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Why Gas Prices Will Stay High

The chief economist at gasoline distributor Tesoro argues that a shortage of refining capacity is the culprit for consumers' pain

You have to give [Lynn Westfall](#) credit. Not only is the chief economist for Tesoro ([TSO](#)) willing to talk to reporters as gasoline prices shoot up to a record of more than \$3.20 a gallon, he even stopped by *BusinessWeek's* Los Angeles offices recently to discuss why prices are so high with Senior Correspondent [Christopher Palmeri](#).

Westfall doesn't paint a pretty picture for motorists as Americans begin the peak summer driving season. Prices are likely to stay high for the foreseeable future, he says, hitting consumers in their pocketbooks. The Government Accountability Office (GAO) says that consumers already have spent \$20 billion more on gasoline this year than last.

Tesoro and Westfall have emerged as more prominent players in the energy industry. The once sleepy, San Antonio-based company has in the past 10 years become a major force in gasoline distribution. Tesoro snapped up a half-dozen refineries, most recently the \$1.8 billion purchase of a Los Angeles plant, and 278 gas stations from Royal Dutch Shell ([RDS](#)). Last year, Tesoro earned \$800 million on sales of \$18 billion. In just five years, its stock has shot up from \$2 a share to \$120, a performance that recalls of dot-com back in the day.

What's been behind the recent runup in gas prices?

First of all, you have to remember that 60% to 70% of the cost of gasoline is the cost of crude. When that doubles from \$30 a barrel to \$70, prices go up. This spring we had a number of refineries not running well. In the past, the industry had spare capacity. If a refinery was down we'd run the rest at a higher utilization. Gasoline demand has grown at a rate of 2.5 refineries every couple of years. We can't expand existing capacity at that rate. The industry is running at full capacity.

Sounds like someone should build a new plant. Hint, hint.

You're looking at seven to eight years and costs in the billions. Kuwait was looking at building a refinery. It was originally projected to cost \$6 billion. Last November the price had run up to \$10 billion. By February, it was \$16 billion and the project was canceled. In the U.S. we're looking at twice the cost because of pollution controls. Now are you going to go to your board of directors and argue for an investment like that?

There are folks in Washington who say there is a conspiracy on the part of the industry to drive up prices, and that anti-gouging legislation, a windfall profits tax, or some kind of breakup of the big oil companies is in order. There's never been a successful case for gouging or price-fixing against our industry after all these investigations and all these years.

What would it take to get you to build a plant? Tax breaks?

You can't give enough incentives.

Are the big oil companies doing all they can to produce more oil?

There's never been a liquid shortage. When the hurricanes hit a couple of years ago we were being offered crude from places we'd never seen before. There's a lot of panic built into the price, out of fear there will be shortages. And there's been a lot of money from hedge funds looking for a place to invest.

What impact do regulations on greenhouse gas emissions, such as those in California, have on your business?

We're still waiting to see what the regulations will be. They want to take us back to 1990 emission levels by 2020. We can add new insulation, burner tips, and oxygen sensors to reduce our consumption. Two-thirds of greenhouse gas emissions come from burning transportation fuels. If we added more ethanol to gasoline, do refiners get credit for that?

Do environmental regulations affect supply?

Right now, there are 150 grades of conventional gasoline to meet requirements in various cities and states. The specifications are so tight. In the past if one unit at a plant went down, you could still make gasoline. Now every unit at a plant is required to be running at exactly the right ratio. The industry wasn't built to handle this capacity. We're importing more gasoline than ever, 13% of demand. But the foreign refineries were not built to manufacture our grades of gasoline.

So the future is continued, high prices?

Our society was built on cheap energy. You don't have a lifestyle anymore where you live and work in the same little village. We're seeing tremendous growth in production in places like the Rocky Mountains, but it's only been two years ago that oil producers bumped up their long-term price forecast from \$20 a barrel to \$40 a barrel. It took 25 years to get in this position. It won't get solved quickly.

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