



HOUSE OF REPRESENTATIVES I

Gasoline Prices

By Andrew Chan

Introduction

Almost all Americans agree that rising gas prices are one of the chief economic concerns facing the United States today. With close to 250 million automobile vehicles registered in the country, the US consumes more than 178 million gallons of gasoline daily. With prices exceeding \$4 per gallon, the cost of gas has hit consumers hard, whether at the pump, in increased costs of air travel, or in the general rising price of almost all goods that are transported in the United States. Along with increasing unemployment rates and instability in the housing industry in 2008, most economists believe that the US is still experiencing or recovering from a **recession**. Consequently, in a Gallup Poll from June 2008, more than 85% of Americans responded that gas prices were one of the most important economic issues facing the United States. For this reason, 2008 presidential candidates Barack Obama and John McCain both made gas and energy policy one of the most debated issues throughout their respective presidential campaigns. Unfortunately, both local and national politicians failed to address the issue satisfactorily in 2008. Congress left for its August **recess** without coming to a consensus on the gas crisis, resulting in the lowest congressional approval ratings in history since the 1950s. However, with a new President in office and Congress retooled after the November elections, American citizens are looking to Congress to pass responsible and effective long term legislation to solve the spike in gas prices immediately. Anything less than a complete and permanent fix may not be acceptable to the American people.

Recession—*period of economic contraction, sometimes limited in scope or duration.*

Recess—*break.*

Explanation of the Problem

Breakdown of Gas Prices

Although American citizens are sometimes misled to believe that the price of gas is based solely on the price of its parent product, **crude oil**, a number of different factors go into the gas prices that consumers see at the pump. Furthermore, no matter how expensive gas becomes, each agent in the chain of supply receives a portion of the money eventually paid. As the United States Department of Energy estimates, each dollar that is spent on gas in the US can be broken up into four parts: 11 cents to the government from taxes, 6 cents to the distributors of gasoline, 10 cents to refineries which process crude oil into the gasoline which goes into cars, and 73 cents to the crude oil companies. There-

Crude oil—*the unprocessed oil, as it is collected from the ground.*

fore, an increase or decrease in any of these prices affects the overall price of gasoline that is paid by consumers.

How Oil Prices Change

With that in mind, most economists consider the primary reason for the spike in gas prices over the past several years to be fluctuations in the 73 cents per dollar that go to crude oil companies. Basic economic theory states that when the quantities demanded for a good increase, the price for that good will increase, and when the quantity supplied decreases for a good, the price of the good will also increase. Most economists acknowledge that both increasing demand and decreasing supply have been affecting United States oil markets over the past several years. Indeed, according to the Department of Energy, the United States has quadrupled its demand for oil over the past 20 years, today consuming about 20 million barrels of oil products per day, of which half goes to motor gasoline. Because each barrel of oil contains 42 gallons, which usually yields between 19 and 20 gallons of gasoline, Americans consume roughly 178 million gallons of gasoline each day. Furthermore, because both the demand for gasoline and other oil-based products has increased dramatically over the past several decades, the prices of oil, and consequently gasoline, have also increased.

This does not even take into account the rising demand for oil and gasoline in the rest of the world. As countries like China and India enter a new phase of economic growth through the development of their industries, their demand for oil and other natural resources has expanded tremendously, thus further increasing the price of oil globally. In 2005, the price of a barrel of **light sweet crude oil** crossed \$50 per barrel for the first time in history. Contrast this with the fact that in the past three years the price of oil has more than doubled, ultimately reaching \$120 per barrel in June 2008. The price of oil is only expected to continue to increase in the long run.

Additionally, the supply of oil available to the United States and the rest of the world has decreased substantially over the past several decades. Because crude oil is a product that requires hundreds of years to create through the breakdown of living matter, and because many oil wells are emptying, many countries pumping oil at full capacity have already begun to slow their annual production of oil. Indeed, Saudi Arabia is thought to be the only country in the world with excess oil capacity and the ability to immediately increase its production and supply of oil. However, in 2005, economists predicted that by the year 2070 the world might be completely without light sweet crude oil, which is what oil refineries typically use to make gasoline. At that point, the world would be forced to rely completely on oil sands and other types of petroleum which require more energy and money to refine.

Light sweet crude oil—the most sought-after type of crude oil, due to its low levels of sulfur.

