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ANSWERS ON ENERGY

# SAY NO TO BIG OIL

*The industry's claims don't wash, and its tax breaks should be revoked*

BY JEFFREY HOOKE

Near-record prices at gas pumps and record earnings for oil companies prompted calls at congressional hearings this month for the companies to pay extra taxes, to find more oil supplies and to invest in alternative energy. Lawmakers suggested that the industry is failing the American consumer, and its tax breaks should be revoked. Oil executives, meanwhile, insist the companies are doing all they can to alleviate the crisis. They note that although their profits are high in absolute terms, such returns are consistent with other businesses.

Who's right?

The oil companies' claims don't stand up to scrutiny; it's time to revoke their tax breaks. Consider the facts:

- *Oil company shares have superior performance.* Had you invested \$10,000 in the top five oil companies 20 years ago, your portfolio would now be worth \$100,000. That same \$10,000 invested in an S&P 500 index fund is now worth \$60,000. Oil shareholders enjoy a big advantage.
- *Big Oil's profits are in line.* Oil executives lament that only 9 cents of every sales dollar is profit, which is below the average for American business. However, if profit margin were a reliable yardstick, all supermarkets would close, because they earn less than 1 cent per sales dollar. The relevant accounting yardstick for an industry's health is return on investment, and Big Oil's returns are in line with other sectors.

- *Oil accounting understates positive results.* When prices increase, the value of the industry's in-the-ground reserves goes up. For example, in 2007, the oil reserves of the top five companies grew in value by \$190 billion, according to federal filings. None of this gain is reflected in accounting profits, but stock market investors pay close attention.

- *There is little emphasis on exploration.* What does Big Oil do with its record profits? Management directs most of the cash to dividends and stock repurchases, both of which drive up the companies' share prices and the executives' stock option values. Less than 4 percent of profit goes to the exploration for new oil fields. This dis-

treasing situation means reserves for Big Oil remain flat, when more supply is desperately needed.

Brazil's state-run oil company, Petroleo Brasileiro, spends twice as much on exploration. On April 13, it announced a new oil field discovery possibly amounting to 33 billion barrels. This single find exceeds total U.S. reserves of 22 billion barrels, as determined by the Energy Department. One day before, on April 12, in a nationally televised interview, Chevron Vice Chairman Peter Robertson defended tax breaks because "fewer

taxes mean more supply." Petroleo Brasileiro pays taxes at rates comparable to Chevron and produces far greater reserves.

- *There is a lack of interest in alternative energy.* Alternative energy research has a minuscule budget at Big Oil. Any oil substitute would be a prized commodity, but its discovery presupposes a reduced value for the industry's reserves, refineries, pipelines and the like. The companies' incentive to find a substitute is thus quite weak.

Our political leaders cannot expect Big Oil to act contrary to its

economic interest, and they should discontinue tax breaks that have proved ineffective in stimulating exploration. The federal government's goals for new supplies and alternative technologies cannot rely excessively on the oil companies, whose fundamental priorities remain shareholder return and management enrichment.

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