Testimony of

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Statement of the American Petroleum Institute

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Mr. Chairman and members of the Committee, I am John Felmy, Chief Economist and Director of Policy Analysis and Statistics of the American Petroleum Institute (API). API is a national trade association representing more than 400 companies engaged in all sectors of the U.S. oil and natural gas industry. API is pleased to have the opportunity to present a statement on gasoline and natural gas - and urge Congress to enact national energy policy legislation.

The recent spikes in gasoline prices are primarily due to fundamentals in the supply and demand for crude oil. Demand for crude oil has risen due to a cold winter and strengthening economies. Unrest in key supplying countries such as Venezuela and Nigeria and lower Iraqi production have kept world supplies tight. OPEC continues to operate under production quotas and has recently confirmed its intent to cut production by a million barrels per day to 23.5 million barrels a day, potentially worsening the current situation. However, there is no guarantee member nations will reduce output sufficient to comply.

The United States continues to import more than 60 per cent of the crude oil and petroleum products used each day to provide Americans the products they need. While 20 percent of current imports are from the Middle East, the U.S. Energy Information Administration (EIA) expects that figure to climb substantially, as the gap between U.S. oil production and consumption widens.

In addition to higher crude prices, several other factors have affected gasoline prices. We have experienced refinery problems, a Mississippi River accident that shutdown traffic for several days, the difficulty of switching from winter to summer fuel in California, the introduction of new low-sulfur gasoline (Tier II), the bans of MTBE in gasoline in New York, Connecticut and California and sharply higher demand. I have attached two papers that elaborate on these points.

As a consequence of all these factors, gasoline prices have reached a record level - unadjusted for inflation - of over $1.76 per gallon. When adjusted for inflation, the real price of gasoline has fallen over 40 percent from a peak of $2.77 in 1981. The real cost of crude oil and manufacturing, delivering and marketing gasoline has fallen over the past twenty years while the real cost of federal and state taxes has risen.

Demand for gasoline continues to be strong, as our economy grows. Gasoline production is running at record levels this year. However, inventories are low, because of strong demand and lower imports. Imports play a very important role, even though 90 per cent of the gasoline we use is refined in this country. High tanker freight rates, low European inventories, and increasingly more restrictive U.S. fuel specifications have contributed to the curtailing of gasoline imports.

What, then, can be done about the situation?

Some want to suspend filling the Strategic Petroleum Reserve (SPR) and releasing the 150,000 barrels a day currently going into the reserve onto the marketplace. That would have a negligible effect on supply, because the amount made available is the equivalent of only about two-tenths of one percent of world supply. The SPR was established as a backup in the event of a real emergency supply shortfall, not as a non-market mechanism aimed at influencing prices. Turning to the reserve when prices go up sends precisely the wrong message to the marketplace

at exactly the wrong time. Unintended consequences may include foreign nations curtailing production.
Let me also briefly discuss the situation in natural gas markets. Like gasoline, natural gas has increased substantially in price over the past two years. We have seen three price spikes in three years and prices remain high due to high demand and low supply growth. Weather and economic growth and continued increases in demand for gas by electricity generators have kept prices over $5.00 per million Btus. The industry has responded to the higher prices by operating more drilling rigs searching for natural gas. We have also continued our efforts to obtain access to lands that are currently off limits to exploration for natural gas.
API has argued for several years that we need a national energy policy that increases supplies, streamlines regulation, fosters energy efficiency and growth in renewables and allows for increased infrastructure to get supplies to consumers. The Senate was only two votes short of passing an energy bill that contains provisions that would have helped consumers. A comprehensive energy bill needs to be passed and sent to the President for his signature. Failure to pass meaningful energy legislation will increase the risk that we will stay on the energy price treadmill.