

CRS Report for Congress

Gasoline Prices: Issues for the 110th Congress

Updated April 7, 2008

Carl E. Behrens
Specialist in Energy Policy
Resources, Science, and Industry Division

Carol Glover
Information Research Specialist
Knowledge Services Group



Prepared for Members and
Committees of Congress

Gasoline Prices: Issues for the 110th Congress

Summary

The high price of gasoline was an important consideration during the debate on the Energy Policy Act of 2005 (EPACT 2005), P.L. 109-58. As prices continued to surge, the continuing crisis renewed attention on some issues that were dropped or compromised in the debate over P.L. 109-58, as well as to a number of initiatives to reduce the impact of high prices on consumers. However, the 109th Congress adjourned after passing only one of them: a measure lifting some restrictions on oil and gas leasing in the Gulf of Mexico.

Continued high gasoline prices, and the change in leadership in the 110th Congress, put the energy issue in the forefront, and after much debate the Energy Independence and Security Act of 2007 (H.R. 6, P.L. 110-140) was passed and signed by the President in December 2007. The main provisions of P.L. 110-140 were an increase in the Corporate Average Fuel Economy (CAFE) standards for automobiles and light trucks, and an increase in the requirement for the use of renewable fuels in gasoline, including advanced biofuels such as cellulosic alcohol starting in 2016.

Numerous other proposed initiatives, including repeal of some tax benefits to domestic oil and gas producers contained in EPACT2005, provisions on price gouging, and reform of oil and gas leasing in the Gulf of Mexico, were not included in P.L. 110-140, and remain under active consideration in the 110th Congress.

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

The gasoline price surge has stimulated much legislative activity, but without the urgency of previous energy crises. 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.

Contents

| | |
|---|---|
| Most Recent Developments | 1 |
| Background and Analysis | 1 |
| Legislative Activities | 1 |
| Why Are Prices So High? | 2 |
| Crude Oil Prices | 2 |
| Gasoline Prices | 3 |
| Policy Options | 6 |
| Oil-Related Legislation | 6 |
| Reducing Impacts on Consumers | 6 |
| Mid- to Long-Term Supply and Demand | 7 |
| Savings Goals | 8 |
| OCS Leasing | 9 |

List of Figures

| | |
|---|---|
| Figure 1. Average Daily Nationwide Price of Unleaded Gasoline, January 2002 - April 2008 | 2 |
| Figure 2. China's Oil Production and Consumption, 1986-2006 | 3 |
| Figure 3. U.S. Gasoline Consumption, January 2000 - March 2008 | 4 |
| Figure 4. Nominal and Real Price of Gasoline, 1973-2005 and April 2006 | 5 |
| Figure 5. Consumer Spending on Oil as % of GDP, 1970-2001 | 5 |

Gasoline Prices: Issues for the 110th Congress

Most Recent Developments

Gasoline prices surged over \$3.00 per gallon in the spring of 2007, stayed near that level during the summer driving season, and after a brief retreat returned there at the beginning of 2008. (See **Figure 1**.) However, consumption of gasoline continued above 9 million barrels per day (mbd), setting a record high summer peak of over 9.7 mbd during 2007. Some observers claimed to detect signs that the threat of an economic downturn had curbed gasoline consumption, but others claimed that growth was continuing unabated. (See **Figure 3**.)

In December 2007 the Congress passed the Energy Independence and Security Act of 2007 (H.R. 6, P.L. 110-140). The main provisions of P.L. 110-140 were an increase in the Corporate Average Fuel Economy (CAFE) standards for automobiles and light trucks, and an increase in the requirement for the use of renewable fuels in gasoline.

Background and Analysis

Legislative Activities

The persistence of high gasoline prices led to a broad spectrum of proposed new legislation in the First Session of the 110th Congress. Despite passage of the major Energy Policy Act of 2005 (P.L. 109-58), many Members continued to explore a variety of measures to increase supply and reduce demand in the short term, and to reduce the impact of high prices on consumers, as well as revisit longer-term policies that were left behind in the process of reaching agreement on P.L. 109-58.

