

# Financial Services Update

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## Greetings from Financial Services:

This is the fifth in the series of updates on financial and economic topics of interest to ODOT managers and stakeholders.

The focus of this issue is on the recent increase in fuel prices and the impacts this has had and may continue to have on ODOT's business.

This update briefly examines the recent history of oil prices, current projections of where fuel prices are headed, and the likely effects of continuing high fuel prices on ODOT's revenues, construction program, and internal operations.

As always, we welcome your comments and suggestions on these and other financial issues of importance to the Department. Please email me at:

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## Fuel Prices and Their Impact on ODOT

We've all seen the news and felt the pain at the pump; fuel prices have been surging. The good news is that, barring a major disruption in crude oil supply from existing oil fields, the U.S. Department of Energy does not anticipate further increases. The bad news is that prices are expected to remain at historically high nominal levels (i.e., above \$2.60 per gallon at retail) until significant additional supplies of crude oil become available. This is not anticipated to happen until 2008.

As shown in the chart, the price of oil historically has been highly variable and has not followed any discernable long-term trend. Over the last 27 years, the real price of crude oil (in 2005 dollars) has ranged from almost \$90 per barrel in 1981, to about \$10 per barrel in 1999, to around \$70 per barrel today. During this period, many smaller upward and downward price spikes also

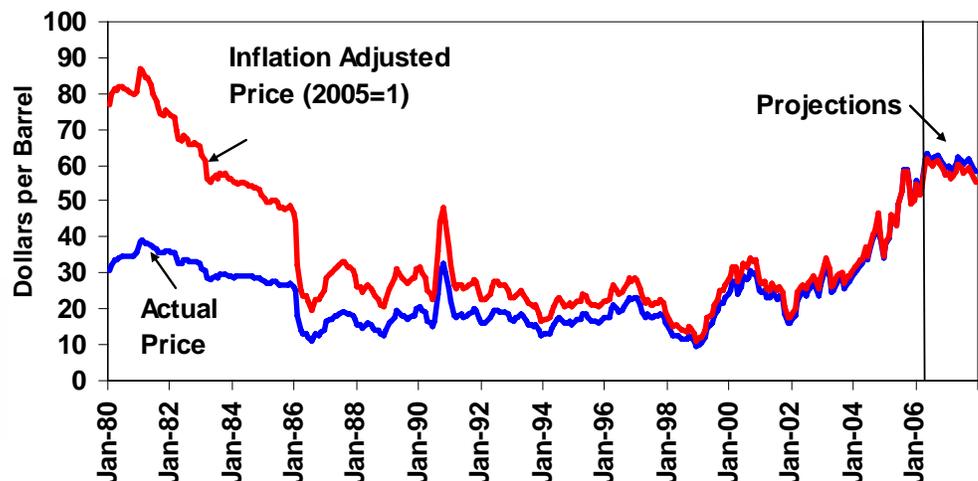
occurred. This variability occurs not just because of changes in today's consumption and supply, but also because of expected changes in future demand and supply.

We know how high fuel prices affect us personally. High fuel prices also affect ODOT in three main ways by: (1) reducing Highway Fund revenue, (2) increasing construction costs, and (3) increasing the cost of internal operations.

## Revenue Impacts

Oregon's Highway Fund is heavily dependent on the fuels tax as its primary source of revenue. In the absence of population growth, when individuals drive less or shift to vehicles with better fuel economy, fuels tax revenue falls. With population growth, fuels tax revenue may continue to increase, but at a reduced rate. Fortunately for ODOT,

Imported Crude Oil Prices From 1980



## Fuel Price Impacts

Petroleum prices have always been highly variable and attempting to predict their future course is hazardous. Nevertheless, the current consensus is that fuel prices will retreat somewhat from their peaks of the past few weeks, but remain at historically high levels for the next couple years.

If fuel prices remain high for a biennium or more, this may well impact ODOT's ability to deliver its projects and programs by reducing fuels tax revenues at the same time it increases the cost of our construction program and internal operations.

*Financial Services is a branch of ODOT's Central Services Division. Financial Services provides centralized accounting, financial reporting, payroll and benefits, budget development, economic and financial analysis, business planning, debt administration, cash management, the Oregon Transportation Infrastructure Bank, tax collection and auditing, revenue forecasting, tax policy analysis and cost allocation services.*

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in the short-run, consumers are not very sensitive to fuel price changes. For example, the American Petroleum Institute indicates April 2006 national gasoline deliveries were down only 1.9 % compared to April 2005, despite significantly higher prices.

However, when fuel prices remain high for longer periods (e.g., 1979-1983), motorists will look for and find ways to use less fuel. When this happens, significant reductions to fuel tax collections may occur. This is likely to be amplified by the "cost-responsibility" provisions of the Oregon Constitution requiring commensurate reductions in revenue from heavy vehicle fees.

## Construction Cost Impacts

In 2003, before the recent surge in prices, fuel (mainly diesel) was estimated to comprise about 3.5 percent of highway construction costs. While this is a small percentage, we have a very large construction program, and prices have increased dramatically since 2003. As a result, increased project costs will total in the millions of dollars. ODOT, for example, now manages approximately \$600 million per year in construction contract expenditures. Before recent price increases, fuel costs would have been about \$21 million per year. If fuel costs increase 50 percent on average, ODOT's increase in contract costs would be \$10.5 million per year. Over time, this would result in a reduced number of projects.

## Internal Operations Impacts

Fuel prices also affect the cost of virtually all ODOT operations and

services. For instance, during the 2003-05 biennium ODOT spent \$6.3 million on regular diesel fuel. In the 2005-07 biennium regular diesel fuel expense is now expected to total \$11.1 million, the increase being due mostly to fuel price increases. Similarly, in January 2004, reimbursement for private car use was 37.5 cents per mile, while it is now 44.5 cents per mile. The increase again is largely attributable to higher fuel prices.

Although the focus of this article is on vehicle fuel prices, it also needs to be noted that oil is used to make numerous other materials and equipment used in the Department's construction, maintenance and operations programs. These range from asphalt to the tires used on our maintenance and other fleet vehicles. Increases in the price of oil therefore in turn increase the price of these items, further magnifying the impact on ODOT budgets.

Clearly, high fuel prices are having and will continue to have an effect on ODOT. Considered separately, the factors discussed above have a minor but noticeable impact on our budget. Taken together, however, these factors may be substantial. If fuel costs remain high for a biennium or more, these financial impacts may well affect ODOT's ability to deliver its projects and programs.

Finally, since crude oil prices are expected to remain at relatively high levels and consumers are less sensitive to price changes at high price levels, we should expect increased price variability (in dollar terms) as an on-going characteristic of the petroleum market. This may have further implications for cost forecasting and budgeting.