

# CRS Issue Brief for Congress

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## **Gasoline Prices: New Legislation and Proposals**

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## Gasoline Prices: New Legislation 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 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 received new attention were vehicle fuel economy standards, leasing on the Outer Continental Shelf, and refinery “revitalization” provisions. The Gasoline for America’s Security Act of 2005, H.R. 3893, was passed by the House on October 7 by a vote of 212-210. A similar bill, S. 1772, was defeated in the Environment and Public Works Committee on October 26 by a tie vote of 9-9.

The budget reconciliation process was the vehicle for two major energy initiatives: the opening of part of the Arctic National Wildlife Refuge (ANWR) to oil and gas

development and the lifting of the moratorium on oil and gas leasing on much of the Outer Continental Shelf (OCS). Both the Senate Energy and Natural Resources Committee and the House Resources Committee included leasing ANWR in their reconciliation bill sections. The House Resources Committee included provisions regarding OCS leasing, but the Senate Energy Committee did not. ANWR leasing was included in the Senate bill that passed on November 3 (S. 1932), but the House leadership dropped both ANWR and OCS provisions before its reconciliation bill, H.R. 4241, was passed on November 18 by a vote of 217-215. The conference report on the bill, approved by the House but amended in the Senate, does not contain either measure.

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 or 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.

## MOST RECENT DEVELOPMENTS

As gasoline prices retreated from the post-Katrina peak of over \$3.00 a gallon but remained well over \$2.00 in the new year, President Bush targeted “oil addiction” in his State of the Union message to Congress January 31 and announced an Advanced Energy Initiative, with a goal to “replace more than 75 percent of our oil imports from the Middle East by 2025.” Substantial increases in research on alternative fuels and vehicles, particularly ethanol, were among the proposals mentioned by the President. Funding for the research was included in the Department of Energy FY2007 budget request, submitted February 6.

The Administration’s budget request for the Department of the Interior assumes that \$8 billion can be raised in 2008 through leasing of oil and gas resources in the Arctic National Wildlife Refuge (ANWR), despite failure in the last session of the 109<sup>th</sup> Congress of the measure to allow such leasing.

