

How to Lower Gasoline Prices

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Testimony before the House Committee on Natural Resources

March 21, 2012

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Chairman Hastings, members of the Committee, I am honored to be invited to testify before you today on the subject of how to lower gasoline prices. This is an important issue to millions of Americans, and I thank you for holding this hearing.

As well as the owner of three 1990s gas guzzling General Motors vehicles, I am a senior fellow at the Manhattan Institute. From 2003 until April 2005 I was chief economist at the U.S. Department of Labor. From 2001 until 2002 I served at the Council of Economic Advisers as chief of staff. I have served as Deputy Executive Secretary of the Domestic Policy Council under President George H.W. Bush and as an economist on the staff of President Reagan's Council of Economic Advisers.

As Americans are discovering, when crude oil prices jump, gasoline prices can leap even more, pulling their payroll tax cuts out of their wallets and into their gas tanks. Oil prices are over \$100 per barrel, and prices for a gallon of gasoline in Hawaii, California and Arkansas are well past \$4.00. Other states are not far behind.

But though Iran, in a tussle with Europe over economic sanctions aimed at its suspected drive for atomic weapons, is a convenient scapegoat, the heart of the problem lies closer to home, with our own energy policy.

President Obama proclaims that he wants to make the United States less dependent on imported foreign oil, and we have moved a little in that direction. Domestic crude oil production averaged 8,184 thousand barrels per day for the month of November 2011, up from 6,895 thousand barrels per day average in 2005. But we could do better.

On January 20, 2009, when Mr. Obama was inaugurated, the average price of gasoline was \$1.84 per gallon and the price of oil was about \$39 for a 42-gallon barrel. Now refiners must pay about \$124 for a barrel of crude oil and the average price of gasoline is \$3.83 per gallon. Some are predicting gasoline prices above \$5 per gallon.

Gasoline prices are directly related to the price of oil. Mr. Obama, preoccupied with keeping environmentalists happy before the November elections, is failing to secure an adequate supply of oil that our refiners can make into gasoline.

Some say that oil prices are rising only because the dollar is weakening and the price of oil is denominated in dollars. But the recent jumps in the price of oil are

clearly related more to political turmoil in the Middle East than to the level of the dollar. A more encouraging attitude to domestic oil exploration on the part of the administration would not affect the inflationary component of oil prices, but it would mitigate the effects of disturbances in foreign supplies.

Expectations are crucial to all prices, including oil prices. A forecast of a major hurricane in the Gulf, or rumors of a supply cut-off from an oil exporter, will raise prices without subtracting one single barrel of oil from the supply chain, even with a possible rise in the dollar. This is because lower supplies are seen for the future without actually occurring in the present.

The converse is also true. If the White House announced a truly favorable environment for upstream and downstream oil production—additional leases, approval of Keystone XL, faster drilling permits, suspension of boutique fuel requirements—prices would decline due to expectations of greater supply. Natural gas prices have declined due to expectations of future supply because of new hydrofracturing technology, even though most of the gas is still in the ground.

Although the White House recently announced a lease sale for June in the Central Gulf of Mexico for 38 million acres, this is not new, because it was included in the Mineral Management Service's previous 5 year lease plan, announced in 2007. Other areas in the 2007 plan, such as Virginia and the Beaufort Sea, will not meet their prior lease goals.

The president is discouraging domestic oil production and imports of oil from our trading partner, Canada, so our refineries are not operating at capacity. In November 2011, refineries were producing at 87 percent of capacity, but they can produce more. In the summers from 1993 through 2006 refinery capacity regularly exceeded 90 percent. In June of 2004 and 2005, it reached 97 percent.

Meanwhile, prices are rising throughout the United States, hurting household budgets. Table 1 shows how much average households in different states pay for gasoline now each month, and how much they will pay in the future if prices continue to increase.

On January 1, 2012, Connecticut households on average paid \$344 monthly for gasoline. Now, with gas at \$3.98 per gallon, they pay \$384, a 12 percent increase. If prices were to increase by \$1.00 per gallon, they would pay \$473, an increase of 23 percent over March 1.

Residents of New York are more fortunate. The average price of gasoline was \$3.97 on March 1, but New Yorkers drive less, so their gasoline bills are lower. If gasoline increased by \$1.00 per gallon, the average household expenditure in

New York, for example would increase from \$242 per month to \$298 per month, a 23 percent increase.

