Kay Bailey Hutchison, Chairman
Bill Hughes, Staff Director

347 Russell Senate Office Building
Washington, DC 20510
202-224-2946
http://rpc.senate.gov

SENATE REPUBLICAN POLICY COMMITTEE

June 17, 2008

Running on Empty: Why the Democrats' Energy Bill Won't Lower Prices at the Pump

Introduction

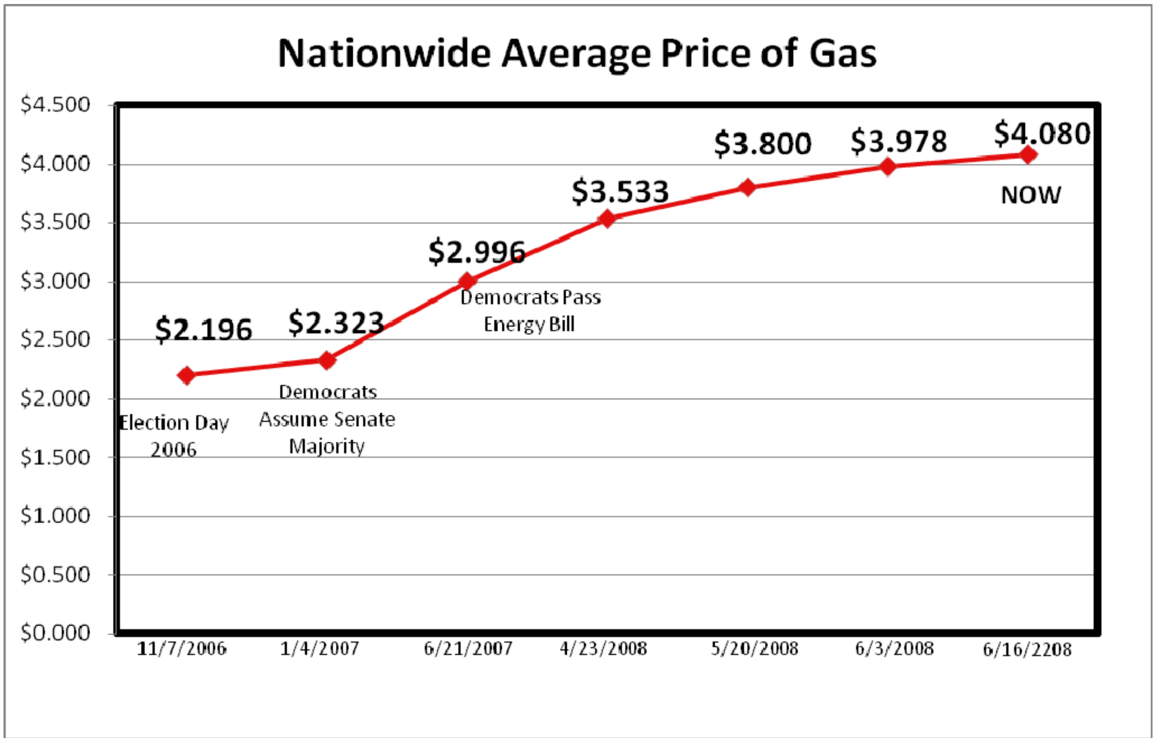
The solution to rising energy costs will require that America take steps to not only conserve energy, thereby helping to curb the growth in demand, but also to increase domestic energy supply in ways that are both safe and environmentally sound. In order to help lower energy prices, Republicans have offered legislation providing for more diverse sources of energy, including renewable energy, greater innovation through science to meet our nation's energy needs, and expanded domestic supply through production from the Outer Continental Shelf (OCS), the Arctic National Wildlife Refuge (ANWR), and use of domestic oil shale. While the Senate has passed several energy measures this Congress, those measures have only focused on reducing demand in the long term. Democrats have opposed increasing supply through the production of more energy here at home. This opposition has created scarcity in the energy supply and ensures greater dependence on foreign oil, which means consumers will continue to suffer from higher prices in the face of rising global demand.[1] The solution to high energy prices is to both reduce demand and increase domestic supply.