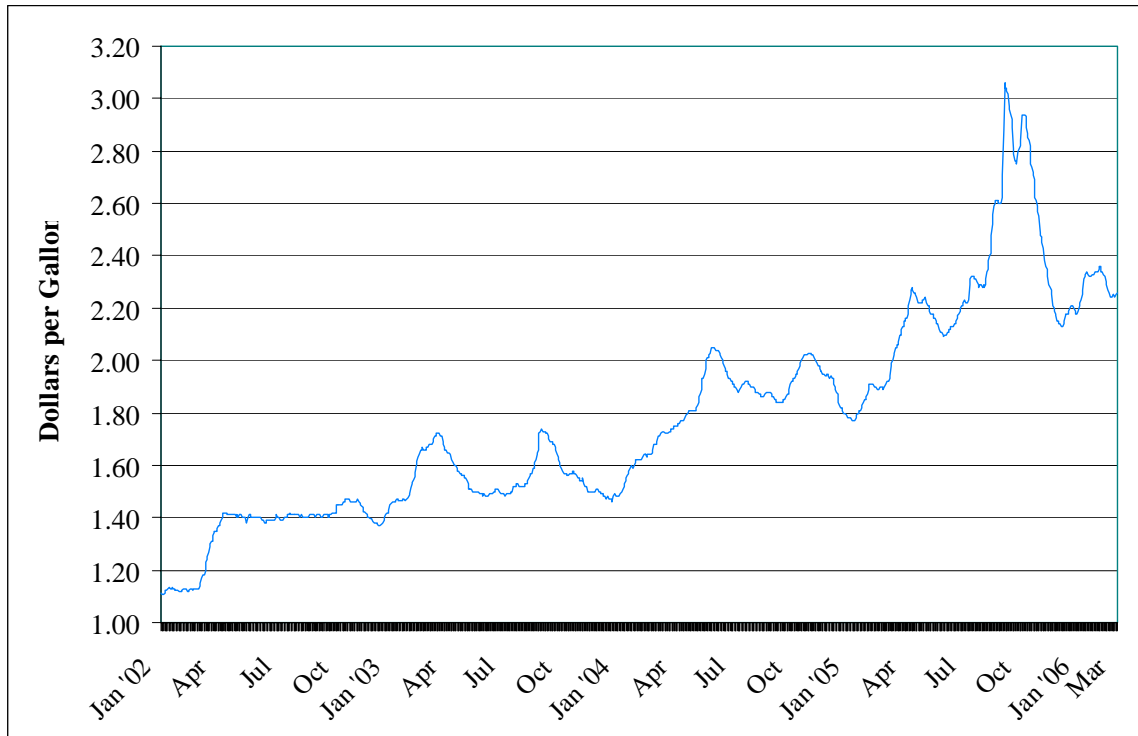
## BACKGROUND AND ANALYSIS

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 the following:

- 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 - March 2006**



**Note:** Prices include federal, state and local taxes. Last date above is March 2, 2006.

**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 continued (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.

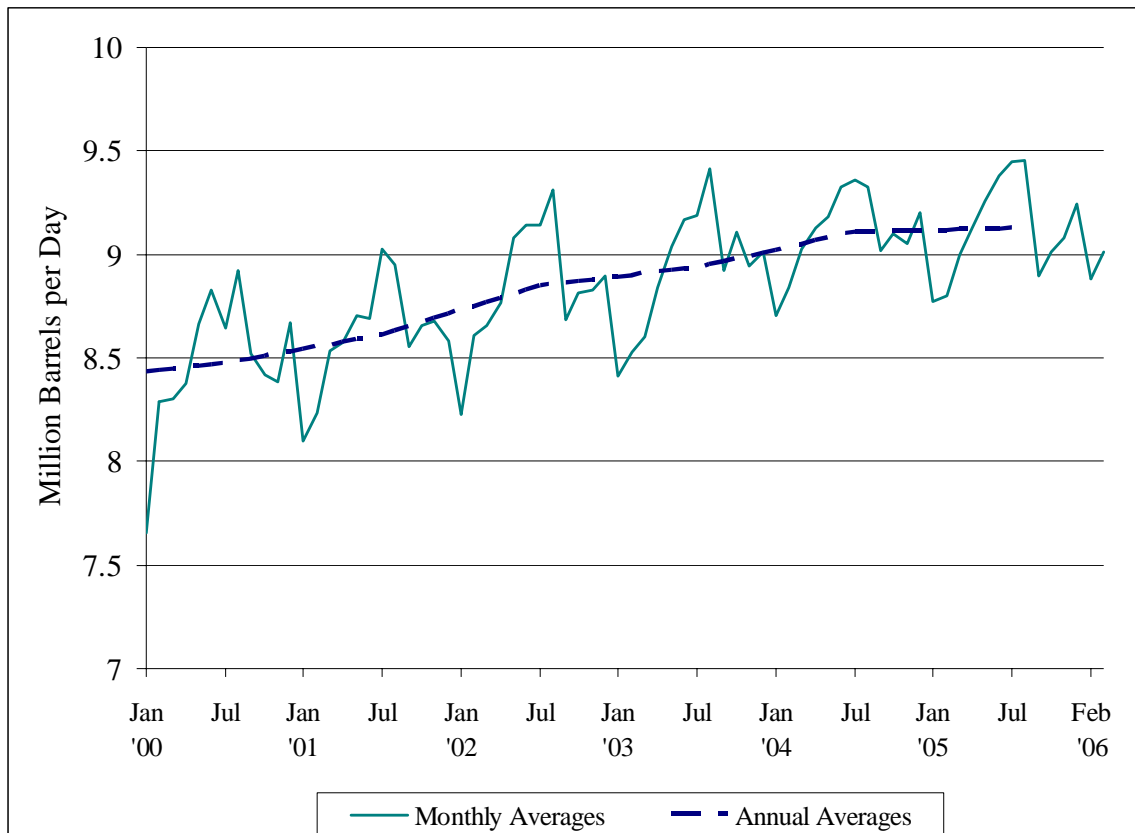
- The refining industry has been operating with lower inventories of both crude oil and gasoline, as a means of cutting costs. The side effect has been reduced ability to meet unanticipated demand, leading to greater price pressure.
- Gasoline markets are fragmented regionally because air quality requirements 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.”<sup>1</sup> 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.<sup>2</sup> In fact, in August the price surged close to \$70.