One such proposed policy was increasing CAFE standards for automobiles and light trucks, and the Energy Independence and Security Act of 2007 (H.R. 6, P.L. 110-140) resolved a decades-long debate by setting new standards and procedures for meeting them. P.L. 110-140 also increased the requirement to use renewable fuels in gasoline, including advanced biofuels such as cellulosic alcohol starting in 2016. However, a number of proposals included in one or more versions of energy legislation in 2007 were dropped from the final bill, and those issues remain of interest to the Congress during the Second Session.

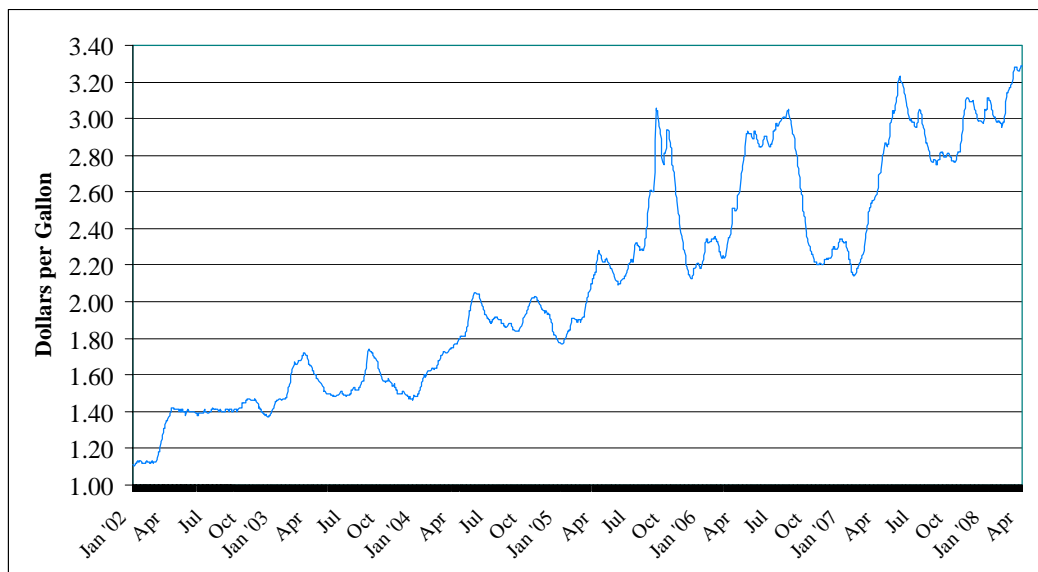
This report reviews the major legislative initiatives to deal with the gasoline price issue. To put these proposals in perspective, it first describes some of the factors that have led to the high prices of both crude oil and gasoline.

Why Are Prices So High?

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.

Crude Oil Prices. 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. As a result, the price of crude oil is set through the interaction of world demand and supply. Major factors in the run-up of crude oil prices have been the sharply increased consumption of imported oil by China (see **Figure 2**) and the continuing possibility of a supply disruption, either from violence or terrorism in the Middle East, or from natural disasters like Hurricanes Katrina and Rita in 2005.

Figure 1. Average Daily Nationwide Price of Unleaded Gasoline, January 2002 - April 2008

