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Subcommittee on Energy Policy, Natural Resources and Regulatory Affairs
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Thank you, Mr. Chairman and Members of the Subcommittee, for the invitation to appear here today. Today's hearing is timely. I appreciate the opportunity to discuss the vital role cleaner burning gasoline plays in improving America's air quality and to comment on initiatives related to gasoline contained in the recently announced National Energy Policy. I also will comment on the Environmental Protection Agency's clean gasoline program and the steps taken by Administrator Whitman to make the program more efficient and effective.

Mr. Chairman, first and foremost, the Environmental Protection Agency is concerned that consumers receive the air quality benefits of cleaner burning gasoline (also called reformulated gasoline, or RFG) at a reasonable price. Before discussing recent gasoline price trends, I will review the history and development of the RFG program, and document the air quality benefits derived from the program. I will also explain our on-going actions related to our pending Volatile Organic Compounds (VOC) adjustment rule and concerns regarding "boutique"

fuels.

Let me begin with a history of the RFG program.

History of RFG

When Congress passed the Clean Air Act Amendments of 1990, it established a number of programs to achieve cleaner motor vehicles and cleaner fuels. These programs have been highly successful in protecting public health by reducing harmful exhaust from the tailpipes of motor vehicles. In the 1990 Amendments, Congress struck a balance between vehicle and fuel emission control programs after extensive deliberation. The RFG program was designed to serve several goals. These include improving air quality and extending the gasoline supply through the use of oxygenates.

Congress established the overall requirements of the RFG program by identifying the specific cities in which the fuel would be required, the specific performance standards, and an oxygenate requirement. The oil industry, states, oxygenate producers and other stakeholders were involved in a successful regulatory negotiation that resulted in the development of the RFG regulations in 1991. EPA published the final regulations establishing the detailed requirements of the two-phase program in early 1994. Thus, the oil companies and other fuel

providers had six years to prepare for the performance requirements of the second phase of the program that began last year. In addition, the oil industry has been involved in an EPA RFG implementation advisory workgroup since 1997.

The first phase of the federal reformulated gasoline program introduced cleaner gasoline in January 1995 primarily to help reduce vehicle emissions that cause ozone (smog) and toxic pollution in our cities. Unhealthy smog levels are a significant concern in this country, with over 53 million people living in counties with air quality above the 1-hour ozone standard.

The federal RFG program is required by Congress in ten metropolitan areas which have the most serious air pollution levels. Although not required to participate, some areas in the Northeast, in Kentucky, Texas and Missouri have elected to join, or “opt-in,” to the RFG program as a relatively cost-effective measure to help combat their air pollution problems. Today, roughly 35 percent of this country’s gasoline consumption is cleaner-burning reformulated gasoline.

The Clean Air Act Amendments of 1990 also required that RFG contain 2.0 percent minimum oxygen content by weight. Neither the Clean Air Act nor EPA requires the use of any specific oxygenate. Both ethanol and MTBE are used in the RFG program, with fuel providers choosing to use MTBE in about 87 percent of the RFG. Ethanol is used exclusively in RFG in the upper Midwest (Chicago and

Milwaukee) which are closer to major ethanol production centers.

Ambient monitoring data from the first year of the RFG program (1995) indicated that RFG had a positive impact on reducing toxic emissions. RFG areas showed significant decreases in vehicle-related tailpipe emissions. One of the air toxics controlled by RFG is benzene, a known human carcinogen. The benzene level at air monitors in 1995, in RFG areas, showed the most dramatic declines, with a median reduction of 38 percent from the previous year. The emission reductions which can be attributed to the RFG program are equivalent to taking 16 million cars off the road. About 75 million people are breathing cleaner air because of RFG. Since the RFG program began six and one-half years ago, we estimate that it has resulted in annual reductions of VOC and NO_x of at least 105,000 tons, and at least 24,000 tons of toxic air pollutants.

As required by the Clean Air Act, the first phase of the RFG program began in 1995 and the second phase began in January of last year. As an example of the benefits, in Chicago, EPA estimates that the Phase II RFG program results in annual reductions of 8,000 tons of VOC and NO_x and 2,000 tons of toxic vehicle emissions, benefitting almost 8 million citizens.

Administration Actions Regarding Clean Fuels Programs

In early March, EPA sent a team to Chicago to meet with refiners and marketers in advance of the transition from winter to summer gasoline.