Households in other states may see their expenditures increase past \$300 and even \$400 per month. In Georgia, if prices were to increase by \$1.00 per gallon, household expenditures would rise from \$361 per month to \$452 per month, a full 25 percent increase. And in Ohio, monthly household gas expenditures are hovering just below \$300 monthly. Residents of the Buckeye State would see gas bills of \$365 monthly if gas prices increased by a dollar.

Here are six actions that Mr. Obama could take to lower gasoline prices.

Approve Keystone XL Pipeline. The Keystone XL pipeline could bring oil down from Canada to our refineries in the Gulf. The supply of Mexican and Venezuelan oil used by the Gulf refineries is shrinking, and needs replenishing from new sources. Instead, Canada is planning to build another pipeline to its West Coast, so as to ship its oil to China.

Plus, the shale oil produced in the Bakken and Utica fields, in North Dakota and Ohio, needs a pipeline for transport to the Gulf refineries. According to Lou Pugliaresi, president of the Energy Policy Research Foundation, Inc., "The lack of infrastructure throughout the Northern Tier now means that U.S. production in the Bakken and Utica is facing infrastructure constraints and lower wellhead values. This may even lead to lower investment and drilling rates."

Additional Oil Exploration. Mr. Obama could allow individual states more flexibility to determine their level of oil exploration. Alaska, for example, wants to drill for oil in a small part of the Arctic National Wildlife Refuge, but federal law prevents that. Mr. Obama could also allow for oil leasing on federal lands which would bring in revenue for the U.S. Treasury and oil for the refineries in the Gulf.

California would likely see more exploration if the state could find a faster way to approve permits, given the historic production in the prolific, long-producing fields in Kern County and the Monterey shale, still in the very early stages of development. California's environmental lobby is all-powerful, but in November 2011 Governor Jerry Brown, a Democrat, announced that he was replacing the two individuals who were directly responsible for overseeing oil and gas permits, in an attempt to speed up the process. Occidental, the largest lease holder in the Monterey shale, has noted that it would do more if the permitting process would speed up.

Many producers focus on areas where they do not have to deal with federal regulators, because much federal land is either off-limits or tied in red tape. Almost all substantial U.S. onshore oil and gas developments have been on

private lands. That is not saying that geology is the main reason for this, rocks really do not care about who owns the land above them. Areas of North Dakota where the oil boom is taking place are privately-owned, as are areas in Pennsylvania. If Wyoming, Utah and Alaska had more private property, they would be able to put into place a streamlined development approval process.

Speed Up Permitting. It would be easy for Mr. Obama to ask the Interior Department to speed up permitting in the Gulf of Mexico. Following the BP oil spill in April 2010, Mr. Obama, with the support of the Secretary of the Interior, Ken Salazar, issued a moratorium on all drilling below 500 feet, including halting the issuing of new permits to drill in the Gulf of Mexico. Since the moratorium was lifted in October 2011, the pace of permits approval has been almost 30 percent slower than it was prior to the incident.

At the end of 2011, Baker Hughes, an oil services company that publishes a widely-respected index of drilling activity, estimated there were 13 fewer rigs working in the Gulf of Mexico than before the BP oil spill.

Production has still not recovered. It now takes three months to approve an offshore drilling plan, whereas it used to take two months. In 2012, as this brief went to press, the Interior Department has approved 23 percent of drilling plans submitted, compared with prior averages of over 70 percent.

Add Flexibility to Fuel Requirements. Environmental Protection Agency regulations require 18 different blends of gasoline in different states, depending on the season and on air quality in the different states. This keeps the price of gasoline high because excess supply of gasoline in one state cannot be shipped to another. Waiving these boutique fuel requirements, as they are known, would allow the price of gasoline to decline.

Senator Roy Blunt, a Missouri Republican, has introduced the Boutique Fuel Reduction Act of 2011. The bill, which has 38 cosponsors, would give the EPA Administrator the flexibility to waive or expand boutique fuel requirements for states if the need warrants. A similar bill in the House, sponsored by Representative Lee Terry, a Republican from Nebraska, has 11 cosponsors.