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<sup>1</sup> Guy Caruso, statement before the Senate Committee on Energy and Natural Resources, June 15, 2004.

<sup>2</sup> “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 - February 2006**

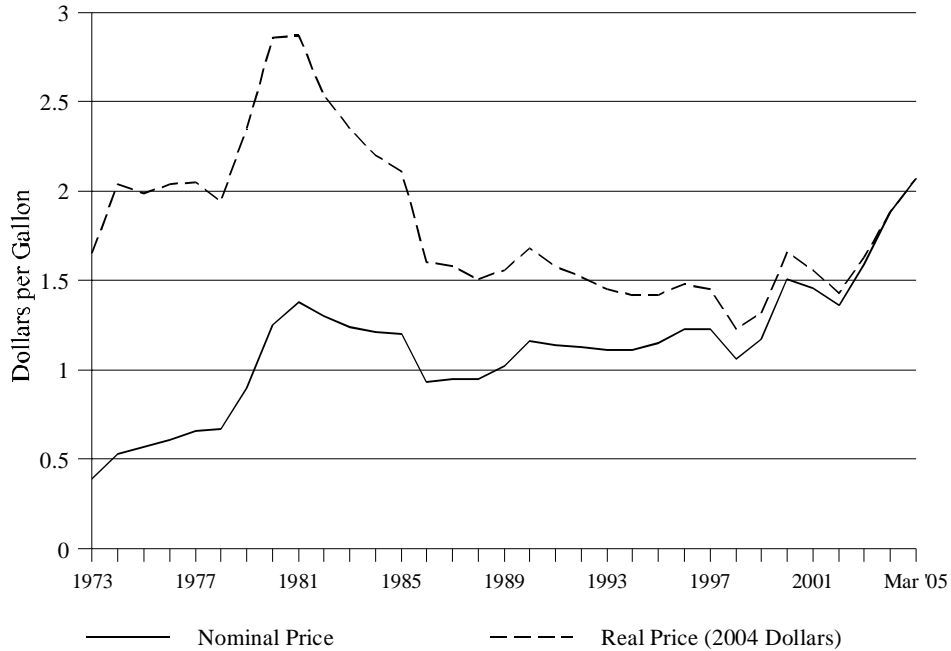
**Source:** EIA, *Monthly Energy Review*, February 2006, Table 3.4 and *Weekly Petroleum Status Report*, March 1, 2006, Table 10.

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, except in local disaster-affected areas. Consumption of gasoline fell sharply after prices peaked. The drop was typical of the post-Labor Day decline but more steep than in previous years.