Representatives from EPA and the Energy Information Administration have been in weekly contact with refiners and marketers throughout this spring.

VOC Adjustment

Late in March, Administrator Whitman announced that EPA would finalize its VOC adjustment rule for ethanol-blended reformulated gasoline used in Chicago and Milwaukee. EPA believes that this rulemaking will help provide maximum flexibility for refiners and reduce costs for blending ethanol into gasoline by adjusting the volatile organic compounds (VOC) standards for ethanol reformulated gasoline. This regulatory change responds to one finding of a 1999 report by the National Research Council which suggested that EPA recognize the contribution of CO to ozone formation in assessing of the effects of RFG. The proposal recognizes the CO benefits from oxygenates in the RFG program by offsetting those CO reductions with an adjustment to the VOC performance standard. We expect to complete this action soon. In the interim, EPA has provided enforcement discretion to allow refiners to take advantage of the

adjustment.

Tank Turnover

Tank turnover refers to the need to replace gasoline in terminal storage tanks due to seasonal changes in gasoline specifications. Fuel providers have been doing this for over ten years to comply with summertime gasoline volatility requirements. Before that, fuel providers followed American Society of Testing & Materials (ASTM) specifications for seasonal changes. Under the cleaner burning RFG program, the tanks at terminals must meet summertime RFG requirements by May 1. Retail stations must meet summer fuel requirements by June 1. This year, EPA asked refiners and marketers to contact us if they experienced tank turnover problems. Although no problems with turnover were reported by anyone in the fuels industry this year, the Agency will discuss with refiners and marketers the subject of tank turnover to determine if additional flexibility can be provided while maintaining the air quality benefits of the RFG program. Any changes in the program would be made prior to the 2002 ozone season.

Reducing the Use of MTBE

There is significant concern about contamination of drinking water in many

areas of the country. Current data on MTBE in ground and surface waters indicate widespread and numerous detections of MTBE at low levels. Data from the U.S. Geological Survey indicates a strong relationship between MTBE use as a fuel additive in an area and finding detections of low levels of MTBE. A number of states have taken action to ban MTBE. Accordingly, EPA published last year an Advance Notice of Proposed Rulemaking requesting comments on a phase down or phase out of MTBE from gasoline under Section 6 of the Toxic Substances Control Act (TSCA). EPA believes that TSCA is the best regulatory process available for limiting or eliminating the use of MTBE. TSCA gives EPA authority to ban, phase out, limit or control the manufacture of any chemical substance deemed to pose an unreasonable risk to public health or the environment. We expect to have a proposal prepared for inter-agency review later this summer. Actions taken by a growing number of states to ban the use of MTBE as a gasoline additive is the single biggest factor that threatens to proliferate boutique fuel requirements around the country. Eleven states have banned MTBE, one as early as the end of 2002. At least a dozen more states are considering similar bans.

Boutique Fuels

The Clean Air Act authorizes states to regulate fuels through state

implementation plans if EPA finds such regulations necessary to achieve a national air quality standard. This has resulted in a number of different formulations being required by states which are often referred to as boutique fuels. EPA understands the challenge that state and local “boutique” fuel requirements place on the production and distribution of gasoline in the U.S. These state fuel programs could limit flexibility in the fuel distribution system, particularly if a disruption occurs. If the number of special fuels could be limited, while maintaining needed air quality benefits, greater fungibility within the distribution system could possibly result. The National Energy Policy report issued on May 17, 2001 includes a recommendation that directs EPA to study opportunities, in consultation with DOE, USDA and other agencies, to maintain or improve the environmental benefits of state and local "boutique" fuel programs while exploring ways to increase the flexibility and fungibility of the fuels distribution infrastructure, and provide added gasoline market liquidity. We have begun our boutique fuel assessment; we are consulting various stakeholders, including the states, and will make recommendations shortly.

Production Costs for RFG Do Not Explain Price Increases

There are many factors that contribute to the price of gasoline. These

include: the cost of crude oil; refining costs and profits; refining capacity utilization; distribution and marketing costs; the size of inventories; the size of demand for gasoline and other petroleum products; the balance between this demand and readily available supplies; and the availability of alternative supplies in tight markets.

