

MISSOURI HOUSE OF REPRESENTATIVES

**REPORT OF THE INTERIM COMMITTEE ON
MOTOR FUEL PRICES**

Representative Bill L. Ransdall, Chair

District 148

Representative Judy Berkstresser

District 141

Representative Melba Curls

District 41

Representative Barbara Wall Fraser

District 83

Representative Daniel J. Hegeman

District 5

Representative Carl H. Hendrickson

District 97

Representative Don Koller

District 153

Representative Jim Murphy

District 95

Representative Francis Overschmidt

District 110

Representative Carson Ross

District 55

Representative Gary Wiggins

District 8

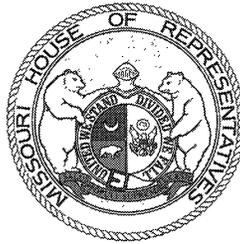
Prepared by
Terry Finger, Senior Legislative Analyst
October, 2000

BILL RANSDALL

State Representative
District 148

HOME ADDRESS

503 Wildwood Lane
Waynesville, MO 65583
Tele: 573 • 774-6080

**CAPITOL OFFICE**

State Capitol
201 West Capitol Avenue
Jefferson City, MO 65101-6806
Tele: 573 • 751-1727
Fax: 573 • 526-7768
E-Mail:
bransdal@services.state.mo.us

**MISSOURI
HOUSE OF REPRESENTATIVES**

October, 2000

The Honorable Steve Gaw, Speaker
Missouri House of Representatives
State Capitol, Room 308
Jefferson City, Missouri 65101

Dear Mr. Speaker:

Pursuant to your charge, your Interim Committee on Motor Fuel Prices gathered information from a variety of sources during the summer and fall. The committee was briefed by the Missouri Department of Natural Resources Energy Center, the Missouri Department of Transportation, and the Office of the Missouri Attorney General at an organizational meeting in Jefferson City on June 27, 2000, and heard testimony at hearings conducted in St. Peters on July 24, 2000, in Independence on August 28, 2000, and in Jefferson City on September 12, 2000. We also accepted written testimony from individuals who could not attend the hearings or wished to provide additional materials. The Department of Natural Resources Energy Center provided extensive statistical data; the committee also gathered data from a variety of other sources.

There was widespread interest and concern about the recent increases and volatility of fuel prices. The committee expresses its gratitude to the Missouri Department of Natural Resources Energy Center, other state agencies, and to all the citizens and businesses who provided vital information and assistance.

Although some of the factors related to the recent fuel price increases are beyond the control of the state, the committee has formulated several recommendations that could help Missouri avoid a recurrence of the situation that caused the rapid price increases this spring and summer. Enclosed herein is our report.

Sincerely,

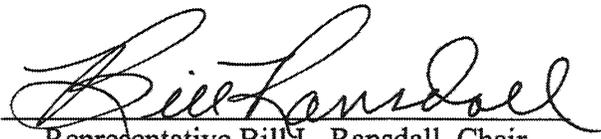
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Bill Ransdall, Chair

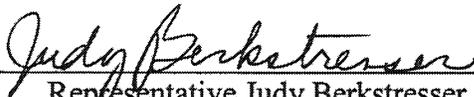
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Vice Chair: Environment & Energy

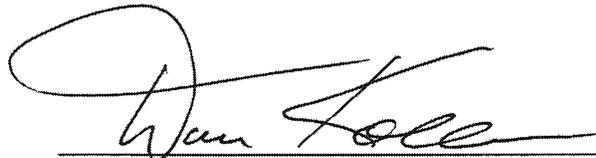
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Representative Bill L. Ransdall, Chair
District 148



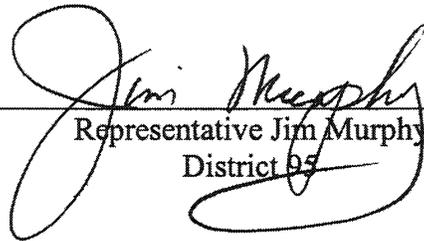
Representative Judy Berkstresser
District 141



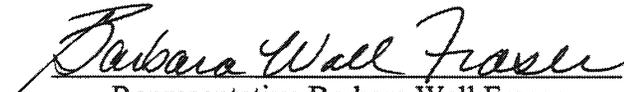
Representative Don Koller
District 153



Representative Melba Curls
District 41



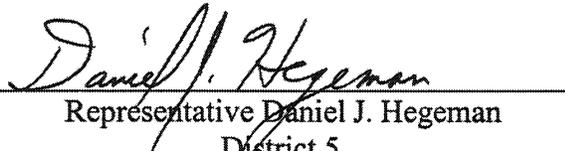
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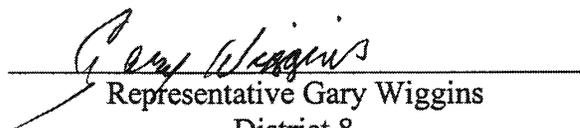
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Representative Gary Wiggins
District 8

INTRODUCTION

For the last several years, motor fuel prices in Missouri had been below the national average and near historically low levels when prices were adjusted for inflation. In January, 2000, however, fuel prices began a rapid, unprecedented rise, peaking in June, 2000, at a statewide average of \$1.70 per gallon and with a record price of \$1.80 per gallon recorded in Kansas City on June 15, 2000. The price increase occurred nationwide, but was particularly pronounced in Missouri and other midwestern states. During this period, fuel prices also fluctuated widely, both on a day-to-day basis and from place to place within small geographical areas.

Energy costs are fundamental to the cost of doing business and have a significant impact on the economy. The effects of high motor fuel prices are particularly widespread. Individual consumers are affected, especially those on fixed incomes. Increases in fuel costs exert hardship on farmers, particularly at a time when prices for many agricultural commodities are near all-time lows. High fuel prices can also be a deterrent to tourism and have a serious impact on the trucking industry and other small businesses.

