
H. The oil industry in context

- a. Key points**
- b. Oil and gas company returns in perspective and related matters (includes industry profits, comparison of profitability with other industries, taxes, investment, and ownership issues)**
- c. Who owns the oil companies?**

Key points

Some of the key points made in this section include:

- The data presented in this section place oil company profits in perspective. Specifically these data show that net returns (after taxes) as a percentage of either sales or investment for oil companies are comparable to those for other industries. Although oil company profits have been very large in absolute terms, these are not disproportionate when adjusted for scale.
- The data also show that, over the past 25 years, taxes paid were about three times as great as net profits.
- A report by Ernst & Young, LLP, commissioned by API, concludes that over the 12-year period from 1996 to 2007, that total new investments exceeded net income for the major five oil companies, the 21 Financial Reporting System (FRS) companies, and a broader oil & gas industry group.
- Data are presented from a recent study on ownership of oil companies. A study commissioned by API concludes that the ownership of International Oil Companies is as follows: 1.5 percent of the total outstanding shares of these public companies are owned by the officers and board members of those companies (“insiders”), compared to 29 percent owned by individual investors who manage their own holdings and who are not insiders, 42.7 percent owned or held by mutual funds and other asset management companies that have mutual funds, 18.1 percent owned or held by asset management companies that do not have mutual funds, and the remaining 8.7 percent owned or held and directly managed by pension funds, insurance companies, endowments and foundations, banks and other financial institutions.

Oil and gas company returns in perspective and related matters

Background

Recent high prices for gasoline and diesel and record oil and gas company profits have angered consumers and prompted some in government to call for legislation to create a “Windfall Profits Tax,” similar to that by President Carter.¹ This section provides some perspective on oil and gas company profits and related matters. In brief, the data show that today’s record profits are commensurate with the scale of the industry. Measured in relation to sales or investment, these profits are similar to those of other industries. This realization may not ease the pain at the pump, but it suggests that the policies of the oil companies are far from predatory.

Details

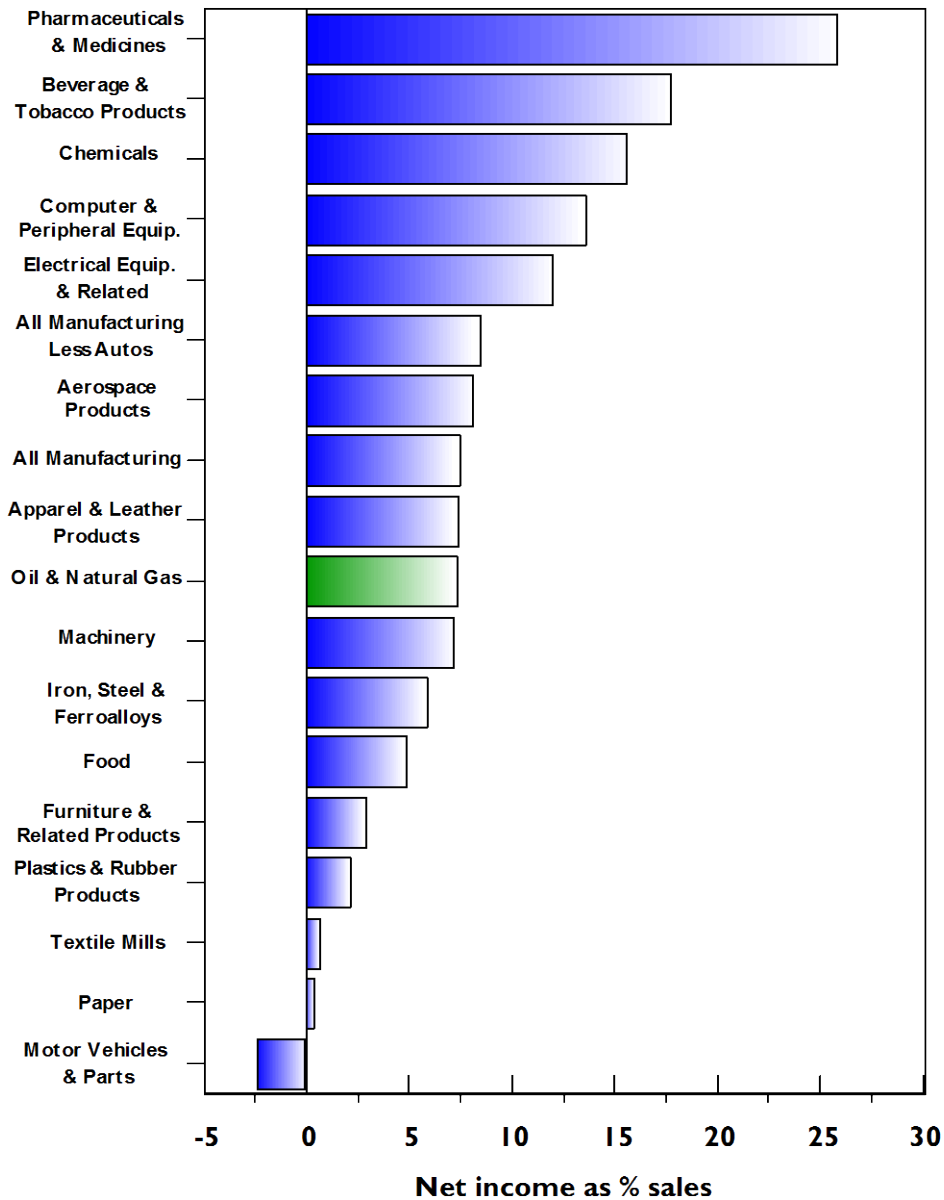
There are several financial measures used to judge a firm’s profitability. *The total value of earnings in any period is not a good measure,* because this fails to take the scale of operations into account. Perhaps the simplest measure that incorporates scale is the ratio of net income after taxes to sales. The use of after tax profits also captures the effect of effective tax rates, which some have argued have been “too low” for the oil industry.

