Order Code IB10134

Gasoline Prices: Policies and Proposals

Updated September 15, 2005

Carl E. Behrens and Carol Glover
Resources, Science, and Industry Division

CONTENTS

Gasoline Prices: Policies and Proposals

SUMMARY

The high price of gasoline was an important consideration during the debate on major energy legislation, which ended August 8 as the President signed the Energy Policy Act of 2005, H.R. 6 (P.L. 109-58). However, prices continued to surge, spiking at the end of August when Hurricane Katrina shut down refining operations in the Gulf of Mexico. The continuing crisis has renewed attention to some issues that were dropped or compromised in the debate over P.L. 109-58.

A large number of factors combined to put pressure on gasoline prices, including increased world demand for crude oil and U.S. refinery capacity inadequate to supply gasoline to a recovering national economy. The war and continued violence in Iraq added uncertainty and a threat of supply disruption that added pressure particularly to the commodity futures markets.

Among the issues that have received new attention are vehicle fuel economy standards, leasing on the Outer Continental Shelf, and refinery "revitalization" provisions.

The gasoline price surge influenced the debate over P.L. 109-58, but the urgency of previous energy crises was lacking. In part this may be due to the fact that there has been no physical shortage of gasoline, and no lines at the pump. In addition, the expectation of former crises, that prices were destined to grow ever higher, has not been prevalent.

However, the persistence of high gasoline and oil prices into a second summer has raised alarms over the economic consequences of the situation, heightened following the disastrous effects of Hurricane Katrina.

Another post-Katrina issue is the widespread suggestion that price gouging occurred in the surge in gasoline prices following the disaster. On September 14 the Senate, in considering the FY2006 Appropriations bill for Commerce, Justice, Science programs (H.R. 2862), passed an amendment by unanimous consent requiring an expedited study by FTC into price-gouging following Katrina.

MOST RECENT DEVELOPMENTS

As gasoline prices shot over $3.00 a gallon following Hurricane Katrina, Congress began to revisit the energy issue despite having just passed the massive Energy Policy Act of 2005 (H.R. 6, P.L. 109-58). Katrina caused shutdown of refining capacity in the Gulf of Mexico area and closed some pipelines, as well as disrupting oil and gas production offshore. (For details see CRS Report RS22233, *Oil and Gas: Supply Issues After Katrina,* by Robert L. Bamberger and Lawrence Kumins.)

At hearings by the Senate Energy and Natural Resources Committee September 6 and the House Energy and Commerce Committee September 7, suggestions for further legislation to deal with the energy crisis included reexamination of fuel economy standards and expanding off-shore oil and gas production beyond the Gulf of Mexico. Also of concern were allegations of price gouging by gasoline retailers and distributors.

BACKGROUND AND ANALYSIS

The run-up of gasoline prices that began in spring 2004 (see **Figure 1**) climaxed a period of almost five years during which gasoline prices demonstrated a great deal of regional volatility but less of an increase at the national level. In 2004 a large number of factors combined to exert pressure on gasoline prices in all parts of the country. Some of these factors have affected the price of crude oil, and others the cost of producing and marketing gasoline.

Past energy crises have demonstrated that oil is traded in a world market, in which events in remote areas affect the price of crude for almost everyone. In the 12-18 months leading up to the crisis, these events included:

- Decisions by the Organization of Petroleum Exporting Countries (OPEC) cartel, after having reduced production quotas in 2002, to raise them only slowly and reluctantly;
- Unexpected demand growth in China;
- Disruptions in oil production in major exporters, including Venezuela, Iraq and Nigeria;
- Decline in the value of the U.S. dollar, the currency in which oil is traded in the world market, compared to other major currencies, particularly the Euro.
- Uncertainty and fear of major disruptions in Iraq and Saudi Arabia, in the context of the war in Iraq and the threat of terrorism.

Figure 1 . Average Daily Nationwide Price of Unleaded Gasoline, January 2002 - September 2005

Note: Prices include federal, state and local taxes. Last date above is Sept. 12, 2005.
Source: *Daily Fuel Gauge Report*, American Automobile Association, [http://www.fuelgaugereport.com], compiled by CRS.