In response to the sheer magnitude of the sudden rise in motor fuel prices and the importance of the issue to Missouri citizens, the Honorable Steve Gaw, Speaker of the Missouri House of Representatives, appointed an interim committee to determine the cause of increased prices and to ensure that no illegal marketing activity is occurring within the state. Members of the committee were Representative Bill L. Ransdall, Chair (D-148, Waynesville), Representative Judy Berkstresser (R-141, Crane), Representative Melba Curls (D-41, Kansas City), Representative Barbara Wall Fraser (D-83, St. Louis), Representative Daniel J. Hegeman (R-5, Cosby), Representative Carl H. Hendrickson (R-97, St. Louis), Representative Don Koller (D-153, Summersville), Representative Jim Murphy (R-95, Crestwood), Representative Francis Overschmidt (D-110, Union), Representative Carson Ross (R-55, Blue Springs), and Representative Gary Wiggins (D-8, New Cambria). This report includes an analysis based on information received from the Missouri Department of Natural Resources Energy Center, the petroleum industry, the public, and other sources, and the committee's findings and recommendations.

SUMMARY OF AVAILABLE INFORMATION

The committee was briefed by the Missouri Department of Natural Resources Energy Center, the Missouri Department of Transportation, and the Office of the Missouri Attorney General at an organizational meeting in Jefferson City on June 27, 2000, and heard testimony from citizens, state agencies, farmers, truckers, gasoline retailers and wholesalers, and representatives from the oil industry at hearings conducted in St. Peters on July 24, 2000, in Independence on August 28, 2000, and in Jefferson City on September 12, 2000 (see Appendix A). We also accepted written testimony from individuals who could not attend the hearings or wished to provide additional materials. The committee also received detailed data from the Missouri Department of Natural Resources Energy Center and collected information from a variety of other sources, including the Federal Trade Commission, the U.S. Energy Information Administration, the American Petroleum Institute, The Foundation for Taxpayer and Consumer Rights, and the news media.

PRICE PATTERNS

For the last six years, motor fuel prices have been quite variable, both in Missouri and in the nation. Between 1994 and late 1998, retail prices for conventional gasoline in Missouri varied between 85 cents and \$1.20 per gallon (Figure 1). From late 1998 to March, 1999, prices fell to very low levels, averaging about 82 cents per gallon. Prices then rose gradually, reaching an average of about \$1.10 in January, 2000. Prices then began a rapid increase and reached their highest levels in mid-June, 2000, with a statewide average of \$1.70 per gallon (Figure 2). A state record price of \$1.80 per gallon was recorded in Kansas City on June 15, 2000. Prices fell to approximately \$1.30 per gallon shortly after the peak in mid-June. Since that time, prices have increased, then fluctuated between \$1.35 and \$1.50 per gallon.

With the exception of brief periods in 1997, retail prices in Missouri have been below the national average (Figure 1). By June, 2000, however, prices had reached the national average. During the period of increasing prices during the first half of 2000, there were also pronounced regional differences of up to 22 cents per gallon in retail prices around the state.

Since the inception of its use in the St. Louis area on June 1, the price of reformulated gasoline (RFG) in the St. Louis region has generally remained a few cents above the statewide average price of conventional gasoline (Figure 3). During several periods in September and October, 1999, March, 2000, and June, 2000, however, the price of conventional gasoline met or slightly exceeded the price of RFG in St. Louis. During these periods, some distributors purchased RFG for resale in other parts of the state. The retail prices of conventional gasoline and RFG have thus followed essentially the same general patterns of increase throughout the time that RFG has been in use in Missouri.

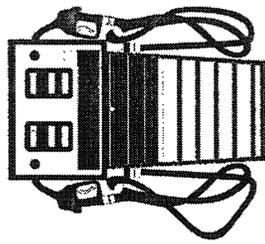
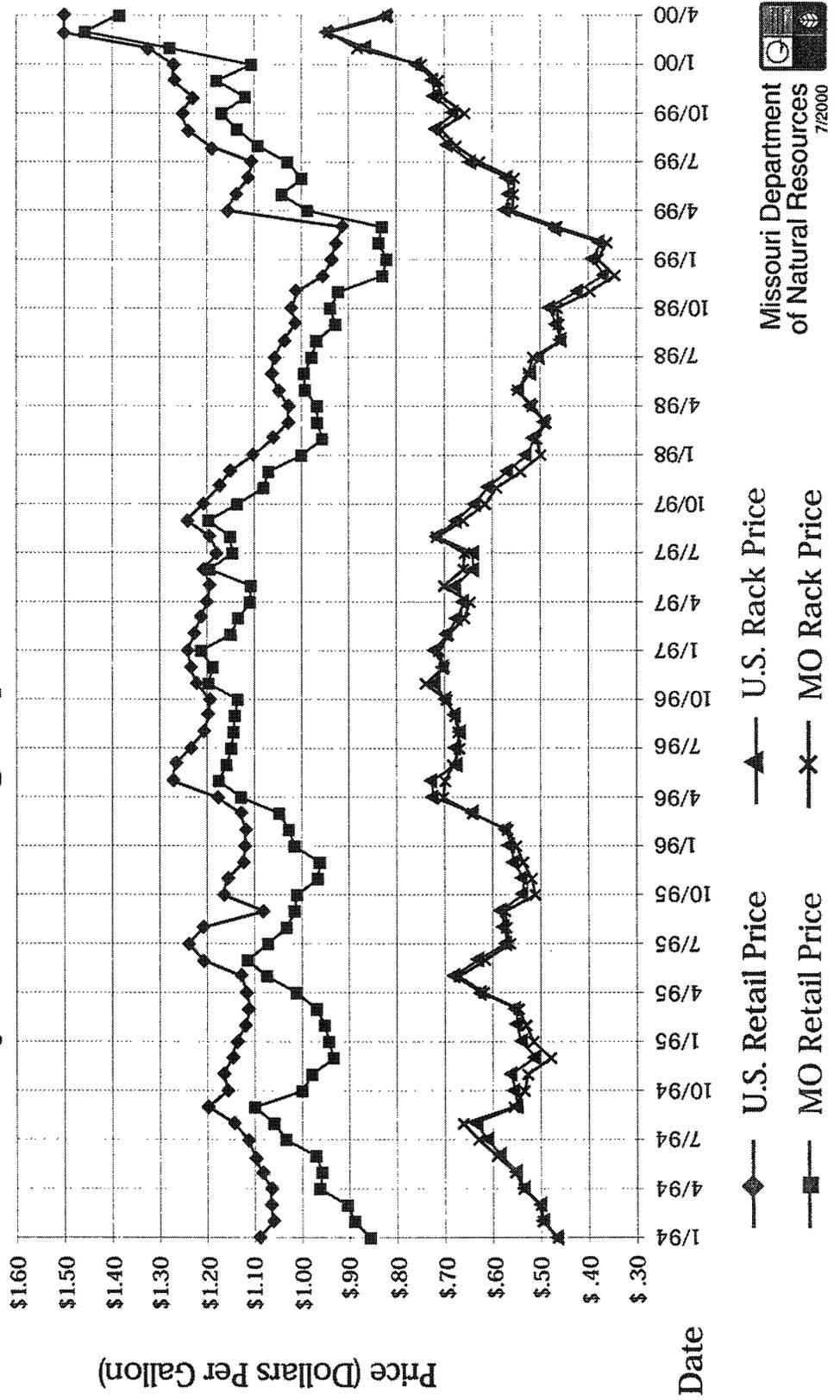


