WebMemo

Published by The Heritage Foundation

No. 1174
July 25, 2006

Time to Remove Barriers to Boosting Oil Refining Capacity

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The high price of oil is the main reason that the price of gasoline has nearly doubled over the last three years, but it is not the only reason. The cost of turning oil into gasoline has also risen, thanks in part to costly federal regulations on refinery operations and expansions. Many in Congress are aware of this problem, and the House recently passed the Refinery Permit Process Schedule Act (H.R. 5254) to address it. This very modest measure would streamline refinery-related regulations and would be a useful step in expediting badly needed capacity additions. If it is serious about reducing Americans' pain at the pump, the Senate should consider measures at least as strong as those passed by the House.

Paying the Price for Years of Anti-Refinery Policy

No new refineries have been built in the U.S. since the 1970s. Growing demand for gasoline has been met by expansions of existing refineries, but even these have come with considerable difficulty. Part of the reason for lagging refining capacity is that the sector is very heavily regulated under the Clean Air Act.

These regulations number in the dozens and affect both refinery operations and fuel specifications. According to the Federal Trade Commission, "[N]ew environmental regulations have required substantial investments in refineries, and a gallon of environmentally mandated gasoline costs more to produce than a gallon of regular gasoline."[1] Since the Clean Air Act's massive 1990 rewrite, the refining sector has had to spend a much as $4 billion each year on regulatory compliance at existing refineries.[2] These investments, which by now total nearly $50 billion, maintain existing capacity but do nothing to increase it. This regulatory burden has siphoned away substantial resources that could have otherwise gone into expansion. When expansions do occur, the regulations make them much more expensive. In addition to costs, the many procedural requirements—and in some cases litigation—can delay new capacity by months or even years.

As a result, refining capacity in the U.S. is barely adequate under ideal circumstances and is vulnerable to adverse events. This was seen last year, when Hurricane Katrina knocked out many Gulf-area offshore oil wells and adjacent onshore refineries and helped send prices skyrocketing. Even instances of unexpected downtime at individual refineries have caused noticeable price increases, showing how little margin for error exists in this tight market.

The refining industry has embarked on expansions that will help ease the burden, but that pro-

This paper, in its entirety, can be found at:
www.heritage.org/research/energy/wm1174.cfm

Produced by the Thomas A. Roe Institute for Economic Policy Studies

Published by The Heritage Foundation
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cess is slow and beset by regulatory roadblocks. These expansions may not be able to keep pace with demand that is set to increase by over 1 percent annually in the years ahead, according to Energy Information Administration projections.[3]

For now, foreign refineries are gaining market share, partially filling the domestic refining gap. Currently, 10 percent of America's gasoline is refined overseas, but that source of supply is complicated by domestic fuel formulation regulations. The nation's gasoline must meet complex and unique requirements, and not all foreign refiners have the ability or desire to produce these specialized blends. [12 3]

The end result is that all of these unnecessarily complicated environmental regulations are adding to the upward pressure on gasoline prices.

Regulatory Relief Long Overdue

H.R. 5254 would make no substantive changes to the underlying regulatory requirements but merely expedite existing refinery regulatory processes and approvals. The bill also would make closed military bases available as future refinery sites.

The Senate Energy and Natural Resources Committee is now considering the Senate's next step. A refinery bill similar to H.R. 5254 failed in the Senate Environment and Public Works Committee last year. This year, the Senate will most likely include refinery provisions in a larger energy package, but time is running short on the legislative calendar.

A good Senate bill should do at least as much to expedite approvals as the House bill, if not more. For example, the costly and cumbersome New Source Review program tangles refinery expansions in unnecessary red tape. Several provisions of this program should be cut back or eliminated. And the stringent deadlines of the EPA's new smog standard are inconsistent with other Clean Air Act provisions, creating further difficulties for many refiners seeking to expand. Simple harmonization of these provisions would be helpful. Other measures, such as simplifying fuel specifications, could reduce the regulatory burdens that prevent more gasoline from being produced. These changes could be done without risking additional pollution or adversely affecting public health.

Conclusion

Whether modest or ambitious, any effort to streamline the refinery regulation would be a welcome reversal of a federal policy that has piled more and more requirements on the refining sector over the past 15 years. That policy has added to the pain consumers are experiencing at the pump, and changes could make a real difference in gasoline prices in the years ahead.

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1. Federal Trade Commission, "Gasoline Price Changes: The Dynamic of Supply, Demand, and Competition," June 2005, p. 57.
2. Id.
3. Energy Information Administration, "Annual Energy Outlook 2006," p. 11.