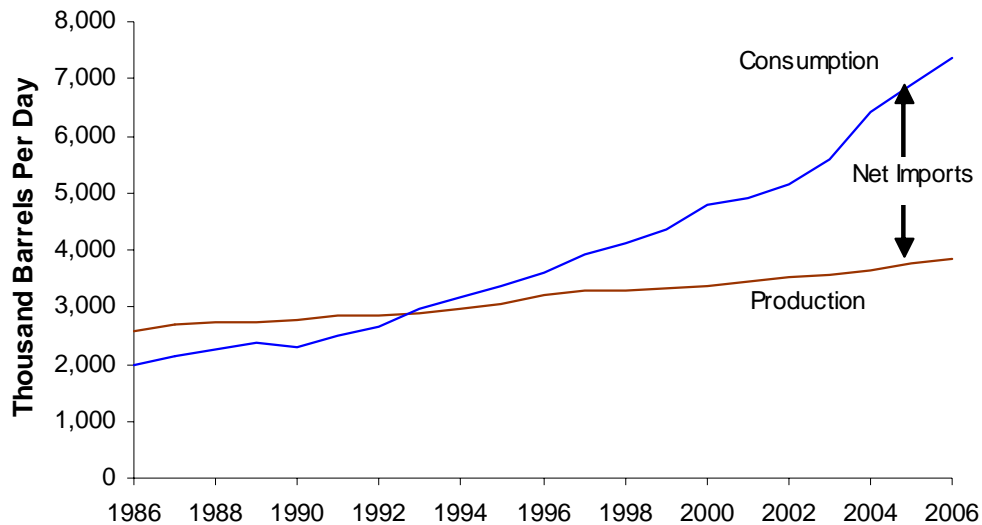


Source: *Daily Fuel Gauge Report*, American Automobile Association [<http://www.fuelgaugereport.com>], compiled by CRS.

Notes: Prices include federal, state, and local taxes. Last date above is April 2, 2008.

World demand for crude oil grew by 4% in 2004 but moderated to 1.4% in 2005 and 1.1% in 2006. It is forecast to grow by 1.7% in 2007.¹ World supply, at 84.5 million barrels per day in 2005, was less than 1 million barrels per day more than demand, leaving relatively little excess supply to draw on if the market was disrupted by natural or political disasters. When excess supply on the market is low, prices tend to rise and become more volatile.

¹ International Energy Agency, *Oil Market Report*, December 13, 2006, pp. 4-6.

Figure 2. China's Oil Production and Consumption, 1986-2006

Source: EIA, *Country Analysis Brief—China*, August 2006, at [<http://www.eia.doe.gov/emeu/cabs/China/Oil.html>].

Note: 2006 is January through August only.

Gasoline Prices. Higher prices for crude oil tend to translate directly into higher prices for gasoline. Crude oil accounts for about 54% of the cost of gasoline. Refining, distributing, and marketing account for about 30% of the cost of gasoline, and taxes account for about 16%.² Whether the crude oil a refiner processes is purchased on the open market or is produced by the oil company itself, higher costs for any element in the cost of gasoline are likely to be passed on to consumers. A number of factors have aggravated the pressure on gasoline prices, including limited refining capacity in the United States, the range of fuel blends required to meet air pollution requirements, and the mandated use of ethanol as an additive. Perhaps most important, U.S. demand for gasoline has increased as economic growth continued, at least through 2007. Some reports that consumption has slowed in light of a threatening economic downturn have been challenged by other observers.³ (See **Figure 3**.)

