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Déjà vu All Over Again: Why We Face More Pain at the Gas Pump

Josh Freed & Robert Walther

Rising gas prices have become an annual rite of spring, increasing 14 times in the last 25 years between March and June. ¹

But 2012 is different.

Gas prices are rising higher, earlier in the year than we typically experience. According to the Energy Information Agency, it cost 34 cents more on average for a gallon of gas in February 2012 than it did one year ago. ² In fact, in inflation-adjusted dollars, the last time gas prices were this high in the United States was at the beginning of the last century, just as a major war was winding down. *It was 1918.* ³ This is happening despite the fact that the U.S. gets more of its oil domestically than it has since 2003 ⁴ # and oil consumption is at a 13 year low. ⁵

Why Gas Prices are So Damn High

There are four main pressures forcing the price of gas up even as domestic demand has dropped and production increased:

- **Unrest in the Middle East** – Tensions with Iran over their continued development of nuclear weapons, and Iran's threats to cut off oil to Europe and close the Strait of Hormuz, has spooked the oil market. Closing the Strait would shut off the shipping route for 20% of the world's oil, dramatically curtailing supply. In 2011, the civil war in Libya had a similar impact on oil prices, despite the fact that Libya only accounted for 2% of oil supply. ⁶
- **Greece and Positive Economic Outlook** – Through the end of 2011, markets were frightened by the prospect of a Greek default pulling Europe, and the world, into a deep recession. This helped keep oil and other commodity prices down. In mid-February 2012, the European Union agreed to provide Greece an additional round of bailout funding to meet its debt obligations. ⁷ With an economic crisis seemingly averted, economists anticipate that the global economy, and the demand for oil, will begin to grow more quickly in 2012. ⁸
- **Increased Developing World Demand** – Growing demand for oil in developing countries has re-shaped the global market. Demand for oil from developing nations is now up to 47% of the global total. In 1970, it was just 25%. ⁹ The growing middle class in the emerging economies of Brazil, Russia, India, and China are driving the surge in demand. Over the past decade, these countries increased their share of global oil consumption from 15% to 21%, and the trend is likely to continue. ¹⁰
- **Refineries Offline** – Every year, domestic refineries take a time-out in the spring to perform maintenance and switch to a summer blend of gas. This year, a host of refineries began maintenance early, disrupting gas supplies earlier than usual. ¹¹ At

the same time, several refineries are closing because high oil prices have destroyed their profit margins.¹²

What's NOT Contributing to Higher Prices

Three other factors many policymakers in Washington like to talk about have *not*, in fact, had an impact:

- **Domestic Demand** – Gas and home heating oil consumption declined from the winter of 2010–2011 to 2011–12 in the United States. Fuel-efficient vehicles and the lingering impact of the Great Recession have reduced gas use. The average passenger vehicle now gets 25 miles per gallon, the highest on record. Americans are driving 35.7 billion miles less today than they did in 2010.¹³ The warm winter had a similar impact on heating oil demand, which increased only 1% from the previous year.¹⁴
- **Keystone XL Pipeline** – No one expected the Keystone XL pipeline would be online in February 2012. In fact, there's real debate as to whether its construction, which would take at least three years, will minimally decrease or even increase gas prices in the U.S. That is because the oil would bypass Midwest refineries and instead go to Gulf Coast refineries that produce gasoline at a higher cost.¹⁵
- **Excessive Speculation** – Like any commodity in the market, financiers will place bets on future prices based on expectations. Companies, like airlines, that use large amounts of oil in their operations hedge against possible price spikes by buying it on the commodities market.¹⁶ Right now, a lot of hedging is being driven by Middle East unrest, growing worldwide demand, and a stabilizing Europe. It is not at all clear that there is "excessive speculation" by Wall Street traders trying to drive up prices so that they can dump oil on the market at a later date.¹⁷



How High Gas Prices Impact the Economy

- Each penny of higher gasoline prices takes out over \$1 billion from economic spending each year.¹⁸
- In 2008, the last time gas rose from \$3 to \$4 a gallon, consumers reduced their driving by 34 billion miles.¹⁹
- In 2011, the average American household spent \$4,155, or 5.7% of its budget, on gasoline.²⁰

- According to the Federal Trade Commission, in 2011, higher prices cost the average U.S. household \$60 a month, or about an additional 1.5% of their average monthly expenditures. ²¹
- According to Shawkat Hammoudeh, an economics professor with Drexel University, if there is a continued increase in oil prices, “the (U.S.) economy will suffer from a spending reduction that effects 70% of the economy.” ²²

Why Washington Can’t Lower Gas Prices

As we noted in our 2011 memo “Dealing with the End of Cheap Gas,” there is little that the government can do in the short run to reduce the price of gas. That’s because to truly control gas prices, we would need to provide drivers choices in how they power their vehicles, whether it’s with electricity, natural gas, or advanced biofuels, in addition to gasoline. Nonetheless, today Washington is talking about:

- **Increased domestic production** – The U.S. is producing more oil than we ever have and using less. It has not kept prices from rising. Any additional domestic production would be subject to the same factors. That does not mean we should not continue to increase domestic oil development. But under even the most optimistic scenarios, the U.S. has access only to limited additional oil capacity, which would only have a small impact on oil prices.
- **Tapping into the SPRO** – The Strategic Petroleum Reserve (SPRO) was created to protect the US against an oil embargo similar to the 1973 crisis. If tapped, it could reduce prices by between 4% and 20%—or 18 and 75 cents per gallon. But releasing oil from the SPRO now would leave us more vulnerable to potentially disastrous economic and national security consequences if Iran shut down 20% of the world’s oil. ²³ On June 23, 2011, President Obama ordered the release of 30 million barrels of oil from the SPRO. This was less than 5% of reserves and was part of an international effort to replace 60 million barrels of Libyan oil that was not available to the global market. ²⁴ Gas prices declined for the week following the announcement, but quickly crept back to June 23’s \$3.61 average by July 8. ²⁵
- **Controlling Speculation** – As *The Washington Post*’s Brad Plumer notes, speculation is “not always nefarious.” Companies that use a lot of oil need to protect themselves from wild price fluctuations and large swings in demand that outstrip supply. This can have dramatic impacts on oil prices. Particularly when there are clear external events driving prices higher, it is very hard to identify if, let alone how much, oil prices are influenced by traders trying to manipulate the market. ²⁶

- **Eliminating tax subsidies/Adding a windfall profits tax** –Both the elimination of tax subsidies and imposition of a windfall profits tax are popular with the public. They are even more popular if paired with a rebate to consumers to help cushion the blow of high gas prices. Particularly in the context of the deficit debate, there are strong arguments to be made for reforming fossil fuel energy subsidies. But those opposed to removing subsidies or imposing a windfall profits tax counter that any action that adds to the cost of producing oil will only increase oil, and ultimately gas, prices. At best, this would cancel out any rebate benefits. At worst, it could make gas even more expensive for consumers.

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