FIGURE 1
Monthly Average Rack and Retail Price for
Regular Unleaded Gasoline in U.S. and Missouri
January 1994 through April 2000



Missouri Department
of Natural Resources
7/2000

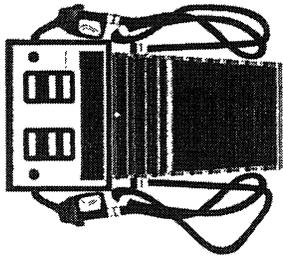
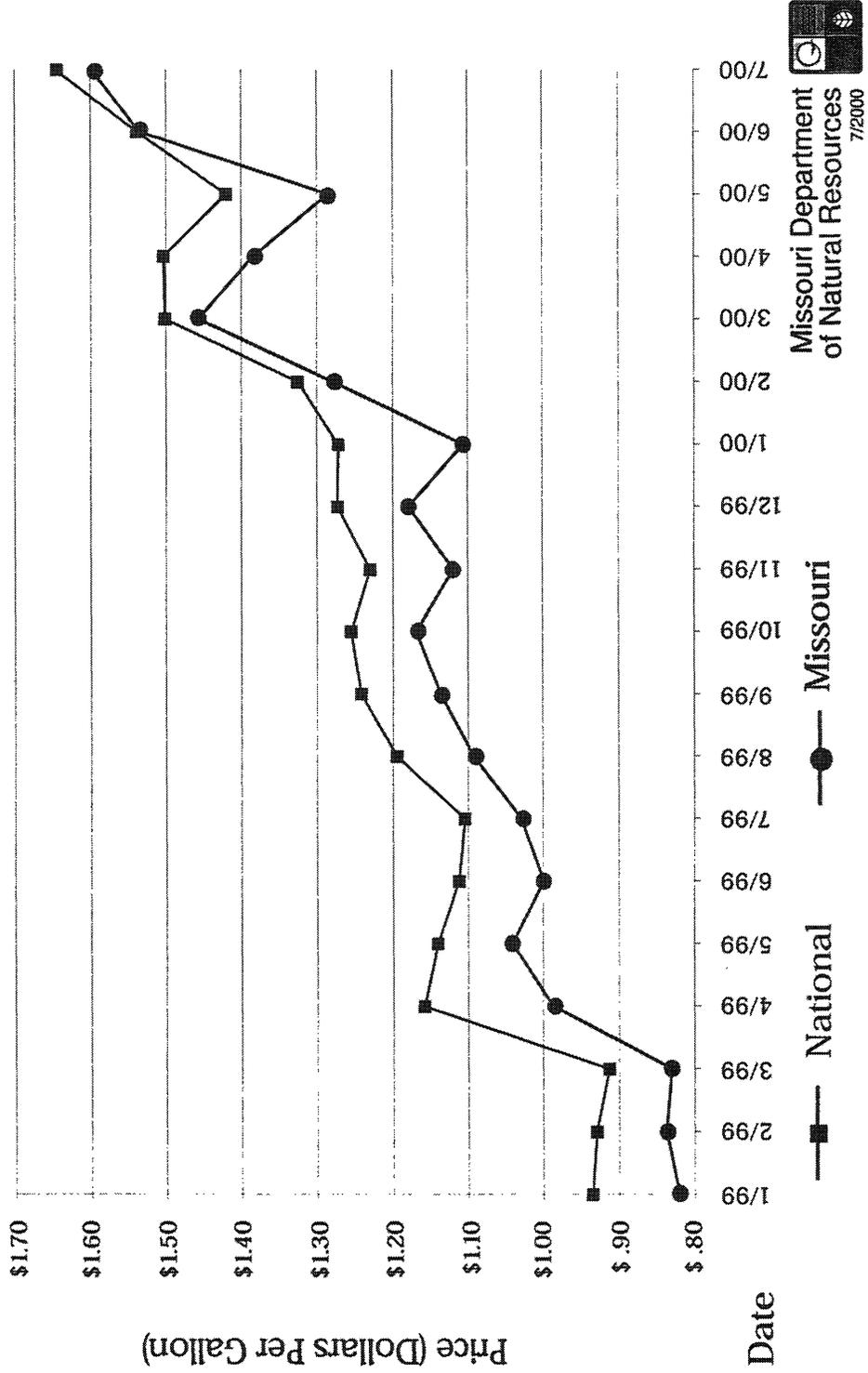


FIGURE 2

Average Retail Price for Self-Service Regular Unleaded Gasoline in Missouri and U.S. January 1999 through July 2000