Recent Developments

Although the long-term discussions of increasing demand and decreasing supply are useful, they do not answer the question of why gas prices increased by over 25% from 2007 to 2008. However, economists **retrospectively** cite changes in fuel regulations and speculation in the **oil futures** market to be the causes of the more short-term changes in gas prices that the country has experienced in recent months.

Ethanol Drives up the Price of Commercial Gasoline

On December 19, 2007, President Bush signed House Resolution 6: *The Energy Independence and Security Act of 2007*, a piece of energy legislation involving a proposed increase in fuel efficiency regulations in cars and **SUVs** by 40 percent. While Republicans fought the proposal, calling the new regulations economically infeasible, Democrats argued that it was a vote that was necessary for the future; the bill eventually passed the legislation with the signatures of 100 Republicans who crossed the political aisle to support this more liberal piece of legislation.

However, little was mentioned regarding the second part of the energy bill, which called for a six-fold increase in the amount of **ethanol** required to be used in gasoline mixtures by 2027. A popular measure at the time, Republicans and Democrats agreed that increasing the use of ethanol could only reap positive benefits in decreasing the country's dependence on oil in its mixture of gasoline. However, what many in Washington, DC did not recognize was that the cost to produce ethanol is substantially greater than the cost of refined crude oil. Indeed, while refining oil costs around \$1.75 per gallon, creating ethanol from corn costs more than \$2.50 per gallon. Although ethanol use may decrease the demand and price of crude oil in the future, it could also easily increase the cost of refining gasoline.

Oil Speculation

Furthermore, 2008 also saw more **speculation** in the oil futures market in the **New York Mercantile Exchange (NYMEX)** than ever; the market price for oil futures often increased by one to two percentage points each day, thus substantially raising the price of gasoline at the pump. After the 1970s oil **embargo**, the United States began to set the price of crude oil by trading "paper oil barrels" called oil futures, which were the rights to delivery of a certain quantity of oil at a specific time, usually 6 months or 12 months in the future. Like **stocks**, the oil futures can be bought and sold by investors; however, unlike stocks, when the futures fully mature, the oil is delivered and the futures no longer have any value. This means that the trading of oil futures depends on expect-

Retrospectively—*after the fact.*

Oil futures—*commodities traded in the New York Mercantile Exchange in which a specific amount of oil is guaranteed to be delivered at a future date. Only the final holder of the oil future is required to accept the oil delivery.*

SUVs—*sport utility vehicle; a type of automobile that is often fuel inefficient.*

Ethanol—*a compound that is added to fuels.*

Speculation—*act of assuming risk of losses despite uncertainties about the possibility of a reward on that risk.*

New York Mercantile Exchange, NYMEX—*the world's largest physical commodity futures exchange.*

Embargo—*the prohibition of trade with a certain country.*

Stocks—*a share of ownership in a company.*

tations of the supply and demand for gasoline and other oil products in the future rather than in the present. Consequently, an expectation that the country will be increasing its demand for oil or decreasing its supply usually leads to an increase in the price of oil futures today. During 2008, oil speculators bought many of these oil futures, driving up the price of gasoline substantially. This speculation in the market, combined with stricter standards on the proportion of ethanol in gasoline mixtures in automobile vehicles, led to the spikes in gas prices that US consumers experienced in 2008.

Congressional Action

Although Congress has yet to pass legislation to deal with the crisis in gasoline prices, there has been plenty of discussion in Washington, DC about this problem. Initially, discussion centered on whom to blame for the increasing cost of gasoline, but conversation eventually turned into a more substantive discussion about how to best increase the supply of gasoline while decreasing the domestic demand for oil and natural gas.

Congress Tries to Blame Someone...Anyone

As gasoline prices began to skyrocket in the spring and summer of 2008, Congress's initial reaction was to point fingers at the usual suspects in the oil scene, calling for measures to punish **Big Oil** and speculators on Wall Street. Under the assumption that oil speculators were manipulating the market by buying oil futures, Democrats proposed the *Stop Excessive Speculation Act* in July of 2008. The bill was sponsored by Senate Majority Leader Harry Reid and other members of Democratic leadership and would provide more resources and authority to the **Commodities Futures Trading Commission (CFTC)** to detect and punish speculation, stop speculators from using foreign markets to manipulate the price of oil in the United States, require more transparency in oil markets, and limit the trading of market players who do not intend to take delivery of the oil they purchase. However, the bill eventually failed since Republicans criticized the measure as being a **smokescreen**: perhaps it was a part of the solution, but to them it was definitely not the answer.

