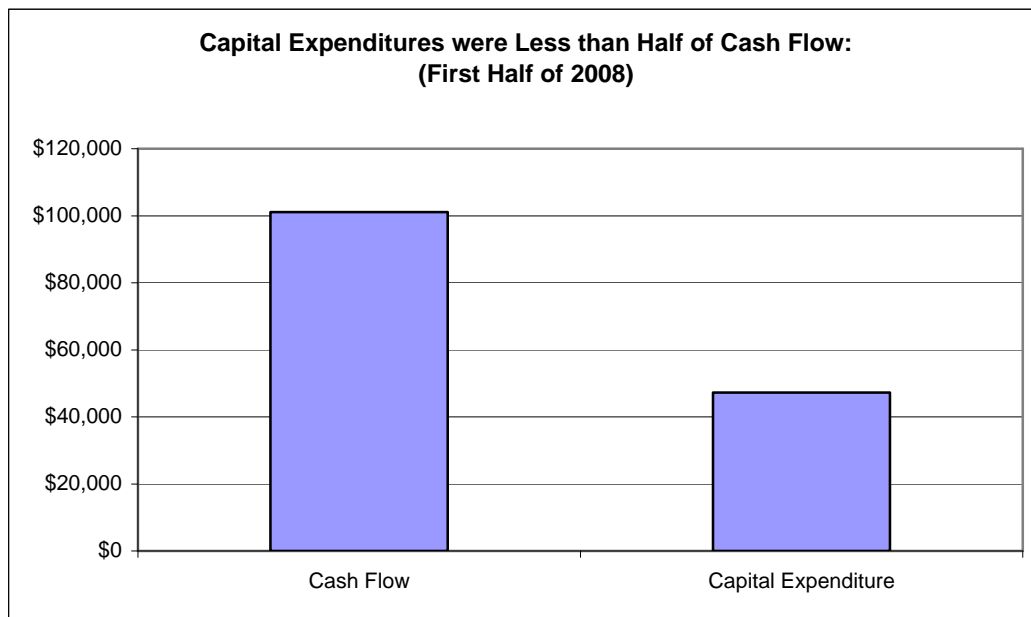


Source: second Quarter Press Statements, ChevronTexaco, Royal Dutch Shell, British Petroleum, ConocoPhillips, ExxonMobil.

The massive increase in prices and profits creates a cash flow problem for the oil companies; they have too much of it to absorb. . In the first half of 2008, these five companies generated over \$100 billion of cash flow. Less than half of it it went into capital expenditures and exploration. The

<sup>1</sup> J. Stephen Simon, Senior Vice President ExxonMobil, Select Committee on Energy Independence and Global Warming, put the cost at \$50-\$55. John Hofmeister, President of Shell Oil Co. put the cost at \$35-\$60 per barrel. Other experts confirm this conclusion. Energy Information Administration, *Annual Energy Outlook: Retrospective Review, Evaluation of Projections in Past Editions (1983-2006)*, *Annual Energy Outlook, 2008* puts the landed cost of crude oil at about \$60 per barrel. Akira Yanagisawa, *Decomposition Analysis of the Soaring Crude Oil Prices: Analyzing the Effects of Fundamentals and Premium* (Institute of Energy Economics, March 2008), p. 5, The average WTI "fundamental price," consistent with the underlying supply/demand situation, was around \$US60/barrel during the December half-year. Adam Siemiski's Testimony Subcommittee on Oversight and Investigations, Committee on Energy and Commerce, U.S. House of Representatives, June 23, 2008, p. 7, suggests a cost of \$70, at the margin.

rest was used to pump up stock prices – over a quarter went repurchase of stock, a sixth to dividends.



**Source: Second Quarter Press Statements, ChevronTexaco, Royal Dutch Shell, British Petroleum, ConocoPhillips, ExxonMobil. For ExxonMobil free cash flow is calculated as net income plus depreciation and amortization. ChevronTexaco did not report at this level of detail. Cash flow is set at net income plus depreciation, depletion and amortization.**

