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# THE RISE IN GASOLINE PRICES

Statement by

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Subcommittee on Energy Regulation and Conservation

of the Committee on Energy and Natural Resources

U.S. Senate

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## THE RISE IN GASOLINE PRICES

### Outline of Testimony

I. SUMMARY: *Retail motor gasoline prices have recently risen sharply, by 10.9 cents per gallon from March 17 to April 7, according to the authoritative Lundberg Survey. Some observers have erroneously pointed to the Exxon Valdez oil spill in Prince William Sound as the "cause" of the increase. However, gasoline prices had been poised to rise before the March 24 spill. Since their low point in late 1988, crude oil spot prices had risen by about 18 cents per gallon, while average retail gasoline prices had not risen at all according to the Lundberg Survey. Since crude oil costs are reflected in product prices over time, it was expected that gasoline prices would soon show additional increases. The supply uncertainty in the aftermath of the spill thus affected the timing of the price moves, but did not cause them.*

II. THE PERIOD UP TO MARCH 24: *Crude oil prices in the first quarter of 1989 were unexpectedly strong, rising 18 cents per gallon between November 1988 and March 24, but retail prices did not follow.*

A. OPEC's factionalism and its high 4th quarter 1988 production had been expected to keep crude markets weak.

B. Market psychology was subsequently buoyed by upward revisions in world oil demand, North Sea production problems, OPEC's ability to agree on quotas and other matters at its November meeting, and its willingness to tolerate limited quota violations.

C. The crude price low point was October and November, just prior to the OPEC meeting--less than $13 per barrel for both West Texas Intermediate (WTI) in Cushing, OK, and for U.S. refiner acquisition cost.

D. WTI prices rose to $18-19 by mid-January. On the day *before* the Exxon Valdez spill, they were quoted at over $20 per barrel.

E. The crude price increase between November and March 23 was $7.50/Bbl **--18 cents per gallon.**

(fig. I)

F. Retail prices always follow significant changes in crude oil costs because crude oil cost represents 50-60% of the retail price of gasoline excluding the tax, but they follow with a lag. In November 1988, the gasoline price had been about the same as on March 17, the last Lundberg Survey before the spill. (In fact, gasoline prices had dipped in the interim, an indication of the lag.) The same pattern is evident in the weekly ex-tax retail price survey of the *Oil & Gas Journal.*

G. Wholesale gasoline prices, such as dealer tank wagon prices, began to increase in early March, rising about 3 cents per gallon by March 24. Barge prices for gasoline, one step closer to the refiner and a harbinger of changing market conditions, had risen 7 cents in New York Harbor between March 1 and the Valdez spill.

H. The general market expectation on the eve of the Alaskan oil spill was that crude oil prices had peaked and would likely weaken somewhat in April, while gasoline retail prices would rise significantly, reflecting the increased wholesale costs.

(fig. II and III)

I. The West Coast is a special situation: prices had begun to climb well before March 24, as shown in the accompanying charts. In fact, they show a markedly different pattern from the U.S. average.

   1. For instance, Los Angeles dealer tank wagon prices fell 7 cents per gallon between mid-November and mid-January, and then moved up by 16 cents between mid-February and March 23. On balance, however, the dealer tank wagon price still only gained 9 cents on the November base by the time of the Alaskan spill, or about half of the crude oil price increase over the period.
   2. West Coast retail prices for unleaded gasoline also declined between November and January and then rose by about 6.5 cents to just before the Alaskan oil spill.

## II. AFTER MARCH 24: *Wholesale markets reacted quickly to supply uncertainty, and retailers began to raise their prices to reflect increased costs.*

A. The Alaskan oil spill temporarily curtailed supplies. Since PAD V receives about 60% of its crude oil from Alaska (about 1.5 million barrels daily) and another 400 - 500 thousand barrels per day goes to the U.S. Gulf Coast, uncertainty over the duration and volume of the curtailment and announcements of *force majeure* by two major oil companies brought on fears of shortages. The loss of Alaskan crude totaled some 13 million barrels.