Looking to Increase Supply

After Congress exhausted the issue of punishing those at fault for high gas prices in the US, parties began to debate the best ways to increase the supply of crude oil in order to drive down the global price of oil. On May 13, 2008, the Senate and House unanimously voted to temporarily suspend the 70,000 barrel per day shipment of petroleum to the **Strategic Petroleum Reserve (SPR)**. President Bush then approved the proposal on May 19th. However, Republicans and then-President

Big oil—a term used to refer to the six largest energy companies.

Commodities Futures Trading Commission (CFTC)—an agency of the US government that prevents the fraudulent trading of oil futures.

Smokescreen—a measure designed to confuse or mislead.

Strategic Petroleum Reserve (SPR)—inventory of oil that is kept by the US in case its foreign supply of oil gets cut off in a time of national emergency.

George W. Bush condemned a proposal by Democrats to increase oil supplies by tapping into the 707 million barrels of oil in the reserve as a national security mistake. Instead, President Bush and Republicans continued their long push for a vote to open up the **Arctic National Wildlife Refuge (ANWR)** for oil drilling. Bush and the Republicans also proposed to lift a 1981 ban on **offshore drilling** as a cure-all solution for gas prices. More than 72% of Americans agreed with this idea at the time. However, Democrats, led by Barack Obama and Speaker of the House Nancy Pelosi (D-CA) rejected the idea, arguing that offshore drilling would have a negligible effect on gasoline prices both in the present and in the future. Instead, they advocated tapping into the SPR. It was during this state of **gridlock** that Congress left for its annual five week recess in August, having neither passed legislation nor developed a plan on how to relieve US citizens of skyrocketing gas prices.

Focus of the Debate

Conservative View

Conservatives in Congress believe that the best way to lower American gas prices is to decrease demand for oil through the development of new technology while increasing domestic supply. While President Bush was still in office, he called for **tax credits** to be offered to companies to research and develop alternative sources of energy, as well as for competitions with prizes to be held for scientists who could further improve fuel efficiency in vehicles. Additionally, between 2000 and 2008, Republicans approved increased **Corporate Average Fuel Economy (CAFE)** fuel standards half a dozen times and offered tax credits to owners of **hybrid electric vehicles**. These measures show Republicans' willingness to both impose restrictions on gas guzzling vehicles and offer incentives to consumers of fuel efficient cars.

In recent months many Republicans have also become more open to the idea of cutting federal taxes on gasoline as a temporary relief to consumers. In January 2008, Republicans sponsored legislation which would have created a gas tax holiday, initiating a **moratorium** on gas taxes which would have lasted from Memorial Day, which is in the end of May, to Labor Day, which is in the beginning of September. However, Democrats opposed the proposal, citing the need for federal gas taxes in order to build and maintain roads and interstate highways.

Finally, conservatives in Congress also believe that in order to offer relief to consumers, the supply of oil coming into the United States must increase. To Republicans, the best way to do this would be by lifting the ban on offshore drilling and initiating exploration in the Arctic National Wildlife Refuge. Most Democrats oppose this.

Arctic National Wildlife Refuge (ANWR)—*environmental region in Alaska that is believed to store enough oil to manufacture several hundred millions of barrels of light sweet crude oil.*

Offshore drilling—*the drilling for oil in the oceans as opposed to on land.*

Gridlock—*a situation in which no movement or progress is possible.*

Tax credit—*money returned to citizens when paying for their taxes.*

Corporate Average Fuel Economy (CAFE)—*the US federal regulations aimed at improving vehicles' fuel efficiency.*

Hybrid electric vehicles—*automotive vehicles that run both on gasoline and electricity.*

Moratorium—*a legally authorized period of delay.*

Liberal View

Like conservatives, liberals believe that in order to lower gas prices in the US permanently, the country's demand and supply levels of oil must be addressed. To decrease demand, Democrats roughly agree with Republicans that funds must be allocated for the research and development of new sources of energy and that incentives must be made to consumers to increase demand for fuel efficient vehicles. In July 2008, Democrats in the Senate proposed a \$3000 tax break each year for owners of plug-in hybrid vehicles, which are automobiles that can attain fuel mileage standards of up to 100 miles per gallon. Throughout the summer, Democrats supported incentives for consumers to check the pressure of their tires and change their oil, small habits which can increase fuel efficiency of a vehicle over time.