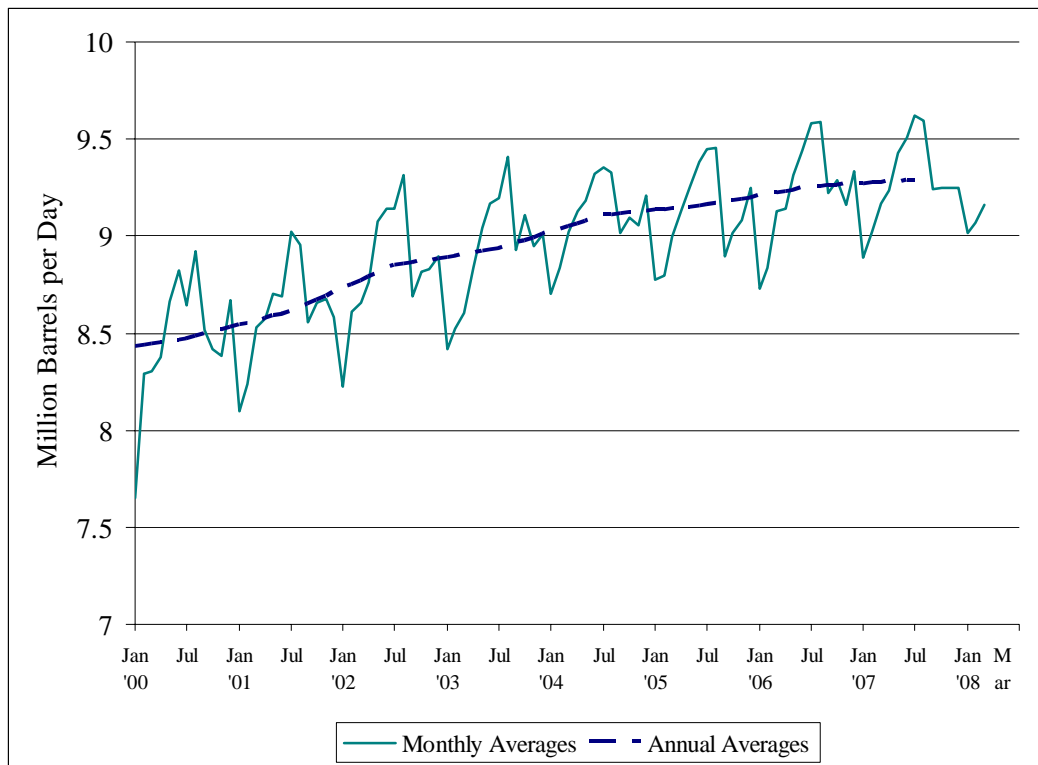
The 2004 price surge intensified discussion of energy policy and led to further calls for passage of energy legislation. However, until the climax of the Katrina disaster, the urgency of previous energy crises had been lacking. Throughout the period, U.S. gasoline consumption continued to rise. In part, 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 4**); that is, until Katrina pushed it toward the \$3.00-per-gallon mark. Further,

² Energy Information Administration data based on June 2006 data and a base price of gasoline of \$2.89 per gallon. See *Gasoline & Diesel Fuel Update* [<http://www.eia.doe.gov>].

³ “Big Goof by the *Wall Street Journal*,” *Lundberg Letter*, March 14, 2008, p. 5.

unlike the earlier crises, there was no physical shortage of gasoline and there were no lines at the pump, except in local disaster-affected areas.

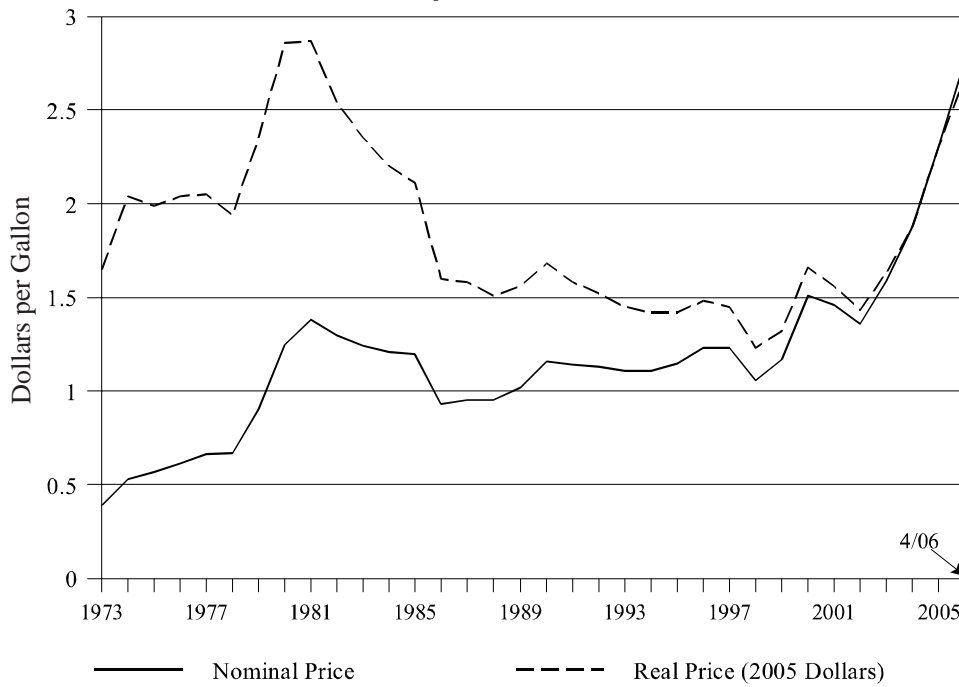
Figure 3. U.S. Gasoline Consumption, January 2000 - March 2008



