National Center for Policy Analysis

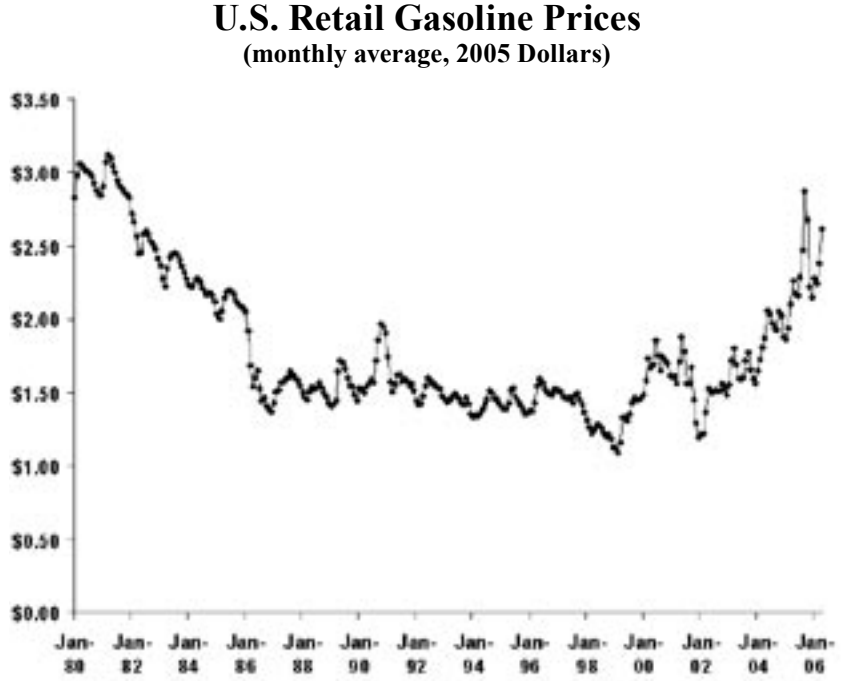
BRIEF ANALYSIS
No. 557
For immediate release:
Thursday, June 8, 2006

Bringing Down Gasoline and Oil Prices

by Kenneth P. Green

The national average price of gasoline is approaching the record high of $3.21 per gallon (adjusted for inflation) set in 1981. [See the figure.] The public is upset, and politicians are scrambling to find ways to reduce the pain of high prices or, failing that, to appease their constituents by investigating, penalizing or punitively taxing oil companies.

The price pinch at the pump is causing serious consumer discomfort. An April 2006 poll by CNN found 69 percent of respondents felt that high gasoline prices were causing them hardship, and 59 percent said high gasoline prices were affecting their ability to maintain their current standard of living. The CNN results were reinforced by an April 10, 2006, *Washington Post*/ABC News poll that showed 70 percent of respondents felt recent gasoline price hikes have caused them some hardship.



Source: Energy Information Administration.

Why Are Gasoline Prices High? The primary reason for high gasoline prices is simple: demand for oil and gasoline is high, and the available supply is limited.

Supply Disruptions and the Demand for Oil. By far, the largest factor determining prices at the pump is the international price of oil. About 85 percent of the fluctuations in gasoline prices over the last 20 years were due to changes in the price of crude oil in the world market, according to the Federal Trade Commission. According to the Energy Information Administration, world oil prices have risen sharply since 2000 due to strong demand growth in developing economies, such as China, coming on top of supply disruptions and "inadequate investment to meet demand growth."

The causes of supply disruptions are fairly obvious — for instance, the September 11, 2001, terrorist attack, and the wars in Afghanistan and Iraq all undoubtedly played a role. In 2003, Iraq contributed 2.6 million barrels per day to the world oil market, an outflow already lowered by United Nations sanctions before the war. At the end of 2005, however, total Iraqi oil exports amounted to only 1.2 million barrels per day.

Moratoria on Exploration and Production. According to the Interior Department, there are 102 billion barrels of oil under the Outer Continental Shelf of the lower 48 states and Alaska — enough oil to fuel 85 million cars for 35 years. Regrettably, most of that oil has been placed off-limits to production by presidential, congressional and state moratoria on exploration and development. For example, had Congress opened the Arctic National Wildlife Refuge to development 10 years ago, it would already be producing a million barrels per day of domestic oil, or about 6 percent of total U.S. consumption.

