

# Counting with Mitt: A Review of Energy Subsidies and the Romney Campaign

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Mitt Romney is a market-focused guy, so he clearly understands the importance of a level market playing field if firms are to create jobs and deploy capital in the right areas. Unfortunately, his statements on energy policy don't walk-the-walk in terms of keeping government out of the role of selecting winners.

This summary highlights key problems with Romney's subsidy totals, and then fills in some of the important subsidies that Mitt forgot. If Romney were to be elected the next president, this list can also serve as a starting point for making energy policy neutral – and for challenging the inevitable pressure that his some of his rather [biased](#) energy advisors will levy for still more, not less, subsidies to oil and gas.

## **Private equity and national policy: differentiated advantage versus level playing field**

Romney naturally sees the world through the lens of his own corporate experience – most significantly his role at private equity firm Bain Capital. But this is not entirely a good thing. In the private equity and venture capital businesses, you look for anomalies in markets – poorly run companies that can be made better; new ideas that are short on capital; and yes, business sectors where government interventions and subsidies generate the prospect of excess profits. These policies often create opportunities that can be exploited over the short- to mid-term. Then the early investors exit at a profit, and somebody else manages the opportunity over the long-term. In the corn ethanol market, for example, by the time overbuilding began to compress margins and force shutdowns and sales, much of the “smart” money was already out.

But running a country is not like running a private equity fund. Where private equity thrives on short- and mid-term profit opportunities, national policy must focus on long-term, sustainable growth. It is much more about setting and maintaining unbiased, less-bureaucratic, and transparent parameters in which markets can function than about finding niches of opportunity to quickly exploit. Yes, improving performance is critical for both VC/private equity and in government policy. But the framework for success is difference. VC/private equity thrives on differentiated advantage. National policy is successful only if a neutral playing field can be established – one on which many different ideas, methods, and enterprises focused on solving particular problems or meeting particular needs can compete on an equal footing.

This difference matters a great deal because subsidies can and do create differentiated advantage for one industry or region. Like virtually all government spending, subsidies also create jobs – though not always *net*, jobs since other sectors may be negatively impacted. But

politicized subsidies often undermine the long-term competitive business environment that the country needs to prosper over time.

### **Adjusting Romney's subsidy baseline**

According to Romney, there is about \$90 billion/year in subsidies to clean energy, matched by only \$2.8 billion in subsidies to oil and gas. And even that piddly amount (a) goes only to the smaller companies; and (b) reflects mere accounting nuances. Here's what he actually said in the [first debate](#):

*First of all, the Department of Energy has said the tax break for oil companies is \$2.8 billion a year. And it's actually an accounting treatment, as you know, that's been in place for a hundred years. Now ...*

*And in one year, you provided \$90 billion in breaks to the green energy world.*

*Now, I like green energy as well, but that's about 50 years' worth of what oil and gas receives. And you say Exxon and Mobil. Actually, this \$2.8 billion goes largely to small companies, to drilling operators and so forth.*

Romney's claim about subsidies to oil being merely accounting treatments is channeling American Petroleum Institute [president Jack Gerard](#). Here's Gerard: "We think it's important to remind the public that we don't receive subsidies. These are cost recovery mechanisms, just as everyone else receives." Yup. They are just *better* cost recovery mechanisms that what everybody else gets. Percentage depletion – the century-old subsidy – is unique to natural resource extraction industries and lets firms deduct more in costs than they actually invested. And many of the other tax breaks allow oil and gas, to deduct multi-year capital immediately, something most other industries can't do.

Romney's subsidy numbers are problematic, with the green energy greatly overstated (as noted in [this](#) blog post) and those to oil and gas vastly understated. Romney's oil and gas numbers rely on the [narrowest framing](#) of energy subsidies by any group; yet Table 1 illustrates that even using their numbers, proper framing of the subsidies alters the comparisons made by the Romney campaign in material ways.