As often happens when commodity prices are volatile, speculation in futures contracts accentuated the upward price pressure and appeared to continue high prices longer than would be expected as market fundamentals push toward lower prices.

Just as a number of factors led to increased crude prices, a combination of features in the U.S. refinery industry contributed to an increase in gasoline prices.

- U.S. demand for gasoline has increased as economic growth has increased (See **Figure 2)**.

- Domestic refining capacity has declined, both in number of refineries — from 324 in 1981 to 153 in 2002 — and in total capacity — from 18.62 million barrels per day (mbd) in 1981 to 16.78 mbd in 2002.

- The structure of the refining industry has changed. In 1981 most refining capacity was owned and operated by integrated oil companies that supplied their own crude oil, refined it, distributed it, and marketed the products. Refining was only one part of the company's profit-making operation, and frequently was not an important profit maker. Now the refining industry is characterized more by independently owned, nonintegrated firms. When

refineries are the sole source of revenue to the owners, it becomes more important that the operation be profitable, leading to pressure to raise prices.

- The refining industry has been operating with lower inventories of both crude oil and gasoline, as a means of cutting costs. The side effect has been reduced ability to meet unanticipated demand, leading to greater price pressure.

- Gasoline markets are fragmented regionally because air quality requirements have led to numerous different formulations to meet varying standards. In meeting demand for these regional formulations, called "boutique fuels," refiners lose flexibility to meet local variations in demand elsewhere, leading to increased price pressure.

- With domestic refining capacity constraints, a greater proportion of gasoline demand is being met with imported products. Foreign refiners typically manufacture products designed to sell in the international market, not the special product "boutique fuels" demanded by a significant share of the U.S. market.

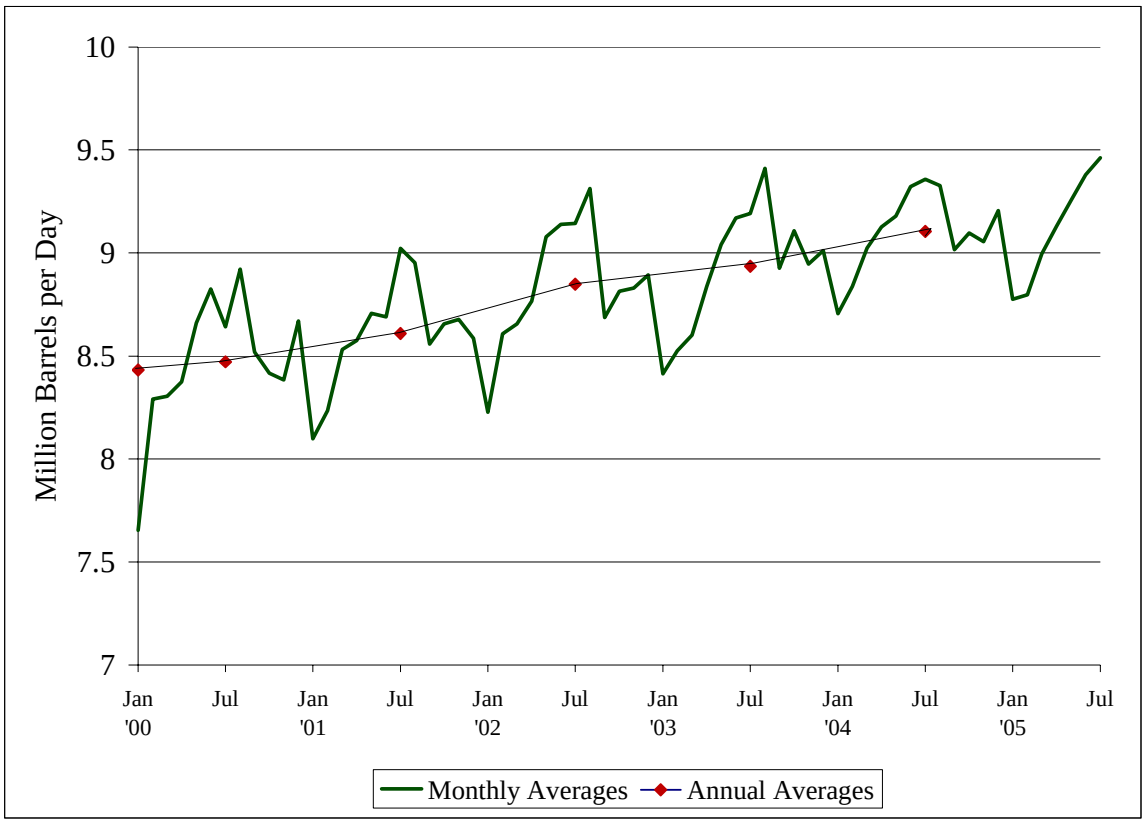
- Refiners have had increased costs in the past year to comply with new requirements to limit sulfur content and to switch from the oxygenate additive MTBE to ethanol.

