

# Executive Memorandum

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## Congressional Mandates Contribute to Higher Gas Prices

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Members of Congress have already received complaints from their constituents about high gasoline prices, and the summer driving season—with its increased demand—has not even started. The U.S. Energy Information Administration (EIA) expects gasoline prices to remain high and volatile throughout the summer months. While government policies are not the sole reason for these high prices, they do contribute to regional and seasonal price fluctuations that increase costs and reduce flexibility to meet consumer demand.

### Primary Costs to Produce Gasoline

Four major components drive the retail price of gasoline: the cost of crude oil, refinery processing costs (including environmental regulations), distribution and marketing costs, and taxes.

**Crude Oil.** Crude oil is the largest cost component. EIA data show that crude oil accounted for 46 percent of gasoline costs in March. Increasing world demand, unrest in energy-rich countries such as Venezuela, and the March decision by OPEC to cut crude oil output by 1 million barrels per day have kept world supplies tight and have driven up crude oil prices.

The EIA's "Summer 2004 Motor Gasoline Outlook" notes that the price for West Texas Intermedi-

ate crude oil surpassed \$38 per barrel in late March—the highest level since early 1991. The EIA projects that crude oil prices will average \$33.40 per barrel (79.6 cents per gallon) during the summer. It expects retail regular gasoline prices to average \$1.76 per gallon from April through September—up 20 cents from summer 2003.

While Congress can do little to drive down the cost of crude oil during the summer driving season, it can and should authorize access to more domestic oil supplies for the future.

**Taxes.** Federal, state, and local taxes account for 24 percent (the second largest component) of the retail price of gasoline. The federal gas tax is 18.4 cents per gallon. State gasoline tax rates vary: They amount to 8 cents per gallon in Alaska, 33 cents per gallon in New York, 32.4 cents per gallon in California, and 36.3 cents per gallon in Hawaii. These taxes add to the price of motor fuel and—in part—drive the regional price differences.

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- Stringent federal air quality requirements drive up the cost of gasoline and affect price volatility.
  - Increased oil supplies and regulatory flexibility would reduce price volatility and ensure affordable gasoline for consumers.
  - Regional gasoline price differences are largely driven by taxes and regulation.
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This paper, in its entirety, can be found at:  
[www.heritage.org/research/regulation/em932.cfm](http://www.heritage.org/research/regulation/em932.cfm)

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On average, local taxes add approximately another 2 cents per gallon to the price.

**Distribution and Marketing.** The EIA also reports that distribution and marketing costs in March accounted for 11 percent of the retail price of gasoline. The wide variety of specialized regional gasoline formulas required by federal and state regulators make storage and distribution more difficult and increase the potential for supply disruptions and short-term price spikes. Moreover, specialized blends required for one area of the nation may not be suitable for another area.

Furthermore, not every refinery can produce every grade of gasoline and pipelines have limited flexibility to move different grades of gasoline to different places. The American Petroleum Institute states that these circumstances make it difficult for refiners to get the right grade of gasoline to the right market in the right quantity.

**Regulations.** According to the EIA, refining costs represented almost 20 percent of the retail cost of gasoline in March. Congress could significantly reduce these costs by scaling back the excessive and cumbersome federal regulations on refiners.

For example, the 1990 Clean Air Act amendments mandate the sale of cleaner-burning reformulated gasoline (RFG) in order to reduce summer smog in nine major metropolitan areas. The law also requires that RFG contain at least 2 percent oxygen by weight. To comply with these regulations, refiners must switch from winter-grade fuel to costlier summer-blend gasoline. According to the Federal Trade Commission (FTC), this adds 4 cents to 8 cents per gallon to the price of gasoline.

Moreover, a common oxygenate, MTBE (methyl tertiary butyl ether, which is used in about 70 percent of the reformulated gasoline) has been banned in California, New York, and Connecticut. This means that refineries must use a different additive, such as ethanol—which requires more crude oil in the production process. Reducing or phasing out MTBE use—but leaving the 2 percent oxygenate requirement in effect—would increase ethanol use. This would further contribute to price volatility and unnecessarily high gasoline prices.

Likewise, complying with a new national low-sulfur gasoline regulation for passenger cars not only presents scientific challenges for refiners, but also could adversely affect gasoline supply and availability. The industry will need to invest more than \$8 billion over the next three years to meet this requirement—which will result in higher prices at the pump.

In addition to these federal regulations, some state and local governments require specialized fuel blends—“boutique fuels”—to satisfy local air quality needs.

This hodgepodge of customized fuel requirements increases production costs, which are ultimately reflected in the price of gasoline. These varied gasoline specifications also restrict the ability of refiners and distributors to move supplies around the country in response to local and regional shortages. Further proliferation of boutique fuel requirements would only contribute to the overall problem and drive up costs during disruptions.

## Reducing the Price of Gasoline

Instead of calling upon the FTC to investigate recent price spikes for alleged market manipulation, Congress should take note of past FTC findings that “unusual movements in gasoline prices typically have a natural cause” and act to reduce the high cost of producing gasoline. Specifically, Congress should:

- **Repeal** the federal oxygen mandate;
- **Provide** protections against additional specialized fuels that complicate production and distribution;
- **Open** exploration in areas currently off-limits to domestic production—such as the Arctic National Wildlife Refuge and off-shore moratoria areas; and
- **Remove** burdensome restrictions on domestic production.

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