**Table 1:**

**Adjusting categories weakens Romney's argument, even using the flawed EIA subsidy data**

<b>\$90b/yr</b>	Amount Romney claimed was provided to green energy in a single year. This value actually includes multiple years, commitments rather than just cash outlays, and a variety of recipients outside of the renewable energy category.
<b>\$15b/yr</b>	Amount of subsidies to renewable energy estimated in the same EIA report Romney relied on for his oil and gas subsidy figure. <sup>1</sup> EIA counts seven separate energy resources in its renewable category (biomass, geothermal, hydroelectric, solar, wind, liquid biofuels, and other).
<b>\$2b/yr</b>	Subsidies to renewable energy based on the EIA report Romney used for his oil and gas subsidy figure, once not-very-green biofuels (\$6.5b) and short-term incentives under the stimulus package (\$6.2b) within the American Recovery and Reinvestment Act (ARRA) are backed out.
<b>\$2.8b/yr</b>	Total subsidies to oil and gas according to Romney. Amount is from EIA's 2011 report, and leaves out many subsidies. Some of the gaps are shown below; for a full critique of EIA's approach see Koplow, 2010. <sup>2</sup>
<b>\$6.4b/yr</b>	Total subsidies per EIA data to conventional, well established fuels. Category includes oil and gas, coal, and nuclear. Since Romney combines multiple renewable fuels into a single total, a comparison to all conventional fuels is more accurate than just O&G.
<b>\$11.2b/yr</b>	Total subsidies to conventional fuels, according to EIA, once the fossil and nuclear shares of consumer subsidies through the low-income home energy assistance program (LIHEAP) are included. The renewable share of LIHEAP is \$225m, versus nearly \$5b for fossil fuels and nuclear. <sup>3</sup>
<b>20%</b>	Recurring (net of ARRA) subsidies to non-biofuels renewables as a share of subsidies to fossil fuel and nuclear, according to EIA data.

**Escaping corporation taxation entirely: Master Limited Partnerships**

With all of the talk this campaign season about reducing income tax burdens on small business, it is easy to forget that an ever higher percentage of small businesses (and many larger ones) are adopting corporate forms that escape corporate income taxes entirely. This includes sub-S corporations, partnerships, and limited liability corporations. As a result, the share of national income paid from corporate income taxes has dropped from nearly 30% in the

<sup>1</sup> U.S. Energy Information Administration, *Direct Federal Financial Interventions and Subsidies in Energy in Fiscal Year 2010*, 2011, p. xiii.

<sup>2</sup> Doug Koplow, *EIA Energy Subsidy Estimates: A Review of Assumptions and Omissions*, (Cambridge, MA: Earth Track, Inc.), March 2010.

<sup>3</sup> LIHEAP spending was allocated based on EIA residential energy survey data for incomes below \$40,000 per year. The electricity share of consumption was allocated to fuels based on average shares of net generation in 2010.

1950s to less than 11% for the period 2000-2009.<sup>4</sup> But one group of enterprises – those raising capital on public equity markets – must generally still use corporate forms that pay corporate taxes.

One glaring exception is publicly-traded partnerships (PTPs), also known as Master Limited Partnerships (MLPs). Under special rules, this group of companies can both raise capital on public markets and bypass corporate income taxes entirely. Tax liabilities (and enterprise-related subsidies) pass directly out to the partners’ individual tax returns. MLPs don’t make up a huge chunk of listed firms on the stock market. But within the tax favored MLP universe, oil and gas companies dominate, including a new one focused on fracking sand.

One other sector able to use the MLP approach is also relevant to this debate: private equity firms. If Bain Capital wanted to go public so partners could cash in their built-up equity, they would likely become an MLP. Blackstone and KKR, two large private equity firms, have already done so.

