

Transcript of NPR segment

Interview: Philip Verleger discusses the price of oil

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NEAL CONAN, host: This is TALK OF THE NATION. I'm Neal Conan in Washington. Tomorrow political conventions are big news for host cities. They bring challenges, attention and lots of visitors, but do they bring in the big bucks? Are they worth the inconvenience and the investment? We'll find out tomorrow at this hour.

Today we're talking about **oil**. Crude **prices** hit an all-time high late last week then retreated slightly. But with the record \$50 barrel benchmark still looming, some economists predict a full-blown energy crisis. So what does this mean for the economy? Our conversation, if you'd like to join it, is at (800) 989-8255, (800) 989-TALK. E-mail is totn@npr.org. How does the **price of oil** affect your life and what lifestyle changes have you considered as gas **prices** and other kinds of fuel **prices** have increased?

Joining us now is energy economist Philip Verleger, who's a fellow at the Institute for International Economics here in Washington, DC. He's with us by phone now from his home office in Aspen, Colorado.

If you had to pick between two places to work, I think you picked the right place.

Mr. PHILIP VERLEGER (Institute for International Economics): Well, thank you very much. I certainly believe I did, although fall is coming in to Aspen awfully early this year.

CONAN: And, well, with the way fuel **prices** are going up, it's gonna cost quite a bit to heat that chalet or whatever it is that you...

Mr. VERLEGER: Well, you're absolutely right, and, you know, it's well designed, new place that has lots of insulation, but it's--you know, energy **prices** are on their way up and we are, I'm afraid, on the verge of a second real energy crisis similar to the one we faced in 1973.

CONAN: Well, everybody seems to back, in terms of the benchmarks, to 1980 when **prices** were, I guess, about \$35 a barrel for crude **oil**. And they say in today's dollars that's about \$75 a barrel, and it's nowhere near that now.

Mr. VERLEGER: I understand that comparison. The trouble is, when we look at same **prices**, we like to look for productivity. Alan Greenspan's been talking about the gains in productivity for the economy for years now, and the computer I'm looking at today would have cost \$100,000 in 1980. It costs \$2,000 today. So the **prices** of many other goods are coming down, and if energy **prices** go up--and I worry they will go up significantly from these levels, not tomorrow and probably not for the rest of this year, but sometime next year or the year after--they will act as a brake on economic activity. Whether they get to the 1980 levels or not is almost immaterial. We are going to be facing higher energy **prices**, and we're going to be--and these come about in good part because we've done nothing for the last 20 years really to cut back on our use.

CONAN: And that's another conversation, but let's go back to just this year. What's been driving the rise in **oil prices** this past year?

Mr. VERLEGER: Well, there are two phases. From March to July, **prices** were pulled up by gasoline. The US has instituted new regulations requiring that sulfur be removed from gasoline, and the refiners in the United States and the world just don't have enough capacity to make gasoline to meet demand, so gasoline **prices** rose by 50 cents and they pulled up crude **oil**. Since July 1st, we've had a different phenomenon. Part of it has been attributed to hedge funds, but I think another part is attributable to Asian buyers who, as in 1979 and '80, rushed into the market when they thought **prices** were going to rise and actually bid them up. This time they've been buying futures for delivery in 2007 to 2008, and so those **prices** have gone up by \$15 a barrel. And that panic buying has just lifted the whole floor **price** for **oil**, I'm afraid, for--I don't want to use the word permanently, but for a long time to come. And, you know, the Asian buyers are, in many ways, being sensible. They probably expect the dollar to weaken, and so what--their decisions now won't cost them that much when the time comes, and they also don't have to put up much. They can put up Treasury bills, and the Asians certainly have a lot of Treasury bills to hold their positions on the NYMEX.

CONAN: So this is--of course, **oil** is priced in dollars, so a weak dollar translates into, well, a weaker **oil price**, which is one reason the **prices** are going up.

Mr. VERLEGER: Yes, that's exactly right. The expectations of a weak dollar causes Asians to come in and buy it and bid up the **price**. It's really a nice way to speculate against the US economy.

CONAN: And in terms of Asian buyers, one thing that is driving the market is unexpectedly high demand from China.