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. Data are not yet available to indicate what effect the price run-up starting in 2004 has had on this measure. 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 price increase 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**

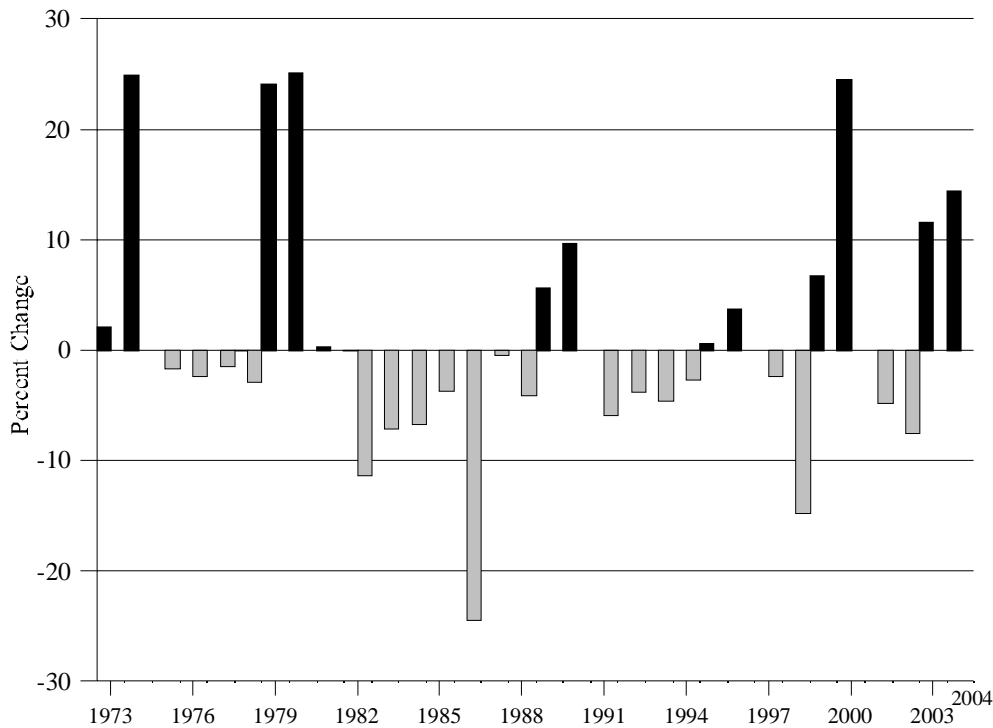




**Source:** Calculated by CRS with data from EIA, *Annual Energy Review* 2005, Table 3.5. GDP from Bureau of Economic Analysis, Department of Commerce.

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, gasoline price increases have far outpaced the general CPI increase.

**Figure 5. Percent Change in Gasoline Prices Compared to the Consumer Price Index, 1973-2004**



**Source:** EIA, *Annual Energy Review* 2004, 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 108<sup>th</sup> 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 109<sup>th</sup> 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 address 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 was taken up as part of the budget reconciliation process, but the effort failed in the first session of the 109<sup>th</sup> Congress.

**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 108<sup>th</sup> Congress. Opposition in the Senate kept the measure from the floor, however, and it was dropped in conference.

In the 109<sup>th</sup> 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). The measure was included in the package of provisions for the budget reconciliation bill approved by both the Senate Energy Committee and the House Resources Committee. However, the House leadership removed the ANWR provisions from its reconciliation bill (H.R. 4241) before it was passed on November 18 by a vote of 217-215.

Despite the failure of the ANWR provision, the Administration's FY2007 budget request for the Department of the Interior, submitted February 6, assumes that \$8 billion can be raised in 2008 through leasing of oil and gas resources in ANWR.

**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 increased, and some supporters suggested it might be included in the budget reconciliation process. The House Resources Committee on September 28 marked up a bill that would have given states the option of allowing drilling for petroleum and natural gas. In approving the bill, the committee adopted an amendment that would lift the moratoriums on drilling the OCS for natural gas completely. In the face of opposition to the natural gas provision, Representative Pombo, Chairman of the Resources Committee, decided not to bring the bill to the floor as planned.

On October 26, the Resources Committee, as part of its package of measures for the budget reconciliation bill, included provisions that would make statutory the current presidential moratorium on OCS leasing until 2012 but would allow individual states to opt out of the moratorium and would allow states close to 50% of the royalties from oil and gas

production that resulted. It would also give states the option to extend the moratorium after 2012. However, the provision was removed from the bill (H.R. 4241) before it was passed on November 18 by a vote of 217-215.

