National Capital Area Chapter

United States Association for
Energy Economics
June 2004
http://www.ncac-usaee.org

news

The 2004 BP Statistical Review of World Energy

Peter Davies, Chief Economist, BP

Our Next Meeting—An Evening Event!

WHEN: 5:00 p.m., Thursday, June 17

WHERE: Room 806 of the SAIS Rome Building
1619 Massachusetts Avenue NW
Washington, DC

SPEAKER: Peter Davies, Group Vice President and Chief Economist, BP

Our June event is a joint seminar cosponsored with The Paul H. Nitze School of Advanced International Studies, International Energy and Environment Program of SAIS, at Johns Hopkins University.

Peter Davies, Group Vice President and Chief Economist of BP will present the 2004 BP Statistical Review of World Energy, an authoritative reference work used widely by energy economists. In presenting it, Davies will highlight developments in energy markets over the past year.

A former president of the International Association of Energy Economics, Peter Davis is also an honorary professor at the Center for Energy, Mineral and Petroleum Law and Policy at the University of Dundee.

The event will take place in Room 806 of the SAIS Rome Building at 1619 Massachusetts Avenue, beginning at 5:00 p.m. Coffee and beverages will be available, and the seminar will begin promptly at 5:15 p.m. There will be reception following the seminar around 6:15 p.m. There is no cost for attending this event, but SAIS asks that attendees RSVP in advance.

COST: There is no cost for attending this event. **RSVP:** Please RSVP directly to Danielle Mesko at 202-663-5786 or faxing your response to 202-663-5769. They ask that you provide your name, professional affiliation and title, as well as your preferred method of communication for seminars (e-mail or fax).

BP Statistical Review of World Energy – New York Presentation June 16

In addition to the joint SAIS/NCAC presentation of the BP Statistical Review on June 17 in Washington (see front page), Peter Davies will also be making a similar presentation in New York on June 16. That meeting will be held at the BP offices located at 535 Madison Avenue and 54th Street, 34th floor. The session will begin with a continental breakfast at 8:30 a.m. followed by the presentation and conclude at 10:30 a.m.

USAEE has a limited number of spaces for attendance. Please RSVP Peter Fusaro, NY Chapter President of USAEE at peterfusaro@global-change.com or send a fax to 212-222-0550 by Friday, June 11. They ask that you provide name, organization, e-mail and telephone number.

The USAEE New York Chapter will be relaunched this fall as Energy & Environment Forum and will have an active program of seminars on energy and environmental issues in New York City at various locations with several universities.

NCAC/WCEE Joint Happy Hour – Wednesday, June 30

The National Capitol Area Chapter of the International Association for Energy Economics (NCAC/IAEE) and the Women's Council on Energy and the Environment (WCEE) are hosting a joint networking Happy Hour on Wednesday, June 30, 6:00-8:00 p.m. It will be held on the terrace of Morton's Steakhouse at 1050 Connecticut Avenue. The closest metro stop is Farragut North. Come meet members of WCEE and reconnect with NCAC/IAEE colleagues.

May Luncheon

John Felmy, Chief Economist, API
What's Up with Gasoline Prices?

John Felmy addressed growing concerns about increasing prices for gasoline at the May NCAC meeting. As Chief Economist of API, he is often called upon by media to explain the gyrations of the market.

The most important component in the cost of a gallon of gasoline is the price of crude, and that's been going up and down. Right now crude is roughly $1.00 per gallon—or about half the price of gasoline at the pump. Then add on 18.4 cents/gallon federal tax, and on average 42.7 cents/gallon state tax, the base cost is almost $1.42/gallon, before it's refined, marketed and transported.

Gasoline, historically, has tracked crude oil pretty closely. In May retail prices in the District of Columbia were the highest, at $2.059/gallon, while the national average was $2.023/gallon. The price in Maryland was $2.016/gallon, and in Virginia $1.94/gallon. There are a couple of reasons for these differences. One is the difference in state taxes. Excise and storage taxes in D.C. total 20 cents; in Maryland 23.5 cents and in Virginia, 18.5 cents. And there are differences in the types of fuel that are required. Maryland has three different fuels; D.C. just has one. That affects price.

There are a lot of record prices this year, including diesel, which also tracks crude. On May 20, 2004, the diesel price on the NYMEX tied the region's highest diesel price ever recorded, at $1.45.

Earlier this year Felmy characterized the market as "déjà vu all over again." Back in early 2003 there were a lot of factors that sharply increased crude prices—a cold winter, political problems in Venezuela and Nigeria, as well as the beginning of an MTBE ban in California and led to complications blending gasoline with ethanol. Then we had a price spike in summer with the blackout, which shut down several refineries, followed by threats of rolling blackouts, which roiled the market.