Data on net income after taxes to sales are available from several sources, including (on an industry segment by segment basis) the US Bureau of the Census. The exhibit below shows these ratios for the First Quarter of 2008 by industry segment.² *Judged by this measure, oil and gas companies are comparable to other major US manufacturing industries.* That is, firms in the oil and gas industry earned (after taxes) 7.4 cents of every dollar, compared to 7.6 cents for all US manufacturing (8.6 cents if automobile companies are excluded).

¹ See e.g., <http://www.ncpirg.org/news-releases/tax--budget-policy/tax--budget-policy-news/ncpirg-calls-for-state-windfall-tax-on-excessive-oil-company-profits>. Rep. Dennis Kucinich even called for a 100% tax on excess profits, see his web site at http://kucinich.us/index.php?option=com_content&task=view&id=378&Itemid=2. And one of the major presidential candidates has called for an excess profits tax, see <http://ap.google.com/article/ALeqM5isOFwdbq0tsqatW6vJpkDRTI1gMgD92C64TG0>. For details on the windfall profits tax see <http://www.taxanalysts.com/thp/readings.nsf/ArtWeb/EDF8DE04E58E4B14852570BA0048848B?OpenDocument>.

² The source of the data is the US Bureau of the Census, Quarterly Financial Report, available electronically at http://www.census.gov/csd/qfr/view/qfr_mg.pdf. This same comparison was made by the American Petroleum Institute, America’s Oil and Gas Industry, Putting Earnings Into Perspective, available electronically at http://www.api.org/statistics/earnings/upload/earnings_perspective.pdf. Data on profitability of oil and gas companies is taken from Oil Daily.