Mr. VERLEGER: Well, that's absolutely right. In 19--between 1967 and '73, we had a huge growth in world **oil** demand, and that came from Japan and Europe as they really rushed out of the post-World War II period and began to grow and cars spread across the country. This time it's China, and if you look at the populations in China and compare it to the populations of Japan and Europe at that period of time, the growth factor is roughly two or three times as great. So, you know, in a sense what we have just seen this year is sort of the tropical storm that comes before a hurricane, and it's blowing by, but sitting over the horizon is a huge hurricane that will affect us in 2005, 2006, 2007 thanks to China. That Chinese demand is just gonna--will really pull up world **oil prices** considerably.

CONAN: And when you talked about hedge funds being involved in this, I was reading today that a lot of big sort of institutional investors have been playing in the **oil** market where they're relatively larger fish than since the stock market has not been too great of late.

Mr. VERLEGER: That's exactly right. I mean, Morgan Stanley has become an **oil** company, and in some senses the financial institutions that have the buyers that want to buy the **oil**, and the companies you'd think would buy the **oil**, the refiners, can't afford it. They can't get the letters of credit to cover large inventories, and so what's happened is we have this intermediation by these large financial institutions.

CONAN: So they're all involved in this as well.

Well, let's get some listeners involved in the conversation. Again, (800) 989-8255. E-mail is totn@npr.org. And let's begin with Doug, who's with us from Sacramento.

DOUG (Caller): Oh, I did get on. Wow. Actually really a pleasure to be on with you guys. I love this. I work in the **oil** industry. I've worked--I started off on the heavy fuel **oil** side of things and I moved over to gasolines and naphthas, etc. And really what my question for the speaker was: How do you view the increase in countries such as China, Micronesia and India instituting really large ready reserves like the United States has? I mean, US carries a ready reserve already, and we're seeing not only a growth in the market in terms of, you know, China coming on and India coming on, but on top of that they're also trying to develop their own ready reserves. So instead of buying, you know, one barrel of **oil** they're buying one and a half or two barrels. How do you view that?

CONAN: Philip Verleger, I think he's talking to what's referred to in the United States as the Strategic **Oil** Reserve, correctly or incorrectly, but go ahead.

Mr. VERLEGER: Doug's question is excellent. I'm not sure how much China has bought recently, but the United States has been filling its Strategic Reserve for the last two and a half years since November 2001, and these countries have actually, the United States in particular, been following the policy of buying high and then when we sell we'll sell low. It's important that we add to these strategic reserves. It is probably not a good idea to be filling them at those times in the year when global demand is at its peak. Ideally what we would do is turn these into what are called buffer stocks in economics, where you would fill them during the periods when demand falls, as in the springtime. Demand drops by about, oh, 5 to 7 percent. And then you actually draw them down during the summertimes and you could use that to moderate the **prices**.

You know, I was involved in a dispute with the Department of Energy around the turn of the--in January when the airlines were arguing that crude **oil prices** would be 5 or \$6 a barrel lower if the government had not been so aggressive in filling its Strategic Reserves. And, you know, the 5 or \$6 a barrel number was right. The problem is the government just says, 'We're gonna fill it all the time.' If we were sensible about this, we would be dealing with, say, a **price** in the mid-30s rather than the mid-40s today, and the economy would be doing significantly better.

CONAN: Doug, thank you.

DOUG: Thanks a lot. Have a great day.

CONAN: We were--I realized now we were up in a narrative where gasoline **prices** in this country were very high earlier in the year, up above--everybody remembers well over \$2 a gallon in a lot of places, and that, you said, drove crude **prices** up. Well, gas **prices** are down the last--What?--five, six weeks.

Mr. VERLEGER: Well, that's right. That's why I said you need to separate the **price** increase into two parts. The first part came really from March to July when gasoline pulled up crude **prices**. Then gasoline **prices** have softened but what happened was that we started getting more of these Asian buyers and more of the hedge funds pushing in in July and August, and also, some European buying of heating **oil**. Historically the Germans fill their heating **oil** tanks sometime between June and September, and for an American this will surprise him, because if you've had it, you fill your tank kind of through the year five or six times. The Germans have tanks that'll tide them over for 18 months. This is a throwback to the NATO period when they wanted consumers to have plenty of heating **oil** in case there was a war. And so German buyers can become huge--have a huge influence on the **oil** market if they decide to buy or if they decide not to buy, and they tend to hold off until they think the **prices** are at the lowest possible level, and there were expectations of falling **prices** in the spring and **prices** kept rising, and so they kept holding off. Eventually they have to buy, and so we began to see them coming into the market about two, three weeks ago, and they were bidding up heating **oil prices**, and that tended to add to this Asian buying and hold up crude **prices**.