Similarly, EPA's Low Carbon Fuel Specifications require some states to use gasoline with low levels of carbon in order to reduce greenhouse gas emissions. These standards raise the price of gasoline, according to economics professor Stephen Holland of the University of North Carolina. With gasoline approaching \$5 a gallon, Mr. Obama could put these specifications on hold.

End the Ethanol Mandate. Although ethanol lost its tax subsidy at the end of 2011, its use in gasoline is required by the 2007 Energy Independence and Security Act. The law requires 13.95 billion gallons in 2011, 15.2 billion in 2012,

gradually increasing to 36 billion gallons in 2022. To meet these volumes, EPA calculates a standard percentage blend mandate for each year.

A more sensible policy would be to end the mandate and allow producers to determine ethanol usage based on the relative cost of corn and oil. Since infrastructure for distilling ethanol has already been developed, eradicating the blending requirement would not mean ethanol would go away. Rather than driven by dictate, the composition of ethanol in gasoline would be driven by the relative marginal costs of each product, which would mean greater efficiency in the energy market, and lower prices for consumers.

Now Is Not the Time to Tax Oil. In his fiscal 2013 Budget sent to Congress last week, Mr. Obama proposed raising over \$50 billion during the next decade in taxes on the oil and gas industry, the highest taxes on any industry. Those taxes would reduce the profitability of American companies vis-à-vis foreign ones. Foreign companies would win bidding wars for all phases of petroleum development because their tax burdens would be lower. This would not help America: we want American companies to win the bidding wars.

The late David Salzman, president of LightSpin Technologies, commented: "We're stuck with gasoline for at least the next two decades. Ethanol produces horrible quantities of greenhouse gases and with current technology costs almost as much energy to make as it releases. All-electric cars actually increase the demand for oil, because losses from batteries and distributing electricity over the grid exceed the energy savings from burning oil."

The price of oil at any given time reflects both current supply and demand conditions in the market and what buyers and sellers believe about future supply and demand.

Mr. Obama has sent all the wrong signals. He has done nothing to embrace the hydrofracturing oil renaissance, and he is contributing to expectations of reduced supply both through his slowdown in permitting, which affects domestic oil production, and cancellation of the Keystone XL pipeline, which affects supplies from our largest trading partner, Canada.

This is not a minor policy error. Mr. Obama's actions will result in higher expenditures on gasoline for millions of America households, slowing the economic recovery.

Thank you for giving me the opportunity to testify today. I would be glad to answer any questions you might have.

Current Average Household Monthly Gas Expenditures and Future Projections by State

State	1/1/2012 price	3/1/2012 price*	3/1/2012 price per gallon	+\$0.25/ gal**	+\$0.50/ gal**	+\$0.75/ gal**	+\$1.00/ gal**	+\$1.25/ gal**	+\$1.50/ gal**
AL	236.98	269.07	3.60	286.56	303.89	321.06	338.08	354.95	371.66
AK	331.27	354.52	4.17	374.42	394.17	413.76	433.21	452.50	471.63
AR	305.61	346.90	3.56	369.70	392.29	414.68	436.86	458.83	480.60
AZ	277.70	322.59	3.76	342.67	362.57	382.31	401.87	421.26	440.48
CA	339.66	400.99	4.33	422.67	444.19	465.55	486.75	507.79	528.67
CO	252.26	262.79	3.19	282.05	301.12	320.00	338.68	357.16	375.46
CT	343.93	383.59	3.98	406.15	428.53	450.72	472.73	494.57	516.22
DC	68.46	77.51	3.87	82.20	86.84	91.45	96.02	100.56	105.05
DE	275.40	307.43	3.67	327.03	346.46	365.72	384.80	403.72	422.46
FL	280.28	317.86	3.79	337.49	356.95	376.25	395.37	414.34	433.13
GA	317.91	361.47	3.68	384.45	407.23	429.82	452.20	474.38	496.36
HI	302.67	327.96	4.35	345.61	363.14	380.53	397.79	414.92	431.93
IA	276.12	314.29	3.62	334.60	354.73	374.69	394.46	414.05	433.46
ID	266.19	289.70	3.38	309.75	329.61	349.27	368.75	388.04	407.13
IL	268.10	302.80	3.87	321.11	339.27	357.28	375.13	392.84	410.39
IN	311.38	345.55	3.82	366.71	387.71	408.52	429.16	449.61	469.89
KS	324.58	369.03	3.58	393.15	417.05	440.74	464.20	487.46	510.49
KY	295.14	331.15	3.68	352.21	373.08	393.77	414.28	434.60	454.74
LA	355.68	404.38	3.62	430.51	456.41	482.09	507.53	532.74	557.71
MA	267.64	300.48	3.73	319.33	338.02	356.55	374.91	393.11	411.15
MD	276.21	310.86	3.70	330.52	350.01	369.32	388.47	407.45	426.26
ME	307.87	347.04	3.82	368.31	389.39	410.29	431.02	451.56	471.93
MI	312.56	346.48	3.83	367.65	388.64	409.46	430.10	450.56	470.84
MN	271.95	303.82	3.61	323.51	343.03	362.37	381.53	400.52	419.34
MO	289.41	331.23	3.49	353.43	375.43	397.22	418.81	440.19	461.38
MS	346.97	394.25	3.58	420.01	445.54	470.85	495.92	520.76	545.37
MT	374.48	398.36	3.28	426.80	454.96	482.84	510.44	537.77	564.81
NC	287.92	328.73	3.75	349.23	369.55	389.70	409.67	429.47	449.09
ND	395.60	434.06	3.60	462.31	490.31	518.05	545.55	572.79	599.77
NE	288.19	328.83	3.68	349.74	370.47	391.02	411.39	431.57	451.58
NH	247.61	279.85	3.69	297.58	315.15	332.57	349.84	366.95	383.91
NJ	349.91	393.99	3.61	419.52	444.82	469.89	494.74	519.36	543.75

