
National Capital Area Chapter

United States Association for
Energy Economics

March 2003

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news

The Dogs of War And the Bulls of Oil

Our Next Luncheon at Library of Congress

WHEN: Noon, Friday, April 25

WHERE: 6th Floor, Madison Building—Montpelier Dining Room
Library of Congress (enter from Independence Avenue)
1st Street & Independence Avenue, SE
Washington, DC

SPEAKERS: Michael C. Lynch, President, Strategic Energy & Economic Research, Inc.

Despite the biggest military conflict in a decade taking place in one of the world's largest oil fields, oil prices have tumbled. Is this an accurate reflection of events? Or the flightiness of speculators? After three major oil supply disruptions in as many decades, have the pundits learned to read the market? Or are the remaining uncertainties so severe that we cannot yet judge?

Michael C. Lynch is President of Strategic Energy and Economic Research and a research affiliate at the Massachusetts Institute of Technology's Center for International Studies. He has combined S.B.-S.M. degrees in Political Science from M.I.T., and has performed a variety of studies related to international energy matters, including forecasting of the world oil market, energy and security and corporate strategy in the energy industries, as well as analysis of oil and gas supply. He is currently working on a book, *The Fog of Commerce: Oil Crises and Economic Security*, expected to be published within the next year.

He is a former Chief Energy Economist at DRI-WEFA, Inc. a leading economic consulting firm, and a past-President of the United States Association for Energy Economics, and was the Program Chairman of their 1996 North American Conference, as well as being an appointed council member of the International Association for Energy Economics. His publications have appeared in Spanish, Arabic, Italian, Russian and Japanese, as well as English, and he serves on the editorial board of the journal *Energy Policy*.

Join us on Friday, April 25 at 12:00 pm for networking, with the lunch-line forming promptly at 12:30 and the presentation beginning at 1 pm so we are done by 2 pm.

COST: \$20.00 for members (\$5.00 for student members) and \$25.00 for non-members—guests are always welcome. Make checks payable to NCAC-USAE. **RSVP:** By COB Tuesday, April 22 to Leslie Coleman by phone (202/463-9780) or email (lcoleman@nma.org). Cancellations after noon Wednesday will be billed.

NCAC Spring Policy Seminar with Daniel Yergin – May 5

Mark your calendar for the NCAC Spring Policy Seminar, scheduled May 5. We are pleased to announce that **Daniel Yergin**, celebrated author of *The Prize* and *Commanding Heights*, will provide the keynote address. This year's event will focus on energy and war, terrorism and disruption in the world market. The full program is now available on the NCAC web site. Please reserve your space now for this program!

Highlights of the March Lunch

**SPEAKER: John Felmy, Director of Policy Analysis and Statistics
And Chief Economist, American Petroleum Institute (API)**

Information the Public Needs to Know about Energy Prices

Our March speaker program featured John Felmy of the American Petroleum Institute, where Felmy is Chief Economist and Director of Policy Analysis and Statistics. (Note: the originally scheduled program on Rocky Mountain oil and gas inventories, featuring Jack Belcher as speaker has been postponed and will be rescheduled for a later date.)

With the war in Iraq and other oil market disruptions (turmoil this year in Venezuela and Nigeria), energy topics are receiving plenty of attention in the media. So Felmy, who receives a great number of media inquiries, started out by discussing tools for working with journalists, especially how to explain issues to those who might know little about energy.

What is the first thing reporters need to know?, Felmy asked. How many gallons per barrel of oil! (There are 42 gallons in a barrel of crude oil.) The price of oil is typically discussed in dollars per barrel, while the U.S. public tracks gasoline prices in cents per gallon. Felmy frequently shares with reporters a chart showing both crude and gasoline prices (historical) in dollars per gallon. A dollar change in the price of crude (dollars per barrel) thus translates into a change of 2.4 cents per gallon of crude. If one looks at the recent past, crude oil prices have risen by about \$0.35/gallon – and gasoline prices have also risen by about \$0.35/gallon. (Felmy noted that precision helps when working with reporters.)