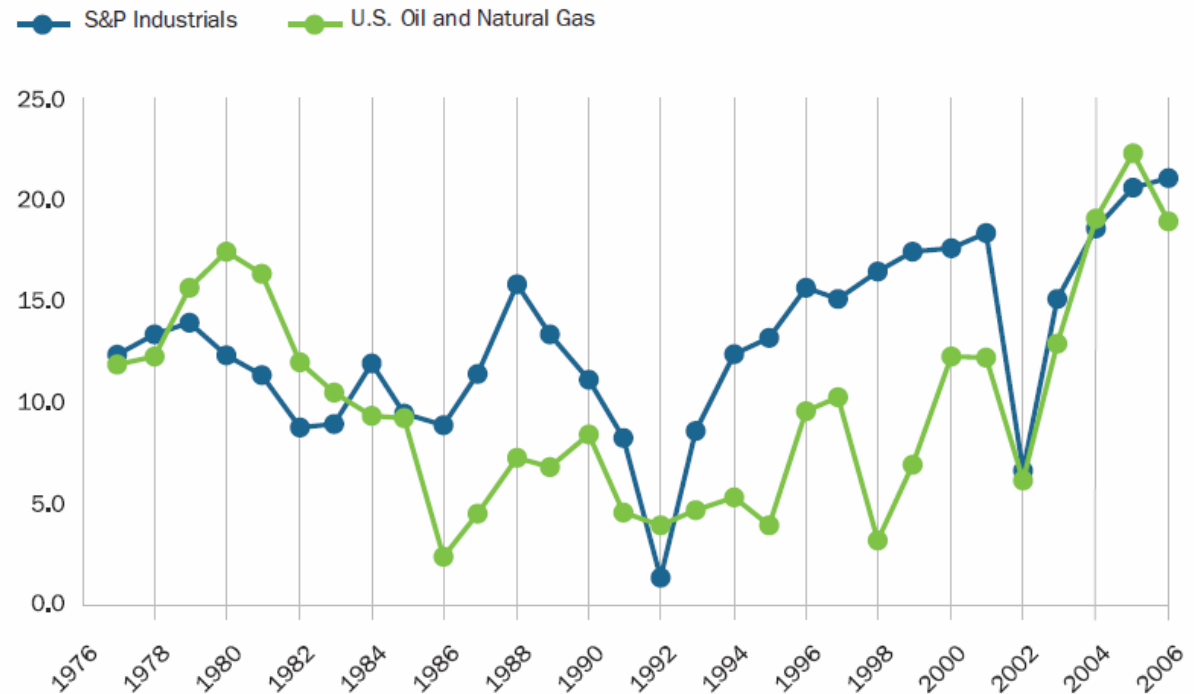
The data for Q1 2008 are not in any sense unique. API shows that these results are comparable for the period 2003 – 2007.



Source: US Bureau of the Census, Quarterly Financial Report, available electronically at http://www.census.gov/csd/qfr/view/qfr_mg.pdf

Another measure frequently used to assess profitability is the return on investment, defined as the net income divided by net investment in place. The figure below, taken from API³ shows that the oil and gas industry has had returns comparable to the Standard and Poor (S&P)⁴ Industrials over the period from 1976 to 2006.

Return on Investment (net income/net investment in place)



Source: EIA, *Performance Profiles of Major Energy Producers*, various issues and 2006 S&P figure compiled by PWC from Compustat data.

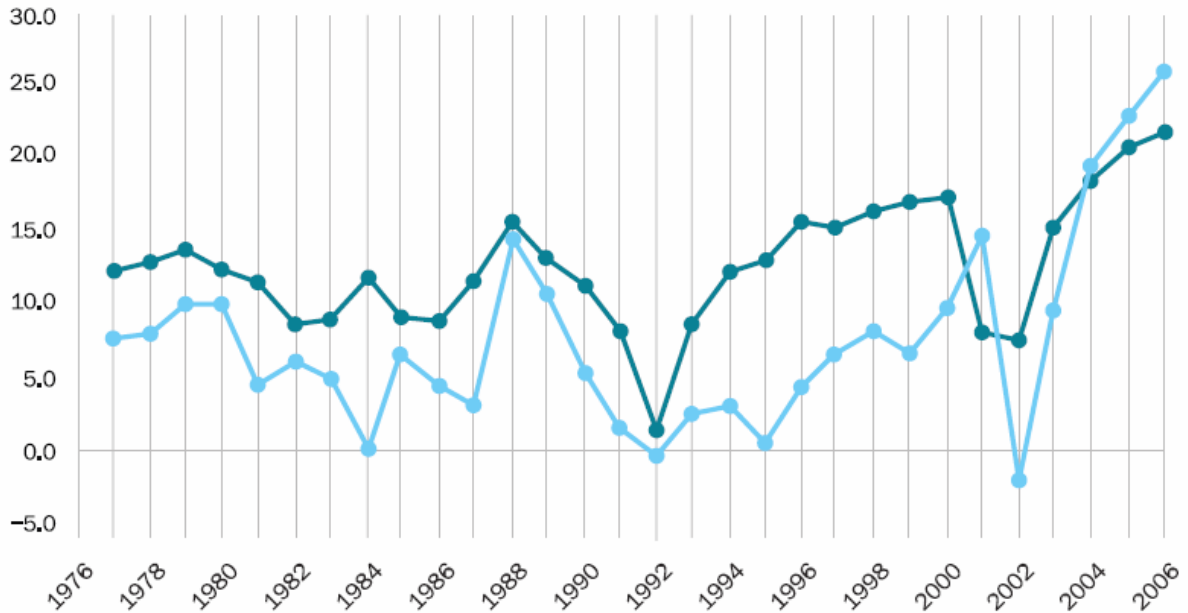
And, indeed, for some segments of the oil and gas industry, returns have actually been lower than the S&P Industrials index. As shown below, for many years the rate of return on investment in US refining operations have been lower than the S&P Industrial Index. Nonetheless, firms in the oil and gas industry have continued to invest in this segment; since 1985, refining capacity has increased by 20 percent even though there are 57 fewer refineries.

