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Issue Paper on Reformulated Gasoline Regulations

ISSUE

A program to guarantee a market share for ethanol in reformulated gasoline may be removed from a proposed EPA rule. OMB has asked the Secretary of Energy for her official position on the proposal.

BACKGROUND

Clean Air Act requirements to reformulate gasoline are now being promulgated by EPA. EPA initially conducted a regulatory-negotiation with the interested parties. In August 1991, an agreement was signed and, in April 1992, EPA published a Supplemental Notice of Proposed Rulemaking reflecting that agreement. The regulatory-negotiation agreement did not provide a waiver for the use of ethanol. Any refiner that used ethanol instead of, for example, methyl tertiary butyl ether (MTBE) would have to reduce the volatility of gasoline to compensate for ethanol's higher Reid vapor pressure (RVP).

NO: When the ethanol industry and its Congressional supporters realized this, they demanded that the administration provide a waiver for ethanol, as it enjoyed under the RVP control program. A Coalition of Governers, including then - Governor Clinton, strongly supported the waiver. However, the Clean Air Act provides no legal basis for a waiver under the reformulated gasoline program. Nonetheless, President Bush responded to the ethanol industry by proposing that 30% of ethanol used in Northern cities receive the waiver. Refiners would have to reduce gasoline volatility by 0.3 psi RVP in order to make up for the use of ethanol.

EPA has now provided a Supplemental Notice of Proposed Rulemaking to OMB for release that reflects this proposal. It also includes a complex enforcement and entitlements scheme to implement the proposal. The proposed rule also contains non-related provisions for Phase II (2000 and later) reformulated gasoline emission performance standards, a "complex model" for use in certifying gasoline and more specific enforcement rules for use with the complex model. OMB's proposed action would be to remove the ethanol related provisions from the proposed rule. NO.

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2.9.93.

RECOMMENDED POSITION

The Policy Office recommends that the ethanol proposal be removed from this second supplemental notice of proposed rulemaking because:

- <u>The Proposal is Not Legal</u>: The authority cited in the Clean Air Act for this proposal is that "Such regulations [for reformulated gasoline] shall require the greatest reduction in emissions....taking into consideration the cost of achieving such emission reductions, any nonair quality and air quality related health and environmental impacts and energy requirements." The ethanol proposal would increase the cost of reformulated gasoline by about 1 cent per gallon and would not save any petroleum or energy. DOE analysis indicates that refiners would use more oil to produce gasoline as a result of this proposal and that ethanol has no energy security advantages relative to MTBE (primarily made from domestic natural gas).

- <u>The Proposal Would Harm the Environment and Does Not Meet CAA Requirements</u>: The RVP reduction required by refiners is not sufficient to offset 30% ethanol use because ethanol has a non-linear impact on RVP (a 2% ethanol blend increases RVP almost as much as a 10% blend). When both ethanol and MTBE blended gasoline are mixed together in the fuel tanks of motor vehicles, emissions increase more than allowed by the Clean Air Act.

- <u>The Proposal is Unfair to Refiners and the MTBE Industry</u>: Refiners who have made investments in MTBE production or have contracts for MTBE purchase will have to cancel contracts, underutilize their in-house MTBE plants, or have their "ethanol use credits" be transferred to ethanol-using refiners (worth about $.01 per gallon of gasoline).

Not relevant

- <u>Cost to Consumers</u>: Under the proposal, reformulated gasoline costs will increase by about $.005/gallon in 1995 and by as much as $.015 per gallon in 2000 and later. This is equivalent to a $.25 to $.75 per gallon additional subsidy to ethanol. Overall cost to consumers could be $200 million per year.

- <u>Current Support for Ethanol Already Generous</u>: Ethanol already receives a "blenders" income tax credit or lower Federal excise taxes for gasoline blends with 10%, 7.7% or 5.7% ethanol. This subsidy is worth 54 cents per gallon of ethanol regardless of how it is taken and will cost the U.S. Treasury $3.4 billion (FY 1994 through FY 1998).

SENSITIVITIES

- Those ethanol supporters that encouraged President Bush to make this proposal will likely mount a campaign to restore this or a similar waiver for ethanol.

- One alternative is increased tax subsidies to use ethanol to make ethyl tertiary butyl ether (ETBE). ETBE, unlike ethanol, does not have any environmental problem and would be used freely by refiners if it were cost competitive. In the past, DOE has supported an ETBE credit.

- However, other alternatives, such as mandated use of renewable fuels in gasoline, could be worse than the current proposal.