The Democrats' Promise of Lower Gas Prices

American consumers are aware that their paychecks simply are not buying as much as they did just a few years ago.[2] Nowhere is this more evident than with respect to the high prices consumers are paying for gasoline.[3] Gas prices have risen dramatically

[1] In 1980 President Carter signed legislation into law which placed much of the Arctic National Wildlife Refuge (ANWR) off limits for exploration. In 1995, President Clinton vetoed legislation that would have opened an area of ANWR for exploration. More recently, on December 21, 2005, Senate Democrats filibustered legislation to expand domestic exploration in ANWR.
[2] Bureau of Labor Statistics, "Real Earnings in May, 2008," June 13, 2008.
[3] Institute on Energy Research press release, "U.S. Senate Debates 'Greatest Hits' Compilation of Failed Energy Policies," June 10, 2008.

over the last two years despite the fact that in 2006 Democrats ran on the promise that they had a "commonsense plan" to lower gas prices.[4] As the chart below shows, on Election Day 2006, the nationwide average cost for a gallon of gasoline was $2.196.[5]



At the beginning of 2007, the average price for a gallon of gas was $2.323 per gallon. Five months later, on June 21, 2007 when the Senate passed the Democrats' energy bill (H.R. 6), Americans were paying an average of $2.996 for a gallon of gas. Since the Senate passed this energy bill, the price of gas has not decreased, as Democrats promised would happen, but has instead increased by $1.084 per gallon.

Today the average cost for gasoline is $4.080 per gallon. That is an increase of $1.884 per gallon, or 86 percent, in the 19 months since Election Day 2006. Despite Democrats' promise to lower gas prices, their majority has not taken any action that would reduce gas prices in the short term. Meanwhile, Americans are struggling daily with the high cost of gas prices.

---

[4] On April 27, 2006, Senate Democrats held a press conference at the Exxon station at the corner of Massachusetts and Second Street NE in Washington, D.C. At the time, gas prices nationwide were $2.927 per gallon. House Democrats held similar events in 2006 promising that they had a "commonsense plan" to lower gas prices.

[5] American Automobile Association, http://www.fuelgaugereport.com.

Analysis of the Global Petroleum Marketplace

According to an analysis completed by the Heritage Foundation, the cause of high oil prices is a result of a "perfect storm of supply and demand."[6] The Heritage Foundation found that the increase in recent demand for petroleum is not due to a significant increase of demand from developed countries, like the United States and Japan, but rather due to emerging economies like India and China. In fact, between 2008 and 2030, China and India will account for 70 percent of the increase in global demand.

Furthermore, the Heritage Foundation concluded that supply is also being negatively affected by political forces. For example, nearly one-third of Iraq's production is presently off-line, Iran's production has fallen due to that nation's inability to attract private capital and advanced technology, Nigeria's production has fallen due to civil unrest, and Venezuela's production has fallen as well.[7] The solution to an increase in demand in the face of declining supply is for "consumer countries [to] expand cooperation in order to level the playing field and reduce prices by increasing investment and production, promoting conservation, and diminishing geopolitical risk."[8] As will be made evident later in this paper, the Republican energy bill will increase production and is therefore the only bill that contains those steps necessary to actually lower prices.

Republican Support for Broad-Based Energy Initiatives

Republicans are looking for energy anywhere and everywhere that America can find reliable and environmentally safe sources of energy. Republicans understand that if we have broader and more diverse supplies of energy, Americans will have more choices and benefit from lower prices.

