America's Oil and Natural Gas Industry



# What's Up With Gasoline Prices?

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## Changes in gasoline and diesel prices mirror changes in crude oil prices.

The roller coaster rise and fall in gasoline and diesel prices over the last couple of years tracks changes in the cost of crude oil. Those changes are determined in the global crude oil market by the worldwide demand for and supply of crude oil. Weak economic conditions in the U.S. and around the world in 2008 and into 2009 led to less demand which helped push prices down. Now, with the worldwide economic recovery underway, demand is on the rise again and is helping to push prices higher. In addition to economic growth, crude and product prices are affected by a host of other factors including weather events, geopolitical risks, inventories, exchange rates, and spare capacity.



World oil consumption is expected to grow as the global economy rebounds. The world's demand for oil increased sharply for several years, peaking at over 86 million barrels per day in 2007. However, the global economic slowdown in recent years reversed this trend and demand fell for the second consecutive year in 2009, reaching over 84 million barrels per day, or 2 million barrels per day less than at its peak before rebounding in 2010. ElA projects continued moderate gains in consumption over this year and next. In OECD countries consumption is projected to be nearly flat in 2011 and 2012. Growth is concentrated in the non-OECD countries, including China, other Asian countries, and the Middle East with gains of about 1.5 million barrels per day expected in 2011 and another 1.6 million barrels per day in 2012.



#### Surplus crude oil capacity is expected to continue to grow.

The amount of surplus crude oil capacity to meet surges in demand or disruptions in supply increased in 2009 and 2010 as demand for crude oil declined along with the global economic slowdown.

According to EIA, OPEC's surplus production capacity reached 4.7 million barrels per day in 2010 compared to an average of just 1.5 million barrels per day during 2003-2008. EIA forecasts surplus capacity to continue to expand this year as production of non-crude liquids increases and expected capacity expansions come on line in several OPEC countries.





Oil is a commodity and changes in the price of oil are similar to changes in prices of other commodities. The rise in commodity prices early in 2008 and their subsequent fall largely reflect worldwide supply and demand conditions. The downturn in the economies of the U.S., Europe and Asia resulted in declines in the prices of a broad range of commodities, including coal, natural gas, oil (e.g., WTI and Brent) and refined products like gasoline. The subsequent rebound in the economy is reflected in the rise in prices for a number of commodities over the past year.

#### Percent Change of West Texas Intermediate Crude (WTI) in Dollars and Euros

(January 1, 2007 - February 4, 2011)



#### Percent Change of West Texas Intermediate Crude (WTI) in Dollars and Yen

(January 1, 2007 - February 4, 2011)



Source: Federal Reserve Bank of St. Louis, EIA, NYMEX.

### The value of the dollar makes a difference.

The depreciation of the U.S. dollar against other countries around the world has narrowed compared to the Euro, but widened compared to the Yen. For American consumers it means they are more affected by rising crude oil prices than the citizens of Japan, but about on a par with the citizens of Europe. As oil prices have gone up all around the world, the price increase has been less for countries who have a strong currency other than the U.S. dollar, but more for those who don't.

EIA Price Forecast	Voor Boroont Change							
	2009	2010	2011	2012	2009-2010	2010-2011	2011-2012	
<b>WTI Crude</b> <sup>a</sup> (\$/barrel)	61.65	79.4	93.26	97.5	28.8	17.5	4.5	
<b>Gasoline</b> <sup>b</sup> (\$/gallon)	2.35	2.78	3.15	3.3	18.4	13.4	4.8	
<b>Diesel</b> <sup>c</sup> (\$/gallon)	2.46	2.99	3.43	3.51	21.5	14.7	2.4	
<b>Heating Oil</b> <sup>d</sup> (\$/gallon)	2.52	2.97	3.41	3.55	17.5	14.8	4.3	
Natural Gas <sup>d</sup> (\$∕mcf)	12.12	11.17	11.29	12.01	-7.8	1.1	6.3	
<b>Electricity</b> <sup>d</sup> (¢/kwh)	11.51	11.58	11.65	11.74	0.7	0.6	0.7	
<sup>a</sup> West Texas Intermediate	<sup>b</sup> Average Regular Pump Price			<sup>c</sup> On-Highway Retail		<sup>d</sup> Residential Average		

Source: EIA, Short-Term Energy Outlook, February 2011.

### Looking ahead: EIA's price forecast.

Looking ahead, the Energy Information Administration projects the annual price of WTI crude will increase from an average of \$79 per barrel in 2010 to \$93 per barrel in 2011 and then continue to rise to \$98 per barrel in 2012.

EIA expects the higher costs for crude oil will be passed on to all petroleum product prices with retail gasoline prices expected to average 37 cents per gallon more in 2011, and another 15 cents per gallon more in 2012.



#### Pump prices: A fractional story.

The biggest single component of retail gasoline prices is the cost of the raw material used to produce gasoline – crude oil. For example, for the first 11 months of 2010, crude oil alone made up 68 percent

of the price to consumers at the gasoline pump. Refining the crude oil into gasoline and retailing added another 17 percent to the retail price of gasoline. Excise taxes accounted for 15 percent of the price of gasoline.



