



**Committee on Small Business  
Subcommittee on Investigations and Oversight  
U.S. House of Representatives**

**Hearing on the Impact of Rising Gas Prices on America's Small Businesses**

**Testimony of**

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Good morning, Chairman Altmire, Ranking Member Fallin, and Members of the Subcommittee. My name is John M. Urbanchuk and I am a Director at LECG LLC, a global expert services consulting firm, where I specialize on agriculture and the economics of biofuels. I am pleased to be here this morning to discuss the impact of the rising gasoline prices and the potential for renewable fuels in addressing this problem.

Background

American consumers and small businesses are reeling under the financial pressure of rapidly rising motor fuel prices. Crude oil prices have topped the \$100 per barrel level which, when combined with constrained refinery capacity, has pushed retail gasoline and on-highway diesel fuel prices to new records levels. According to the Energy Information Administration Americans used 137.7 billion gallons of gasoline and 55.1 billion gallons of No.2 diesel fuel in 2007.<sup>1</sup> At average pump prices this amounted to \$396.9 billion of spending on gasoline and nearly \$159 billion on diesel fuel. Moreover, crude oil, gasoline and diesel fuel prices show little evidence of receding. The national average retail price of gasoline (all grades) reached \$3.26 per gallon in March 2008, 28 percent above prices in March 2007 while retail level diesel fuel prices

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<sup>1</sup> Petroleum Marketing Monthly. Tables 45 and 47. 2007 Issues. Energy Information Administration



were 52 percent above year-earlier levels in March, averaging \$3.88 per gallon.<sup>2</sup> In fact diesel prices have been consistently higher than gasoline prices for the past eight months.

Motor fuel prices affect consumers in several ways. First high pump prices force drivers to allocate a larger share of their disposable income to gasoline. Perhaps more importantly, since rising fuel prices increase operating costs for businesses at virtually every stage of production and distribution, high fuel prices eventually affect the prices of all consumer goods and services. Rising motor fuel prices have been a major contributor to the recent increases in inflation measured by the Consumer Price Index. The CPI, all Urban Consumers for all items has been increasing at a year-over-year rate of 4.2 percent over the last four months. During this same period the CPI for motor fuels increased 33.4 percent.

The impact of fuel prices on other consumer goods is illustrated by their impact on food prices. Many critics have blamed the recent increases in consumer food prices on rising grain prices due in part to increased demand for biofuels. While grain and other agricultural prices have increased sharply over the past year, their impact on consumer food prices is overshadowed by energy and energy prices. Energy plays a significant role in the production of raw agricultural commodities, transportation and processing, and distribution of finished consumer food products. An analysis I conducted for the Renewable Fuels Association last year concluded that an increase in energy (fuel) prices has twice the impact on consumer food prices measured by the CPI as does the same percentage increase in corn prices.<sup>3</sup> These results have been confirmed by other analysts.<sup>4</sup>

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<sup>2</sup> Weekly U.S. Retail Gasoline Prices. EIA.

[http://www.eia.doe.gov/oil\\_gas/petroleum/data\\_publications/wrgp/mogas\\_home\\_page.html](http://www.eia.doe.gov/oil_gas/petroleum/data_publications/wrgp/mogas_home_page.html)

Weekly U.S. Retail On-highway Prices. EIA. <http://tonto.eia.doe.gov/oog/info/wohdp/diesel.asp>

<sup>3</sup> John M. Urbanchuk. "The Relative Impact of Corn and Energy Prices in the Grocery Aisle". June 11, 2007.

<sup>4</sup> Informa Economics. "Marketing Costs and Surging Global Demand for Commodities are Key Drivers of Food Price Inflation". December 10, 2007.



## Biofuels and Motor Fuel Prices

Biofuels (ethanol and biodiesel) have had a significant impact on restraining the increase in motor fuel prices. Increased production and use of ethanol is helping to displace gasoline demand and reduce prices at the pump. The ethanol industry produced nearly 6.5 billion gallons in 2007, has current capacity of 8.5 billion gallons with an additional 5.1 billion gallons under construction. Ethanol currently is blended in about 48 percent of the nation's gasoline supply and makes up about five percent of total motor fuel use. The U.S produced an estimated 450 million gallons of biodiesel in 2007.

Ethanol is blended with gasoline primarily to improve air quality and add octane. Biodiesel is a naturally low-sulfur non-petroleum diesel fuel. Both products extend the supply of motor fuel and help relieve pressure on prices at the pump.

Ethanol saved American consumers an estimated 10.3 cents per gallon at the retail pump in 2007 for a total savings of \$6.8 billion. Reflecting current gasoline and ethanol price movements similar savings are projected for 2008. The details of this projection are shown in Table 1.