³ See American Petroleum Institute, *America's Oil and Gas Industry, Putting Earnings Into Perspective*, available electronically at http://www.api.org/statistics/earnings/upload/earnings_perspective.pdf.

⁴ Standard and Poor's Industrial Index is a subset of S&P 500 Index, made up of the companies in the S&P 500 Index that are considered industrial companies.

Return on Investment (net income/net investment in place)

—●— S&P Industrials —●— U.S. Refining



Source: EIA, *Performance Profiles of Major Energy Producers*, various issues and 2006 S&P figure compiled by PWC from Compustat data.

Taxes

Just as many have expressed emotions ranging from concern to outrage over oil company profits, others have railed against tax loopholes and corporate welfare.⁵ Nonetheless, a more dispassionate evaluation indicates that oil and gas companies pay substantial amounts of tax. On several occasions, the Tax Foundation⁶ has studied taxes paid by the oil and gas industry. As one example, the Tax Foundation completed an analysis of oil and gas industry taxation in 2005. The objective of this analysis was to determine whether or not additional taxation was appropriate. They concluded in part:

“Before rushing to create a new federal tax, lawmakers should ask two questions:

- (1) Do oil companies currently pay too little in taxes compared to profits?
- (2) What was the effect of the last windfall profits tax enacted in 1980?

⁵ For one example, see http://www.thirdworldtraveler.com/Corporate_Welfare/Oil_Tax_Breaks.html.

⁶ This is a nonpartisan educational institution based in Washington, DC, see <http://www.taxfoundation.org/about/>.

The answer to the first question is that over the past 25 years, oil companies directly paid or remitted more than \$2.2 trillion in taxes, after adjusting for inflation, to federal and state governments—including excise taxes, royalty payments and state and federal corporate income taxes. *That amounts to more than three times what they earned in profits during the same period, according to the latest numbers from the Bureau of Economic Analysis and U.S. Department of Energy.* “

“These figures do not include local property taxes, state sales and severance taxes and on-shore royalty payments.”

“The answer to the second question, *according to the Congressional Research Service (CRS), is that the 1980s windfall profits tax depressed the domestic production and extraction industry and furthered our dependence on foreign sources of oil.*”⁷

If it can legitimately be argued that oil company profits are excessive and it is also true that taxes paid are greater than profits, can it not also be argued that taxes are excessive?

⁷ The *Congressional Research Service (CRS)* report published in 2006 (located [here](#)) summarized the results of the 1980s windfall profits tax as follows: “From 1980 to 1988, the WPT may have reduced domestic oil production anywhere from 1.2% to 8.0% (320 to 1,269 million barrels). Dependence on imported oil grew between 3% and 13%. The tax was repealed in 1988 because (1) it was an administrative burden to the Internal Revenue Service (IRS), (2) it was a compliance burden to the oil industry, (3) due to low oil prices, the tax was generating little or no revenues in 1987 and 1988, and (4) it made the United States more dependent on foreign oil.”