**Table 2: Avoided taxes on oil and gas MLPs alone exceed all O&G subsidies Romney counted**

<b>\$293b/yr</b>	Market capitalization of <i>fossil fuel-related</i> MLPs, as of August 2012. <sup>5</sup> The MLP corporate form allows many oil and gas operations to both raise capital on public stock markets and pay no corporate-level income taxes.
<b>\$20-56b/yr</b>	Estimated income generated by fossil fuel MLPs, based on reported yields. This income entirely escapes corporate taxation. <sup>6</sup>
<b>\$5-15b/yr</b>	Estimated tax savings to fossil fuel sector from using an MLP relative to a standard corporation, based on assumptions on tax rates by the National Association of Publicly Traded Partnerships.
<b>87%</b>	Share of all MLPs, by market capitalization, in the fossil fuel sector.
<b>\$0</b>	Subsidies associated with MLPs that the US Energy Information Administration captures in its evaluations, excluding it on the basis that “the tax treatment of PTPs is not exclusive to the energy sector.” <sup>7</sup>
<b>1.8 – 5.4</b>	Tax subsidy to fossil fuel MLPs as a multiple of all subsidies to oil and gas EIA counted in its 2011 analysis.

<sup>4</sup> Chuck Marr and Brian Highsmith, “Six Tests for Corporate Tax Reform,” Center for Budget and Policy Priorities, 24 February 2012.

<sup>5</sup> National Association of Publicly Traded Partnerships, “Master Limited Partnerships 101: Understanding MLPs,” August 2012.

<sup>6</sup> Low-end assumes a yield of 6.7%, the average of fossil-fuel-related MLPs based on MLPs listed on the [Yield Hunter website](#) with additional data from Google Finance. High-end estimate is from Telis Demos and Tom Lauricella, “Yield-Starved Investors Snap Up Riskier MLPs,” *Wall Street Journal*, 16 September 2012.

<sup>7</sup> EIA 2011, p. x.

## Ignoring transportation infrastructure

The concept of “free-riding” in economics applies when people use shared resources like a subway or a road without paying for them. Transportation infrastructure is relevant to energy markets in two ways. First, bulk fuels are transported by road, rail, pipeline, and ship. Coal and oil shipments, for example, have consistently exceeded 50% of the tonnage shipped through the country’s inland waterway system. These shipments are subsidized, with oil and coal the largest beneficiaries. But they are not discussed here.

The second connection between fossil fuels and transportation infrastructure (which is discussed) is that road use makes up most of the demand for petroleum fuels. Subsidies to highways bolster demand for fuels, and those subsidies are enormous.

Highway infrastructure has long been subsidized by taxpayers, rather than paid for entirely by users through taxes on fuels or road tolls. There are millions of partial free-riders in this system. The problem could be fixed simply by increasing user charges or by spending money on highways more efficiently. However, proposals to increase taxes on gasoline often cause political uproar. This is unfortunate: current motor fuel taxes aren’t even high enough to cover the cost of building and maintaining the highways. These subsidies spur excess fuel use and enlarge fiscal deficits.

**Table 3: Annual subsidies to highway construction far larger than Romney’s recognized O&G subsidies; full user fee funding would require much higher fuel taxes**

<b>72%</b>	Percent of all liquid fossil fuels used in the transport sector. <sup>8</sup>
<b>\$70b/yr</b>	Amount that charges on users fell short of federal highway spending in 2007, the most recent year tabulated by the Pew Subsidyscope Project . This calculation credits all collections, including funds used for non-highway purposes like mass-transit, to highway funding. <sup>9</sup> Motor fuel taxes are the largest source of user fees to pay for highways; tolls are a distant second. The share of total costs paid by users dropped from 70% in 1970 to only 51% in 2007.
<b>\$685 billion</b>	Cumulative user-fee shortfalls in highway funding between 1994, the year Mitt Romney first ran for national office, and 2007 (in 2007\$).

<sup>8</sup> EIA, calculated from “Table 2: Energy Consumption by Sector and Source,” *Annual Energy Outlook 2012*, release date June 2012. Scenario: ref2012.d020112c

<sup>9</sup> Pew Subsidyscope project, <http://www.subsidyscope.com/transportation/direct-expenditures/highways/funding/analysis/> and related data tables. Accessed 2 November 2012.

## Stop giving away valuable resources for less than they are worth

Exit strategies for valuable companies in a private equity portfolio are discussed in terms of multiples of the original investment: the higher the multiple, the better the return. US natural resource policy seems to take a different approach: spur economic growth or reward powerful constituencies by giving away valuable minerals for far less than they are worth. The two examples below, all related to fossil fuel extraction on federal property, are estimated to result in more than \$100 billion in losses to taxpayers.

