Consumers Union
NONPROFIT PUBLISHER OF CONSUMER REPORTS

CFA Consumer Federation of America

May 19, 2004

The Honorable George W. Bush
President
1600 Pennsylvania Avenue, NW
Washington, DC 20500

Dear Mr. President:

As you know, this week the average price for self-service unleaded gasoline topped $2 per gallon for the first time. In some places the price is substantially higher. Premium blends of gasoline can now be found for as much as $3 per gallon. These prices are having a serious impact on consumers' pocketbooks, and as transportation costs increase for businesses, the burden on consumers will only grow as goods and services of all kinds increase in price.

Consumers Union, the independent, non-profit publisher of *Consumer Reports*, and the Consumer Federation of America urge you to take action in the face of this crisis that has the potential to dramatically slow down our economy. The problem is particularly acute as we enter the summer driving season when demand for gasoline traditionally increases.

There are a number of steps that we urge you to consider that would help address the skyrocketing price of gasoline.

First, we believe that you should press the Federal Trade Commission (FTC) to investigate the behavior of oil and gas companies. A recent report that we published shows that domestic oil companies have been raising prices faster than their costs went up over the last four years. The report, including other findings, can be found at www.consumersunion.org. Even when the industry's costs have gone down, prices at the pump do not seem to follow. Consequently, the industry is racking up extraordinary profit margins that do not match historical numbers, and they are above the rate of profit found in other industries.

We think that a significant part of the problem is lack of competition in the domestic oil and gas market. In the 1990s, mergers turned 34 major oil and gas companies into 13. Fifteen refining companies merged into seven. All of this led to the closure of about 50 oil refineries. A recent Bloomberg analysis reports 33 refinery mergers in the past three years. Without adequate competition in the market, there is no downward pressure on prices.

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Additional consolidation in the energy industry is unacceptable – the problems in the market are already bad enough. With fewer players in the market, it is easier for oil companies to "shadow" each other's behavior as prices climb higher. These companies know that there are no independent producers who can come in and knock the bottom out of the market, thus bringing prices back down.

Any investigation that finds illegal conduct should result in swift and vigorous prosecution. If no illegal activity is found, the results of the investigation should be used to make the market more competitive and transparent. In the meantime, an FTC investigation should have a moderating influence on industry conduct as the oil companies modify their behavior to avoid any further negative publicity. That would mean lower prices for consumers right now.

Second, oil companies should be required to keep more gasoline in storage. In the 1980s, oil companies routinely kept as much as a week's supply in storage. Thus, they were able to respond quickly to any unexpected disruptions in the supply chain, mitigating any short-term price increases. Today, oil companies are keeping only a couple of days supply in storage. Since it is difficult to quickly move supplies between regions to respond to sudden problems, this lack of storage means that those sudden problems lead to price spikes and, in some cases, major shortages. If oil companies were required to maintain regional stockpiles to deal with shortages, prices would not spike due to temporary, minor disruptions in supply. To be clear, these stockpiles would be separate from the nation's Strategic Petroleum Reserve, and would be used to respond to economic emergencies.

Third, instead of closing refineries, we need to increase refinery capacity so we can increase production of gasoline. Existing refineries are working at or near capacity. If a refinery is forced to shut down production even for a short period – to deal with maintenance issues or a fire, for instance – prices will rise quickly. By closing refineries permanently throughout the 1990s, the domestic oil companies knew that they were tightening supplies; they knew what impact that could have on consumer prices; and they knew how it would affect their bottom line. In addition, the major oil companies helped to drive independent refiners out of the market, reducing competition even further. We need to look at the shuttered refineries to see if those sites can be reopened, and we need to examine the possibility of expanding capacity at existing refineries.

While we are ready to embrace potential short-term solutions to the problem of rising gasoline prices, long-term thinking and dedication – and presidential leadership – are sorely needed to tackle this issue in a balanced manner. Taking the actions we have outlined in this letter will moderate prices somewhat in the short-term, especially if they are coupled with pressure on foreign oil suppliers to increase production. More importantly, these actions can have a significant long-term impact.

We also would urge you to take the lead in finding demand-side solutions for the long-term as well, including increasing automobile fuel efficiency standards, promoting the use of more fuel efficient household appliances, and investing in the development of vehicles and products that use alternative, renewable fuel sources. No long-term solution can be based only on dealing with supply issues. However, while there may be ways to increase domestic supply, we do not believe that drilling in pristine wilderness areas should be part of the "solution" to our current crisis – the supply is limited, the environment fragile and the costs high. We would do better by increasing our use of renewable sources of energy and using conventional energy more efficiently.

Mr. President, now is the time to address this very important issue. Americans are growing increasingly anxious about rising gasoline prices, and they are seeing a significant impact on their pocketbooks. The energy bill pending in Congress fails to include this balanced approach. We urge you to chart a new and aggressive course to address this urgent problem.

Sincerely,

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