If the tax were enacted again, the report states the following: “Reinstating the windfall profit tax would reduce recent oil industry windfalls due to high crude and petroleum prices but could have several adverse economic effects. If imposed as an excise tax, the WPT would increase marginal production costs and be expected to reduce domestic oil production and increase the level of oil imports, which today is at nearly 60% of demand [*Note: in 2007, net imports account for 58% of petroleum supply*]. Crude prices would not tend to increase. Some have proposed an excise tax on both domestically produced and imported oil as a way of mitigating the negative effects on petroleum import dependence. Such a broad-based WPT would tend to reduce import dependence, but it would lead to higher crude oil prices and likely to oil industry profits, potentially undermining its original goals.”

Net investment and net income

Ernst & Young LLP recently completed a study sponsored by the American Petroleum Institute. It is titled Investment and other uses of cash flow by the oil industry, 1996-2007.⁸ This study presents an analysis of the oil industry's historical investment trends and other uses of cash flow over a 12-year period.

“New investment” is defined as capital expenditures on property, plant and equipment (PP&E), plus exploration expenses and research and development (R&D) expenditures. This study looked at three groups of oil & gas companies:

- The Major Five oil companies, including BP, Chevron, ConocoPhillips, Exxon Mobil, and Royal Dutch Shell.
- A group of 21 large oil and gas companies that currently report to the US Department of Energy in the *Financial Reporting System* (FRS).
- A yet broader grouping of the industry, which includes 41 of the largest US oil & gas companies (i.e., the five biggest majors, along with the other major integrated companies, the large and medium-sized independent E&P companies, and the larger independent refiners and diversified natural gas companies).



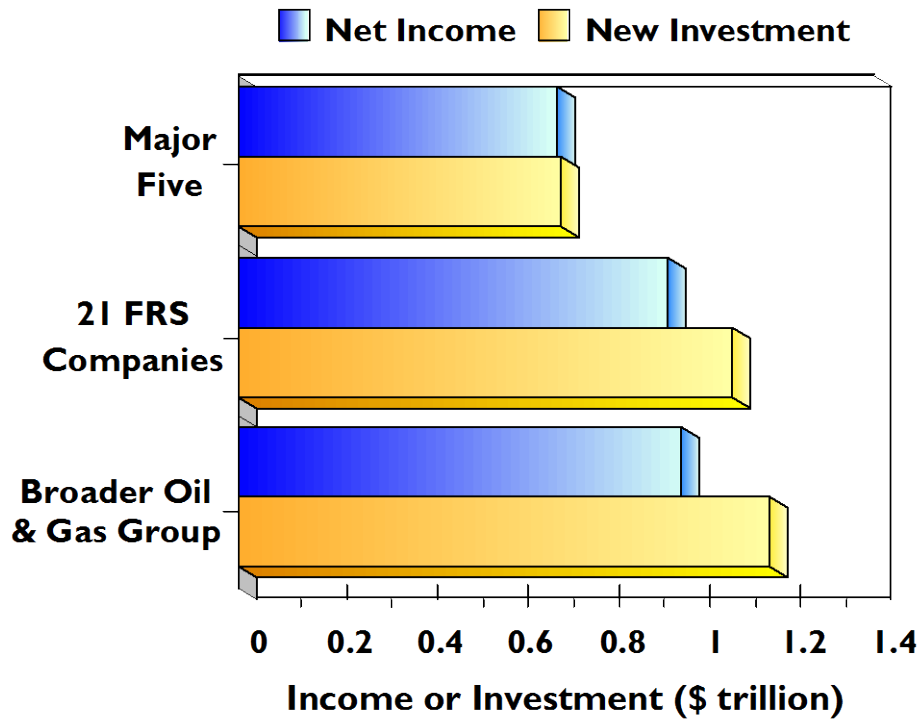
The study concluded that, over the period from 1996 through 2007:

- The five major companies had \$712 billion in new investment compared to net income of \$705 billion and cash flow from operations of \$1.18 trillion.
- The companies included in the FRS had new investments of \$1.09 trillion over the same period compared to net income of \$948 billion and cash flows of \$1.66 trillion.
- The broader group of companies made new investments of \$1.17 trillion over the same period, compared to net income of \$974 billion and cash flows of \$1.74 trillion.⁹

⁸ It is available electronically from the API website at:
http://www.api.org/aboutoilgas/upload/EY_Investment_Trend_CY2007_Update_July_2008.pdf.