Missouri Department of Natural Resources
7/2000

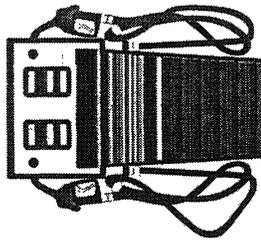
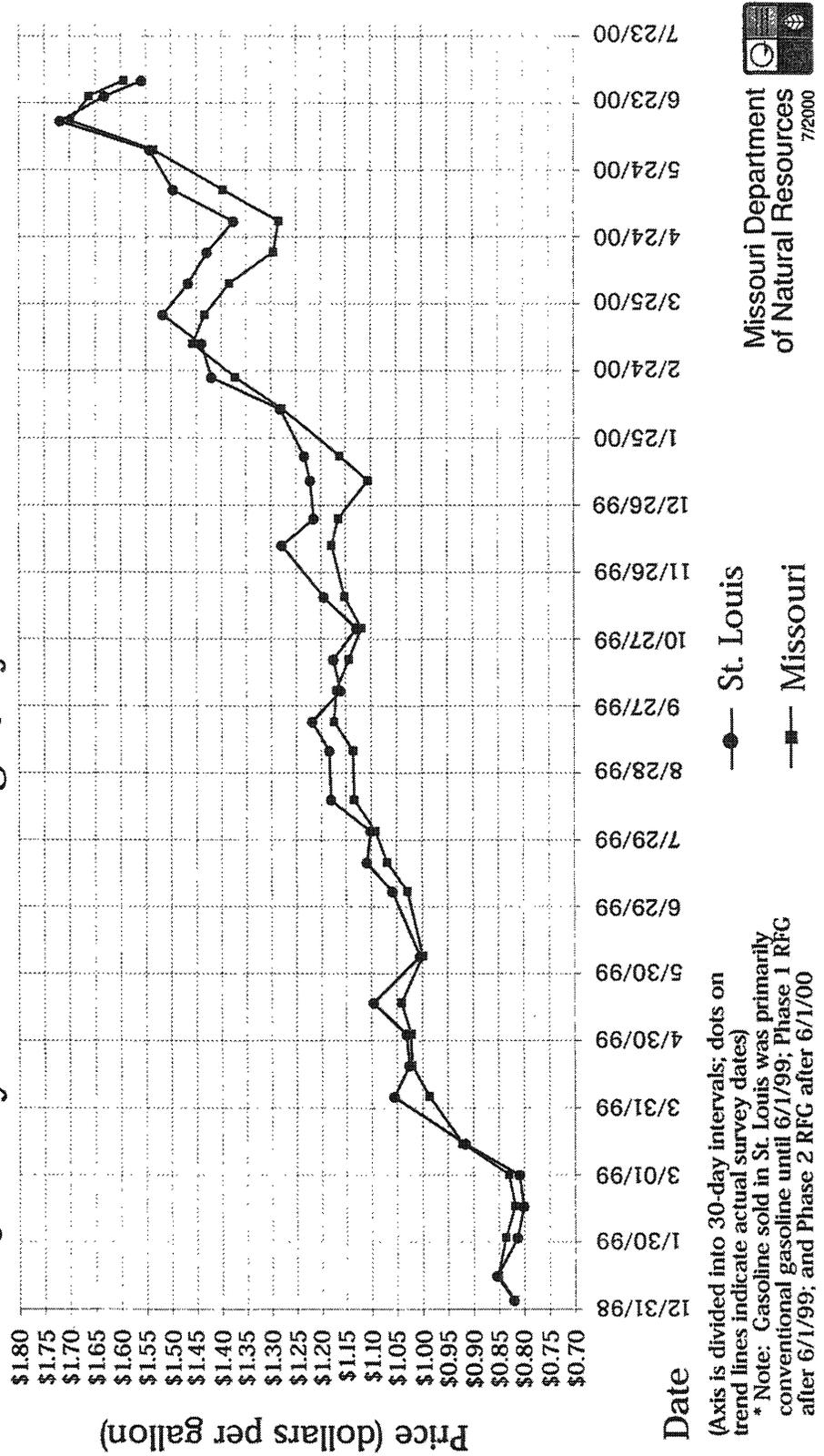


FIGURE 3

Average Price of Regular Unleaded Gasoline* in St. Louis Compared to Average Price of Regular Unleaded Gasoline in Missouri January 4 1999 through July 3 2000



(Axis is divided into 30-day intervals; dots on trend lines indicate actual survey dates)
 * Note: Gasoline sold in St. Louis was primarily conventional gasoline until 6/1/99; Phase 1 RFG after 6/1/99; and Phase 2 RFG after 6/1/00



Wholesale rack prices have generally followed fluctuations in retail gasoline prices closely in Missouri, maintaining approximately the same margin since 1994 (Figure 1). Generally, retail prices have remained 40 to 50 cents higher than wholesale rack prices throughout the period of retail price increases.

POTENTIAL CAUSES

The increase in motor fuel prices during the first half of 2000 has been suggested as being caused by a number of factors, including the following:

Crude Oil Prices -- The price of crude oil accounts for approximately 43% of the retail gasoline price. Further, because the U.S. imports about half of the crude oil consumed in the nation, the U.S. market price is closely tied to both domestic and foreign production. The Organization of Petroleum Exporting Countries (OPEC) produces about 44% of the world's oil and holds more than 77% of the world's oil reserves. OPEC thus has a powerful effect on world prices for crude oil and, hence, prices for gasoline in the U.S.

Crude oil prices were unusually low in early 1999, approaching \$10 per barrel. In April, 1999, OPEC announced plans to limit production during a period when several Asian countries began to recover from a regional recession. In response to decreased supply and increasing world-wide demand, crude oil prices rose sharply, exceeding \$30 per barrel by March, 2000. Prices dropped slightly after the peak, but have been fluctuating between \$28 and \$33 per barrel since April, 2000. By increasing costs for refiners, high crude oil prices on the world market are undoubtedly directly responsible for a portion of the increase in retail motor fuel prices. Increases in crude oil prices do not, however, explain why prices increased more sharply in Missouri and other midwestern states than in other regions.

High crude oil prices also had an indirect effect on retail prices by affecting local supplies. When crude oil prices were high in early 2000, refiners elected to cut production and use available gasoline supplies. They expected crude oil prices to fall and planned to rebuild gasoline inventories more cheaply when crude oil prices were low. Crude oil prices, however, never fell and refiners failed to accumulate sufficient stocks to meet summer demand. The resulting low inventories during the start of the summer driving season also contributed to increasing retail prices.

