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SENATE REPUBLICAN POLICY COMMITTEE

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Senate Republicans: Supplying What the American People Are Demanding – Lower Gas Prices

Executive Summary

- American consumers, family-owned businesses, and the U.S. economy as a whole are suffering as a result of high gas prices.

- High energy prices are a result of increasing global demand in the face of tightening supply, factors driven primarily by China and India's increased demand for petroleum.

- Economic and business leaders like Federal Reserve Chairman Ben Bernanke and Warren Buffett, Chairman and CEO of Berkshire Hathaway, agree that the rise in gas prices is not the result of speculation but rather is a function of supply and demand.

- Senate Republicans have proposed The Gas Price Reduction Act, a comprehensive plan to "Find More, Use Less," which includes provisions to:
  - Increase U.S. based supplies of energy by expanding production from the outer continental shelf and through the use of oil shale.
  - Reduce U.S. demand for foreign oil through conservation efforts such as a shift to plug-in hybrid vehicles that can run on electricity instead of petroleum.
  - Ensure that energy futures markets are operating fairly and efficiently by increasing transparency and by providing for better market oversight.

- By contrast, Senate Democrats do not have a comprehensive plan. Their proposed legislation focuses on "Speculation Only" while doing nothing to increase supply or decrease demand. As a result, the Democrats' plan will not provide America's families with any relief from high gas prices.

- There is only one plan in the United States Senate that will increase supply and lower demand in a way that will provide relief to consumers. That plan is The Gas Price Reduction Act offered by Senate Republicans.

Introduction

The American people are suffering as a result of high energy prices. Today's high energy prices are being caused by the fact that global demand is outpacing available supply. In an attempt to address high prices, two different plans have been proposed in the Senate.

Senate Republicans have proposed The Gas Price Reduction Act, a balanced and comprehensive approach that would address both supply and demand. This bill would help lower gas prices in the short term, ensure that America has enough supply to meet our long term needs, and encourage conservation by reducing demand for oil.[1] At a time when energy experts are saying the cause of high prices is a result of supply and demand, Senate Democrats have put forward a bill that fails to produce one additional drop of oil and also fails to encourage conservation.[2] The Democrats' bill instead focuses only on oil speculation and is, therefore, not comprehensive. Their bill ignores the laws of supply and demand and fails to provide a way forward for American energy security.

The solution to high energy prices requires that America begin finding more supply while using less. An increase in supply can and should come from both traditional and alternative sources. Finding a way to increase supply is not just a matter of energy security; it is also a matter of economic and national security. As a result, the Republican energy bill is the right plan at the right time to solve America's energy crisis.

Rise in Oil Prices Fueled by Growth in Global Demand

America, like other countries, relies on energy to grow the economy and to create jobs. In order to meet our needs, America must buy energy in the global marketplace. The price we pay for energy is affected by both global supply and global demand. In recent years, global supplies have tightened while global demand has risen dramatically. As a result, prices have also increased dramatically.

Global Demand Continues to Grow: Driven by Economic Growth in India and China

According to the Energy Information Administration (EIA), global demand for oil has grown substantially over the past 15 years, fueled primarily by economic growth in India and China. From 1994 to 2007, global demand has grown from about 68.87 million barrels per day (bbl/day) to 85.54 million bbl/day. EIA projects that global demand will continue to increase to 87.76 million bbl/day by 2009.[3]

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[1] S. 3202, the *Gas Price Reduction Act of 2008*.
[2] S. 3268, the *Stop Excessive Energy Speculation Act of 2008*.
[3] http://tonto.eia.doe.gov/cfapps/STEO_Query/steotables.cfm?periodType=Annual&startYear=2005&startMonth=1&endYear=2009&endMonth=12&tableNumber=6. See also, International Energy Agency (IEA), *Monthly Oil Market Stocks Assessment*, June 10, 2008.