As my colleague from EIA said in his testimony, most of the factors that affected prices last year have been again at work this year: high refinery capacity utilization; relatively tight crude oil markets; relatively tight spring gasoline supply/demand balance, compounded by extensive refinery maintenance and unplanned outages; unique regional and seasonal products, many of which are referred to as “boutique fuels”; and dependence on distant supplies. I would also like to highlight a few specific points to amplify on this list:

- Gasoline inventories were lower than normal this past spring. Following a longer than normal winter heating season, gasoline supplies going into the 2001 summer driving season were at their lowest levels since 1994.
- Fuel demand continues to increase. March 2001 gasoline usage was up 3% compared to March 2000. Americans continue to travel more. Although recently there have been signs of slowing, Vehicle Miles Traveled (VMT)

have been increasing. Over the past twenty years, as the economy has grown, onroad VMT has increased by 114% while population has only grown by 27%. In addition, the fuel economy of the vehicle fleet is the lowest in 20 years and is declining, as Americans have purchased many more pick up trucks, minivans and sport utility vehicles. By 2000, nearly half of the new vehicles purchased in the U.S. fit into these categories.

- Refineries are producing gasoline at nearly full capacity. Any disruption or temporary shut down, whether from natural disaster, accident or routine maintenance, has a rippling effect through regional, and sometimes national, gasoline and petroleum product markets.
- Finally, it is worth noting that prices this spring rose in areas that do not use clean fuels as well as those that do.

For the past 20 years, the United States has benefitted from declining energy prices. As recently as 1998, gasoline was less expensive compared with overall consumer prices than ever before in U.S. history - 60 percent cheaper than the price of gasoline in 1981- when inflation is factored in. Even today, when adjusted for inflation, the price of gas is much lower than it was during the energy shocks of the 1970's. Today, however, we confront a situation in which supplies of refined

products are tighter and prices can be more volatile.

Against this backdrop, the manufacturing cost of RFG II has contributed relatively little to the overall price of gasoline. EPA has estimated that the incremental manufacturing costs of RFG II are four to eight cents per gallon.

As I stated earlier, EPA is concerned that consumers receive the benefits of the RFG program at a reasonable price. Across the country, hundreds of communities are benefitting from RFG II for pennies per gallon. Since prices peaked in mid-May, wholesale prices have fallen by about 24 cents per gallon. Retail prices at the pump are also easing. Most analysts are predicting no further rise this summer, barring unforeseen problems.

Mr. Chairman, I would like to make one final comment about a recent EPA action. Earlier this week, Administrator Christie Whitman announced that EPA could not approve the State of California's request to waive the federal oxygen content requirement for RFG. After an extensive analysis, the Agency concluded that there is significant uncertainty over the change in emissions that would result from a waiver. California has not clearly demonstrated what the impact on smog would be from a waiver of the oxygen mandate. As the Administrator said, "We cannot grant a waiver for California since there is no clear evidence that a waiver will help California to reduce harmful levels of air pollutants."

The Administration is concerned about the risks of MTBE in drinking water in California and other states. Clean air and clean water are equally important. We do not want to pursue one at the expense of the other. As it currently stands, the Clean Air Act provisions limit the Agency's ability to address these concerns. We are exploring all options and currently assessing the health risks of MTBE. EPA is committed to working with Congress to address concerns about MTBE, while maintaining the air quality and other benefits of the RFG program.

Conclusion

In closing, the President's National Energy Policy identifies one of our principal energy challenges as "increasing our energy supplies in ways that protect and improve the environment." Clean burning gasoline is one way to ensure that our energy needs are met while our environment is protected. Clean burning RFG II is providing significant public health benefits to 75 million citizens nationally.

EPA does not believe that the RFG program is the major factor influencing the gas prices. EPA estimates the average cost for the production of Phase II RFG ranges from 4 to 8 cents per gallon over conventional gasoline. This Administration is committed to explore whether there are ways to maintain the air quality benefits of RFG while enhancing flexibility for refiners. The

Administration is actively working to maximize flexibility and has already provided, through enforcement discretion, a VOC adjustment for ethanol-blended RFG in the upper Midwest. We are also looking for ways to minimize disruptions when the distribution system switches from winter to summer fuel (tank turnover period).

As directed by NEP, EPA is working in consultation with DOE, USDA, and other agencies with the fuels industry and states, to study opportunities to maintain or improve environmental benefits of state and local “boutique fuel” programs while reducing the number of boutique fuels. We see the study as an opportunity to provide maximum flexibility to the fuel production and distribution system.

This concludes my prepared statement. I would be pleased to answer any questions that you may have.