Table 1  
2007 Consumer Savings from Ethanol

| Gasoline US Rack (\$/gal) | Gasoline US Retail (\$/gal) | Ethanol FOB Plant (\$/gal) | Ethanol Net (\$/gal) | E-10 Wholesale (\$/gal) | E-10 Retail (\$/gal) | Savings (cts/gal) (\$/gal) | U.S. E-10 Use (Mil Gal) | Consumer Savings (Mil \$) |
|---------------------------|-----------------------------|----------------------------|----------------------|-------------------------|----------------------|----------------------------|-------------------------|---------------------------|
| \$2.177                   | \$2.886                     | \$1.938                    | \$1.428              | \$2.302                 | \$2.783              | \$0.103                    | 65,880                  | \$6.779                   |

The savings from ethanol were estimated using actual 2007 gasoline price data at the rack and retail levels published by EIA and ethanol price data published weekly by USDA. Gasoline and ethanol prices projections were estimated using projections published by EIA in its 2008 Annual Energy Outlook as a basis.<sup>5</sup>

<sup>5</sup> EIA Annual Energy Outlook 2008 (Revised Early Edition). Report #DOE/EIA-0383(2008). March 2008. National Weekly Ag Energy Round-Up, USDA Livestock & Grain Market News. 2007 Weekly issues.



Retail gasoline prices reflect a wholesale price plus a retail margin and state and federal taxes. The wholesale price represents the price of gasoline at the terminal or “rack” which is supplied from a refinery, port, or pipeline. This is the level at which ethanol typically is blended with gasoline. Gasoline is then supplied to retail stations by truck. A margin is added to the wholesale price at terminal and again at the retail level before state taxes of 21.9 cents and federal taxes of 18.4 cents per gallon are added to make up the final retail price for consumers. Our analysis is based on an average price for all grades of gasoline.

As can be seen in Table 1 EIA reported that the average wholesale, or “rack” price for gasoline was \$2.177 per gallon in 2007. The margin, or difference between the retail and rack price, was 15.4 cents per gallon. This is made up of a distributor margin (the difference between the “rack” price and the dealer tankwagon (“DTW”) price which is the price of a truckload of gasoline delivered into storage at a retail station) and a retail margin (the difference between the dealer tankwagon and retail price). When the combined state and federal gasoline excise taxes were added, the average retail price of gasoline (all grades) was \$2.886 per gallon.

Ethanol is blended with gasoline at the terminal for delivery to retail stations. As reported by USDA, the average price of ethanol, FOB plant in Iowa was \$1.938 per gallon. The blender who purchases ethanol for use with gasoline qualifies for the \$0.51 per gallon Volumetric Ethanol Excise Tax Credit (VEETC) which reduced his actual cost of ethanol to \$1.428 per gallon. The wholesale price of E-10 reflects a weighted average of wholesale gasoline (90 percent) and ethanol (10 percent) plus transportation to get ethanol from the biorefinery to the blender (estimated at 12.5 cents per gallon) and the distributor margin. The retail margin and taxes are added to the wholesale price to yield the retail pump price. Using actual data for 2007, the price of an E-10 blend in 2007 was \$2.783 per gallon or 10.3 cents below the published retail price for all blends. EIA Prime Supplier gasoline sales data for 2007 indicates that 137.7 billion gallons of gasoline were sold in 2007. The 6.5 billion gallons of ethanol produced in 2007 would provide 65,880 million gallons of E-10 gasoline. This amounts to a savings for consumers of \$6.8 billion.



Future savings for consumers will depend on what happens to both gasoline and ethanol prices. The Renewable Fuel Provisions of Energy Independence and Security Act of 2008 (EISA 2008) requires that 36 billion gallons of renewable fuels, largely ethanol, be used in the nation's motor fuel supply by 2022. This amounts to about 30 percent of the nation's motor fuel supply. Ethanol from corn starch is capped at 15 billion gallons by 2017 with the remaining 16 billion gallons to be produced from "advanced biofuels feedstocks", largely cellulose. As ethanol production expands to meet this aggressive target ethanol prices are expected to reflect the larger supplies and remain favorable relative to gasoline. Consequently, we expect that consumers will continue to benefit from increased production and use of biofuels.

### Conclusion

Rapidly rising crude oil and motor fuel prices are putting consumers and businesses under significant financial stress. Biofuels are an important contributor to reducing America's dependence on imported petroleum. Ethanol extends the nation's motor fuel supply, provides important environmental benefits, and improves fuel performance. The ethanol industry produced 6.5 billion gallons of ethanol in 2007 which was blended into 48 percent of the nation's motor fuel supply. When all factors are considered, the price of an E-10 blend was 10.3 cents per gallon below gasoline providing consumer savings of \$6.8 billion.

Full implementation of the Renewable Fuel Provisions of EISA 2008 will ensure that consumers and small businesses continue to benefit in the future.