Instead of offering tax breaks to oil companies for the research and development of new technology, however, Democrats proposed a **windfall profits tax** on oil companies, which seem to be the "winners" of high gas prices. **Exxon Mobil** posted record quarterly profits in August at hundreds of billions of dollars. Democrats proposed taxing those profits, redistributing those funds to consumers of gasoline. Democrats have long opposed any suspension of federal or state tax prices.

Finally, with regards to increasing the supply of oil in the United States, Democrats have passionately argued against offshore drilling and exploration for oil in the Arctic National Wildlife Refuge, asserting that both policies are ineffective and environmentally harmful. Instead, during the summer of 2008, Speaker of the House Nancy Pelosi (D-CA) called on President Bush to tap into the Strategic Petroleum Reserve, increasing the domestic supply of oil in order to temporarily decrease gas prices over the summer.

Presidential View

During his presidential campaign, President Obama was initially opposed to the idea of offshore drilling, calling it a proposal that would be ineffective and would have no real impact on the price of gasoline for consumers. Eventually, Obama amended his position slightly by proposing that he would be in favor of offshore drilling if it was just one piece of a more comprehensive plan to cut gasoline prices. During the campaign, Obama was also particularly passionate in criticizing oil companies and speculators. Consequently, Obama expressed favor of issuing windfall profits taxes on oil companies in order to redistribute funds to consumers paying for gasoline. He was also in favor of creating new taxes that would increase transaction costs to discourage oil speculation, increasing the cost of buying and selling oil futures on **Wall Street**. Finally, President Obama also emphasizes the small things that consumers can do to improve their fuel efficiency, such as taking their automobiles to the mechanic for regular check-ups, driving with tires

Windfall profits tax—*higher tax rates on profits of a company that result from a sudden, unexpected gain.*

Exxon Mobil—*an American oil and gas company.*

Wall Street—*America's chief financial district; located in New York City.*

that are properly inflated, and changing oil regularly.

NGO Perspectives

Greenpeace

Greenpeace, a special interest group devoted to the preservation of the environment and green policies, has long advocated lifting America's dependence on fossil fuels and has consequently supported any policies aimed at decreasing the demand for oil and gasoline in the United States. In the past, Greenpeace, has strongly advocated for the development of alternative sources of energy and for tax incentives for consumers to purchase hybrid electric vehicles and other automobiles with higher fuel efficiency. However, Greenpeace has remained **staunchly** opposed to proposals to increase the supply of oil within the United States, calling such policies a delay of the **inevitable** day when there is no more crude oil left to be drilled in the rest of the world, thus forcing the US to rely on other sources of energy.

Staunchly—*firmly.*

Inevitable—*impossible to avoid.*

Citizens Against Government Waste

Citizens Against Government Waste (CAGW), a special interest group dedicated to the ideals of free markets, has long opposed Democratic proposals to increase taxes on corporations or to spend funds on research and development of alternative sources of energy. Instead, CAGW has long supported a gas tax holiday, claiming that the temporary relief would be beneficial to consumers everywhere. CAGW has claimed that increasing taxes on corporations or on oil speculators would create inefficiencies in the market, calling such proposals an overreaction to a crisis in the oil markets that will naturally correct itself in the near future. Indeed, CAGW has long believed that the best way to deal with most economic problems is to offer temporary relief to those whom the crises affect, while doing as much as possible to allow for markets to adjust itself.

US Chamber of Commerce

The US Chamber of Commerce, a special interest group representing corporations and businesses in the United States, has always opposed imposing new taxes on the profits of oil companies, claiming that it is not the fault of oil companies that prices are high and that companies are benefitting from these high prices for oil. In the past, the US Chamber of Commerce has supported policies geared at increasing governmental funding of corporations that wish to develop alternative sources of energy, calling such actions beneficial to both corporations and consumers in the United States.

Possible Solutions

Reducing Demand for Gasoline

One prominent solution to high gas prices is to reduce consumer demand for gasoline; this can occur in many ways: offering tax incentives to consumers of fuel efficient vehicles, researching alternative sources of energy, increasing fuel efficiency standards of vehicles, or offering tax incentives for drivers to get their cars checked regularly and to drive with properly inflated tires. Because the United States will eventually run out of oil in the future, decreasing the domestic demand for gasoline is absolutely necessary as a long-term solution to high gas prices.

