Memo to: New Congressional Leadership

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H.R. 6 Risks Making Energy More Expensive

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This bill invests in clean, renewable energy and energy efficiency by repealing billions in subsidies given to big oil companies that are raking in record profits.

—House Speaker Nancy Pelosi (D–CA)

The public has responded with anger to recent high energy prices for natural gas, electricity, and especially gasoline. When the price at the pump hit $3.00 per gallon last July, it was arguably America's number one gripe, and it remained a significant Election Day issue despite the post-summer decline in prices.

Doing something about energy prices is understandably high on your agenda. Unfortunately, the Creating Long-Term Energy Alternatives for the Nation Act of 2007 (H.R. 6) is the wrong approach to meeting Americans' energy needs. H.R. 6 will, at best, do nothing to reduce gasoline prices and could actually increase them over the long term.

What H.R. 6 Does. In H.R. 6, you propose to cut back two tax code provisions favorable to domestic oil and gas companies: the manufacturer's deduction under the American Jobs Creation Act of 2004 and the amortization of geological and geophysical costs under the Energy Policy Act of 2005. These changes would reduce deductions against income for the costs of new domestic oil and natural gas drilling, thereby raising the taxes paid by energy companies working to expand supplies.

You also propose modification to the federal royalty program. This would increase fees paid by companies drilling in federally controlled offshore areas under certain leases signed in 1998 and 1999 that contained exemptions from royalty payments.

Overall, the purpose of H.R. 6 is to increase revenues to the federal government from domestic energy companies. The bill then proposes to place these additional revenues into a fund for alternative energy programs.

The Wrong Approach. H.R. 6 would have a negligible impact on the price at the pump. The current tax code and royalty program have absolutely nothing to do with recent increases in energy prices, so Washington-style tinkering with these provisions will not benefit the driving public. The price of gasoline is set by supply and demand, not by how much taxes and royalties are paid by oil companies. In the short term, H.R. 6 will not add even one gallon to the nation's energy supply, and over the long term it could prove counterproductive by discouraging domestic energy production, thus reducing supplies and raising prices.

To begin with, the underlying assumption that the domestic oil and gas sector is currently undertaxed may have been popular campaign rhetoric, but it is not supported by the evidence. According

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to the Department of Energy's Energy Information Administration (EIA), total income taxes paid by this sector reached a record $71 billion in 2005, the last year for which complete data is available. This is up from $48 billion in 2004 and $32 billion in 2003. Revenues from other taxes on the oil and gas sector are also up. Overall, taxes have risen along with oil company profits. By many measures, energy companies face tax rates comparable to or higher than those of other industrial sectors.

Most importantly, H.R. 6 may cause harm in the long run by discouraging investment in new domestic drilling for oil and gas. America's demand for energy is growing along with its economy, and so it needs more domestic oil and natural gas supplies in the years ahead. However, increased taxes on energy would move America in the opposite direction because they would leave the industry with less after-tax revenues to reinvest in new exploration and production. Furthermore, higher taxes would make new domestic projects less attractive to energy firms. Increased energy taxes would also give a comparative advantage to OPEC and other non-U.S. oil producers whose imports are not subject to most of these provisions.

Learn from History. The bottom line is your proposal to raise energy taxes could reduce domestic supplies of oil and gas, increase imports to fill the void, and ultimately increase prices for consumers.

This is the lesson of the infamous windfall profit tax (WPT) on oil firms imposed under the Carter Administration in 1980 and repealed under the Reagan Administration in 1988. In 1980, anger at "Big Oil" over high prices led to this punitive tax, but America learned the hard way that this approach does not benefit the American people. According to the Congressional Research Service, "The WPT reduced domestic oil production from between 3 and 6 percent, and increased oil imports from between 8 and 16 percent. This made the U.S. more dependent upon imported oil." You should take pains to avoid repeating that energy policy blunder.

The best that can be said of the proposed tax changes and royalty relief provisions in H.R. 6 is that they might not be large enough to seriously reduce domestic energy production, in which case they would not cause much harm. Even so, they set a bad precedent and, if repeated in subsequent bills, could do as much or more damage than the WPT.

Your proposal to place the additional revenues into a fund for alternative energy projects is also problematic. The 30-plus-year history of federally directed energy programs contains numerous boondoggles, such as the Carter era Synfuels program, which spent more than $2 billion in an unsuccessful effort to produce alternatives to petroleum-based fuels. According to EIA, alternative energy sources today supply well under 10 percent of America's energy needs, and EIA does not expect that percentage to rise appreciably in the decades ahead.

If the past is any guide, most of the money in H.R. 6 will be wasted. On the other hand, these revenues, if left in the hands of the energy companies, would be reinvested—in 2005, for example, the energy industry reinvested $131 billion, an amount actually higher than its net income of $119 billion for the year, according to EIA. Needless to say, private sector investments—including research and development of alternatives—have a much better track record than government expenditures.

A Better Way. The real answer to high energy prices is not to tinker with tax and royalty rates on existing domestic energy supplies, but to expand those supplies so that more oil and gas become available. Recent Department of the Interior studies, conducted pursuant to the 2005 energy bill, confirm that the United States has substantial oil and natural gas deposits. But these studies also show that much of these onshore and offshore resources are off-limits due to legal and regulatory constraints. In fact, America remains the only nation on earth that has restricted access to a substantial portion of its domestic energy potential.

Reducing the restrictions on domestic exploration and drilling—not rewriting the tax code or revising royalty agreements as in H.R. 6—will allow for greater supplies and lower prices in the years ahead. And by expanding the resource base, it would lead to far greater increases in tax and royalty revenues than H.R. 6 ever could. This should be the main focus of any genuinely pro-consumer energy policy from Congress.

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