B. For a number of reasons, all of them preceding the accident, gasoline markets were expected to be somewhat tight in 1989.
   1. Demand is expected to increase.
   2. Sophisticated downstream refinery equipment for gasoline manufacture is close to full utilization.
   3. Tighter volatility standards carry a significant volume penalty, perhaps as much as 150 thousand B/D, and uncertainty over RVP policy has stymied efforts to prepare.

C. Wholesale markets are mature, active, relatively transparent and include a large number of players. Trade publications and electronic reporting services provide rapid reporting of price changes. The New York Mercantile Exchange's gasoline contract provides information and flexibility to the market and in times of rapid changes, may accelerate the move.

D. Dealer tank wagon prices, on average, according to *The Oil Daily*, have risen 9 cents since March 24. Barge prices in New York Harbor rose 6 between March 24 and April 7.

E. Retail prices, according to the Lundberg Survey, rose on average about 10.9 cents between March 17 and April 7, the expected response to wholesale price increases.

IV. **RETAIL MARKETS:** ***Many thousands of retailers set pump prices in this highly competitive market; large integrated refiners do not set prices at most retail service stations.***

A. Companies only set prices at stations they operate; independent dealers, who account for the vast bulk of retail outlets, set their own prices. According to the Department of Energy's data on major energy producers (the "FRS" series), the 22 reporting companies operated 16% of the stations they sold through.

B. The retail market, with some 150,000 outlets, is highly competitive, and competitive pressures are very localized, in particular in the very short term. Prices do not move up or down in a given area just because prices in a distant market have moved. When their wholesale prices begin to move, however, retailers of course try to pass these costs on.

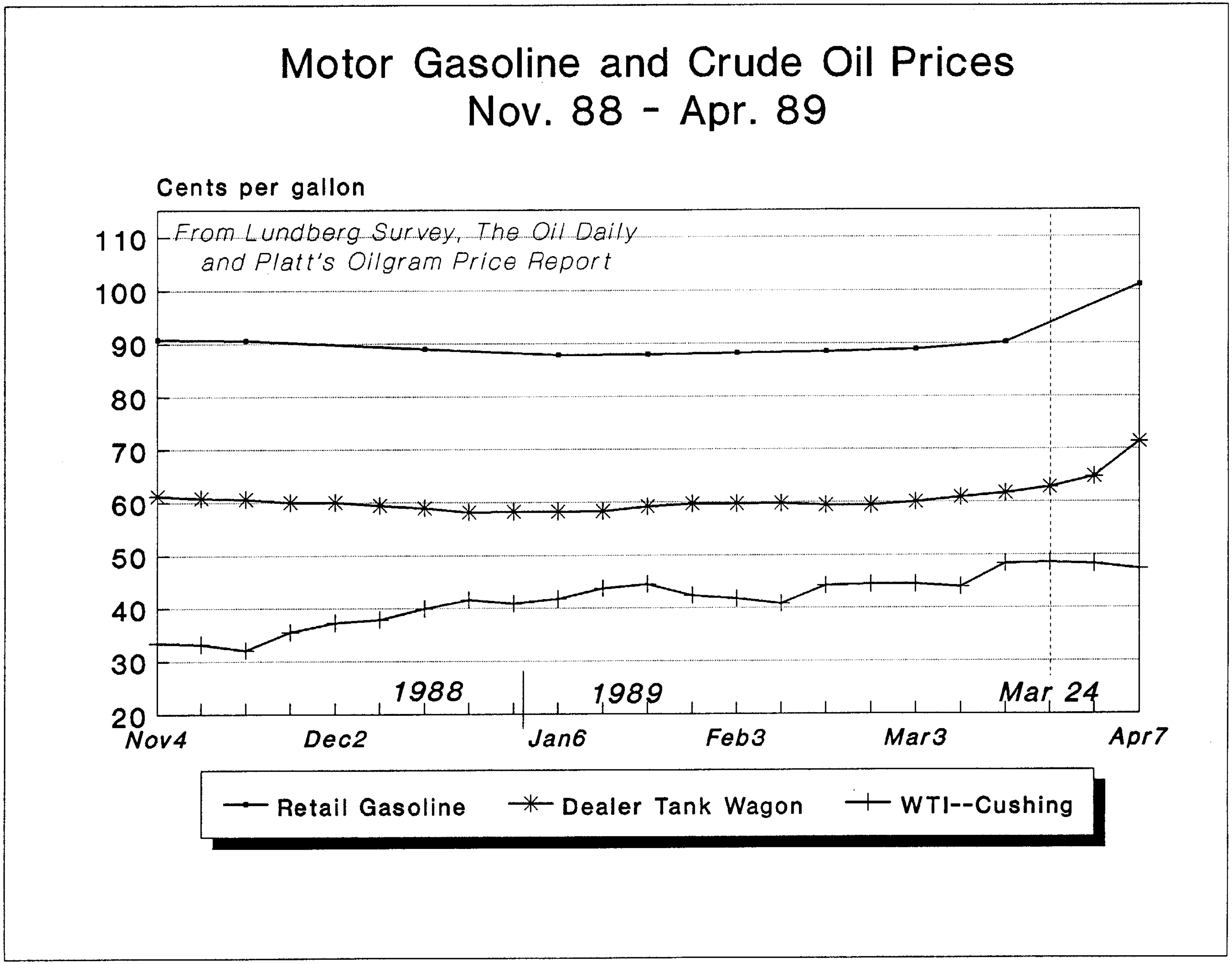
(fig. IV)