China and India's increased demand for energy has grown substantially in recent years and will continue to grow well into the future. In 2008, China's demand for oil is projected to grow by 5.5 percent.[4] Looking into the future, China's demand is projected to continue to grow dramatically. From 2006 to 2030, China's consumption is projected to double to 15.69 million bbl/day and its imports are projected to grow 4 to 5 times higher to 10.9 million bbl/day.[5] Likewise, in 2030, India's consumption is projected to be 4.37 million bbl/ per day, which is nearly double its 2006 consumption of 2.49 million bbl/day.[6]

Economic experts have concluded that limited supply, in the face of this rise in global demand, is the cause of high gas prices. At the same time, these experts have expressed doubt that addressing speculation alone will have a substantial effect on the price of oil. For example, Warren Buffett has said: "But it's not speculation, it is supply and demand…. We don't have excess capacity in the world anymore, and that's what you're seeing in oil prices."[7]

In addition, last week Federal Reserve Chairman Ben Bernanke testified:

> [I]f financial speculation were pushing oil prices above the levels consistent with the fundamentals of supply and demand, we would expect inventories of crude oil and petroleum products to increase as supply rose and demand fell. But in fact, available data… show[s] notable declines over the past year. This is not to say that useful steps could not be taken to improve the transparency… only that such steps are unlikely to substantially affect the prices of oil or other commodities in the longer term.[8]

As a result, American consumers can expect to see sharp increases in gas prices unless worldwide oil supplies are able to continue to keep pace with increasing demand.

Supplies Have Tightened

Uncertainties in global supplies have eroded the expectation that supply can meet global demand. Supply fears have been fueled by EIA's revelation that, so far in 2008, non-OPEC production has fallen short of expectations by nearly 630,000 bbl/day:

> Faster declines in older fields and delays in expansion projects have limited supply growth. At the beginning of this year, non-OPEC supply growth was projected to rise by 860,000 bbl/d in 2008 and by over 1.5 million bbl/d in 2009. Production is now expected to rise by only 230,000 bbl/d in 2008 and by 830,000 bbl/d in 2009.[9]

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[4] IEA, *Oil Market Report*, p. 15. Congressional Research Service (CRS), "China's Economic Conditions," CRS Report for Congress RL33534, updated June 27, 2008 and Energy Information Administration (EIA), *Annual Energy Outlook 2008*, June 2008.
[5] EIA, *Annual Energy Outlook 2008*, p. 148. See also, CRS Report for Congress RL33534.
[6] Id.
[7] Warren Buffett, Chairman & CEO of Berkshire Hathaway, interview with Becky Quick, CNBC's Power Lunch, June 25, 2008.
[8] Ben Bernanke, Chairman of the Federal Reserve Board of Governors, in testimony before the Senate Committee on Banking, Housing, and Urban Affairs, July 15, 2008.
[9] EIA, *Short Term Energy Outlook*, July 8, 2008.

Meanwhile, OPEC production in the second quarter expanded by only 100,000 barrels per day, from 32.2 million bbl/day in the first quarter to 32.3 million bbl/day in the second quarter.[10]

Surplus oil production capacity, a critical measure of how much supply could expand to meet additional demand or make up for sudden supply interruptions, is about half of the 10-year average surplus production capacity. EIA data shows that between 1997 and 2007, OPEC's average surplus capacity was 2.93 million bbl/day. EIA estimates that OPEC's 2008 surplus oil production capacity will reach only 1.55 million bbl/day.

Near-term excess production estimates are even lower. EIA estimates that surplus capacity in the third quarter of 2008 will average only 1.2 million bbl/day, well below the projected 2008 average and about 40 percent of the 10-year surplus production average.[11] This surplus production margin represents just over 3 percent of OPEC production in the third quarter, and about 1.4 percent of 2008 projected OPEC and non-OPEC total production.[12] According to EIA, "(a)ny industry operating at close to 99 percent of capacity will remain vulnerable to surprises that either boost consumption or disrupt production. Such surprises would place additional upward pressure on prices and contribute to oil price volatility."[13]

A Comprehensive Republican Plan: Find More, Use Less

Experts agree that addressing the current energy crisis requires a comprehensive approach that: provides additional supply to a tight market; addresses demand by encouraging conservation through new technology like plug-in hybrids; and increases transparency in the energy markets to ensure those markets are functioning properly.