These various factors pushed the nationwide average price of gasoline over $2 per gallon in May 2004. By mid-June, Energy Information Administrator Guy Caruso was able to note a slight decline in prices, and tell a Senate Energy Committee hearing that, "absent major disruptions, oil and gasoline markets may be turning a corner."[1] However, persistent high crude prices pushed gasoline prices over $2 again in October, and yet again in March 2005. By April 2005, Caruso was suggesting that increasing world demand for oil might keep the price of crude above $50 per barrel through 2006.[2] In fact, in August the price surged close to $70.

[1] Guy Caruso, statement before the Senate Committee on Energy and Natural Resources, June 15, 2004.

[2] "EIA: Oil to remain above $50 through '06." *Oil Daily*, April 8, 2005, p. 1. Report of a speech by Guy Caruso at the National Press Club in Washington, D.C., April 7, 2005.

Figure 2. Consumption of Motor Gasoline, 2000 - July 2005



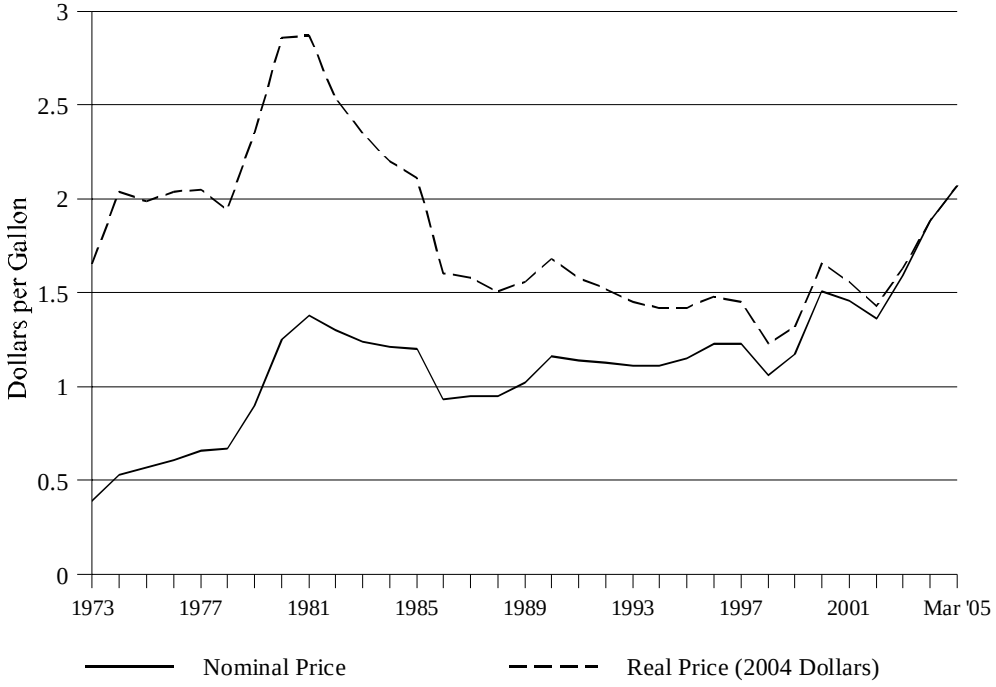
Source: EIA, *Monthly Energy Review*, January 2003, January 2004 and August 2005, Table 3.4.