Source: EIA, *Monthly Energy Review*, March 2008, Table 3.5 and EIA, *Weekly Petroleum Status Report*, April 2, 2008, Table 10.

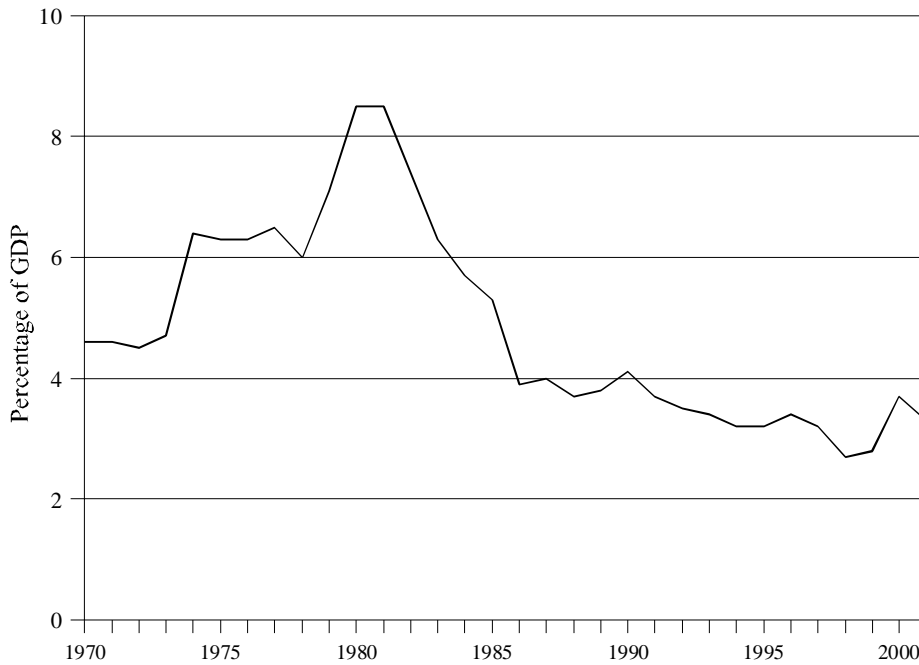
As **Figure 5** indicates, by the early 1990s the proportion of consumer expenditures on oil and gasoline had declined from the high levels of the 1970s and early 1980s. Data are not yet available to indicate what effect the price run-up starting in 2004 has had on this measure. Perhaps most important, 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. Most 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 4. Nominal and Real Price of Gasoline, 1973-2005 and April 2006



Source: EIA, *Monthly Energy Review*, May 2006, Tables 1.6 and 9.4, calculated by CRS.

Figure 5. Consumer Spending on Oil as % of GDP, 1970-2001



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

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 Energy Policy Act of 2005 differed from the previous actions because 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 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, and this process led to passage of the comprehensive Energy Policy Act of 2005.

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, although the 109th Congress adjourned after passing only one bill, lifting some restrictions on oil and gas leasing in the Gulf of Mexico. Continued price pressure, and the change in leadership in the 110th Congress, led to passage of the Energy Independence and Security Act of 2007 (H.R. 6, P.L. 110-140).