Increasing Supply

Increasing supply is the other main strategy that most lawmakers are considering when considering ways to relieve consumers of high gas prices. Possibilities for increasing supplies include: offshore oil drilling, exploration in the Arctic National Wildlife Refuge, tapping into the Strategic Petroleum Reserve, requesting an increase in oil production from **OPEC**, and funding the construction of new oil refineries. Most economists agree that increasing the supply of gasoline in the market usually has a quick and strong effect on gas prices in the short run but that it can only offer temporary relief.

Innovative Tax Policy

Proposals that do nothing to change the supply or demand for gasoline most often affect tax policy. These proposals use taxes to create market incentives for lower gas prices and can include taxing oil speculators by increasing transaction costs, creating a windfall profits tax on oil companies, and lifting federal gas taxes temporarily. Many of these proposals are criticized for inhibiting regular market activity, which runs the risk of long term consequences. However, many politicians, especially Democrats, are in favor of such policies because they take money from profit-seeking companies and redistribute it to consumers.

OPEC—*Organization of Petroleum Exporting Countries; composed of thirteen oil-rich nations that wish to safeguard their individual and collective interests.*

Questions for Policymakers

Because of the complexity of the gas price issue, a successful piece of legislation must address several important questions: To what extent are gas prices an issue in the United States? If so, what should the primary goal of the legislation be? Is it to decrease gas prices by 10 cents? 50 cents? 2 dollars? What are the most effective ways of decreasing gas prices for consumers? Furthermore, how will the legislation deal

with any consequences of the solutions that are being proposed? How long will the regulations implemented by the legislation be set in place? What happens if the situation does not improve or if it becomes worse?

Conclusion

Gas prices are at the highest that they have ever been in the United States, and they are having a tremendous effect on the rest of the American economy, prompting Americans to demand an effective solution that will allow them to drive their automobiles at an affordable price. Unfortunately, gas prices are a problem that the government cannot easily control; consequently, solutions to this situation must be both effective and innovative. While Democrats and Republicans agree that demand must be decreased and supply must be increased, the parties disagree on how to effectively do that. Therefore, negotiation and **compromise** will be crucial in restoring the public's confidence in Congress, as well as in ensuring Congress' ability to pass legislation that will relieve consumers in the United States.

OPEC—*a settlement of differences by mutual concessions.*

Guide to Further Research

The issue of gas prices and how they function in the United States is a topic that is easily understood but is difficult to master. However, with further research in journals, newspapers, and economic policy organizations, you can become an expert at discussing gas prices in the United States, which will enable you develop informed speeches and legislation at the conference. Below are a few websites that you may find useful as you learn more about the topic. Please follow the links below.

- <http://auto.howstuffworks.com/gas-price6.htm>
“Howstuffworks” is a website that specializes in explaining in simple terms difficult topics in science, politics, and other fields. At this website, you'll be able to learn more about the breakdown of gas prices, how gas prices change across the United States, the effect that OPEC has on US gas prices, current domestic supplies of gasoline in the US, and more about options for finding oil elsewhere. This is a recommended place to start to get more familiar with the issue.
- <http://news.google.com>
Google News is a powerful tool for searching through all major US newspapers and periodicals. I recommend making a search for “gas prices,” and all newspaper articles which discuss the

topic will appear. In particular, pay close attention to articles that discuss Congress's ideas and proposals for lowering gas prices.

- <http://www.npr.org/templates/story/story.php?storyId=4816228>
National Public Radio has created a website full of useful information on gas prices in the United States, discussing small steps that consumers can take to increase their fuel efficiency as well as addressing questions that many consumers have about high gas prices. In particular, the pages on “What’s Behind Soaring Gas Prices” and “How High Can Gas Go” are excellent for the purposes of the conference.
- <http://money.cnn.com>
An article titled “Who’s to Blame for \$4 Gas” – This article is useful in that it provides a timeline of what factors have caused gas prices to increase so quickly over the past several years, from 2005 until 2008. The factors that they mention can be useful in thinking about possible solutions to present in legislation at the conference.
- <http://blogs.wsj.com/economics/2008/05/26/oil-bubble-the-debate-rages/>
This page is a blog on the *Wall Street Journal* where the author of the blog lays out the debate as to the future of gas prices in the United States. Not only should you closely read the content of the article, but you should also pay attention to the comments that are made in response to the article, as many of the readers and responders on the website have informed opinions about gasoline prices in the United States.

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