The price surge intensified discussion of energy policy and led to further calls for passage of energy legislation. However, until the climax of the Katrina disaster, the urgency of previous energy crises has been lacking. Throughout the period, U.S. gasoline consumption has continued to rise, although the usual summer peak in consumption appears to have been somewhat blunted in 2004, as shown in **Figure 2**. In part this may be because, although the price of gasoline in nominal terms set a record, in real terms it did not appear to be reaching the level of the Iranian crisis years of the early 1980s (see **Figure 3**), again until Katrina pushed it toward the $3.00-per-gallon mark. Further, unlike the earlier crises, there was no physical shortage of gasoline, and no lines at the pump.

In addition, as **Figure 4** indicates, the proportion of consumer expenditures on oil and gasoline had declined from the high levels of the 1970s and early 1980s, and the current price increases did not appear to be significantly reversing that trend. Perhaps most important, the common view during the earlier crises was that oil prices not only were high, but were destined to become ever higher in the coming years. This view is no longer prevalent, and the general expectation has been that the run-up of prices starting in 2004 is a temporary phenomenon, although lasting longer than expected. The current crisis has led to some analytical speculation that world oil production has peaked, but additions to proved world oil reserves seem to contradict that thesis. Oil industry analysts appear confident of a long

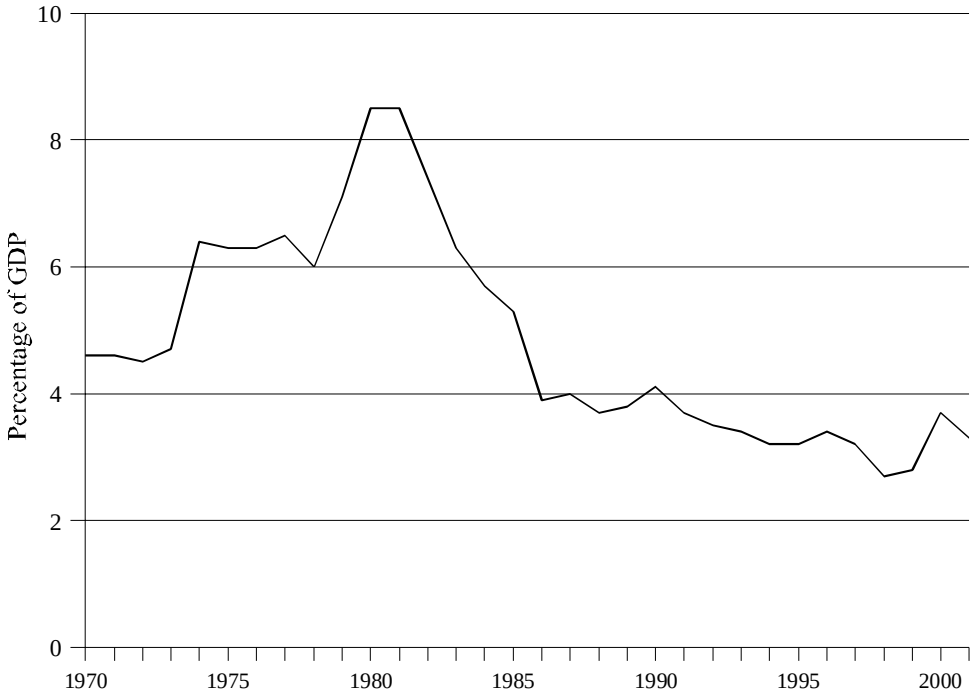
life remaining for the resource, and argue that if oil is replaced, it will be because of improved alternative technologies, not because the world is running out of oil.