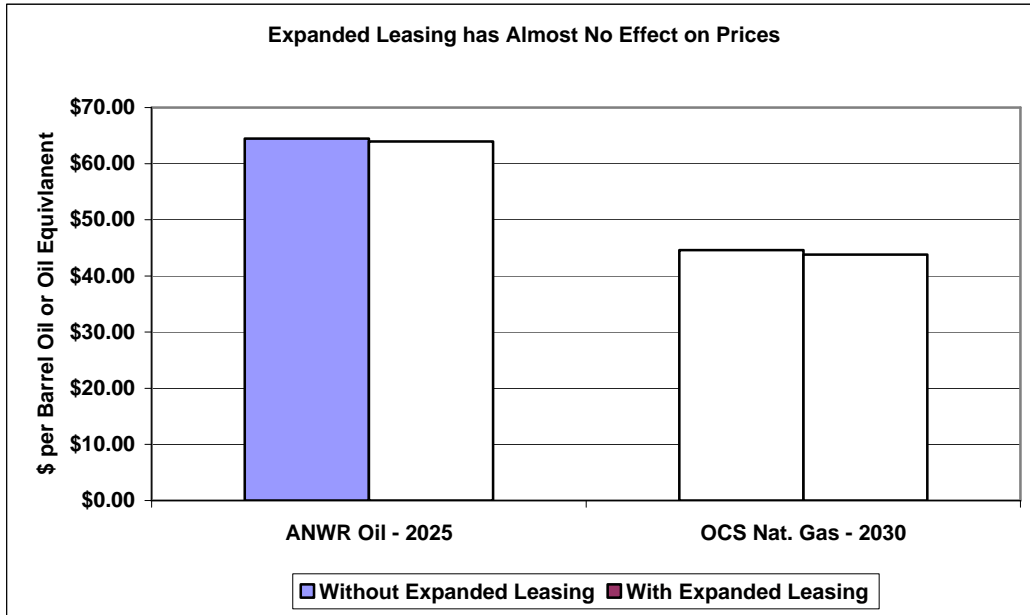
Thus, there is no doubt that the oil companies will profit handsomely from expansion of domestic U.S. output. Whether the consumer will benefit depends on what impact the increase in domestic U.S. production will have on the world price of oil and the domestic price of natural gas. Unfortunately, the prospects of a consumer benefit are slim. The U.S. Department of Energy has analyzed the amount of resources that might be found in areas where exploration and production are restricted and concluded that levels of production could not be achieved that significantly change the world price in wither the short or long term.<sup>2</sup>

As the EIA report put it with respect to the Outer Continental Shelf, “Because oil prices are determined on the international market, however, any impact on average wellhead prices is expected to be insignificant.”<sup>3</sup> Similarly, with respect to the Alaska Nation Wildlife Refuge, EIA concluded that “ANWR oil production is not projected to have a large impact on world oil prices... \$0.75 per barrel in 2025 in the mean oil resource case.”<sup>4</sup>

<sup>2</sup> Energy Information Administration, *Impacts of increased Access to Oil and Natural Gas Resources in the Lower 48 Federal Outer Continental Shelf*, (available at <http://www.eia.doe.gov/oiaf/aeo/otheranalysis/ongr.html>)

<sup>3</sup> Id. The report comments on natural gas as follows: “a decrease of \$0.13 in the average wellhead price of natural gas (2005 dollars per thousand cubic feet).” The EIA *Annual Energy Outlook: 2008* projects the consumer cost of natural gas in 2030 at \$13.70 per thousand cubic feet (2005 dollars), which means the cost reduction to consumer would be less than one percent. The Energy Information Administration reached a similar conclusion with respect to Alaska National Wildlife Refuge

<sup>4</sup> *Analysis of Crude Oil Production in the Arctic National Wildlife Refuge* (Washington, D.C: May 2008, p. 11), which works our to less than 2 cents per gallon. .



Source: Energy Information Administration, *Impacts of Increased Access to Oil and Natural Gas Resources in the Lower 48 Federal Outer Continental Shelf* (available at <http://www.eia.doe.gov/oiaf/aeo/otheranalysis/ongr.html>); *Annual Energy Outlook: 2008*, (Washington, D.C., June 2008); Table A13; *Analysis of Crude Oil Production in the Arctic National Wildlife Refuge* (Washington, D.C: May 2008), p. 11);

The reason that opening areas that are presently unavailable for leasing and development to drilling will have an insignificant impact on production and world oil prices is simple; the recoverable resources located in these areas represent a small fraction of the global resources – about 1.5 percent.<sup>5</sup>

For oil companies, expanded drilling is a boom; for U.S. gasoline consumers, it is a complete bust.

<sup>5</sup> Energy Information Administration, International Petroleum (Oil) Reserves and Resources, puts the global total at approximately 1.2 trillion barrels and the resources unavailable for leasing at 18 billion barrels <http://www.eia.doe.gov/emeu/international/oilreserves.html>