Boutique Fuel Requirements. Another factor increasing gasoline prices, according to the Federal Trade Commission, is the proliferation of boutique fuels. In order to fulfill various air pollution reduction plans, gasoline sold in the United States has been fractionated into about 17 different boutique fuels sold in dozens of discrete markets. With three grades of gasoline per fuel, refiners are producing over 50 separate blends. The situation will only get worse as the Environmental Protection Agency's (EPA) new ozone standards force more areas to require reformulated gasoline.

Dallas Headquarters: 12770 Coit Rd., Suite 800 • Dallas, TX 75251• 972-386-6272 • Fax: 972-386-0924 • Web site: http://www.ncpa.org
Washington Office: 601 Pennsylvania Ave., N.W., Suite 900, South Building • Washington, D.C. 20004 • 202-220-3082• Fax: 202-220-3096
For more information, contact the NCPA Communications Department at 972/386-6272 or 800/859-1154.

According to the U.S. Government Accountability Office, producing these blends requires the installation of expensive new equipment. The different blends of gasoline must be transported separately, which has limited pipeline and storage capacity, as well as the number of suppliers. Furthermore, it is difficult to replace supplies when there are disruptions, since the required blends of gasoline may be located hundreds of miles away.

Ethanol Mandate. The supply of gasoline has been further constrained recently by congressional actions mandating the rapid substitution of ethanol — a scarce and expensive fuel additive — for MTBE (methyl tert-butyl ether). Congress passed an energy bill in the summer of 2005 mandating the use of 7.5 billion gallons of ethanol by 2012. As a result, the cost of ethanol has risen 91 percent. Ethanol is produced in a number of countries, but tariffs on ethanol — currently $0.54 per gallon — raise the price of imports.

Lack of New Refineries. Another factor contributing to the increased price of gasoline is the reduction in the number of operating refineries in the United States over the last 30 years. The number and capacity of U.S. refineries peaked in 1981. Since then, 171 plants have closed, although the remaining plants have increased output (through on-site expansion and improved levels of operating efficiency) to partially offset the loss of production. In addition, extremely tight environmental restrictions and opposition from local communities have hampered the ability to site new refineries and significantly increased the costs of building new ones.

Steps to Increase Supply. There are a number of steps Congress and the administration could take to relieve short- and long-term pressure on oil and gasoline prices.

Open ANWR to Development. Opening the Arctic National Wildlife Refuge (ANWR) for exploration and eventual oil production would not lower gasoline prices in the short-term but over time would increase supplies to the world market, thus providing a buffer against price fluctuations.

Facilitate Exploration and Development of Offshore Oil Reserves. Modern technology allows environmentally conscientious offshore oil and gas exploration and production. Congress and the president should end their separate moratoria that preclude exploration in coastal areas. In addition, the current approval process for offshore exploration requires satisfying the regulatory requirements of four different agencies or departments. It should be streamlined to a one-stop process that simplifies access and increases the predictability that applications for exploration and eventual development of offshore reserves will be successful.

Lift Federal Boutique Fuel Requirements Permanently. Removing all reformulated gasoline requirements could eventually lower the cost of gasoline as well as smooth regional spikes in gasoline prices. Due to improving technology, air pollution levels will continue to decline, independent of reformulated gasoline requirements.

The federal government can remove its own boutique requirements easily, but to eliminate all boutique fuel markets, the federal government would have to curtail the ability of California and other states to set higher environmental standards than the EPA does under the Clean Air Act.

Terminate the Ethanol Mandate and Tariffs. Congress should eliminate the requirements in the Energy Policy Act of 2005 for increased ethanol use. It should also end tariffs on ethanol imports. This would help regions which continue to use ethanol-blended gasoline to acquire it at the least cost.

Reduce Regulatory Barriers to Building and Expanding Refineries. The administration should convene a task force specifically mandated to find and implement realistic short-term measures to reduce the negative impacts of environmental compliance procedures and opposition to new facilities on the petroleum refining industry, thus allowing market forces to determine refinery growth. Such measures could include streamlining the regulatory process and allowing new refineries to be located on federal lands, possibly on already-polluted Superfund sites or closed military bases.

Conclusion. Instead of wasting time and causing speculative distortions in the market for gasoline with talk of addiction, attacking Iran, windfall profit taxes, price gouging, executive compensation, alternative fuels and so forth, Congress and the administration should focus on removing impediments to supply and production, and ending actions that raise the cost of energy.

Kenneth P. Green is a visiting fellow at the American Enterprise Institute and an NCPA E-Team adjunct scholar. *A longer version of this article was published by the American Enterprise Institute and is available at http://www.aei.org/publications/filter.all,pubID.24336/pub_detail.asp.*