Chairman Doug Ose
Opening Statement
California Gasoline Markets: From MTBE to Ethanol
July 2, 2003

Welcome to beautiful Diamond Bar, California. At today's hearing, we will review the transition from using MTBE to ethanol in California's reformulated gasoline and the cause of the recent gasoline price spikes

The fact that we are holding today's hearing in the headquarters of the South Coast Air Quality Management District is no accident. Automobiles produce 65 percent of the air pollution in California. The standards set for gasoline are important because they not only affect the pocketbook of every single California but also affect the quality of the air we breathe and the water we drink.

The seeds of California's transition to ethanol were sown by a 1998 University of California study, which concluded that MTBE contaminated our groundwater. The following year, Governor Gray Davis announced a ban on MTBE use in gasoline, beginning in 2003. The MTBE ban forced refiners to blend ethanol into our gasoline in order to satisfy the reformulated gasoline requirements of the Clean Air Act. The Governor subsequently pushed back the ban to 2004 when it became clear that not all of California's refineries could make the transition in time.

From January 1, 2003 to March 17th, retail prices of gasoline in California increased 57 cents. Gas pump prices soared above the $2.00 per gallon range up and down the State. Since Californians consume about 1.1 billion gallons of gas each month, this increase roughly translates to an additional $20 million per day spent on gasoline.

On March 27th, I sent a letter to the Energy Information Administration (EIA) requesting a report on the cause of these price spikes. EIA Administrator Guy Caruso will present the preliminary findings of that report today.

From EIA's preliminary report, and reports from the California Energy Commission (CEC), we can start to understand the causes of the recent gasoline price spike. The most significant cause appears to be the sharp increase in world prices for crude oil. The loss of Iraqi oil fields, a crippling strike in Venezuela, and historically low inventories of crude oil were a significant factor in the high prices at the gas pump.

In addition, California has had the misfortune of experiencing a large amount of refinery outages. Since January, no less than 12 major outages, planned and unplanned, have occurred in California. This high number of outages is significant because California essentially exists as a gasoline island. Due to California's stringent air standards, California's reformulated gasoline is very difficult to make. With very few exceptions, California cannot simply bring in new supplies from out of State when its refineries are down. That is why we saw a 50 percent increase in gas pump prices in Northern California after the fire at the Richmond refinery and an explosion at the Martinez refinery in 1999.

However, the whole world is susceptible to high prices for crude oil. And, California has operated as a gasoline island for years. The biggest difference between this year's price spike and previous price spikes is the use of ethanol in our gasoline. Unfortunately for California, ethanol is an inferior product to MTBE in terms of its performance as a gasoline additive and its effect on air quality.

Ethanol has a greater propensity to evaporate than MTBE. If you substitute ethanol for MTBE, you will have a higher level of volatile organic compounds (VOCs) that lead to ozone formation. To mitigate this problem, refiners have had to make complicated adjustments to the gasoline blend. These adjustments result in reduced refining capacity. In its preliminary report responding to my questions, EIA predicted that the transition to ethanol-blended gasoline in the summertime would result in a 10 percent loss in gasoline production capability. While refiners will attempt to make up some of this loss through refinery expansions, a net loss in California gasoline production will cause gasoline prices to rise.

Furthermore, to account for the loss in refining production, California will have to import more gasoline components and finished products from out of State. Some of these imports will come from domestic sources, but much will come from abroad. In other words, the use of ethanol will actually increase our reliance on foreign oil.

As California completes the transition to ethanol, it is important for the public to understand the physical properties and characteristics of this gasoline additive. In addition to adverse air quality, ethanol production also contributes to land and water pollution. When underground storage tanks leak, as we have seen with MTBE, soil bacteria metabolizes ethanol quickly, allowing carcinogens to travel through aquifers and drinking water wells. A June 2003 study by Professor Tad Patzek of the University of California at Berkeley concludes that it takes as much energy to produce a gallon of ethanol as can be gained from it. In addition, significant water degradation from fertilizers, pesticides, and herbicides results from the additional corn production needed to meet the ethanol demand.

Today's hearing offers an important look into the challenges of using ethanol-blended gasoline outside the Midwest. In addition to California, 15 other States have banned MTBE. Gasoline market observers are particularly concerned about New York and Connecticut. These States have done much less to prepare for the transition to ethanol.

The lessons learned in California are relevant nationwide. Congress is currently considering a proposal to mandate the use of 5 billion gallons of ethanol by the year 2015. If this bill becomes law, every American living outside the ethanol-producing centers in the Midwest could experience the gasoline price increases that California has seen due to ethanol.

I want to welcome out witnesses today: Guy Caruso, Administrator, EIA, Department of Energy; William J. Keese, Chairman, CEC; Joe Sparano, President, Western States Petroleum Association; Bob Gregory, Vice President and General Manager of Valero's Wilmington, California Refinery; and Lynne Kiesling, Director of Economic Policy, Reason Public Policy Institute.