Oil-Related Legislation

Reducing Impacts on Consumers. A number of proposals are aimed at easing the impact of high prices on consumers, or are aimed at the oil industry's price-making policies.

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 increased gasoline prices.

The issue reemerged in the 110th Congress as gasoline prices surged past \$3.00 per gallon. On May 23, 2007, the House passed the Federal Price Gouging Prevention Act (H.R. 1252). The bill would ban sale of gasoline at "unconscionably excessive" prices during energy emergencies declared by the president, and impose heavy fines and imprisonment for violations. The White House complained that the bill could result in gasoline price controls, and threatened to veto it, but the House vote of 284-141 indicated enough support to override a veto.

The Senate, in passing its version of H.R. 6, the Creating Long-Term Energy Alternatives for the Nation (CLEAN Energy) Act of 2007 on June 21, included a

price-gouging provision similar to that in H.R. 1252. However, the provision was not included in the final version of H.R. 6, which became P.L. 110-140.

Tax Provisions. EPACT 2005 included several provisions to encourage production of oil and gas on federal lands. The Senate, in considering its version of H.R. 6, discussed the possibility of revising the tax structure, but did not include such provisions in the bill. On August 4, 2007, the House passed the Renewable Energy and Energy Conservation Tax Act, H.R. 2776, which would have repealed some of the EPACT 2005 provisions and redirected the tax relief to renewable energy and conservation. It then attached H.R. 2776 to H.R. 3221, the New Direction for Energy Independence, National Security, and Consumer Protection Act, which it had passed earlier that day.

The tax provisions were included in the House version of H.R. 6 that it sent to the Senate in December, but the Senate did not pass the bill with those provisions in it. The tax provisions were largely removed in a later version of the bill, and that bill was approved by both Houses and signed by the President. (For details on energy tax issues, see CRS Report RL33578, *Energy Tax Policy: History and Current Issues*, by Salvatore Lazzari, and CRS Report RL33763, *Oil and Gas Tax Subsidies: Current Status and Analysis*, by Salvatore Lazzari.)

The issue of tax relief for renewable energy continues to be involved with tax provisions for the oil and gas industry. In the Second Session of the 110th Congress, the House passed H.R. 5351, the Renewable Energy and Energy Conservation Tax Act of 2008, on February 27, 2008. The bill would extend renewable tax credits to 2011 and pay for them by repealing several EPACT oil and gas tax provisions. In the Senate, a bill extending the renewable tax credits but without the oil and gas revenue provisions was offered by Senators Ensign and Cantwell April 4 as an amendment to a housing bill under consideration on the Senate floor (H.R. 3221).

Mid- to Long-Term Supply and Demand. Most proposals affecting supply and demand of crude oil and gasoline would not affect the current short-term crisis but would be aimed at longer term trends.

Fuel Economy. Corporate average fuel economy (CAFE) standards also have a long history of controversy, going back to their establishment in the 1970s. 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, 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. New fuel economy standards for light trucks were issued in 2006, to take effect in the 2008 model year, but implementation was blocked in court.

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.

Continued high gasoline prices raised congressional interest in higher mandated CAFE standards again. On January 22, 2007, a bipartisan group of 10 Senators introduced S. 357, the Ten-in-Ten Fuel Economy Act, which would raise standards for SUVs and passenger cars to 35 mpg by 2019. The President argued that standards should be set by the executive branch, not by Congress, and in his State of the Union speech on January 23, 2007, he set a goal of reducing gasoline consumption by 5% by 2017 through more stringent standards. The White House said that would be the equivalent of increasing CAFE standards 4% per year starting with model year 2010.