Figure 3. Nominal and Real Price of Gasoline, 1973-2004 and March 2005



Source: EIA, *Monthly Energy Review*, May 2005, Tables 1.6 and 9.4, calculated by CRS.

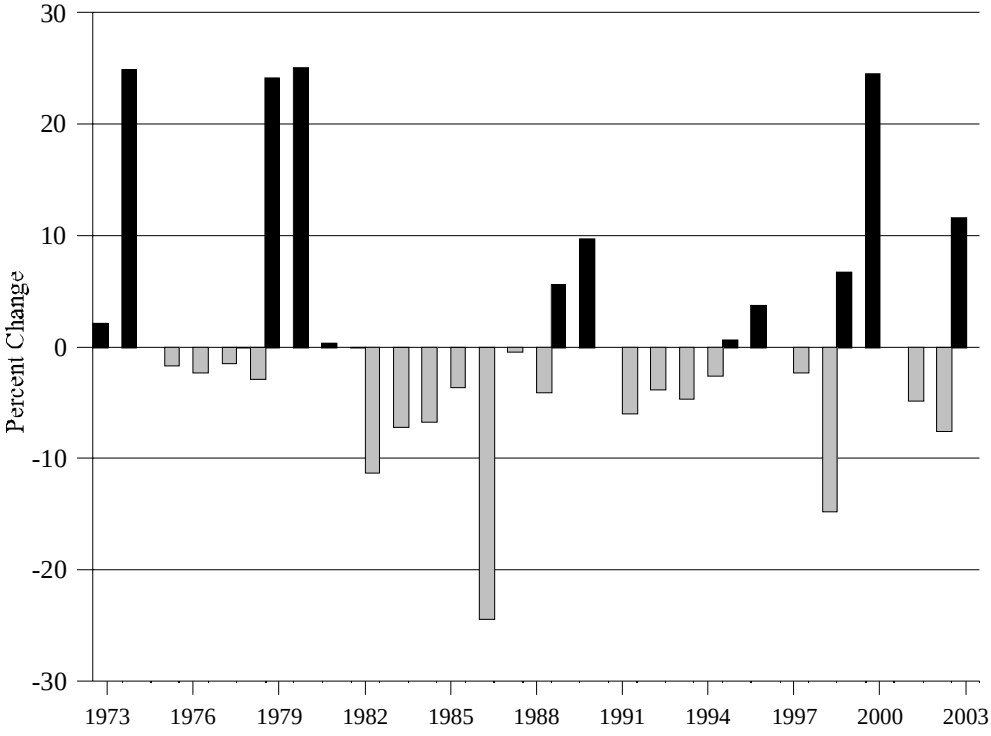
Figure 4. Consumer Spending on Oil as % of GDP, 1970 - 2001



Source: Calculated by CRS with data from EIA, *Annual Energy Review* 2005, Table 3.5. GDP from Bureau of Economic Analysis, Department of Commerce.

As shown in **Figure 5**, gasoline prices historically have increased less than the general rate of inflation, as measured by the Consumer Price Index (CPI). After the surge in 1973, and again after the 1979-1980 run-up, gasoline prices grew very slowly and even declined, dropping sharply in 1986. A sudden increase in 2000 was similarly followed by slow or declining prices. During the current run-up, for which data are not yet available, gasoline price increases have far outpaced the general CPI increase.

Figure 5. Percent Change in Gasoline Prices Compared to the Consumer Price Index, 1973-2003



Source: EIA, *Annual Energy Review* 2003, Table 5.24. CPI from the Bureau of Labor Statistics. Calculated by CRS.

Policy Options

The several energy crises of the past led to major legislative action, twice in the 1970s and once following the 1991 Gulf War. The just-passed Energy Policy Act of 2005 differs from the previous actions because the Congress had been considering major energy legislation for three years before the situation became a nationwide concern. By the time the bill finally moved through the Congress, the major issues had already been fully debated, and the final version differed little from previous initiatives except for resolving a number of issues that had blocked passage before.

