

Crude awakening

Difficult choices await a nation – and world – stuck on oil

By Craig D. Rose and Dean Calbreath

UNION-TRIBUNE STAFF WRITERS

May 29, 2005

It's the stuff of American romance: summer, a big car, a tankful of gas and the endless highway.

But that fabled love is now a troubled relationship.

We can still drive where we want, if the traffic isn't too bad. And we can still drive something nice, if our credit holds out. But Americans can no longer control the cost of the gasoline that enlivened the romance.

To be sure, America long ago lost its energy independence and has at times lost control of prices, as it did when OPEC flexed its muscle in the 1970s.

But new forces in world energy markets, unrestrained consumption epitomized by the boom in sport utility vehicles and the depletion of oil have subjected the United States to buffeting by forces outside its control.

Call it the era of the permanent oil shock.

Despite a recent dip, the long-term trend for oil prices appears to be a slow but steady ascent, with just short-lived downward blips.

Just two years ago, the notion of oil rising above \$40 per barrel was nearly unthinkable. Now, a consensus is developing among economists that the floor for oil prices is in the mid-\$40 range, compared with the mid-\$20 range that prevailed from 1985 to 2002.

"We're looking at a situation where we think that the shock that we've seen to prices is a permanent shock," said David Robinson, deputy director of research at the International Monetary Fund.

There are signs that oil has reached an era where it is beyond the power of any single entity to rein in prices.

Beyond the United States, which is beginning to lose its dominance as the world's most influential oil consumer. Beyond the Organization of Petroleum Exporting Countries, which seems to have lost its ability to keep up with demand. And beyond even the big oil companies, whose record profits disguise costly bottlenecks in oil exploration, refining and production.

As the summer traveling season begins, drivers can be thankful for one thing: The price of gas is not as high as it could have been.

In the past month, the price of a barrel of crude oil has dropped from a 20-year inflation-adjusted high of \$58.28 to its current price, just above \$50. A gallon of gas has dropped from an average of \$2.67 in San Diego in mid-April to \$2.46 last week.

Nationwide, gasoline prices are expected to average \$2.17 a gallon through the end of summer and remain above \$2 through the end of 2006, according to projections by the U.S. Energy Information Administration – the highest range since 1985, even after adjusting for inflation.

In San Diego, one of the nation's most expensive fuel markets, prices should average \$2.50 to \$2.60 throughout the summer, but could spike as high as \$3, according to the Utility Consumers' Action Network, a San Diego consumer group that monitors local pump prices.

Even if the price of oil has peaked for the year, prices remain high by historical standards.

And unlike previous spikes in oil prices, which were tied to wars and unrest in the Middle East, the current spike has a more fundamental cause: the inability of oil suppliers to keep up with global demand.

OPEC is pumping more than 29 million barrels daily, its highest level in 25 years, and it is still barely able to keep up with global demand. Analysts at the International Monetary Fund say the cartel may have only about 1.5 million barrels a day of spare capacity, compared with 5.5 million spare barrels four years ago.

Supply is so tight because demand has risen so quickly in the past few years, led by surging demand from China and India – which account for more than a third of the world's population – along with unrestrained increases in the United States, still by far the world's largest energy consumer.

China and India have developed enough economic strength for a substantial number of their citizens to begin buying automobiles, said Raghuram Rajan, research director at the IMF.

In both countries, demand for oil has doubled in 10 years. Although ox-drawn carts are still common as the two nations leapfrog from the 19th century into the 21st, the impact on the oil market has been enormous.

"This demand starts taking off in a tremendous way," Rajan said. "Our sense is that the growth in transport demand will account for a very, very big chunk of the growth in oil demand going forward."

Said Stephen Levy, director of the Center for the Continuing Study of the California Economy, "They have doubled their use in a decade, and eventually that kind of doubling gets you."

But it's misleading to assign Asia sole responsibility for the surge in world oil prices. The United States uses twice as much oil as India and China, despite having a less than a sixth of the combined population. Person for person, the United States uses 15 times as much oil as China.

In addition, Public Citizen, a consumer group in Washington, D.C., and President Bush find themselves in rare agreement on another matter: The United States does not have enough oil refinery capacity.

Bush says regulatory hurdles have made oil companies reluctant to take on new refinery construction. Public Citizen contends that oil companies made a conscious decision to maximize their profits by restraining the growth of refining capacity as demand grew.

But most observers agree that gasoline pump price hikes are still largely the result of increases in crude oil costs, driven by the stunning growth in demand.

The strain between supply and demand could push prices up indefinitely, some economists suggest.

A growing number of oil analysts say petroleum is hitting its peak as a form of energy – the point at which 50 percent of the world's oil will have been consumed, leaving an ever-diminishing amount that will not be able to match demand.

Sweden's Association for the Study of Peak Oil and Gas estimates that the global supply of gas will peak as early as 2008. The Energy Institute in London makes the same prediction. The International Energy Agency says a peak could happen by 2013.

Other oil experts say the peak could be two or three decades away. The U.S. Department of Energy, which has one of the most optimistic outlooks, estimates oil will not peak before 2040.