Last winter, once again, we had a cold winter (although warmer than the previous year), OPEC had been cutting output, more problems in Venezuela, instability in Nigeria, a lot of economic growth and the depreciation of the American dollar. But this time it wasn't déjà vu all over again—as the price has continued to rise.

[A 30% depreciation of the American dollar is clearly a factor in OPEC's decisions, because their purchasing power goes down when the dollar is devalued against the Euro. It also means that Europe has not been affected to the same extent that the U.S. by rising gasoline prices. Europe has experienced a 20% increase in gasoline prices, while the U.S. has seen a 50% rise.]

We've experienced two major changes in the gasoline market. The first is the introduction of low-sulfur gasoline, the first phase of Tier II gasoline, which is a higher-cost gasoline and impacts the amount that can be imported.

California finished a transition from MTBE to ethanol. That creates a problem because of the chemistry involved in blending, not the ethanol itself. Ethanol is highly evaporative. So when you blend it with gasoline you have to change the base gasoline to achieve the correct evaporative characteristics. It's more expensive to produce the base gasoline, because you have to eliminate a lot of the inexpensive additives. You also have much less ability to import that product, because there are fewer facilities outside that can produce RBOB—which is the base gasoline used for blended gasolines.

This year we also had a Mississippi River accident that shut down barging, which meant that a lot of crude couldn't get upstream to refineries, and a lot of refined products couldn't get barged out.

And finally, we had very strong gasoline demand—the strongest month—with an increase of over 4%, even though prices are over $2.00/gallon.

New York has banned MTBE. That's significant because 60% of the reformulated gasoline on the East Coast is imported. So that means that DOE asked if it could be supplied by foreign refineries. It wasn't a problem with winter gasoline. For most of the country we switch between winter and summer gasoline on May 1. California switches March 1 in the south, April 1 in the middle of the state, and May 1 in the north. So they have a more complicated changeover.

The real problem is that when you switch to summer gasoline you've got to change the evaporative content, to lower the reactive vapor pressure (RVP) of gasoline to meet Clean Air requirements.

In the beginning of 2002 we had very low prices. Post September 11, we had a warm winter, low economic activity. A lot of opponents love to calculate oil industry profits by comparing the first quarter of 2002, taking the lowest quarter. But we've had crude oil prices, month over month, rising 30%.

Over the past few weeks we've had an astonishing run-up in the price of gasoline—a clear divergence from previous periods, from $1.05 to $1.45/gallon in a matter of four weeks. For those wishing to track gasoline prices, the AAA provides prices on a web site: www.fuelguage.com.

About 90% of gasoline service stations are independently operated. Prices can vary significantly. One station near Nebraska Avenue in the District was selling gasoline at $2.23/gallon, while another station about two blocks away was offering gasoline at $1.99/gallon. But the busy station was the higher-priced one.

On the West Coast gasoline prices have risen even more than elsewhere. California produces the most expensive gasoline in the world, with Santa Barbara as the highest-priced gasoline in California. The Golden State also supplies Arizona, Nevada, Oregon and Washington. It's a perfectly balanced market in the best of times, but when there are sustained outages, and when you net out the West Coast, there are still substantial increases.

What is the industry doing? It's running refineries harder than they've ever run them. While the refineries are operating at record levels, they have lower inventories, which is down roughly 20-25% year to date. Part of the problem is the ability to match fuel specifications. We have lower sulfur gasoline, fewer refineries outside the U.S. that can produce it, RBOB in the New York-Connecticut area that fewer refineries can produce.

As a result, when you marry this production, lower imports, record demand, we've got lower inventories. We're operating, on average, 6% below average. In New England and the South Atlantic states, it's 13% below average. "We're running on a treadmill," said Felmy.

"Our opponents claim we are keeping inventories low to improve price conditions. I categorically reject that," said Felmy.

Felmy presented a map that shows the "boutique fuel problem." "This is not really raising prices in the most recent interval run-up, but it does mean that when you have problems in the gasoline market, you can't solve those problems by trucking fuel from one area to another easily, if they are using different fuel specifications. What's the right combination? California would prefer everyone to move to their specs, but that would result in higher fuel costs for everyone.

API supports a renewable fuel standard, which includes eliminating the oxygenate mandate requiring either ethanol or MTBE in gasoline. These problems began with Clean Air Act requirements, winter oxygenate programs in the Rockies, and some areas that opted for adjusting the RVP, or the sulfur content mix, to get a gasoline that's somewhere in between and lowering costs for certain areas.

Felmy argues that a lot of statements in the press about profit margins for the oil industry are misleading. "You can go from $1,000 to $6,000 profits, and you've got a 500% increase, but you haven't made any money," said Felmy. Compared to other industries, oil companies aren't nearly as profitable. At an average 4-5% rate of return for refineries, that's a very low profit by most standards.

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2004 MEMBERSHIP RENEWAL/REGISTRATION FORM

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

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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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