Petroleum Industry Profit Taking -- Profits for certain sectors of the petroleum industry rose markedly during the period of rapid retail gasoline price increases. The profits of oil companies like Exxon, Texaco, Phillips, Conoco, and others increased two to four times in the first two quarters of 2000 when compared to the same periods in 1999. Although the reported profit increases were magnified somewhat by comparison to abnormally low profit periods in 1999, certain sectors of the industry appear to have opportunistically taken advantage of market factors, with profit taking contributing in part to increases in retail prices.

Producers of crude oil undoubtedly enjoyed windfall gains when the world price of crude oil increased rapidly in response to OPEC's manipulation of production levels. Crude oil prices approximately tripled, while production costs remained relatively constant. OPEC's activities are, of course, largely out of the control of U.S. companies producing crude oil, but the price of crude oil produced domestically is allowed to rise in parallel with world prices.

Competition at the retail level appeared to remain intense during the period of retail motor fuel price increases. The difference between the wholesale rack price and the retail price fluctuated slightly, but did not change dramatically or exhibit any long-term trends during the first half of 2000. This suggests that the profits of distributors and retailers generally did not increase appreciably during this period.

During the period of high retail prices, however, the difference in price between crude oil entering refineries and wholesale gasoline leaving refineries (the refining margin) was unusually high. Margins typically average 10-12 cents, and in 1999 they were less than 6 cents. Margins rose to about 20 cents in mid-2000. Although this increase could be theoretically caused by increased costs during the refining process, in the second quarter of 2000 profits of U.S. refiners averaged \$6.50 per barrel, one of the highest quarterly averages in a decade, and twice the profit from 1999.

Petroleum Industry Inventory Practices -- For the last several years, the petroleum industry has been moving toward use of smaller inventories and "just in time" inventory practices to save storage costs. Refineries currently maintain inventories that are 10 to 13 percent below 1999 levels. As discussed above, when crude oil prices began to rise in late 1999, refiners failed to build gasoline inventories because they expected the crude oil prices to fall. They planned to rebuild gasoline inventories more cheaply when crude oil prices were low. Crude oil prices, however, never fell, and refiners failed to accumulate sufficient stocks to meet summer demand. Further, the price of gasoline had been near historical lows for some time, and, with returns on capital investments averaging about 4 percent, refiners were not making capital investments to increase production capacity. Thus, production capacity was not sufficient to rapidly rebuild low inventories.

The inventory problem was exacerbated by the oil industry's intentional drawdown of supplies just before implementation of the Phase II RFG requirements discussed below. Considerable quantities of gasoline were exported from the midwest region to other states and countries during the first quarter of 2000. The resulting tight supplies during the start of the summer driving season contributed significantly to the increase in retail prices.

Increased Demand -- Demand for motor fuel in the U.S. continues to grow. Vehicle miles driven by Americans increases by 2 to 2.5 percent per year. Demand for gasoline also typically increases annually at the start of the summer driving season. During the spring of 2000, however, demand increased slightly more than average, rising 13% from January to mid-May. This increase was not in itself sufficient to have a significant impact on price, but did place some strain on supplies when gasoline inventories were low, as discussed above.

Supply Disruptions -- The Explorer pipeline, which supplies approximately half of the RFG used in the St. Louis area, ruptured in March, 2000, and is currently operating at only 80% of capacity. This break occurred when area terminals were drawing down supplies in preparation for delivery of a new summer-blend RFG mixture, Phase II RFG. Temporary disruptions in the supply of RFG were eased when the U.S. Environmental Protection Agency allowed conventional gasoline to be sold in the St. Louis area during three periods from March to June, 2000. At no time did there appear to be a motor fuel shortage to the extent that retailers and consumers faced a scarcity. In fact, gasoline continued to be exported from the region as part of the intentional drawing down of supplies discussed above. Currently, all St. Louis terminals report substantial inventories of RFG, and no shortages are expected for the summer.

Reformulated Gasoline Requirements -- Federal Phase II regulations for summer-blend RFG went into for the St. Louis area on June 1, 2000. Phase II RFG has proven to be somewhat more difficult to refine than anticipated. Production plans have also been complicated by the Unocal patent case, which upheld a patent for some common formulations of RFG. These factors may have caused adjustment difficulties in the production process, production delays, and decreased refinery yields, but their effects appear minimal when compared with the effects of crude oil prices and inventory practices. Refinery profits increased substantially during the period of retail price increases, and, in the midwest as a whole, conventional gasoline prices rose more dramatically than those for RFG.

The RFG requirements do complicate inventory practices. The petroleum industry can elect to meet RFG oxygenate requirements by use of either ethanol or MTBE (methyl tertiary-butyl ether). In areas where both oxygenates are used, supplies must be stored separately to prevent contamination.. Inventory plans are also complicated by seasonal changeovers in formulations and in the changeover from Phase I to Phase II RFG, although the industry has been involved in seasonal changeovers in the vapor pressure of conventional gasoline for decades. The only significant effect of RFG on inventory practices appears to be the industry's intentional drawdown of regional supplies just before implementation of Phase II RFG requirements.

Taxation -- Missouri's motor fuel tax, the seventh lowest in the nation, is 17 cents per gallon. The tax is volume-based rather than price-based, and thus tax revenue did not increase with price increases. Unlike some states, Missouri does not have a price-based sales tax on gasoline.

Illegal Activity -- Motor fuel prices among all companies in the petroleum industry did rise in parallel during the period of retail price increase. Collusive activities, such as agreements to curtail output, divide markets, or increase prices, are illegal. No single oil company, however, appears to have sufficient market share to raise prices unilaterally, and the observation of prices moving in parallel is not in itself evidence of illegal activity. There is, however, considerable integration and shared use of facilities within the industry, increasing the likelihood of prices moving in parallel and making the investigation of marketing practices difficult.

FINDINGS

The committee finds that the recent increases and volatility in motor fuel prices were the result of the interaction of several factors:

1. High Crude Oil Prices

Because the price of crude oil accounts for approximately 43% of the retail gasoline price, Missouri motor fuel prices increased in part with the world-wide increase in the price of crude oil that began in late 1999. OPEC may continue to manipulate production levels and prices, and there is no indication that small increases in crude oil production will lower prices significantly.