As in previous legislative energy debates, a major policy divide existed between those who view the gasoline-fueled automobile as a temporary necessity to be tolerated only until a substitute fuel or alternative means of transportation can be developed, and those who expect oil to be the same dominant transportation fuel in the indefinite future that it is at present. Compromise agreements have been reached via a combination of measures that enhance the development of alternatives or restrain the growth in demand for oil, on the one hand, and those that increase production or reduce the cost of supplying that demand, on the other. However, individual measures often carry with them complicating features that make passage more difficult. In addition, major legislation often becomes the vehicle for measures that typically would not find enough support to pass as individual bills, or which may be added to gain support for the whole measure. In the legislative climate of the 108th Congress, balancing the various interests involved proved too difficult a task, despite the influence of

a nationwide energy crisis in an election year. Under the stimulation of continued high oil and gasoline prices, the 109th Congress pursued the goal again, this time successfully. However, as gasoline prices continued to surge, and damage to Gulf of Mexico oil and gas resources and facilities by Hurricane Katrina was assessed, calls for further measures to addess the crisis were heard in Congress.

Oil-Related Issues Beyond the Energy Policy Act

A number of issues that were major barriers to passage of omnibus energy legislation were either resolved or dropped in passing P.L. 109-58. In light of the current crisis, some of those issues have received renewed attention. Among oil-related issues are proposals to lift the moratorium on offshore oil and gas development outside the Gulf of Mexico, and measures concerning Corporate Average Fuel Economy (CAFE) standards. Measures involving the gasoline fuel additive methyl tertiary butyl ether (MTBE), dropped from P.L. 109-58 in conference, have not been mentioned for possible review. The proposal to open part of the Arctic National Wildlife Refuge (ANWR) to oil and gas development is expected to be taken up as part of the budget reconciliation process.

ANWR. Oil and gas exploration and development of part of the Arctic National Wildlife Refuge have been controversial for many years. This was part of the early proposals for legislation that eventually became the Energy Policy Act of 1992, but was dropped in the face of strong opposition in both houses. Support for action grew gradually through the decade, along with technological developments that advocates claimed would reduce the environmental impact of development, and the House included a development measure in its version of an omnibus energy bill in August 2001. A similar measure was part of the House-passed legislation in the 108th Congress. Opposition in the Senate kept the measure from the floor, however, and it was dropped in conference.

In the 109th Congress, Senate supporters of ANWR development moved the issue to the budget process, where it can be approved by a simple majority vote. On March 9, 2005, the Senate Budget Committee issued a FY2006 budget resolution that assumes $2.4 billion of revenue over five years from leases in ANWR. On March 16 the Senate rejected an amendment by Senator Cantwell to strike the ANWR provisions, by a vote of 49-51. The next day the Senate passed the budget resolution (S.Con.Res. 18). Supporters of the measure expect to include it in the budget reconciliation bill, to be taken up by the Congress in October.

CAFE. Fuel economy standards also have a long history of controversy, going back to their establishment in the 1970s. Proposals to mandate new standards were also considered, but dropped, early in the development of the 1992 Energy Policy Act. In the mid-1990s the National Highway Traffic Safety Administration (NHTSA) was considering a rulemaking that would result in increased standards for light duty trucks (including sport utility vehicles), but for several years the Congress included in its annual appropriation for NHTSA a measure prohibiting NHTSA from analyzing or undertaking such a ruling. That prohibition was dropped in the FY2004 NHTSA appropriations, and a final rule issued by NHTSA in April 2003 requires a boost in light truck fuel economy to 22.2 miles per gallon by Model Year 2007.

Omnibus energy legislation proposed before NHTSA acted would have mandated specific increases in light truck fuel economy, but P.L. 109-58 merely amends slightly the criteria NHTSA must follow in its rulemaking and authorizes appropriations of $2 million annually through FY2008 for that purpose. After passage of the act, but before the Katrina disaster, the Bush administration proposed new fuel economy standards for light trucks, to take effect in the 2008 model year.