After considerable debate, P.L. 110-140 was passed and signed in December 2007, including setting a target of 35 miles per gallon for the combined fleet of cars and light trucks by model year 2020. A number of new procedures, including the trading of fuel economy credits among auto manufacturers, were included in the bill. (For details see CRS Report RL33413, *Automobile and Light Truck Fuel Economy: The CAFE Standards*, by Brent D. Yacobucci and Robert Bamberger.)

Savings Goals. A number of legislative proposals would have set goals for reducing oil consumption. An example is the Enhanced Energy Security Act of 2006 (S. 2747), introduced by Senator Bingaman May 4, 2006, which would have required the Director of the Office of Management and Budget to develop an action plan to save 2.5 million barrels per day (mbd) in 2016, 7 mbd in 2026, and 10 mbd in 2031.

President Bush took up the idea in his State of the Union speech on January 23, 2007, calling for a cut in gasoline consumption of 20% in 10 years, through a combination of increased fuel economy standards (see above) and increased mandated use of alternative fuels (see below).

Alternative Fuels. In his January 31, 2006 State of the Union message, President Bush asserted that the United States is “addicted to oil,” and set the goal of replacing more than 75% of oil imports from the Middle East by 2025. The main thrust of the presidential initiative was 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.

In his next State of the Union speech, on January 23, 2007, the President went further, setting a goal of reducing gasoline consumption by 20% in 10 years, through a combination of more stringent fuel economy standards and setting a mandatory renewable fuels standards of 35 billion gallons of renewable and alternate fuels by 2017, about five times the current consumption. The Energy Policy Act of 2005 (P.L. 109-58) set a target of 7.5 billion gallons by 2012.

On June 21, 2007, the Senate passed its version of H.R. 6, the Creating Long-Term Energy Alternatives for the Nation (CLEAN Energy) Act of 2007, including a provision requiring production of 36 billion gallons of ethanol in 2022. The final version of the bill, P.L. 110-140, set a modified standard that starts at 9.0 billion gallons of renewable fuel in 2008 and rises to 36 billion gallons by 2022. Of the

latter total, 21 billion gallons is required to be obtained from cellulosic ethanol and other advanced biofuels. (For more details, see CRS Report RL34265, *Selected Issues Related to an Expansion of the Renewable Fuel Standard (RFS)*, by Brent D. Yacobucci and Randy Schnepf.)

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 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 Hurricane Katrina, momentum to lift the moratorium increased, along with efforts by Gulf states to increase their share of revenues from oil and gas production in the Gulf of Mexico. This movement culminated in S. 3711, the Gulf of Mexico Energy Security Act of 2006, which lifted some restrictions in Gulf of Mexico oil and gas leases and increased revenue sharing for Gulf producing states. The Senate passed S. 3711 on August 1, 2006, and its provisions were included in H.R. 6111 (P.L. 109-432), the Tax Relief and Health Care Act of 2006, which passed the House on December 8 and the Senate the following day. (For details, see CRS Report RL33493, *Outer Continental Shelf: Debate Over Oil and Gas Leasing and Revenue Sharing*, by Marc Humphries.)

Representative Barton's proposed energy bill, which he submitted in the form of a motion to recommit H.R. 3221 on August 4, 2007, included a provision to open up the OCS to oil and gas leasing beyond 100 miles of the coast. The motion to recommit was defeated by a vote of 169 ayes to 244 noes.

Another issue regarding OCS leasing concerns a number of leases issued in 1998 and 1999 which granted royalty relief under certain conditions without including a price threshold. Several initiatives to force renegotiation of these contracts have been proposed, including the House-passed version of H.R. 6, the CLEAN Energy Act. Similar provisions, including denial of new Gulf of Mexico leases to lessees holding leases without price thresholds, and establishing "conservation of resources" fees, were included in H.R. 3221, as passed by the House August 4, 2007. However, the provision was not included in the final bill, P.L. 110-140. (For details on OCS royalty relief issues see CRS Report RS22567, *Royalty Relief for U.S. Deepwater Oil and Gas Leases*, by Marc Humphries.)