The Windfall Profit Tax Of 2017

By John Harpole

The U.S. oil and gas industry is celebrating about six years of a shale revolution that has contributed greatly to a budding U.S. industrial renaissance. But the next six years could be a lot less worthy of celebration, depending upon the ways that a theoretical Middle East conflict could affect U.S. energy security.

The combination of various (and highly realistic) factors could create huge problems for the U.S. domestic oil and gas industry. Consider this potential future news story:

Crisis in the Gulf

April 1, 2017

It's hard to believe now that it was just seven months ago, this past September of 2016, when world oil prices were $85 per barrel (bbl.).

Americans had taken the often repeated "Energy Independence by 2020" slogan to heart, and they assumed that they were forever insulated from gas pump sticker shock brought on by Middle East conflicts.

As we know now, there is a huge difference between energy independence and energy security. In the real world, U.S. gasoline prices would never be disconnected from events in the Middle East, irrespective of U.S. oil production volumes.

The cold reality of the energy independence myth became brutally apparent just days after the first salvo in the Gulf crisis.

Angry over a string of perceived international slights, militants in Iran began planting mines in the 21-mile Strait of Hormuz, the pinch point for all oil exiting the Persian Gulf. Their short-term goal was simple: to shut down 30% of the world's oil flow for several months. Their more subtle and strategic long-term goal was an attempt to derail the U.S. shale revolution.

During the third and fourth day of the crisis in the Gulf, the U.S. was successful in sinking or destroying four Iranian submarines and countless fastboats. Tensions spiraled, and the United Nations Security Council stepped in.

Russia and China helped negotiate a ceasefire.

Mind the mines

Russia insisted on assuming responsibility for clearing more than 2,000 mines from the Persian Gulf.

"Its promise to clear the mines in "less than two months" is now into its fifth month. Not one oil tanker has successfully exited the Persian Gulf since mid-September last year. Russia, one of the world's top oil producers, has seen a windfall of profit for its treasury as each minesweeping day drags on, casting doubt on Russia's motivation to complete the task.

World oil prices surged upward at the start of the conflict, averaging more than $200 per bbl. since mid-September.

Thanks to energy security, American consumers continued to pump gas while consumers in other countries had none. But the cost was significant, at $7.50 per gallon in the U.S., underscoring the truism that energy security is not equivalent to energy independence.

The U.S. mainstream media immediately cried out for a Windfall Profit Tax (WPT). They also claimed that the U.S. debt crisis could be solved by such a tax. Swiftly enacted, it set artificially low profit thresholds that oil companies could avoid via renewable energy investments.

The final phase of the Iranian plan had fallen into place.

The mainstream media, U.S. senators and congressmen, anti-fracing activists and renewable energy proponents had won what they considered a huge victory with the passage of the WPT of 2017. For vastly different reasons, Iran and Russia agreed.

Within 60 days of its passage, half of the drilling rigs in the U.S. were laid down. It was a simple decision for U.S. domestic producers. Their return on investment for nearly 50% of the natural gas liquids-rich producing basins in the U.S. was suddenly, seriously marginalized.

By the late spring of 2017, the U.S. shale revolution was effectively over. U.S. spot natural gas index and futures prices had increased by 50% to an average of $7 per million Btu (MMBtu) thanks to an alarming drop in gas production. About $3.50 per MMBtu of that "windfall profit" was destined for the U.S. Treasury.

Corporations that were in the midst of building out billions of dollars of new manufacturing facilities suddenly idled their expansion plans. The WPT had simultaneously eliminated low gas prices and the margin on manufactured goods.

The conclusion

The moral to this fictional story?

Energy security and energy independence are two totally different concepts. The U.S. domestic oil and gas industry should make every effort to clarify the difference in communications with the U.S. public. ■

John Harpole *is senior advisor and an editorial advisory board member to* Midstream Business. *He is founder and president of Mercator Energy LLC and can be reached at harp@mercatorenergy.com or 303-825-1100.*