C. Over time, retail prices must follow the cost of crude oil, its raw material, as noted earlier. The relationship functions in both directions, as shown in the accompanying chart. In 1986, crude oil prices (WTI spot prices at Cushing) fell by 26 cents per gallon and retail motor gasoline fell by 32 cents. December 1988 crude prices were 25 cents lower than the December 1985 level; gasoline prices over the same period were down 27 cents. Between December 1988 and the average March 1989 prices, crude oil has risen 7.3 cents while gasoline has risen about half that amount.

D. While crude oil costs inevitably affect the price of gasoline as well as that of all other refined products, each these products operates in its own separate market. Supply and demand factors and expectations as well as extraneous influences set the price in each of these markets.

V. A FINAL NOTE: *What we have seen is a market adjusting, both to cost factors set in motion months before, and to a temporary disruption. As before, if prices run up too far, they will correct to a lower level because demand will respond and so will supply, both foreign and domestic. In any case, for the last three weeks, the U.S. oil market has been reacting to unexpected extraneous events of brief duration but potentially serious. It will take a little while before the market returns to its natural equilibrium. When it does the real impact of the Valdez oil spill on U.S. gasoline prices can be properly assessed.*

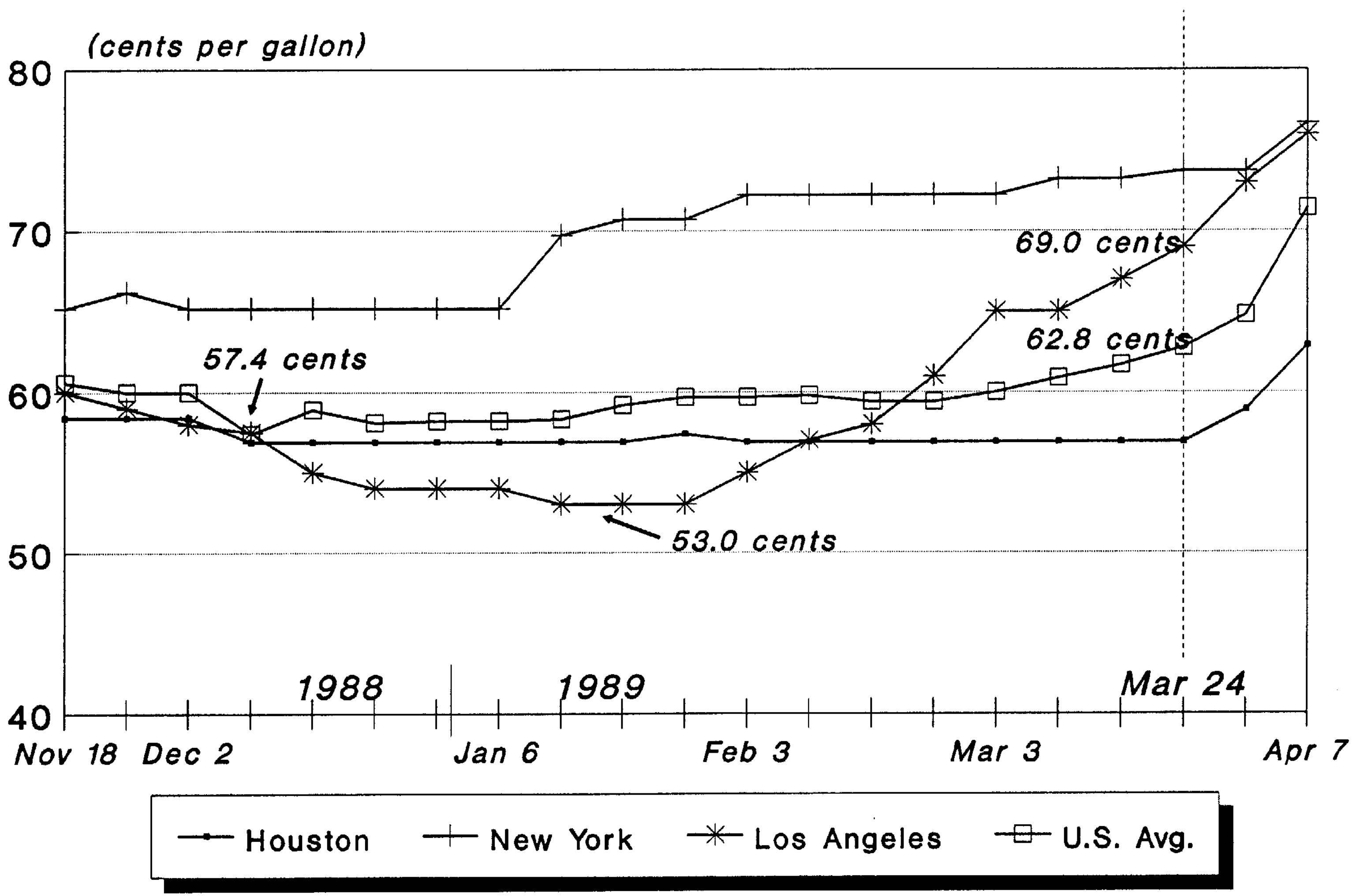
## Figure I



Motor Gasoline and Crude Oil Prices
Nov. 88 - Apr. 89
Cents per gallon
From Lundberg Survey, The Oil Daily and Platt's Oilgram Price Report
110
100
90
80
70
60
50
40
30
20
1988
1989
Mar 24
Nov4
Dec2
Jan6
Feb3
Mar3
Apr7
Retail Gasoline
Dealer Tank Wagon
WTI--Cushing