Looking at the more recent decline in crude prices (with the start of the war in Iraq), reporters are asking how soon will gasoline prices go down, and how much will they go down. In his work, Felmy cannot forecast prices, but he does walk reporters through the recent history of price changes, and he points out that studies say crude prices tend to lead gasoline prices by a period of about 5 weeks. Reporters often respond with the assertion that, “gasoline prices go up quickly, but they don’t come down quickly.” Felmy points out that consumers can’t react to changes in crude oil prices, because the information is not readily available to them in a useable format. Most newspapers, if they print crude oil prices at all, print futures prices in dollars per barrel and frequently at the back of the business section. The industry, Felmy suggests, does not do enough to educate consumers about what is happening in the energy sector. As a result, consumers notice primarily only the fluctuation in their retail prices.

Felmy’s exchanges with reporters about gasoline prices in California require special explanations. California has had much higher price increases for at least two reasons. First, a major section of California – the central valley -- changed its gasoline formula to reflect severe non-attainment (air quality) status. Second, California has banned the gasoline additive MTBE, and as a result, companies are switching to the additive ethanol, which creates major challenges. The typical gasoline includes less

ethanol than it would MTBE, so there is a volume loss. In addition, ethanol is more evaporative, so the gasoline formulated must be adjusted by removing generally cheaper lighter end products – a further volume loss that increases product costs. Furthermore, ethanol is corrosive and cannot be placed in product pipelines, so the blend must occur further downstream, adding to tanker, blending, and storage costs.

All of this results in a major shock to the California system and even affects non reformulated gasoline by increasing demand for high-end blending components. West coast gasoline markets are also complicated by the fact that Arizona and northern California switch from winter to summer gasoline on April 1st and southern California switches on March 1st while most of the country makes this switch on May 1st. This further complicates gasoline distribution processes. Felmy explained how recent actions and claims made by politicians brought gasoline issues into the limelight and contributed to increased attention by the press.

Felmy discussed a few more charts showing the historical relationships between crude and gasoline prices, and between crude and diesel prices. The market for diesel, a middle distillate, is complicated by one-sided substitution that occurs between diesel and heating oil demand. In a high demand or high price environment (for ex., cold weather), diesel can be used for heating oil. However, heating oil cannot be used for (automotive) diesel because of the higher sulfur content in heating oil.

Reporters are also asking why crude oil prices have gone up so much. Felmy worked through several reasons including disruptions in exports from Venezuela (a major supplier to the U.S. market), domestic instability in oil-exporting Nigeria, colder winter weather in the northeast of the U.S., and finally the war in Iraq, which created uncertainty. The net result of all of this is the ‘perfect storm’, as it has been described by Red Caveny, President of API.

Felmy talked about sources of crude imports to the U.S. and common impressions in the media. He noted that people are surprised when they learn how much oil the U.S. has imported from Iraq (as high as a million barrels per day) and how much oil we get from Mexico. The most surprising fact for many is the amount of crude and products imported from Canada, one of the largest U.S. oil suppliers. This topic prompted a number of audience questions and comments. One person noted that listing oil imports by country of origin suggests that the U.S. targets countries to supply oil when the reality is that oil imports are bought in a fungible world market. Felmy was asked how much of previous Venezuelan exports are likely to be restored, and he responded that this is a key question for the world market. He noted that some experts believe there has been real damage to productive capacity during the shut-downs caused by striking workers. He also underscored that approximately 16,000 oil industry workers were fired in Venezuela (as a result of strikes and clashes with the government), which should have a major impact on expertise and capabilities in Venezuela’s oil industry.

To conclude, Felmy turned to fuel inventories and the natural gas situation. While gasoline inventories are just a little bit below average, heating oil inventories are low and natural gas storage is very low, raising questions about how fast it will fill up and at what cost. A lively Q&A period wound up the session. John Felmy, when questioned about next generation fuels, made a “100-year prediction” that methane hydrates will be important because of how vast this resource is, with the fuel to supply 4000 years of energy.

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2003 MEMBERSHIP RENEWAL/REGISTRATION FORM

National Capital Area Chapter U.S. Association for Energy Economics

- Please check here for membership renewal.
- Please check here for new membership registration.
- Please check here for student membership registration.

Membership registration/renewal for the NCAC/USAEE is expected by the end of the preceding calendar year.

Please return your registration form and check to **Leslie Coleman**—NCAC/USAEE 2003 Treasurer at: **National Mining Association, 101 Constitution Ave., Suite 500 East, NW, Washington, DC 20001**. Phone: 202/463-9780. Email: lcoleman@nma.org.

Full membership dues for 2003 are \$20.00 (students \$10.00). Please make checks payable to NCAC/USAEE.

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