

**Remarks to the Western Governors' Association
2005 Annual Meeting
Breckenridge, Colorado
June 12-14, 2004**

By

**Robert E. Ebel
Chairman, Energy Program
Center for Strategic & International Studies
Washington, D. C.**

For the past 18 months or so, the attention of oil producers and consumers worldwide has been captured by just one simple word. And that word is “sustainability.”

- Is growth in production and in development of spare producing capacity by OPEC sustainable?
- Is growth in oil production and exports by Russia, second only to Saudi Arabia, sustainable?
- Is the growth in oil demand by China, India, and the United States sustainable?

China is very much in the news today, particularly because of its expanding need for foreign oil to keep its economy moving ahead. Only the United States surpasses China as an oil consumer. Almost all of the growth in demand for oil must be met through imports. Last year this one country accounted for 40% of world oil demand growth.

Because of that, it very much matters to all of us whether China’s economy continues to expand as it has the past several years, or cools off, or whether it comes to a hard landing.

It matters because we do not live in isolation from the world oil and gas markets. We are vulnerable to any event, anywhere, anytime that impacts on energy supply and demand. When prices go up—or down—they go up or down everywhere. That is why we watch not just China, but energy supply and demand developments in virtually every country, regardless of whether they are a “giver” to the market, or a “taker.”

China today does not face a shortage of oil, but it does face a shortage of coal. Even though coal mining this year should yield at least 2 billion tons, that will not be enough.

Does that mean China is in the market to import coal, say from our western states, to cover the gap between supply and demand? No, unfortunately it does not. China’s coal mining sector faces two problems:

- An overloaded distribution system, and

- Additions of coal-fired electric power generating capacities exceeding the ability of the coal sector to respond.

But things are changing. Limitations are being placed on construction of new power capacities. But it is difficult to hold back on coal production growth as long as prices remain high.

While Chinese officials worry today about coal shortages, they are also beginning to worry about coal surpluses in the not-too-distant future.

That is why I do not see China as a market for your coal for some time to come, if then. China does not like an energy import dependency. China is an exporting country, and it imports in support of its export capability. Today, it is textiles, tomorrow most likely automobiles.

But it is not just China that has pushed oil prices up to where they are today. These other factors relate to supply, while China, India and the United States are factors influencing demand.

The market of course reacts to real events that impact directly and immediately on supply and demand. And the market equally reacts to perceptions of an event that **might** take place, an event that would affect either supply or demand. It does not matter.

Just what supply-related factors were in play in 2004?

- Political uncertainties in Venezuela,
- Civil war and strikes in Nigeria,
- The unfulfilled promise of Iraq,
- Problems in Russia, and
- Terrorist acts in Saudi Arabia.

Then, along came a hurricane in the Gulf of Mexico, taking as much oil off the market as all supply-related factors combined.

Yet, it was our judgment that world oil production had been sufficient to meet world oil demand, but only barely. Rather, it was the fear—the “fear factor” we all talked about—that something might happen to disturb the

tenuous balance between oil supply and demand that helped move prices above and beyond what the market fundamentals would seem to indicate.

Additionally, those factors just referenced had to be weighed against:

- The disappearance of spare producing capacity worldwide,
- Infrastructure limitations, and the need to protect that infrastructure against terrorist acts,

Now, what do all these factors, all these influences have in common? Simply that they were, and remain, outside our control and, with only minor exception, steps that might be taken to resolve them are essentially outside our control as well.

Unfortunately, these factors are still in play, still outside our control.

Well, what **can** we control or rather, what **should** we control? I think it can be said without much argument that our oil problem, and that also includes environmental concerns, begins and ends with the American automobile.

Do we have an energy problem in this country? Is it just high gasoline prices or is it much more than that? Is it that we want to drive our SUVs to concerts raising funds to oppose nuclear power, while on the way not coming across any ugly refineries, electric power plants and transmission lines and the like spoiling our view of the scenery? We want clean air, we want cheap gasoline, and we want everything built somewhere else. Just what **is** the problem?