I think that's going away, and I think crude **prices** are probably gonna soften. They're down today, and I think they're probably gonna head down for the next two to three months. But as I said, we have just gone through kind of that first squall that comes ahead of the hurricane. The hurricane is over the horizon, and it is coming, and it is going to cause significant problems.

CONAN: Energy economist Philip Verleger is the author of "Adjusting to Volatile Energy **Prices**."

You're listening to TALK OF THE NATION from NPR News.

And let's talk now with Andrew. Andrew's with us from Voorhees, New Jersey.

ANDREW (Caller): Hi.

CONAN: Hi.

ANDREW: Hi. How are you?

CONAN: OK.

ANDREW: I'm a longtime listener, first-time caller.

CONAN: Thank you.

ANDREW: Had to say that. I was actually calling in reference to your question of what consumers were thinking of doing. I actually don't have to worry about heating **oil** because I still live at home because I'm still a student, but as a driver I am saving up my money, what little I have, to purchase a hybrid car. And the one thing that I find interesting is, is at least in my area it would appear as though more people are spending their money on buying what I think to be relatively wasteful sport utility vehicles that get four miles to the gallon, whereas certain hybrid cars can get 60. And it just seems ridiculous, because you're wasting your money, and it just seems somewhat irresponsible.

CONAN: Philip Verleger, we have seen obviously certainly at least one of the hybrid cars--there's a long waiting list to buy a Prius, and I understand Hummer sales are down.

ANDREW: Oh really?

Mr. VERLEGER: Andrew should call more often, because he's exactly right. One of the reasons gasoline **prices** went up so rapidly is we have not filled refining capacity, but Detroit kept--has insisted on pushing on the American consumer these SUVs that get fewer and fewer miles per gallon, and so it's just this disconnect. We encourage growing demand, but we don't have the supply for it. And hopefully this market signal will work, just as the market signal worked in 1973. Fuel economy kept falling through the '60s and early '70s as we went to those bigger and bigger cars, and then we had the shock of the gasoline **price** increase, and consumers turned around and started buying more efficient cars. Detroit was hurt because they didn't have anything. And all we can do is cross our fingers that enough Americans look and say, 'You know, we want an automobile that gets 35 or 40 miles per gallon in the city and does even better on the open road,' and the automakers will respond. That is how we moderate the effect of this coming storm, conservation. And consumers can do a much better job than Congress. If the consumers don't buy these inefficient cars, then Detroit will start getting better fuel economy even though it's not mandated.

CONAN: Andrew, safe driving.

ANDREW: Thank you.

CONAN: Bye-bye.

Let's talk now with George. George is calling from Anchorage in Alaska.

GEORGE (Caller): Hello.

CONAN: Hi.

GEORGE: Hi **prices** of **oil** are not negative for everybody. It's great for us here in Alaska because this is how our state gets all its money, from **oil** leases and **oil** royalties, and when the **price** goes up, it just absolutely fills state coffers.

CONAN: Philip Verleger, Alaska is not alone.

Mr. VERLEGER: Well, Alaska isn't alone, and you're absolutely right. It also fills the coffers of Saudi Arabia. And one of the problems I have is that it's clear that the more money that flows to Saudis and to other Middle Eastern countries, the more money that flows to al-Qaeda. And also, the higher **oil prices** on average for the United States as a whole acts as a tax increase and slow economic growth. So I have two strong problems with the increase in **prices**. One that it is gonna slow down consuming economies as a whole even though there will be many areas like Alaska that benefit. And two I worry that if we don't get control on the **price** of **oil**, the terrorists, who we know there are more--we're manufacturing more thanks to our acts in Iraq--will have more cash and more money to spend and make life more difficult for us.

CONAN: George, congratulations, I guess, and thanks for the phone call.

GEORGE: All right. Thank you.

Mr. VERLEGER: Thank you.

CONAN: And, Philip Verleger, we appreciate your time today.

Mr. VERLEGER: Oh, thank you very much. It's always a pleasure.

CONAN: Philip Verleger, a fellow at the Institute for International Economics in Washington, DC, joined us by phone from his home office in Aspen, Colorado.
In Washington, I'm Neal Conan, NPR News.

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