Crude behavior

In a recent piece focusing on energy, New York Times columnist Thomas L. Friedman noted that critics have accused President Bush and his new chief of staff "of doing nothing more than shuffling around the deck chairs on the Titanic, as they shift, hire and fire senior White House officials while the president's popularity continues to plummet." Friedman added, "Personally, I think that is a totally unfair charge — unfair to the captain of the Titanic."

Friedman's position was based on his opinion that, unlike the (unseen) iceberg that sank the Titanic, the energy iceberg has been recognized for years. During the first presidential debate in 2000, then-Gov. Bush criticized the Clinton administration for not having an energy plan — while citing his energy experience, claiming, "It's an issue I know a lot about."

Like nearly everything in Washington these days, the discussion of oil is politically driven. President Bush and Vice President Cheney are being criticized for their close ties to the oil industry, while Democrats are challenged for their opposition to drilling in the Alaskan National Wildlife Refuge. Proposed solutions, such as the $100 tax credit for all taxpayers, have been dismissed as sham.

Increased competition for oil reserves from nations such as China and India, which were not major consumers 10 to 20 years ago, has dramatically changed the oil discussion worldwide. Meanwhile, at home, Congress and the administration are compounding the oil problem. Many experts believe the Energy Policy Act of 2005, signed into law last summer, caused the rising fuel prices. The law mandated a switch to ethanol 270 days after it took effect. No one seemed to remember that May 5, 2006, would mark the beginning of the peak demand season for gasoline. The impact would have decreased substantially if the act were implemented after Labor Day.

The price of crude oil accounts for only 55 percent of the pump price. If crude has increased by "only" 21 percent since the end of 2005, why have prices risen by nearly 40 percent? Part of the reason is that ethanol's price has increased nearly 100 percent in the same period. Not only has demand surged, but ethanol's logistics are expensive. It must be shipped by barge, railroad tank car or tanker truck (rather than pipeline) from its manufacture from corn in the Midwest. (Ethanol absorbs water — and other impurities — that reside in pipelines)

This is the second time in less than a year that pipelines have been exposed as a critical infrastructure component. In the aftermath of hurricanes Katrina and Rita, the damage to the 30,000-mile pipeline network in the Gulf reduced refining capacity and output. Some experts are concerned that pipeline problems will bedevil the introduction of ultra-low-sulfur diesel later this year.

The energy industry — like the transportation industry — faces an increasing shortage of infrastructure. According to the National Petrochemicals and Refiners Association, the last refinery built in the U.S. was in 1976. In the last 10 years, refinery capacity has grown only 2 to 4 percent — a much slower pace than demand for output. The same is true of transportation infrastructure. In that same period, the interstate highway system went from a period of construction to maintenance, and roads downsized excess capacity.

Oil refineries, like proposed transportation projects, are subject to the same environmental review process and NIMBY (not in my backyard) objections from neighbors. This situation parallels the U.S. port capacity problem.

With world trade continuing its ascent, the U.S. must build a port the size of Oakland every year to accommodate growth. Ports must be by the water, preferably near major population centers. The same is true of refineries. However, approximately one-half of the U.S. population lives within 50 miles of a coast, so votes, wealth (and political influence) seek to preserve the coasts from energy and transportation infrastructure projects that might adversely impact air quality, congestion, hazardous materials and general quality of life.

Without action, transportation and energy will increase in price. It is driven by market forces inflamed by infrastructure shortage. The nation requires that energy and transportation issues be dealt with in a comprehensive fashion. Both are essential to our economic well-being, quality of life and national security. Unfortunately, our leaders seem to understand neither — while the risks increase.

Ted Prince is senior vice president of Optimization Alternatives Ltd. He can be contacted at (804) 754-2291, or via e-mail at ted@oax.com.