Find More Supply to Meet U.S. Energy Needs

The Republican bill will ensure America is producing sources of American-made energy by using more of our own energy resources. This responsible and environmentally sound approach will open up deep sea exploration and permit the development of oil shale as an energy source. The Gas Price Reduction Act will lift the congressional moratorium on deep sea exploration by allowing states to explore for oil and natural gas 50 miles or more off the U.S. coast. The Pacific and Atlantic regions of the Outer Continental Shelf (OCS), which would be eligible for leasing activities under the Republican plan, hold an estimated 14 billion barrels of oil and 55 trillion cubic feet of natural gas. Exploration and production activities are currently prohibited in these areas. If the U.S. were to increase domestic production by just 1 million barrels of oil per day, domestic production would increase by 20 percent and our dependence on foreign oil would be cut by 9 percent.[14]

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[10] Id.

[11] EIA, *Short-Term Energy Outlook, 2008*.

[12] EIA *Short-Term Energy Outlook, 2008*, OPEC and non-OPEC petroleum production tables.

[13] EIA, *Short-Term Energy Outlook, 2008*.

[14] Senate Energy and Natural Resources Committee document, "Oil and Gas Leasing on the Outer Continental Shelf, Background and Impact."

The Republican bill also encourages more domestic production by lifting the federal moratorium on oil shale development. Oil shale contains a petroleum-like liquid called kerogen, which can be heated in a process called "retorting," to cause the rock to release the kerogen so it can be used like conventional petroleum.[15] America's oil shale resources could provide at least 800 billion barrels of oil equivalent; total oil shale resources could exceed 2 trillion barrels of oil equivalent. The Department of Interior was scheduled to release final regulations for commercial oil shale leasing by the end of 2008; unfortunately, last year the Democrats placed a federal moratorium on the completion of the final regulations for oil shale development on federal lands in an end-of-year omnibus appropriations bill.[16]

Reducing Demand with the Use of Hybrid Cars and Plug-In Hybrid Vehicles

The Republicans' comprehensive energy plan also seeks to reduce America's demand for oil by encouraging the increased use of hybrid and plug-in hybrid vehicles. By increasing reliance on plug-in vehicles, America could transform its transportation sector from vehicles that depend on foreign oil to vehicles that instead depend on domestic electricity. The benefit to U.S. consumers is that this shift would protect consumers from the impacts of rising gas prices caused by increased global demand and would also lessen America's dependence on foreign oil.

The U.S. transportation sector currently uses about 68 percent, or 14 million bbl/day, of the 20.9 million bbl/day of oil supplied to the United States each year.[17] Motor gasoline accounts for most of this consumption with nearly 9 million bbl/day. The Gas Price Reduction Act helps the transportation sector move away from gasoline dependence toward a more secure future. It includes incentives to foster the domestic manufacturing supply base for hybrid vehicle batteries, the technology where innovation and improvement is most needed. Manufacturing hybrid batteries here in America will help lower their price, helping to make them affordable for all consumers.

It is important that America begin to take the steps that will allow our economy to transition to new sources of energy to drive our transportation sector. Until these technologies become more widely available, America will continue to remain dependent on oil and American consumers and businesses will face the potential of further rising gas prices caused by continuing increases in global demand.