**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. On September 28, the House Energy and Commerce Committee reported out H.R. 3893, the Gasoline for America's Security Act of 2005, and the House passed the bill October 7 by a vote of 212-210. Among other measures, the bill would provide for presidential designation of potential refinery sites on federal lands and military bases that are closing, and set up a process for coordinating authorization and related environmental reviews for construction of new refineries, to be led by the Department of Energy. It would centralize judicial review of the process in the U.S. Court of Appeals for the District of Columbia. The bill as reported would also have amended the Clean Air Act regarding provisions for New Source Review for refineries and other facilities, but the measure was dropped before being brought to the House floor. (For details, see CRS Report RS21608, *Clean Air and New Source Review: Defining Routine Maintenance*, by Larry Parker.) It would also require EPA to develop a Federal Fuels List and limit local gasoline blends to those on the list. The provision is aimed at reducing "boutique fuels" requirements that make the national gasoline market less flexible. (For details see CRS Report RL31361, *'Boutique Fuels' and Reformulated Gasoline: Harmonization of Fuel Standards*, by Brent D. Yacobucci.)

A similar bill, but without the price gouging provisions, was introduced in the Senate September 26, as the Gas Petroleum Refiner Improvement and Community Empowerment Act, S. 1772, but the bill was rejected October 26 by the Environment and Public Works Committee by a vote of 9-9.

**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. H.R. 3893, as passed the House October 7, includes provisions requiring FTC to define price gouging and penalize violators.

**Presidential Proposals: The Advanced Energy Initiative.** In his January 31 State of the Union message, President Bush set the goal of breaking the U.S. "addiction to foreign oil" and of "replacing" more than 75% of oil imports from the Middle East by 2025. In specifying the Middle East as the source, the proposal differed from provisions considered in the previous year to set a goal of reducing total imports.

The main thrust of the presidential initiative is to increase funding for research in producing ethanol from plant fiber biomass (rather than from corn), for improved batteries for hybrid automobiles, and for hydrogen fuels. At the same time, the budget request for FY2007 for DOE, which includes these increases, would eliminate programs for oil and gas research.

## LEGISLATION

**109<sup>th</sup> Congress****P.L. 109-58, H.R. 6**

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 into law August 8, 2005.

**H.R. 3893 (Barton)**

The Gasoline for America's Security Act of 2005. Introduced September 26, 2005. Reported out by the House Energy and Commerce Committee September 28. Passed by the House October 7 by a vote of 212-210.

**H.R. 4241 (Nussle)**

The Deficit Reduction Act of 2005. Introduced November 7, 2005. Passed by the House November 18 by 217 - 215. H.R. 4241, as passed House, was inserted in lieu of the text in S. 1932, and the amended S. 1932 was passed by the House. (See S. 1932.)

**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. 1772 (Inhofe)**

The Gas Petroleum Refiner Improvement and Community Empowerment Act. Introduced September 26, 2005. Rejected by the Senate Environment and Public Works Committee October 26 by a vote of 9-9.

**S. 1932 (Gregg)**

The Deficit Reduction Act of 2005. Introduced October 27, 2005. Passed Senate November 3 by 52 - 47.

**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.

**S.Con.Res. 18 (Gregg)**

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.

## FOR ADDITIONAL READING

### **CRS Issue Briefs**

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

### **CRS Reports**

CRS Report RL31361, *'Boutique Fuels' and Reformulated Gasoline: Harmonization of Fuel Standards*, by Brent D. Yacobucci.

CRS Report RS21608, *Clean Air and New Source Reviews: Defining Routine Maintenance*, by Larry Parker.

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

CRS Report RL33021, *Oil Industry Profits: Analysis of Recent Performance*, by Robert Pirog.

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

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