⁹ Investment by the five major oil companies accounted for 61 percent of the broader industry group's investment during this period.

Thus, the study concluded that, however the domestic oil & gas industry is defined, new investment was more than 100% of net income over the 12-year period—in other words, oil & gas companies are reinvesting their income.



Source: http://www.api.org/aboutoilgas/upload/PWC_State_ContributionsStudy_200107-2.pdf.

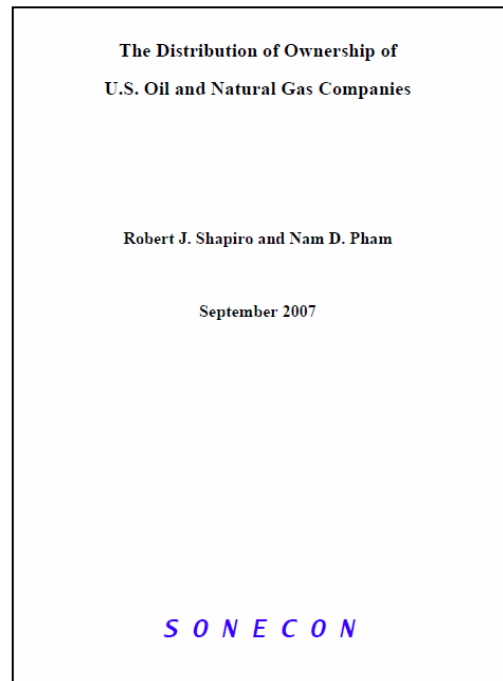
Who owns the oil companies?

In broad terms, oil companies can be partitioned into *National Oil Companies* (NOC), owned in whole or in part by individual countries and *International Oil Companies* (IOCs) which are publicly held and traded.

With respect to publicly traded oil companies, a recent (2007) study by Robert J. Shapiro and Nam D. Pham of the Firm *SONECON*¹ offered the following answer to the question “who owns the oil companies?”

The Shapiro and Pham study concluded that, contrary to expectation, America’s oil companies are not owned by a small group of insiders. Approximately 1.5% of the stock is held by corporate management, the balance is owned by institutional investors, IRAs, mutual funds, pension funds, and individual investors. Here are some of the report’s findings:

“Across the oil and natural gas industry, 1.5 percent of the total outstanding shares of its public companies are owned by the officers and board members of those companies (“insiders”), compared to 29 percent owned by individual investors who manage their own holdings and who are not insiders, 42.7 percent owned or held by mutual funds and other asset management companies that have mutual funds, 18.1 percent owned or held by asset management companies that do not have mutual funds, and the remaining 8.7 percent owned or held and directly managed by pension funds, insurance companies, endowments and foundations, banks and other financial institutions.”



Here is another excerpt from this report:

“These data, along with previous analyses that we conducted further suggest that ownership of oil and natural gas company shares is broadly middle-class.

- “42.7 percent are owned or held by mutual funds and other asset management companies that have mutual funds. Mutual funds manage accounts for 55 million U.S. households with a median

¹ See http://www.sonecon.com/docs/studies/0907_WhoOwnsOilCompanies.pdf.

income of \$68,700, and the owners of mutual funds include 16 percent of households with incomes of \$25,000 or less, as well as 83 percent of households with incomes of \$100,000 or more.”

- “Earlier analysis found that an estimated 27 percent of oil and natural gas company shares are held in private and public pension funds, and these funds manage assets, directly or indirectly, on behalf of 129 million pension-fund participants whose accounts have an average value of \$62,280. For example, some 28 million public pension accounts in over 2,650 public employee pension funds represent the major retirement security for current and already-retired soldiers, teachers, police and fire personnel, social workers and office workers employed at every level of government. In 2004, these funds held approximately \$64 billion in shares of U.S. oil and natural gas companies.”
- “An estimated 14 percent of oil and natural gas company shares are held in IRA-type retirement accounts with an average value of \$22,465, owned by 45 million Americans.”

So, the short answer to the question of who owns the publicly traded oil companies is “millions of stockholders.”