#### Earnings: How do they compare?

It may seem surprising that oil and natural gas earnings are typically in line with the average of other major U.S. manufacturing industries. This fact is not well understood, however, in part because reports usually focus on only half the story - the profits that are earned.

Profits reflect the size of an industry, but they're not necessarily a good reflection of financial performance.

Profit margins, or earnings per dollar of sales (measured as net income divided by sales), provide one useful way to compare financial performance among industries of all sizes.

The latest published data for third quarter 2010 shows the oil and natural gas industry earned 6 cents for every dollar of sales in comparison with all manufacturing, which earned 8.6 cents for every dollar of sales.



### Earnings: Keeping America going strong.

Over the last five years, average earnings for the oil and natural gas industry have been well in line with the rest of the U.S. manufacturing industry, averaging about 7 cents for every dollar of sales. That average was just over 5 cents on the dollar for the oil and natural gas industry by the third quarter of 2009 as a result of the downturn of the U.S. economy. By the third quarter of 2010 earnings rebounded as the U.S economy continued to recover.

Like other industries, the oil and natural gas industry strives to maintain a healthy earnings capability. It does so to remain competitive and to benefit its millions of shareholders, across the country and in all walks of life. Healthy earnings also allow the industry to invest in innovative technologies that improve our environment and increase production to keep America going strong – even as it leads the search for newer technologies, and new sources of energy that will provide a more secure tomorrow.



#### If you're wondering who owns Big Oil, chances are good the answer is, "You do."

Contrary to popular belief, and what some politicians might say, America's oil companies aren't owned just by a small group of insiders. Only 1.5 percent of industry shares are owned by corporate management. The rest is owned by tens of millions of Americans, many of them middle class. If you have a mutual fund account, and 55 million U.S. households do, there's a good chance it invests in oil and natural gas stocks. If you have an IRA or personal retirement account, and 45 million U.S. households do, there's a good chance it invests in energy stocks.

When politicians talk about taxing "Big Oil" or taking their "record profits," they should think about who would they really be hurting.



U.S. oil and natural gas companies pay considerably more in taxes than the average manufacturing company. An important part of the revenue earned by U.S. oil and natural gas companies goes to taxes. The industry's 2009 income tax expenses (as a share of net income before income taxes) averaged 48.4 percent, compared to 28.1 percent for the rest of the S&P Industrial companies. As one would expect with such a high effective rate, the U.S. oil and natural gas industry pays a substantial amount in income tax. According to EIA, during the three-year period from 2006-2008, the major energy producing companies paid or incurred over \$280 billion of income tax expense.<sup>3</sup>

<sup>1</sup>  $\,$  Oil and gas extraction (NAICS 211) and petroleum refining (NAICS 32411).

<sup>2</sup> Excludes companies engaged in oil and gas extraction (NAICS 211) and petroleum refining (NAICS 32411).

<sup>3</sup> Energy Information Administration, 2008 Performance Profiles of Major Energy Producers, December 2009. These 27 companies accounted for 41 percent of the total U.S. crude and NGL production, 43 percent of natural gas production, 77 percent of U.S. refining capacity and 0.2 percent of U.S. electricity. These companies include: Alenco, Anadarko Petroleum, Apache, BP America, Chesapeake Energy, Chevron, CITGO Petroleum, ConocoPhillips, Devon Energy, El Paso, EOG Resources, Equitable Resources, ExxomMobil, Heess, Hovensa, Lyondell Chemical, Marathon Oil, Motiva Enterprises, Occidental Petroleum, Shell Oil, Sunoco, Tesoro Petroleum, The Williams Companies, Total Holding USA, Valero Energy, WRB Refining, XTO Energy.



### Raising taxes is a recipe for disaster.

With America just beginning to recover from the worst economic recession since the Great Depression, now is not the time to impose new taxes and fees on the nation's oil and natural gas industry. Increasing taxes could wipe out American jobs and hurt American businesses.

In the long run, the negative economic consequences of higher taxes more than offset any short-term tax revenue gains. An additional \$5 billion in new, annual taxes — similar to what's been proposed by the Administration, or some in Congress could actually decrease cumulative government revenue by \$128 billion by 2025 according to an economic analysis by Wood Mackenzie.<sup>4</sup> And even worse, higher taxes could result in the loss of tens of thousands of jobs between now and 2025. Right around the corner, in 2014 alone, we'd lose 170,000 of these jobs. There is a better way than saddling a troubled economy with new taxes and fees that hurt consumers and workers. The oil and natural gas industry should be allowed to develop the vast energy resources that belong to the American people. If we open areas that are currently off-limits to development, we could create more than 500,000 jobs throughout the economy and generate an additional \$150 billion in government revenue by 2025.

We can either take momentum *away* from recovery or put it *behind* American prosperity. On election night this fall, one poll showed that 60 percent of voters oppose an increase in taxes on the oil and natural gas industry; 54 percent said an increase could destroy jobs. They were right.

Wood Mackenzie, "Energy Policy at a Crossroads: An Assessment of the Impacts of Increased Access versus Higher Taxes on U.S. Oil and Natural Gas Production, Government Revenue, and Employment," January 2011.

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