Population and prosperity are among the key drivers of our oil demand, as they are elsewhere around the world. U.S. oil demand in turn reflects the dominance of transportation fuels, basically gasoline. Our population increases annually, more automobiles show up on our roads annually. We currently have some 240 million motor vehicles on the road, supported by 170,000 retail service stations. Miles driven, for business and pleasure, reflect the state of our economy, the state of our mind.

As we pass these 170,000 service stations, what do we see? The latest price in tall, bold numbers, and that does have a strong psychological impact, possibly higher than the actual impact on the cost of operating a motor

vehicle. I know of no other essential commodity where the daily price is posted so visibly, and at so many sites. There is no escape.

High gasoline prices are always resented. To illustrate, the American housewife while shopping at her favorite grocery store thinks nothing of paying \$2 for a small bottle of water. Next, she stops at the local Starbucks for a \$3.50 cappuccino. From there, she notes the gas gauge of her car is nearly on empty, and she ends up paying \$2.20 per gallon to refuel. What are the oil companies doing to us now, she thinks.

America does have an energy problem. In today's context, that means the American people and our government have lost the political will to take those actions needed to bring about meaningful changes on both sides of the supply and demand equation. At one time we did have the required political will, coming out of the Arab embargo of 1973-74, as our economy was faced with high prices and limitations on the amounts of gasoline that consumers could purchase. That political will led to the creation of our Strategic Petroleum Reserve and to CAFÉ standards, that is, more miles per gallon of gasoline consumed.

But we have lost that political will. Where has it gone? Might it ever return? Not at least until another event intrudes on energy supply, leading to consumer curtailments for an extended period of time.

Americans cherish the mobility, the freedom of movement, the independence that the automobile provides. And we in large measure can lay this mobility, this freedom of movement, this independence at the feet of former president Dwight D. Eisenhower. How so?

As a young Army officer, in 1919 Col. Eisenhower had been directed to lead a military convoy across the country. That trip took 2 months, and made him see the need for a way to move supplies and troops more efficiently around the country to protect national security. Years later, General Eisenhower could marvel at the German autobahn and envisaged the same for the United States.

In 1956, at the urging of then-president Eisenhower, our Congress passed the Federal-Aid Highway Act, calling for 41,000 miles of highways. President Eisenhower defined the legislation as “the National Defense Highway System.”

Consider that, beginning in 1869, a traveler could cross the United States by rail in just 6 days. Almost 100 years would pass before the traveler could cross the United States by automobile in the same 6 days.

President Eisenhower thought of this proposed highway system in military terms, and could not have seen how the pattern of community development in America would be fundamentally altered and would henceforth be based on the automobile.

Without this highway network, would our standard of living be as high as it is today, our economy just as flexible, our job market just as open, our home ownership just as high? I think not.

We all want, we all seek secure, reliable, diverse, affordable and environmentally sound energy not just for our own personal use but as well for our nation as a whole.

Western states are much more conscious of our natural resource base, the state of the environment. We look to your states to take the lead in giving us not necessarily alternatives to oil and natural gas, but supplemental sources of energy, sources that are under our control, and not under the control of a foreign supplier whose national interests cannot be expected to mirror ours. It is leadership by example.

For the most part, American consumers have just two concerns when it comes to oil and energy in general. Price and availability. They do not care where the oil comes from, but if the selling price is acceptable, and if the consumer can buy as much as he needs, then what is the problem?

Every energy-related decision you and I make as consumers, or our government makes, has a tradeoffs. These tradeoffs carry their own costs, their own risks but rarely do we consider that. Generally speaking, decisions taken not to put our remaining energy potential to work translates into a higher import dependency. Remember, we lack the political will to do otherwise, to attack our energy problem in a meaningful way.

It is not just developing alternative forms of energy such as wind or solar, or biomass fuels. It is equally important to educate the American public as to the importance of the task ahead. Politicians speak of energy independence

for this country. Under present and likely future circumstances, that is not possible. It is very misleading to think in those terms.

Instead, think of our unused energy potential, with coal leading the way. Coal liquefaction and coal gasification prospects, even shale oil, are attracting renewed attention. Would this attention, and that given to renewables persist in the face of declining oil prices? Will demand keep pressing on supply? Are high oil prices here to stay?

I wish I had the answer to these questions.