During House floor debate on P.L. 109-58, an amendment to increase fuel economy standards to 33 miles per gallon over 10 years was defeated by a vote of 177-254. A more general amendment to the House bill, requiring the Administration to take "voluntary, regulatory, and other actions" to reduce oil demand in the United States by 1 million barrels per day from projected levels by 2013 was defeated 166-262. The measure was included in the bill passed by the Senate, but was dropped in conference.

OCS Leasing. The moratorium on oil and gas leasing in the Outer Continental Shelf (OCS), except in the central and western Gulf of Mexico and some parts of Alaska, was subject to much controversy during consideration of P.L. 109-58. A proposal to allow states to voluntarily opt out of the moratorium was dropped under threat of filibuster, and even a measure to order the Department of the Interior to perform an inventory of OCS resources barely survived the debate.

Following the disruption of production by Katrina, momentum to lift the moratorium has increased, and some supporters have suggested it might be included in the budget reconciliation process.

Refinery Revitalization. P.L. 109-58 contains some provisions to encourage construction of new oil refineries, but the destruction to refining facilities caused by Katrina in the Gulf of Mexico area has led to calls for further measures.

Price Gouging. The rapid increase in gasoline prices following the Katrina disaster led to allegations of price gouging. P.L. 109-58 included a provision requiring the Federal Trade Commission (FTC) to conduct an investigation into price gouging in the recent increases in gasoline prices. On September 14 the Senate, in considering the FY2006 Appropriations bill for Commerce, Justice, Science programs (H.R. 2862), passed an amendment by unanimous consent requiring an expedited study by FTC into price-gouging following Katrina.

LEGISLATION

109th Congress

S.Con.Res. 18. An original concurrent resolution setting forth the congressional budget for the U.S. government for FY2006 and including the appropriate budgetary levels for FY2005 and FY2007 through FY2010. Contains instructions to the Committee on Energy and Natural Resources that assume revenues from the sale of ANWR leases. Passed Senate March 17, 2005.

H.R. 6 (Barton)
Energy Policy Act of 2005. Introduced April 18, 2005. Passed by the House April 21, 2005 (249-183). Passed the Senate June 28. Reported out of conference July 26 and passed by both Houses July 28 and July 29. Signed by the President August 8 (P.L. 109-58).

S. 10 (Domenici)
The Energy Policy Act of 2005. Introduced June 9, 2005. Approved by the Committee on Energy and Natural Resources May 26 (21-1). Adopted as an amendment in the nature of a substitute to H.R. 6, June 16.

S. 555 (DeWine)
The No Oil Producing and Exporting Cartel (NOPEC) Act of 2005. Introduced March 8, 2005. Adopted by voice vote as an amendment to H.R. 6 in the Senate, June 21. Not included in the final version of H.R. 6.

FOR ADDITIONAL READING

CRS Issue Briefs

CRS Issue Brief IB10143. *Energy Policy: Comprehensive Energy Legislation (H.R. 6) in the 109th Congress,* by Robert L. Bamberger and Carl Behrens.

CRS Issue Brief IB10054. *Energy Tax Policy*, by Salvatore Lazzari.

CRS Issue Brief IB10136. *Arctic National Wildlife Refuge (ANWR): Controversies for the 109th Congress*, by M. Lynne Corn, Bernard A. Gelb, and Pamela Baldwin.

CRS Reports

CRS Report RL32248. *Petroleum Refining: Economic Performance and Challenges for the Future*, by Robert L. Pirog.

CRS Report RS22233, *Oil and Gas: Supply Issues After Katrina,* by Robert L. Bamberger and Lawrence Kumins.

CRS Report RL32583. *Gasoline Supply: The Role of Imports*, by Lawrence Kumins.

CRS Report RS22236. *Price Increases in the Aftermath of Hurricane Katrina: Authority to Limit Price Gouging*, by Angie A. Welborn and Aaron M. Flynn.

CRS Report RL33012. *Oil Industry Profits: Analysis of Recent Performance*, by Robert Pirog.