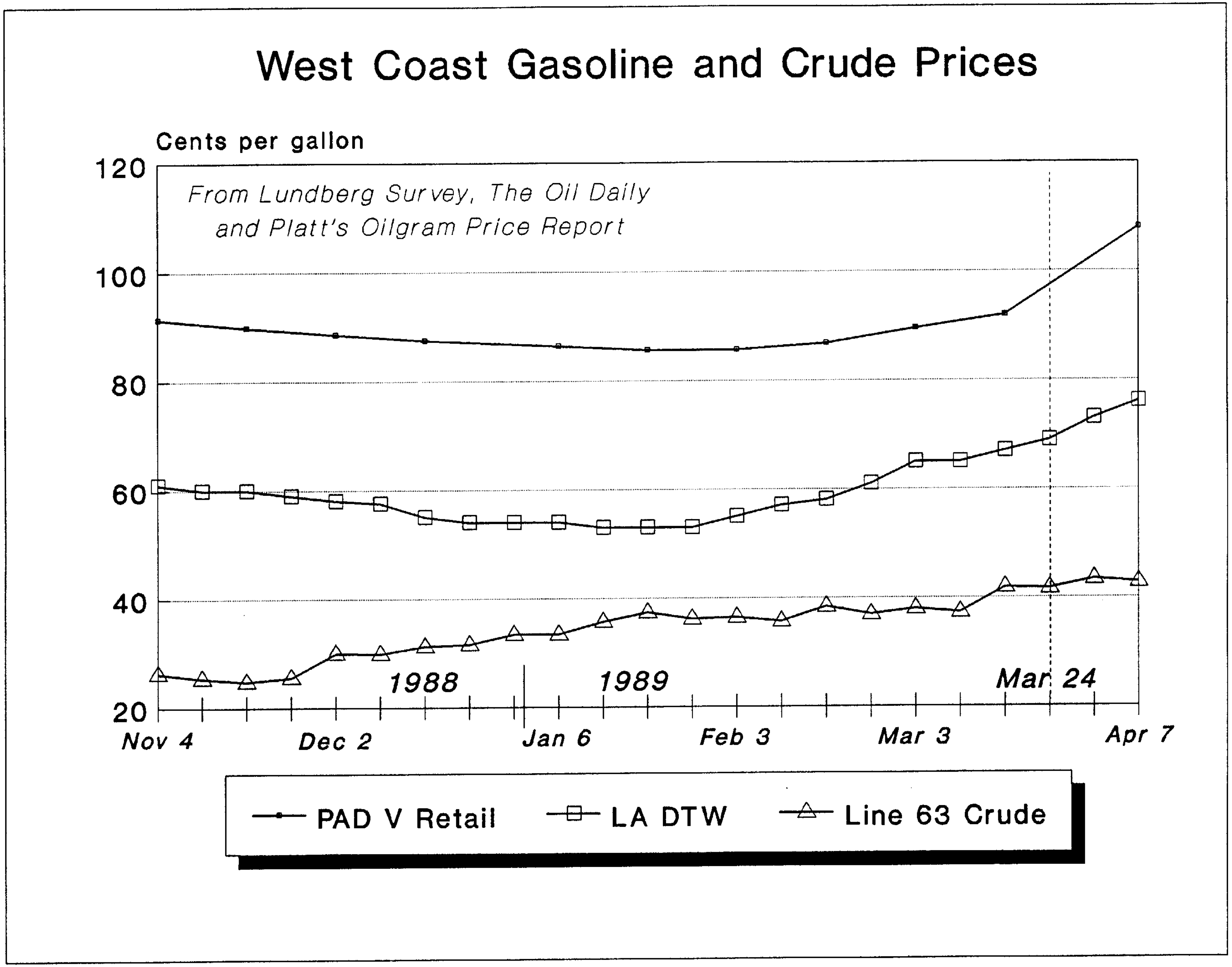
# Figure II

## Dealer Tank Wagon Prices for Motor Gasoline

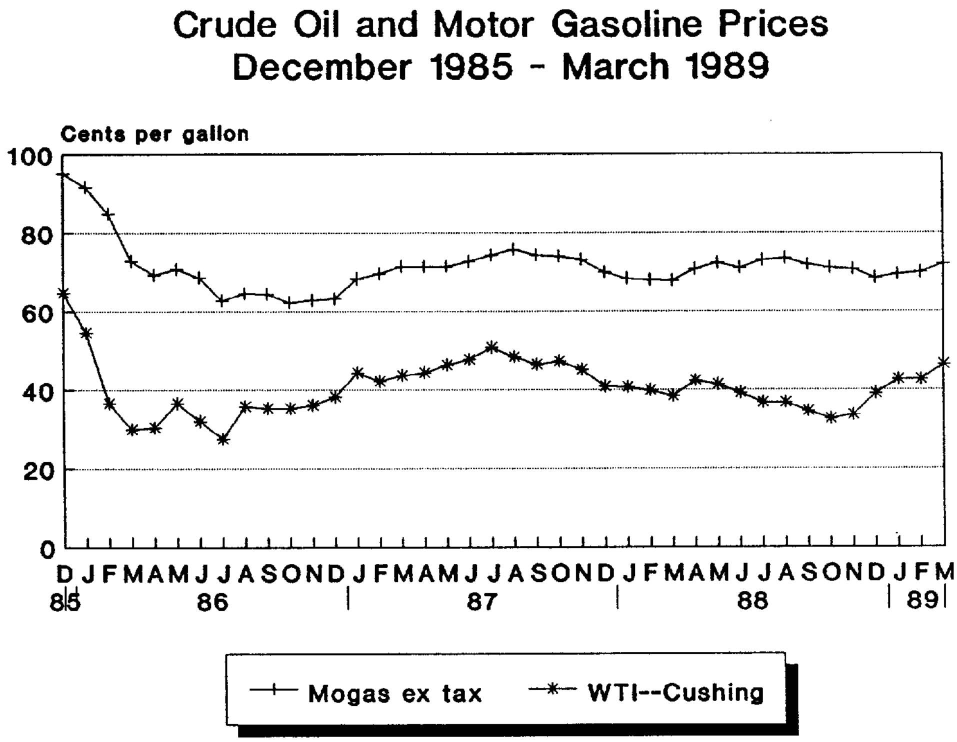


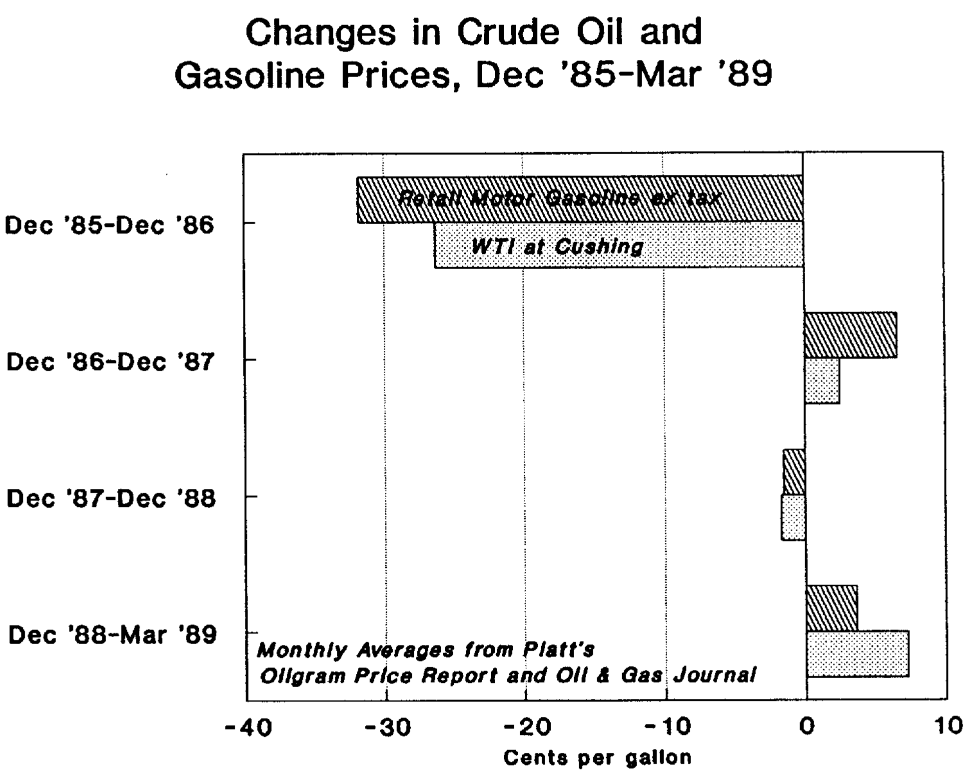

Source: *The Oil Daily*

**Figure III**


West Coast Gasoline and Crude Prices
Cents per gallon
From Lundberg Survey, The Oil Daily
and Platt's Oilgram Price Report
120
100
80
60
40
20
1988
1989
Mar 24
Nov 4
Dec 2
Jan 6
Feb 3
Mar 3
Apr 7
PAD V Retail
LA DTW
Line 63 Crude

# Figure IV


Crude Oil and Motor Gasoline Prices
December 1985 - March 1989
Cents per gallon
100
80
60
40
20
0
D J F M A M J J A S O N D J F M A M J J A S O N D J F M A M J J A S O N D J F M
85
86
87
88
89
Mogas ex tax
WTI--Cushing


Changes in Crude Oil and
Gasoline Prices, Dec '85-Mar '89
Dec '85-Dec '86
Dec '86-Dec '87
Dec '87-Dec '88
Dec '88-Mar '89
Retail Motor Gasoline ex tax
WTI at Cushing
Monthly Averages from Platt's
Oilgram Price Report and Oil & Gas Journal
-40
-30
-20
-10
0
10
Cents per gallon