

## Four Reasons Why Big Oil Is Not To Blame for High Oil Prices

By B. Kinniard

4/28/08

Okay, we have a simple mathematical equation, with a simple answer, concerning Big Oil and the cost of a gallon of gas, right? Obviously, since Big Oil made record profits they must be overcharging the consumer. After all, they are nothing more than money hungry greed mongers who are breaking the backs of hard working men and women in our country with their exorbitant high prices.

That is what the media and our government wants us to believe and much of the country is already buying that story. In fact, I would lay money that you agreed with it while reading the opening paragraph.

However, I am here to tell you that the Big Oil Companies aren't the main problem. In fact, the more I research, the more I find that Big Oil is the *least* of the problem when it comes to the high cost of gas.

Here is why:

### **1. Simple Supply and Demand**

The rule of supply and demand is an easy one to understand. When the supply of a product is low and demand is high, the product is worth more to the consumer. Therefore, the price to purchase the product goes up. Leverage is held by the supplier as to the cost of the product.

However, when *supply* is high and demand is low, the price of a product goes down because the supplier still needs to maintain a certain level of revenue and maximize profits. The best way to do that is to lower prices in order to lure more consumers to buy their product. When this happens, the leverage has moved into the hands of the consumer.

You can see this dynamic in almost every product on the market. A simple example can be seen in the movie industry. When a hot movie comes out, the demand is high so the movie industry only releases the movie to the first run movie houses where they receive the highest ticket prices. As the demand to see this movie decreases, the movie industry allows the second run movie houses to show it at lower ticket prices. As the demand reduces even more, the movie industry allows the budget movie houses as well as the pay-per-view companies to show it at even lower prices. As you can see, when the demand decreases, the prices continue to plummet.

The demand for this same movie will *increase* temporarily when it is released on DVD. For as long as the demand is high, the price of the DVD remains high. After a while, as the demand for the DVD decreases, the prices do too. Eventually, this movie will have reached the floor of the pricing scale and normally will stay there indefinitely.

Oil works the same way. Twenty years ago, demand for oil was much lower than it is today. Therefore, the price per gallon of gas was much lower too.

Over the course of the last twenty years, much of the world has dramatically increased its demand for oil. The United States, who is the biggest single country user, isn't the only culprit for the increase in demand although we do shoulder a significant part of the problem.

In fact, according to the U.S. Energy Information Administration, the U.S. has had an increase in demand for oil of a little over 34% over the course of the last twenty years. This is not a good thing but it isn't the only reason the demand has skyrocketed.

Asia, the second biggest oil user is a much bigger contributor to the increase in demand. In the last twenty years, Asia has increased their consumption of oil by well over one hundred percent! At the current rate, Asia will soon overtake North America as the largest consumer of oil in the world.

Asia isn't the only area of the world that has increased their oil consumption by far more than the United States. Central & South America has increased its consumption by better than 70% as well. Africa has increased their consumption by 60%. Even the Middle East has more than doubled their consumption over the course of the last twenty years.

In all, the world has increased its consumption of oil by over twenty three million barrels per day since 1985 and it is still climbing.

This global increase in demand has left the leverage in the hands of the producers of the raw materials. Unless the global community, not just the U.S., reduces its consumption, the prices will continue to climb with the demand.

While an argument can be made that Big Oil has refused to add refining capabilities that match demand in order to falsely keep the demand high to assure higher prices, it would be a moot point if demand by the consumer decreased.

Therefore, Big Oil can't be blamed for the high prices caused by consumer demand.

## **2. The Government Makes More Money Per Dollar of Oil Purchased Than The Oil Companies do.**

According the United States Census Bureau, in a report released in November of 2007, Big Oil made a net profit of 8.3%. That

means for every dollar that Big Oil took in, they were able to keep almost eight and a half cents.

On those same dollars, the Government at large made a net profit of fifteen cents! Again, that means for every dollar that Big Oil took in, the Government, including Federal, State and Local, were able to keep nearly DOUBLE the money Big Oil was able to!

Although this is an amazing discovery, you won't hear it on most of the media nor will you hear it coming from the mouths of the politicians. All we hear from the politicians is how much money Big Oil makes and how it is such an exorbitant amount. If Big Oil's profits are so exorbitant, then what does it make Big Government's profits on oil?

You can't blame Big Oil for the current fifty cents or more per gallon of gasoline that we pay in taxes.

### **3. The Profits of Big Oil Are About Average For U.S. Industries.**

Yes, Big Oil's billions in profits are big. It is a huge number. However, it is also a huge industry. Even so, when compared to other U.S. industries, Big Oils profit margins are only mediocre.

According to the U.S. Census Bureau, Big Oil Ranks below six other industries in net profit percentages. They rank behind Big Tobacco, Big Alcohol, Big Appliances, Big Medicine, Big Computers, Big Chemicals and Big Manufacturing (not including auto manufacturing).

In fact, on a scale of averages, Big Oil isn't exactly setting itself apart from the pack. If they were to get a grade on their performance compared to their peers, they would get a C+.

So, the argument that Big Oil's profits are exorbitant doesn't hold water when compared to other industries.

#### **4. Big Oil Has A Responsibility To Make As Much Money As Possible.**

The Big Oil Companies are publicly held. As such, they are charged with creating as much profits as they can in order to maximize the dividends paid to the stockholders.

The stockholders aren't simply the folks who sit on the Board of Directors for the Big Oil companies. The stockholder might likely include you! If you have a 401K, an IRA or a money market account, you are likely an investor in Big Oil somewhere in your portfolio. When you invested in these things it was with the hope and intent to turn your investment into more money than what you started with. What would you do if Big Oil generated less or was unconcerned with maximizing profits? I would presume you would transfer your investment to a company would work diligently to grow your money.

Big Oil has the responsibility to grow your money because they are using your money to grow the company. That is how a capitalist society works. In addition, how many jobs would be lost if Big Oil lost its desire to generate maximized profits?

Regardless of the condition of the market, Big Oil along with all other companies, big or small, is charged with exploiting the market to their advantage in the best way possible.

Anything less, would undermine the foundation of our entire economy of Free Enterprise and Capitalism and turn it into an economy with Socialist characteristics. I don't think we want that. That is what killed the USSR's economy and allowed us to win the Cold War.

As we listen to all the Rhetoric we hear from politicians and the media, it is important that we understand the truths behind the rhetoric in order to establish the correct positions which allow us to make the correct decisions.

If we are to fight against the high cost of gasoline, we need to fight the real enemy which in this case, is consumption and the Governmental taxes.

Ironically, the enemy isn't Big Oil.