In the last year, Republicans and Democrats have joined together to pass several energy bills. Congress passed legislation to raise fuel efficiency standards for cars by 2011 (even though today's market conditions of high gas prices have affected consumer decisions sooner than federal mandates were designed to do) and established updated efficiency standards for appliances. This legislation, which focused on demand rather than supply, passed the Senate by a vote of 86-8.[9] This year, the Senate passed an amendment, by a vote of 97-1, to temporarily suspend the deposit of royalties-in-kind and market-based purchases into the Strategic Petroleum Reserve (SPRO).[10] This year, Republicans also worked with Democrats to pass, by a vote of 88-8, an extension of tax provisions to help continue policies that encourage energy sources like solar and wind.[11]

---

[6] Ariel Cohen and Owen Graham, "What is Driving the High Oil Prices?" Heritage Foundation Web Memo, June 10, 2008.
[7] The Heritage Foundation.
[8] The Heritage Foundation.
[9] Roll Call Vote 430 on H.R. 6.
[10] Roll Call Vote 124, S. Amdt. 4737 on S. 2284.
[11] Roll Call Vote 95, S. Amdt. 4419 to H.R. 3221.

The bills that the 110th Congress has passed have been primarily focused on reducing demand but have done nothing to actually increase supply. As Lawrence J. Goldstein of the Energy Policy Research Foundation has said recently, America's "energy policy is bankrupt…. [i]t is not prudent any more to ignore the supply side of the equation."[12] It is important that Congress do more than look at ways to reduce demand over the long-term as Congress must also seek to increase supply.

Overview of Democratic Energy Proposal

While each of the energy-related bills that have passed the Senate this year contain important provisions to reduce demand, they contain little in the way of new or expanded energy production. The legislation that Democrats are now pushing, the so-called "Consumer First Energy Act" (S. 3044), also fails to produce any new sources of energy. The Institute for Energy Research has said the Democrats' bill will "increase taxes, regulations, and the number of trial lawyers employed in the United States but it will not increase our energy supplies."[13]

Increased Taxes Won't Produce Energy

The Democrats' energy bill seeks to punish U.S. integrated oil companies by raising taxes on their income attributable to domestic production and imposing a windfall profits tax on such companies. The bill would take this tax revenue and give it to other energy companies who produce energy from other sources.[14] Congress previously enacted a windfall profits tax in 1980 and it was generally regarded as a failure. The Congressional Research Service (CRS) found that the tax was counterproductive in that it reduced domestic oil production, increased America's dependence on foreign oil, and generated far lower revenues than anticipated.[15]

As the *Wall Street Journal* noted, "If oil companies believe their earnings from exploring for new oil will be expropriated by the government – and an excise tax on profits is pure expropriation – they will surely invest less, not more. A profits tax is a sure formula to keep the future price of gas higher."[16] The Competitive Enterprise Institute (CEI) has reached a similar conclusion that a windfall profits tax would hinder "American oil firms' global competitiveness."[17]

---

[12] *The New York Times*, "Oil Prices Are Up and Politicians Are Angry. Yawn." May 11, 2008.
[13] Institute for Energy Research, June 10, 2008 press release.
[14] S. 3044, Section 104.
[15] Congressional Research Service (CRS), "Highway and Transit Program Reauthorization," CRS Report for Congress RL33305, March 9, 2006.
[16] *Wall Street Journal*, "Windfall Profits for Dummies," May 3, 2008.
[17] Iain Murray and Eli Lehrer, Competitive Enterprise Institute, "The Consumer-Last Energy Bill, a Critical Look at the Consumer-First Energy Act of 2008," May 13, 2008.

While Democrats may argue against the size of the oil companies' "excessive record profits" and seek to impose a tax on profits, the oil companies' profits are not unexpectedly large in relation to their size. Financial analysts routinely consider profitability based on a company's "return on capital." Based on this measure, the oil refiners had a return on assets in 2007 which is far less then the return seen by health care wholesalers or food and drug stores.[18] Another tool to measure a company's profitability is "return on investment," or the return shareholders receive for their money. By this measure, petroleum ranks 14th in per dollar equity compared to other industries.[19] Accordingly, in comparison to other industries oil companies are not making "excessive profits" considering the investment they have made in order to reliably provide American consumers with energy.

Increased Regulations Won't Produce Energy

The Consumer First Energy Act also gives the President the authority to declare an energy emergency in the event there are shortages, disruptions, or significant pricing anomalies in the oil market. In the event of an emergency declaration, this legislation then makes it unlawful to charge "unconscionably excessive prices" for petroleum products and gives the Federal Trade Commission (FTC) the ability to enforce these very vague provisions. The legislation also gives state attorneys general the authority to initiate civil lawsuits to enforce the provisions related to price gouging in the event the FTC fails to investigate allegations of price gouging.

