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MEMORANDUM February 8, 2015

To: Senate Energy and Natural Resources Committee

Subject: **$10 Fee/Tax on Oil**

On February 4, 2015, the White House released a fact sheet describing President Obama's 21st Century Clean Transportation System. Funding for this system would come from a proposed $10 per barrel fee on oil production to be phased in over a five-year period.[1] As you requested, this memorandum draws from news reports published in the Washington Post and New York Times, as well as the White House Fact Sheet, to provide provisional answers to the question of what we know about the proposed $10 fee, and what details of the proposal must still be specified.[2] The memorandum also addresses the key characteristics, or factors, in the proposal that likely will determine its effect on domestic oil production, jobs, and inflation.

The Revenue Proposal

President Obama's budget request to Congress has been reported to include a $10 per barrel fee on each barrel of oil produced by oil companies. It was reported that Jeff Zients, director of the White House National Economic Council, indicated that the fee would apply to domestic oil production, as well as oil imported from overseas, and petroleum products imported into the United States. Oil used for petroleum products exported from the United States would be exempt from the fee, allowing refiners and producers to maintain their competitive position in the world market. The fee would be phased in over a five-year period.

Unspecified details of the proposal that might be important in evaluating its effect include the nature of the phase-in of the fee over the five-year period. Low gasoline prices in 2016 might make it attractive to front-load the phase-in, but this might result in rapidly rising gasoline prices which likely would be unpopular with consumers. A slower phase-in might result in the fee increasing gasoline prices when oil and gasoline prices are increasing due to market forces, accentuating any upward push of prices. Mr.

[1] The levy on oil proposed by the Obama Administration might be considered a tax by some and a fee by others. For purposes of this memorandum the White House terminology will be used.

[2] As the content of this memorandum is based on news reports and a White House fact sheet that did not include details of the program, any conclusions must be considered provisional. News reports drawn from in the preparation of this memorandum include, Coral Davenport, "Obama to Propose a $10-a-Barrel Fee on Oil," The New York Times, February 5, 2016, Steven Mufson,"Obama Backs Transportation Projects," The Washington Post, February 5, 2016, and The White House, "FACT SHEET: President Obama's 21st Century Clean Transportation System, February 4, 2016.

Zients predicted that the fee might result in a gasoline price increase of as much as $0.24 per gallon when fully implemented.

Crude oil is heterogeneous, differing in specific gravity and sulfur content altering its quality rating, and hence, allowing different grades of oil to command different prices. It is unclear whether oils of differing quality and value would all be subject to the same fee, changing the effective relative price structure, in percentage terms, of various grades of oil.

Oil companies may be interested in where in the production process the fee would be collected, as this might have implications for the administrative costs to the companies of the fee, as well as implications for their cash flow at the different stages of production of the oil industry. Oil companies might be sensitive to this issue because of their weakened financial condition due to the low market price of oil. Also, the oil industry is composed of firms that range in size from very large to much smaller, creating a possibility that the administrative costs of the tax might vary between firms, possibly altering the structure of the industry if small firms experience a greater burden due to the fee.

The fee is to apply to domestic and imported crude oil as well as imported petroleum products. However, one barrel of crude oil does not produce one barrel of say, gasoline, or any other petroleum product. Refining crude oil produces a slate of products. One barrel of crude oil typically yields 19 gallons of gasoline and 12 gallons of diesel fuel as well as other products. How the fee would be equalized between crude oil and petroleum products to equalize the tax burden is yet to be defined. In addition, it may be that policy will not favor all the products of a barrel of crude being subject to the same fee. Mr. Zients conceded that Northeast consumers who use distillate fuel for home heating might be subsidized, but those who use propane for heating might feel entitled to similar subsidization. In addition, it might be desirable to direct the fee's burden to consumer goods, like gasoline, and not to other petroleum products that enter industrial processes as intermediate products.

Macroeconomic Effects

Analysts are likely to be concerned with the macroeconomic effects of the oil fee. These effects might include those on employment and jobs, economic growth, and inflation. Key relationships need to be specified in the current economic environment of a weak oil market characterized by low prices, and a domestic economy which is encountering economic headwinds from a weakening Chinese economy.

Mr. Zients conceded that while the fee would be collected from oil companies, the companies would likely shift some, or all, of the burden of the fee to consumers. As consumers face higher transportation and home heating costs, as well as higher costs, in general, for all goods, due to the pervasiveness of petroleum in the general production process, how will consumers alter their consumption and saving decisions? The answer is likely to determine how employment would be affected in various industries. Mr. Zients pointed out that the Clean Transportation System programs would generate transportation infrastructure jobs as a partial offset to the effect of higher petroleum product prices.

As oil companies cut capital budgets due to declining revenues and profit, the degree to which consumers shift consumption patterns away from oil products will accentuate that trend. Weakening employment availability in the oil and related industries is likely to be increased due to the fee. In addition, reduced oil exploration and production budgets are likely to reduce U.S. production potential, reducing energy security, if the oil market tightens in the future and current excess supply conditions in the market change.

Since it is likely that the oil fee would be shifted forward by the oil companies, and since petroleum products enter into many products, consumers will likely see higher prices, not only directly for gasoline and other consumer products, but, in general, for many products to varying degrees. It is possible that these price increases might set the stage for cost-push inflationary pressure.

In general, the fee would likely result in decreased discretionary consumer purchasing power which may translate into lower expected economic growth.