Ensuring a Well-Functioning Futures Market

The Gas Price Reduction Act also increases transparency and ensures the proper functioning of energy futures markets. This bill increases the number of "cops on the beat" by increasing Commodity Futures Trading Commission (CFTC) resources. It includes adding 100

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[15] Senate Energy and Natural Resources Committee document, "Oil Shale, 'The Rock That Burns' Background and Impact."
[16] Public Law 110-161, Consolidated Appropriations Act of 2008 (H.R. 1234). Section 433 of the Act provided that no funds in the Act could be "used to prepare or publish final regulations regarding a commercial leasing program for oil shale resources on public lands pursuant to Section 369(d) of the Energy Policy Act of 2005 (Public Law 109-58) or to conduct an oil shale lease sale" pursuant to such section.
[17] CRS, "Energy: Selected Facts and Numbers," CRS Report for Congress RL31849, May 1, 2008.

full-time employees tasked with increasing public transparency in the futures markets to address the role speculators can play in the oil market. The Republican bill also increases market transparency by requiring traders to provide critical data on key futures markets and maps a way forward on effective regulation.

The bill sets requirements for allowing foreign boards of trade the ability to access market participants located in the U.S. who want to enter trades directly into a foreign board of trade's market system. Specifically, the bill requires the foreign board of trade to: (1) make public comparable daily information as is required for the contract against which it settles on the fully registered exchange; (2) adopt position limits or position accountability levels for speculators as are required for the contract against which it settles on the fully registered exchange; and (3) provide information regarding speculative and non-speculative trading in the contract to the CFTC to allow publication of its Commitments of Traders report for the contract against which it settles.

The bill requires the CFTC to establish routine reporting requirements for index traders and swap dealers in energy transactions. The CFTC is also required to make public the positions and the value of index funds and other passive, long-only positions in the energy futures markets, broken out by type of investment and made available every month. The Republican plan also requires the CFTC to make public the positions and the value of index funds and other passive, long-only positions in the energy (and agricultural) futures markets, broken out by type of investment.

Finally, the Republican bill requires the President's Working Group on Financial Markets (PWG) to conduct a study to analyze similarities and differences between regulations applied by various global regulators relative to energy commodity trading. Within 120 days of enactment, the PWG must submit a report to appropriate committees in Congress describing these differences and providing recommendations to improve openness, transparency, and other elements necessary for a properly functioning market.

The Democrats' "Speculation Only" Plan Misses the Mark

America needs a comprehensive energy policy that will increase the supply of energy produced here at home while also decreasing American demand. In short, America needs a bold and comprehensive energy plan that will find more supply and use less. The American people deserve legislation that will provide relief at the pump in the short term while providing energy security and energy independence over the long term.

The Democrats' "Speculation Only" bill has been criticized because it fails to meet any of these criteria. The Democrats' bill focuses solely on regulating speculation but does nothing to reduce demand by encouraging conservation. In addition, the Democrats' bill fails to produce any new sources of energy.   The way to curb speculation that oil prices will continue to rise, is to pass legislation to encourage an increases in supply. This would produce the fastest drop in the price of oil to the extent speculation has fueled the rise.

Rising gas prices have been caused by rising global demand without a corresponding increase in global supply. The Democrats' bill fails to address both supply and demand. At a time when the world needs more supply to lower prices, the Democrats' bill fails to provide even one additional ounce of supply. As a result, the Democrats' bill misses the mark when it comes to moving America towards lower energy prices and energy independence.

Conclusion

American consumers and businesses are suffering as a result of high gas prices. For too long, America has been dependent on foreign oil. The pain many Americans are experiencing at the pump is a result of rising global demand in the face of constant supply. A responsible solution to this energy crisis, and a solution to America's dependency on foreign oil, is a comprehensive approach that seeks to both increase the supply of energy produced here at home while decreasing U.S. demand on foreign oil. By transforming the U.S. transportation sector so that it runs on domestic sources of energy, America can free itself from dependency on foreign oil and ensure stable prices for American consumers. The Republicans' Gas Price Reduction Act is the only bill that achieves all of these goals.