To extend the current supply of oil even by a few years will require huge investments whose costs will ultimately be passed on to consumers.

"There is a lot of oil out there, but the real question is whether we will make the investment to get it, and the investments are huge," said John Felmy, chief economist for the American Petroleum Institute, an industry group.

The International Energy Agency estimates \$16 trillion in investment will be required by 2030 to meet projected demand for oil and natural gas. But though the world's major oil companies have reported record profits recently, they seem more interested in using those profits to merge with rivals or repurchase their stock than in making the massive investment needed for new refineries or oil wells.

"We haven't built a single refinery over the past 25 years, although we've shut down 100 during that time," said James Hamilton, an economist at the University of California San Diego who specializes in energy issues.

In the past, run-ups in oil prices have had what amounted to a self-correcting valve: economic recessions. From the Suez crisis of 1956 to the Persian Gulf War of 1990, price hikes for oil led to recessions among oil-importing countries, which led to cutbacks in oil usage, which led to drops in the price of oil.

This time, the run-up has been gradual enough to not substantially deter oil demand, and it seems unlikely to cause a recession, although it may limit economic growth.

Despite the proliferation of gas-guzzling SUVs in the United States, the nation's shift to a less energy-dependent service economy and conservation measures instituted decades ago are dulling the impact of rising oil prices.

Claude Mandil, executive director of the Paris-based International Energy Agency, says consumers globally still seem reluctant to change their energy habits, despite the higher oil prices.

"People cannot imagine they could live as well consuming less energy," said Mandil, whose agency coordinates energy policy for large industrialized countries.

He added that he hopes it is just a matter of time before demand starts to slacken and investment in the sector increases.

The Bush administration's response to the oil crisis has focused heavily on boosting supply and less on restraining demand through energy efficiency and conservation.

In a recent speech, Bush explained what he called the fundamental energy problem the nation faces: "Our supply of energy is not growing fast enough to meet the demand of our growing economy."

The speech included energy-boosting initiatives, such as support for nuclear power, building more oil refineries and tapping cleaner coal technologies.

Bush said his objective was to make the U.S. less dependent on foreign energy sources. But even within the

administration, experts concede the initiatives would do little to guarantee energy independence.

An Energy Department report finds that even if the Bush energy plan passes Congress, the United States could be importing 85 percent of its oil by 2025, compared with 65 percent now.

"From the aspect of world market prices, an additional 900,000 barrels a day 13 years from now (from Alaska) would not have any dramatic impact on the supply-and-demand picture," said Jonathan Kogan, a spokesman for the U.S. Energy Information Administration.

Critics note that the bill does nothing to limit consumption – such as requiring that cars and SUVs get better gas mileage – and does little to fund projects to obtain more energy from renewable sources.

Outside the administration, Set America Free, a coalition including conservatives and liberals, labor unions and environmentalists, is pressing for a reduction in the nation's dependence on petroleum, arguing that it is a matter of national security.

The International Energy Agency, in fact, says conservation can achieve much faster benefits than oil exploration. In a report last month, the IEA recommended reducing the workweek, encouraging flex time, slashing prices on public transportation and introducing a 55-mile-per-hour speed limit worldwide, which created dramatic savings in the United States in the 1970s and 1980s.

The IEA, made up of the energy ministers of most industrialized countries, estimates its recommendations would save 6 million barrels of oil per day – enough to buy time as nations try to switch to alternative forms of energy.

But in the United States, the emphasis is still on boosting supply.

Rep. Joe Barton, R-Texas, chairman of the House Committee on Energy and Commerce, the driving force behind the House version of the energy bill, says the bill and other incentives might allow the United States to build enough new refineries to meet its need for gasoline.

Producing enough crude oil for those refineries is another matter.

"We might meet half our demand for oil," Barton said.

Severin Borenstein, director of the University of California Energy Institute, said the energy package continues to cater to the nation's expensive addiction to oil rather than telling the American public it needs to cut back on oil.

Instead of trying to maintain low gasoline prices, Borenstein said, politicians should boost the price of gas to reflect its real costs to the society and encourage the development of more efficient transportation systems and alternative energy sources.

He says the current cost of oil, as high as it is, does not reflect the true price of maintaining the supply, ranging from military operations to guarding oil fields and the unaccounted costs of environmental damage from using fossil fuels.

Barton sees things differently. The gas-burning internal-combustion engine, he says, is remarkably efficient and a boon to the U.S. economy.

"Think of the benefits that accrue from cheap gasoline," he said. "You can move a 4,000-pound vehicle down the road at 60 miles per hour listening to the stereo with the air conditioning on. That is a tremendous bang for the buck."

Some of Barton's Democratic colleagues challenge that viewpoint.

"We've got 3 percent of the world's oil reserves, and we consume 25 percent of its production," said Rep. Henry Waxman, a Los Angeles Democrat, who thinks it is a mistake to put all the focus on boosting the oil supply.

"There is no way we can continue to dig our way out of this problem."

Find this article at:

<http://www.signonsandiego.com/news/metro/20050529-9999-lz1n29oilpric.html>

Check the box to include the list of links referenced in the article.