2. Dependence on Foreign Oil

The U.S. currently produces approximately half of the crude oil consumed in the country, and some domestic production is exported to Asia and other countries. Most of the remaining crude oil is imported from OPEC countries. Because the U.S. has little control over foreign production and pricing, domestic retail prices are heavily influenced by world markets.

3. Profit Taking by the Petroleum Industry

Profits within the petroleum industry increased greatly during the first half of 2000 and contributed to the increase in retail fuel prices. Reported profit increases were magnified somewhat by comparisons to low-profit periods in 1999, and producers of crude oil enjoyed gains because of the world-wide increase in crude oil prices. Available evidence also indicates that competition remains high at the retail level and that profits did not increase significantly for motor fuel retailers. Profit margins for refiners, however, increased sharply during the period of retail price increases, despite industry claims that RFG requirements cause production difficulties.

4. Change in Inventory Practices

Supply disruptions caused by a pipeline failure and RFG requirements complicated fuel inventory procedures, but these complications were exacerbated by the petroleum industry's voluntary decision to move to "just in time" inventory practices. Some of the price increase and volatility that occurred during the first half of 2000 can be attributed to the petroleum industry's decision to allow gasoline inventories to reach very low levels when the price of crude oil began to rise in late 1999. Refiners expected crude oil prices to fall and planned to rebuild inventories more cheaply. Crude oil prices never fell and refiners failed to accumulate sufficient stocks to meet summer demand. The industry also intentionally allowed midwest gasoline stocks to dwindle in anticipation of the changeover to Phase II RFG requirements.

5. Inelastic Demand

Consumer demand for motor fuel has not responded appreciably to price fluctuations, and continues to grow at approximately 2% per year. In 2000, there was a slightly greater than average increase in demand at the beginning of the summer driving season. This increase, coupled with low inventories, placed some strain on supplies.

The committee found no evidence for motor fuel price increases and volatility being directly linked to several suggested causal factors. The committee found no evidence of illegal activity in the petroleum industry. Although prices tended to move in parallel among market participants, that in itself is not evidence for illegal activity. Increasing consolidation within the petroleum industry is a cause for concern. Further, the widespread use of joint ventures and other collaborations at various points in the distribution chain make investigation of pricing activities difficult. The Federal Trade Commission began an investigation at the national level in June to determine whether there has been any anti-competitive, collusive, or otherwise illegal behavior within the industry. The investigation should be completed by late fall, 2000.

The committee also found no evidence for a genuine fuel scarcity within the state. Although pipeline problems created temporary disruptions in supplies that were already stressed because of low inventory levels, at no point were suppliers faced with true scarcity anywhere in the state.

Further, the committee found no evidence that the RFG requirement for the St. Louis area contributed significantly to supply problems or price increases and volatility. The temporary periods of scarcity that occurred after pipeline disruptions were eased by the U.S. Environmental Protection Agency allowing conventional gasoline to be sold in the St. Louis area for short periods. Retail prices for RFG never exceeded the price of conventional gasoline by more than several cents, and at times the price of RFG in St. Louis was the same or slightly less than the price of conventional gasoline in some parts of the state.

CONCLUSIONS AND RECOMMENDATIONS

As the demand for petroleum-based motor fuels continues to rise and approach the limits of the current supply system, motor fuel prices can be expected to remain high and volatile. Some factors responsible for high prices and volatility, such as OPEC's manipulation of world crude oil prices, are beyond the control of the state. There are, however, several state actions that could help Missouri avoid a recurrence of the situation that caused the rapid price increases during spring and summer, 2000.

The committee recommends the follow actions:

1. Monitor and Report Trends

The Missouri Department of Natural Resources Energy Center, in cooperation with the Missouri Department of Economic Development and other state agencies, should continue to monitor trends in motor fuel prices, supplies, and demand, and make this information widely available to the public. Major suppliers and transporters of petroleum products should be required to notify designated state officials within 24 hours of any significant supply disruptions.

2. Ensure Fair Marketing Practices

Appropriate state agencies should identify and obtain information that may be useful in monitoring possible collusion and other illegal anti-competitive activity in the petroleum industry, and continue to work cooperatively with the Office of the Attorney General to ensure fair marketing practices.

3. Improve Energy Efficiency

To lessen dependence on petroleum products, the state should work to increase the energy efficiency of motor vehicles. Missouri should work with the federal government in considering expansion of the federal Corporate Average Fuel Economy (CAFE) standard to trucks and sport utility vehicles. State agencies should lead this effort by complying with existing state laws for energy efficiency in state-owned vehicles. The state should also continue development of a multi-modal transportation infrastructure, including investment in public transportation, car pools, van pools, and pedestrian facilities.

4. Encourage Development of Alternative Fuels

To lessen dependence on petroleum products, particularly those from foreign sources over which the U.S. has little control, the General Assembly and state agencies should continue to explore incentives to encourage the development, production, and use of ethanol, biodiesel, and other alternative fuels. The state should cooperate with the U.S. Department of Energy, the U.S. Environmental Protection Agency, and other federal officials in these efforts. State agencies should lead by complying with existing state laws for use of alternative fuels in state-owned vehicles.

5. Reduce the Number of Mandated Fuel Types

To simplify refinery production and inventory practices in the petroleum industry, the state should work with the U.S. Environmental Protection Agency and other federal officials in efforts to minimize the number of different mandated fuel products required in Missouri. These efforts should consider the impact of different fuel requirements on refineries and storage facilities, but should not compromise environmental quality or public health.

6. Re-establish Less Vulnerable Inventory Practices

The petroleum industry should voluntarily re-establish inventory practices that are less vulnerable to supply disruptions and resulting price volatility than the recently imposed "just-in-time" inventory practices. With OPEC's production manipulation and other world commodity factors expected to cause continued volatility in crude oil prices, these inventory practices seem particularly vulnerable and inappropriate to ensure that motor fuel supplies can meet expected demand.