State	1/1/2012 price	3/1/2012 price*	3/1/2012 price per gallon	+\$0.25/gal**	+\$0.50/gal**	+\$0.75/gal**	+\$1.00/gal**	+\$1.25/gal**	+\$1.50/gal**
NM	270.23	312.31	3.49	333.27	354.04	374.61	394.99	415.17	435.17
NV	287.64	318.89	3.78	338.64	358.22	377.64	396.89	415.97	434.88
NY	216.94	241.75	3.97	255.99	270.12	284.13	298.03	311.81	325.48
OH	265.93	293.37	3.77	311.60	329.67	347.58	365.34	382.94	400.39
OK	329.56	372.11	3.48	397.09	421.85	446.37	470.66	494.73	518.56
OR	264.52	304.41	3.94	322.51	340.47	358.27	375.93	393.44	410.81
PA	206.94	230.88	3.77	245.21	259.42	273.50	287.47	301.31	315.03
RI	367.82	411.96	3.79	437.41	462.64	487.66	512.46	537.05	561.42
SC	322.59	368.41	3.56	392.63	416.64	440.42	463.99	487.34	510.47
SD	369.04	409.16	3.58	435.88	462.36	488.60	514.60	540.36	565.88
TN	303.53	345.75	3.59	368.27	390.58	412.69	434.60	456.31	477.82
TX	356.89	407.72	3.57	434.42	460.88	487.11	513.09	538.84	564.34
UT	287.11	318.93	3.32	341.43	363.72	385.78	407.63	429.26	450.67
VA	345.34	391.81	3.64	417.02	442.01	466.78	491.32	515.64	539.74
VT	331.89	371.33	3.80	394.22	416.93	439.44	461.75	483.88	505.81
WA	280.62	319.07	3.92	338.12	357.01	375.74	394.32	412.74	431.01
WI	296.64	332.87	3.70	353.95	374.84	395.56	416.09	436.43	456.60
WV	257.20	289.48	3.80	307.31	324.99	342.51	359.89	377.11	394.19
WY	310.69	322.64	3.17	346.40	369.93	393.22	416.26	439.07	461.64

Source: Author Calculations and AAA Estimations.

*Estimate based on AAA Fuel Gauge Report Prices for 1/1/2012 and 3/1/2012, and AAA 1/2012 Gallons Per Household by State. All estimates assume a 0.6% decrease consumption in gallons for every 10% increase in price. Price elasticity based on CBO estimate (*Effects of Gasoline Prices on Driving Behavior and Vehicle Markets*, January 2008.) **Estimate based on price per gallon increase from 3/1/2012 price and imputed consumption level.