Democrats have called for FTC investigations into the price of gas in 1998, 2000, 2004, 2006, and 2008 and have repeatedly proposed legislation to prevent "market manipulation," including in 2003 and 2005. Despite these repeated calls, the FTC has regularly concluded that there was "no evidence to suggest" that market manipulation had occurred.[20] The irony of these provisions is that retailers, rather than face excessive fines in emergency situations and the possibility of multi-state litigation, would likely suspend sales altogether, thereby making it even harder for consumers to buy needed supplies in an emergency.

In addition, S. 3044 establishes limitations on oil speculation in two ways. First, the bill prevents traders of U.S. crude oil from routing transactions through off-shore markets to evade speculative limits and sets forth reporting requirements. According to the Competitive Enterprise Institute, this would require that speculators route oil-related trades through the New York Mercantile Exchange while prohibiting trades on the Intercontinental Exchange. This would in turn reduce "competition from the oil trading market," which over time would lead to "less responsive" market realities.[21] In addition,

---

[18] According to Murray and Lehrer, the petroleum refiners had a return on assets of $1.90 per $1.00 of assets compared to $3.91 for health care wholesalers and $2.78 for food and drug stores.
[19] According to *Fortune* rankings, petroleum companies generated $4.32 per dollar equity compared to health care at $11.98 per dollar.
[20] Consumer Energy Institute, quoting the Federal Trade Commission following their investigation into allegations of price gouging in the wake of Hurricanes Katrina and Rita.
[21] Competitive Enterprise Institute.

this would result in non-U.S. players leaving U.S.-based markets, which in turn would lead to "a net outflow of investment capital."

The bill, in an attempt to limit all speculation, also requires the Commodities Futures Trading Commission to set a substantial increase in the margin requirement for all oil futures trades, contracts, or transactions. The Competitive Enterprise Institute has concluded that the "easy mobility of both oil and money make it impossible for any one nation's laws to put an end to speculation in oil prices." Furthermore, CEI has stated that "the provisions intended to reduce speculation will not reduce oil prices, but they will drive capital away from the United States."[22]

Perhaps the most troubling aspect about the provisions geared towards speculation is the fact that they fail to recognize that there are legitimate reasons why an individual or business would buy oil futures.[23] In many cases, businesses buy futures to hedge against rising fuel prices. With the government's failure to enact policies that provide for a stable energy supply in the face of rising global demand, businesses are increasingly seeking to hedge against their future consumption needs. For example, Dallas-based Southwest Airlines has participated in the futures market "to guard against spikes in fuel prices, usually buying options to acquire fuel at set prices."[24] This is a logical market-based response to volatile economic circumstances.

Increased Litigation Won't Produce Energy

The Democrats' bill also allows the U.S. Attorney General to sue the oil producing states of OPEC to prevent them from price fixing in relation to petroleum, including gas and natural gas. Democrats argue that "nations concerned with maintaining good diplomatic relations with the U.S. will likely be reluctant to blatantly act in a way that is counter to U.S. law."[25] This kind of statement reflects a naiveté as to both the depth of U.S. reliance on foreign oil and the fact that OPEC nations could easily sell their crude to other nations. As such, the U.S. has a great interest in maintaining diplomatic relations with OPEC.

In addition, the very idea of punishing OPEC through litigation is unlikely to have its intended effect. As the Chair of the Federal Trade Commission, Deborah Majoras testified before the Senate Commerce Committee in May 2006, "I don't think OPEC would respond to a lawsuit in the United States. I think they are going to laugh at it."[26] As such, the Democrats' energy plan amounts to nothing more than a proposal to increase taxes, increase regulation, and increase frivolous litigation. This legislation will not

---

[22] Competitive Enterprise Institute.
[23] Richard Cobbs and Alex Wolf, "Jet Fuel Hedging Strategies: Options Available for Airlines and a Survey of Industry Practices," Spring 2004. Available here, http://www.kellogg.northwestern.edu/research/fimrc/papers/jet_fuel.pdf
[24] Associated Press, "Airlines That Hedged Against Fuel Costs Reap Benefits," October 21, 2005.
[25] Senator Harry Reid Press Release, "Reid Unveils Consumer First Energy Act," May 7, 2008.
[26] Competitive Enterprise Institute.

produce any new sources of energy; the American people understand that we can't tax, sue, and regulate our way to lower gas prices or to energy independence.