The committee heard several suggestions to reduce motor fuel prices that do not appear to be justified at this time. The committee does not recommend suspension or reduction of Missouri's fuel tax. Because the state's motor fuel tax is based on volume, not price, tax revenue does not increase with fuel prices, and Missouri has no sales tax on fuel. With the state's highway needs already exceeding available revenue, any fuel tax reduction would significantly delay needed road and bridge repairs. Tax revenue would be reduced at a time when high fuel prices are increasing both construction costs and fuel costs within the Missouri Department of Transportation.

The committee also does not recommend suspension of the use of reformulated gasoline in the St. Louis area. Although the requirement of several fuel types in the midwestern region complicates inventory practices for the petroleum industry, there is no evidence that the RFG requirement for the St. Louis area contributed significantly to price increases or volatility. Suspending the RFG requirement for St. Louis would negate potential reductions in air pollution and risk imposition of federal mandates that would further delay needed road and bridge construction and slow economic growth.

APPENDIX A

SUMMARY OF INDIVIDUAL TESTIMONY

I. JEFFERSON CITY, JUNE 27, 2000

1. James Klahr - Office of the Attorney General

Mr. Klahr briefed the committee on the role of the Attorney General in enforcing antitrust laws, including those dealing with restraint of trade and price fixing. He noted that the Federal Trade Commission and a task force appointed by the Governor are also investigating this issue.

2. John Haynes, Missouri Department of Transportation

Mr. Haynes noted that Missouri's fuel tax of 17 cents per gallon is the seventh lowest in the nation. It generates approximately \$678 million per year. Because the fuel tax is based on volume, not price, tax revenue does not increase with fuel price increases. Reducing the tax would now decrease funding for the department at a time when the department's own annual fuel costs are projected to increase by \$6 million.

3. Anita Randolph, Missouri Department of Natural Resources Energy Center

The Energy Center has monitored fuel prices for the last six years and periodically publishes the Missouri Fuels Bulletin. Ms. Randolph noted that the price of crude oil was unusually low in early 1999, but rose when the Organization of Petroleum Exporting Countries (OPEC) reduced production. Prices have been volatile since an initial peak in March, 2000, and are currently about \$30 per barrel. Retail prices in Missouri, traditionally lower than the national average, are now at the national average. Prices in the region have thus increased more than in other regions. The price of reformulated gas (RFG) in the St. Louis area was only slightly more expensive than regular gasoline. When the Explorer pipeline ruptured in March, retail outlets in St. Louis were allowed to sell regular gasoline during periods when RFG could not be supplied. Many reasons for the recent price increases have been suggested, including increases in crude oil prices, pipeline problems and resulting supply disruptions, low gasoline inventories in the midwest at the beginning of the year, and increased demand. None of these factors appear to offer an adequate explanation.

II. ST. PETERS, JULY 24, 2000

1. Representative Don Kissell, District 17

Representative Kissell stated that many constituents have concerns over possible price fixing in the petroleum industry. There are also issues regarding ethanol; with corn prices at an all-time low, use of ethanol could lower the price of gasoline, boost agriculture, and reduce our dependence on foreign oil.

2. Tom Brown, Mayor, St. Peters

Mayor Brown presented a resolution from the City of St. Peters requesting federal and state investigations of fuel prices. He noted that prices have been extremely volatile, with a 40-cent per gallon drop in the last month and daily changes of up to 14 cents per gallon. The explanations offered by the petroleum industry do not seem adequate. With only two major gasoline suppliers for the St. Louis area, price fixing is a real possibility.

3. Judy Bateman, Alderman, St. Peters

Ms. Bateman stated that constituents are very concerned over price increases and volatility.

4. Rocky Rightmeyer, Alderman, St. Peters

Mr. Rightmeyer noted that price increases have been particularly hard on those with fixed incomes.

5. Don Aytes, Alderman, St. Peters

Mr. Aytes noted that prices increase every summer; this year the increase has been particularly large. There is an appearance of monopolistic behavior by the petroleum industry. The increases hurt farmers as well as motorists.

6. Terry Varner, Councilman, St. Charles County

Mr. Varner noted that prices vary widely within small geographical areas and there is no logical explanation for this pattern.

7. Ronald Leone, Missouri Petroleum Marketers and Convenience Store Association; William Starbuck, J. D. Strett and Company; Don McNutt, Midwest Petroleum Retail Stores; David Mangelsdorf, Home Service Oil Company

Mr. Leone noted that, in addition to high demand, five key supply factors contributed to recent price increases: (1) supply disruptions resulting from failures of the Explorer pipeline; (2) OPEC's manipulation of crude oil prices; (3) lack of new refinery construction; (4) the petroleum industry's move to "just-in-time" inventory practices; and (5) federal requirements for many specialized gasoline blends. None of these factors are within the control of the association's members and competition remains high within the industry. Mr. Starbuck, Mr. McNutt, and Mr. Mangelsdorf stated that retailers are now making the same profit that they traditionally have made. Local retail prices are competition-based and can change daily. Most retailers buy each day at prices that are set each afternoon. Use of RFG has complicated storage practices; potential contamination prevents distributors from switching tanks between ethanol-based RFG and MTBE-based RFG.

8. Kelley Ogletree, Missouri Oil Council

Ms. Ogletree stated that gasoline prices in last decade have been low because of strong competition. The extremely low prices during the last few years have made the recent price increases particularly noticeable. These increases can be attributed to: (1) OPEC's manipulation of crude oil prices, which have increased 300% in the last 18 months; (2) low inventories resulting from high crude oil prices and pipeline disruptions; (3) increasing demand; and (4)

requirements for RFG, which costs more to make and commands more refinery resources. The Unocal patent infringement case on a process for making RFG has also created uncertainty and risk for refiners and importers. Refiners are making as much gasoline as possible and the added supplies are beginning to cause price reductions.

9. Leo Lada, Jr., Citizen

Mr. Lada stated that perceived, rather than actual, shortages may be used as an excuse to raise prices.