**Table 4: Below-market sales of energy resources results in an enormous subsidy to fossil fuels**

<b>\$53 billion, total</b>	US Government Accountability Office best-guess estimate for taxpayer losses from lost royalties on Gulf of Mexico oil and gas leases signed between 1996 and 2000 (some scenarios have losses as high as \$80 billion). <sup>10</sup> Foolish flaws in the Deep Water Royalty Relief Act of 1995, exacerbated by subsequent litigation by Kerr-McGee (now Anadarko Petroleum), created the problem. Despite losses larger than the Bernie Madoff scandal, there has been little accountability. Efforts to reverse these losses using a variety of techniques have been blocked in Congress by members close to the oil industry. <sup>11</sup>
<b>\$29 billion, total</b>	Estimated below-market lease terms on Powder River Basin (PRB) coal over the past 30 years. <sup>12</sup> The PRB is one of the richest deposits of high quality coal in the country, and the region produces more than 40% of the country's coal.

## Energy security

Largely because our military and transport sectors rely so heavily on petroleum, ensuring adequate and stable supplies has been a long-term objective of the federal government. Not every form of energy faces the same supply security costs or issues, so this constitutes a differentiated subsidy to oil.

In other markets, firms and customers use a variety of ways to deal with insecure supplies. They diversify products or suppliers. They invest in private stockpiles. They purchase more security services or insurance to shift some of the financial risks of disruption. Many of these strategies drive the price up to consumers, which triggers additional efforts to shift to

<sup>10</sup> Franklin Rusco, "Oil and Gas Royalties: Litigation over Royalty Relief Could Cost the Federal Government Billions of Dollars," letter from GAO to Congressional requestors, 5 June 2008, GAO-08-792R; Mark E. Gaffigan, Acting Director, Natural Resources and Environment, US Government Accountability Office, before the Committee on Energy and Natural Resources, United States Senate, 18 January 2007. GAO-07-369T.

<sup>11</sup> For a description of some of these attempts, see Autumn Hanna, "[Oil and Gas Royalties: 'Relief' for Oil and Gas Companies: A Fiscal Headache for Taxpayers.](#)" (Washington, DC: Taxpayers for Common Sense), November 2009.

<sup>12</sup> Thomas Sanzillo, *The Great Giveaway: The costly failure of federal coal leasing in the Powder River Basin*, International Institute for Energy Economics and Financial Analysis, June 2012.

lower cost, more stable supplies. In the oil sector, much of these security costs are paid by taxpayers rather than by oil markets. Table 5 highlights two areas: oil stockpiling and defense of key oil shipping lanes and regions. In both of these areas, changes to how the programs are funding (such as by shifting to user fees of some sort) would provide better price signals to oil markets, reduce the deficit, and possibly spur innovative but less expensive ways to provide the same services.

**Table 5: Keeping safe costs money, but oil producers and consumers aren't the ones paying**

<p><b>At least \$585m/yr</b></p>	<p>In response to macroeconomic shocks from oil supply cut-offs, and as required by its membership in the International Energy Agency, the US has established oil stockpiling capability in its government-owned and managed Strategic Petroleum Reserve. Many other IEA members recover the costs through fees on oil markets or mandate the private sector to provide stockpiling services. The annual figure shown here reflects interest charges alone on the \$20b in oil inventory being financed by Treasury debt. Subsidies are much higher once capital and operating costs of SPR are included, interest is compounded (as it is on the debt we are carrying to support the inventory), and during periods of SPR's history when government borrowing costs weren't so low.</p>
<p><b>\$220b/yr</b></p>	<p>Average annual cost of military force in the Persian Gulf between 1976 and 2007 based on a detailed cost accounting study by Roger Stern at Princeton University.<sup>13</sup> If ever 10 percent of this amount were attributed to oil, the annual subsidy to oil markets (both domestic and foreign) from US taxpayers would exceed \$20 billion.</p>

<sup>13</sup> Roger Stern, "[United States cost of military force projection in the Persian Gulf, 1976–2007](#)," *Energy Policy*, 2010.