Overview of Republican Energy Proposal

The American Energy Production Act (AEPA) was introduced by Senator Pete V. Domenici (R-NM).[27] This legislation would significantly increase domestic energy production in order to significantly decrease our nation's dependence on foreign oil, reduce the amount of wealth transferred abroad for energy each year, and lower the prices that Americans are paying for energy. AEPA is divided into two titles – one that would address supply-side challenges facing the United States and another that would address traditional resources and alternative resources.

Title I would increase domestic oil and gas production on the Outer Continental Shelf and in the Arctic National Wildlife Refuge. This title would also halt additions to the Strategic Petroleum Reserve for 180 days; repeal a $4,000 fee for new applications for permits to drill for domestic energy; and restore mineral leasing payments to a 50-50 federal-state split. These provisions would enable the production of up to 24 billion barrels of oil that currently sit beneath the Outer Continental Shelf and the Arctic Coastal Plain. Produced at an average rate of 2 million barrels per day, these reserves could increase domestic oil production by nearly 40 percent for more than thirty years.

Title II would mandate six billion gallons of coal-derived fuels by 2022, and repeal a recent one-year moratorium intended to delay and disrupt commercial oil shale leasing. This title would also re-define "renewable biomass" to promote advanced biofuels such as cellulosic ethanol; establish a program of direct loans and grants to accelerate the development of advanced batteries for vehicles; increase the Department of Defense's contracting authority for synthetic fuels; and repeal a provision in last year's energy bill that could prevent the U.S. military from using alternative fuels.

By increasing domestic production, AEPA would also significantly reduce the amount of oil that the U.S. imports within a matter of years. At an average rate of 2 million barrels per day, production from offshore regions and ANWR could reduce oil imports by 18 percent in 2030. As America's tremendous coal and oil shale resources are commercialized, oil imports will be reduced even further. Assuming an additional 750 million gallons of coal-derived fuels are produced each year beginning in 2015, and that oil shale production reaches 1 million barrels per day, oil imports could be reduced by an additional 1.3 million barrels per day by 2030.

Critics of this legislation have suggested that this legislation will not impact gas prices in the short term because the additional production will not come on-line for several years. While there will be a delay in production output, this legislation would

[27] Two different versions of this legislation have been introduced as S. 2958 and S. 2973.

mark a dramatic change in U.S. energy policy. By sending a signal to the markets that the United States will begin producing more energy here at home, the markets should stabilize and positively impact consumer prices. This would curb the speculators more effectively than any action Congress could take. According to recent polling data, 57 percent of Americans now support "allowing drilling in U.S. coastal and wilderness areas now off limits."[28] What the American people intuitively understand is that by saying "no, no, no" to more energy production, Congress is saying it wants prices to continue to go up, up, up.

Conclusion

A responsible energy plan for America's future should address both supply and demand. Republicans have shown a willingness to look at any proposal that has a realistic chance of increasing supply by producing more energy, and reducing demand by stretching current supplies. Republicans have proposed safe and sound means to produce more energy knowing that this will help lower energy prices.

By contrast, Democrats have been unwilling to put forward any new ideas to increase energy production. The Democrats' latest bill will increase taxes, increase regulations, and encourage lawsuits. But we know that America cannot tax, sue, or regulate our way to lower gas prices or better energy independence. Rather, America needs to take steps today that will not only lower energy prices today, but which will also establish a plan for energy security in the long term.

[28] Gallup Poll, "Majority of Americans Support Price Controls on Gas," May 28, 2008.