10. Tim Breeze, Missouri Public Interest Research Group

Mr. Breeze submitted written comments. He noted that RFG is needed for environmental protection and public health, and the RFG requirement does not account for the recent large price increases. There is also no historical evidence that increasing production of domestic crude oil will lower prices. Quantities are not sufficient to affect price manipulation by OPEC and much Alaska crude oil is sold in Asia. Recent mergers in the petroleum industry allow control of substantial percentages of the market and increase the likelihood of price gouging. The best alternative is to encourage use of alternative fuels and fuel efficient vehicles to lower the demand for petroleum. This alternative would also improve air quality.

III. INDEPENDENCE, AUGUST 28, 2000

1. Representative Dick Franklin, District 53

Representative Franklin welcomed the committee and noted the importance of the fuel price issue to constituents.

2. Ron Stewart, Mayor, Independence

Mayor Stewart noted the importance of bringing focus to the fuel price issue, especially because of its significant impacts on agriculture and tourism.

3. Ralph Homline, Citizen

Mr. Homline stated that the reasons given thus far for the large price increases do not make sense. Large oil companies appear to be taking advantage of the situation. Profits of oil companies seem excessive, although small, individual service stations do not appear to be gaining much.

4. Joseph Bittiker, Citizen

Mr. Bittiker stated that abrupt daily price fluctuations of 20 cents or more are evidence that oil companies may be controlling the situation.

5. Harry Keller, Citizen

Mr. Keller noted that prices do not appear to be related to production costs. There is no logical explanation for the price increases, although the case does not appear to be at the local service station level.

6. Anita Randolph, Missouri Department of Natural Resources Energy Center

In July, the Department of Natural Resources Energy Center had provided the committee with packets containing extensive data and analyses. Ms. Randolph provided an update, noting that prices had moderated slightly, but remained volatile and uncertain. Crude oil prices remained high, inventories are tight, and OPEC continues to send mixed signals on expected production levels.

7. Ronald Leone, Missouri Petroleum Marketers and Convenience Store Association; John Cook, Maher Oil Company; Ken Suter, Saco Petroleum, Inc.; Carl King, King Oil Company

Mr. Leone reiterated the five key supply-side factors he had discussed in his July 24, 2000, testimony, and noted their effects on prices. He also noted that since the committee's last meeting, the Governor's Gasoline Price Task Force, chaired by the Attorney General, found no specific evidence of illegal activity in the industry and noted that there is a high level of competition at the retail level which keeps retail profits low. Many different market forces have caused price increases, and none are within the control or discretion of the association's members. Even different federal government agencies cannot agree whether OPEC manipulations or RFG mandates are a significant cause. Low OPEC production, low inventories at refineries, federal fuel mandates, and overall market volatility will keep fuel prices high for the foreseeable future. Mr. Cook, Mr. Suter, and Mr. King explained how pricing and distribution work at the local level. Most retailers buy each day at prices that are set each afternoon, although some may establish contracts with suppliers to ensure adequate supply. Each retailer may buy products from a variety of suppliers, but wholesale prices all tend to move together.

8. Kelley Ogletree, Missouri Oil Council

Ms. Ogletree stressed the importance of developing a national energy policy to address production and supply problems, use of reformulated fuels, including those containing ethanol, and other energy-related issues. The distribution system is operating at near capacity. There have been no refineries operating in Missouri since 1982, although existing refineries nearby have been operating with increased capacity and efficiency.

9. Francis Semlen, Citizen

Ms. Semlen questioned whether RFG requirements were related to price increases.

IV. JEFFERSON CITY, SEPTEMBER 12, 2000

1. Anita Randolph, Missouri Department of Natural Resources Energy Center

Ms. Randolph updated the committee on current market conditions, noting that crude oil prices remain high, inventories remain tight, and questions remain as to whether OPEC can or will increase production.

2. Ray McCarty, Missouri Chamber of Commerce; John Hancock, Prime, Inc.

Mr. McCarty and Mr. Hancock described how high diesel fuel prices affect the trucking business. For a typical vehicle travelling 3,000 per week, a fuel increase from \$1.08 per gallon to \$1.68 per gallon reduces annual profit from \$43,615 to \$28,062. Prime, Inc., has negotiated volume purchases and improved fuel economy, but must impose fuel surcharges on customers, many of which are not paid. To reduce costs, the federal and/or state governments should release fuel reserves, suspend or reduce fuel taxes, call on fuel suppliers to reduce costs, and require payment of fuel surcharges.

3. Kelley Ogletree, Missouri Oil Council

Ms. Ogletree reiterated the four key factors she had discussed in her July 24, 2000, testimony, and noted their effects on prices. Supplies have not been able to meet demand, although supplies have been well allocated. This is not a state issue, but a national and world issue. The need for a national energy policy has been neglected, and the recent fuel supply challenges are a result. Affordable, reliable energy is needed to continue the nation's economic growth, but our energy infrastructure is eroding.

4. Representative John Loudon, District 88

Representative Loudon stated that RFG mandates have been a significant cause of price increases. The issue is basically a supply problem, and RFG chokes the supply side. There are a limited number of refineries making RFG, and none in Missouri. The committee should review the feasibility of establishing one or more refineries in the state.

5. Gary Marshall, Missouri Corn Growers Association

Mr. Marshall noted that high fuel prices are an economic hardship for farmers; the typical farm has had a \$5,000 increase in fuel costs this year. At current prices, ethanol can be used to lower fuel prices and to provide an added market for corn. Substantial production facilities already exist, and more are being built to meet demand. Further, technology has been developed to allow ethanol to be shipped in pipelines.

6. Dale Ludwig, Missouri Soybean Association

Mr. Ludwig noted that soybeans can be used to produce biodiesel fuel that can be used to blend with or replace diesel fuel. Demand must be increased to justify construction of efficient production facilities. Biodiesel is a federally defined alternative fuel in blends of at least 20%, and can be used to meet federal vehicle fleet alternative fuel requirements. If transit and school buses were included in vehicle fleets, demand would increase greatly.

7. William Miller, Independent Truck Driver/Owner

Mr. Miller explained how high fuel prices are causing economic problems in the trucking industry. Repossessions are increasing and finance companies are leaving the field. Transportation problems could result if the trend continues. Mr. Miller did not believe that increasing the allowable weight of trucks would provide a meaningful solution.

