Statement by John Felmy
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Committee on House Transportation & Infrastructure
Subcommittee on Highways and Transit

"Rising Diesel Fuel Costs in the Trucking Industry"

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I am John Felmy, chief economist of API, the national trade association of the U.S. oil and natural gas industry. API represents nearly 400 companies involved in all aspects of the oil and natural gas industry, including exploration and production, refining, marketing and transportation, as well as the service companies that support our industry.

I would like to talk about petroleum markets today and about why prices have been rising. Higher prices are a burden on families and businesses, particularly those in the transportation sector such as trucking and the airlines. Being able to understand why the increases have happened is the first step to being able to do something about them.

The biggest factor in the price increases? It's higher crude oil prices. Through the first four months of the year, average crude oil prices were about $1.00 per gallon higher (or $42 a barrel higher) than the same period a year ago. A similar comparison shows gasoline prices up about $0.71 a gallon and diesel up $1.03 a gallon. Gasoline prices have risen more slowly because of weakening demand, record production, strong imports and ample inventories.

Crude oil – the raw material for all petroleum fuels – is the biggest cost component of gasoline and diesel. Crude oil is bought and sold on international markets, and most of what we need we import.

This week, refiners were paying as much as $2.86 for the gallon of crude oil they need to make a gallon of gasoline or diesel. That's most of the price at the pump. When you add about $0.47 in gasoline taxes (or almost $0.54 in diesel taxes) to each gallon, you've accounted for the vast majority of what people are paying.

Crude oil prices have been rising because of strong worldwide demand – even as U.S. overall petroleum demand, including demand for gasoline, has flattened. However, in the U.S., demand for diesel has remained strong. This follows a long-term trend here and around the world. Over the past five years, U.S. demand for highway diesel has been rising at triple the rate of gasoline. In Europe, demand has also been rising, reflecting growth in diesel vehicles, spurred in part by lower taxes on diesel.

Continuing strong U.S. demand for diesel versus weakening demand for gasoline is a key factor why diesel prices have been higher here than gasoline prices. Demand for diesel has remained strong in the face of higher prices at the pump in large part because its use is less discretionary. Consumption is mostly business related. Fuel is an indispensable cost component and just one of the costs in the manufacturing/distribution chain. Also, keep in mind that, unlike Europe, taxes on diesel in the U.S. are higher than on gasoline, and the new ultra-low sulfur diesel formulations cost more to produce, too.

U.S. refiners have been working hard to meet demand, churning out record amounts of both gasoline and distillate, which includes heating oil and diesel – nearly 9 million barrels per day of gasoline and more than 4 million barrels per day of distillate during the first four months of this year. At the same time, they continue to invest heavily in environmental improvements, including billions of dollars for cleaner-burning gasolines and diesel fuels. Recently, despite healthy industry-wide earnings, refiner and retailer margins have tightened.

Industry earnings are strong, but don't be deceived by the big numbers. The size of gross earnings is largely a function of the size of the industry, which is massive because of the magnitude of the job the industry has to do. Both taxes paid and investments made to keep supplies coming in the years ahead are also massive. Which is why *earnings on each dollar of sales* last year aren't as remarkable as the rhetoric and accusations might suggest. In 2007, earnings per dollar of sales were just over eight cents, about a penny above the all-industry average and a good bit lower than the rates of some other prominent industries.

Siphoning away earnings from the industry through new tax schemes won't help address the current market situation. It won't increase investments, it won't produce more supply, and it won't help consumers. It will hurt oil and natural gas company owners, 98.5 percent of which have no connection with the oil industry other than through the pensions they receive invested in oil company stock or through their 401ks, IRAs and other stock holdings. Price gouging laws – another term for price controls – also won't work. They would discourage investment in new supplies and could lead to allocation controls and gasoline lines.

There's no magic wand to fix this situation nor is there a silver bullet. It comes down to increasing supply and reducing demand. There are a lot of ways to work on both ends of that equation, including developing other forms of energy and conserving. However, one strategy we can't overlook is expanding access to more of the nation's own petroleum resources, much of which government policies have put off limits. Energy independence is a slogan, not good policy, but we can produce more and ease global market tightness. That along with more conservation is how to put downward pressure on crude oil prices.

That concludes my remarks. I'd be happy to answer your questions.