



HOUSE OF REPRESENTATIVES I

Gasoline Prices Update

By Rachel Wilson

Introduction

Because of their importance to virtually all elements of the economy, gas prices can have a tremendous effect not only on family's wallets, but on large-scale economic growth as well. High gas prices affect the cost of many consumer goods, not just payment at the pump, because virtually all goods must be transported to markets, many industries rely on fossil fuels to operate machinery, and plastics are also derived from petroleum. Many Americans feel that this is one of the most critical economic issues facing our nation; however, it is also one of the most complicated, and the government has failed to sufficiently address this problem thus far.

Summary of the Problem

The gas prices that consumers pay are determined by a variety of different factors. Governments, gasoline distributors, refineries that process **crude oil** into gasoline, and crude oil producers each get a part of every dollar spent on gas. This means that if there is a change with any one of the four, the price that consumers pay changes.

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

Economists believe that the increase in the price of gas is largely due to crude oil companies raising prices, because they are responsible for the largest portion of the price that consumers pay at the pump. They determine the supply of crude oil, which directly affects the price because when supply decreases price increases as the commodity becomes more precious. There are a handful of factors that affect supply beyond the decisions of oil producing companies.

First, output in much of the world is determined by governments, or more importantly, OPEC. OPEC is a cartel of oil-producing countries that represents 2/3 of the world's known oil reserves and over a third of its production; OPEC can choose to dramatically affect the supply of oil and in the past has created oil price shocks in this way.

Second, there is the problem that the world's crude oil supply is not inexhaustible. While there are those that argue that the world's supply is virtually unlimited, it is important to note that this does not mean there is an economically sustainable supply of oil. In other words, just because the oil is there doesn't mean it is actually financially possible to extract it. Not all oil is equally accessible. Sometimes oil can be extracted through a simple hole in the ground, which is cheap, but such oil deposits have been exploited for years, and oil producers are forced to

turn to more expensive methods to extract oil like offshore drilling, oil shale, and oil sands. These methods cost producers more to extract the same amount of crude oil, meaning that the price of petroleum products will likely continue to rise as the cost of extracting oil does so.

Third, the demand for crude oil and its derivatives has grown rapidly and will continue to do so as large portions of the world become more industrialized. Specifically, the explosive growth of China and India has put massive pressure on oil suppliers to keep up with demand, and because it takes time to explore new oilfields and make them productive, suppliers are lagging behind demand. This is a pressure that will only continue to grow, and is unlikely to be offset by green energy in the foreseeable future.

Recent Developments

An unprecedented drop in gas prices has occurred very recently. In fact, according to a *Washington Times* article from January 6, 2009, the current average gas price is lower than when President Bush was inaugurated after adjustment for **inflation**. The Energy **Information Administration (EIA)** announced that the average price of gas was \$1.59 on December 29, which would have been approximately \$1.33 in 2001. The EIA also reported that worldwide economic problems have decreased demand for gas, which has helped bring down gas prices. However, this decrease in demand is not expected to be sustained in the long run as the global economy recovers.

Recently, President Obama has backed off of his call for **windfall profits taxes** on large oil companies due to falling gas prices. This is a welcome change for many who believe that a windfall profits tax would hurt oil companies and force them to raise their prices.

In his first day in office, President Obama indicated that he might have changed his mind on another oil-related issue as well. Late in his campaign, President Obama had suggested that he could support offshore drilling as gas prices were at historic highs. However, President Obama may order a hold on an executive order that President Bush issued in his last days in office that would expand offshore drilling into previously banned areas, especially off the coasts of Alaska, California, and Florida. The Interior Department says that Obama's order may also halt their plan to develop oil shale fields in the Western United States.

Essentially, the significant drop in gas prices has removed the issue from the national spotlight. This is evident in President Obama's shift in policies as well as the lack of discussion about gas prices in the news and by policymakers. The nation is now more focused on other issues, such as the economy. However, policymakers are well aware that low gas prices will not last and are working towards pushing for alternative energy. The irony is that alternative energy is much less at-

Inflation—*this occurs when the government puts more money in circulation; the result is an increase in prices.*

EIA—*an independent statistical agency within the US Department of Energy.*

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

tractive when oil is so cheap because of its high costs, meaning that these efforts are also marginalized.

Focus of Debate

Conservative View

To lower gas prices, conservatives favor decreasing demand while increasing supply. They propose decreasing long-term demand by offering tax credits to companies who research and develop alternative sources of energy. They also support improving fuel efficiency in vehicles and rewarding owners of hybrid electric vehicles. It should be noted that conservatives differ from liberals in that they push for incentives for alternative energy use rather than mandatory measures that liberals are typically supportive of. In order to increase the supply of crude oil, conservatives call for an end to the ban on offshore drilling and exploration of the **Arctic National Wildlife Refuge (ANWR)**, both stances that liberals have strongly opposed in the past. Recently, conservatives have also begun to support cutting gasoline taxes.

ANWR—a region in Alaska that is believed to store enough oil to manufacture several hundred millions of barrels of crude oil.

Liberal View

Liberals typically try to address only the demand side of this issue, meaning that they try to pursue alternative energy sources to lower the amount of oil used by the United States rather than also trying to increase the supply of oil available. Like the Republicans, Democrats support research and development of alternative sources of energy although their proposals are somewhat different and often include penalties for companies that do not meet certain standards. Unlike Republicans, they do not support offering tax breaks to oil companies for research and development, and instead have proposed windfall profits taxes on oil companies in order to redistribute their large profit to consumers of gasoline, though as previously mentioned, this is no longer the case. Democrats adamantly oppose offshore drilling and exploration for oil in ANWR, believing that the real problem is that we are too dependent on oil and that drilling in these areas would pose an environmental threat. As an alternative, they supported tapping into the **Strategic Petroleum Reserve** during the summer when gas prices were highest.

Strategic Petroleum Reserve—an inventory of oil that the US stockpiles in case its foreign supply of oil gets cut off in a time of national emergency.

Presidential View

President Obama initially opposed any offshore drilling; however, later in his campaign, he said that he would consider offshore drilling if it were part of a comprehensive package that would cut gas prices. Obama supported windfall profits taxes on oil companies and wants to make it more difficult for commodities traders to affect the price of oil by enacting new taxes on commodity trades involving oil. During his

campaign, Obama also emphasized the small things that people can do to increase the fuel efficiency of their vehicles, such as getting regular maintenance check-ups, changing oil regularly, and properly inflating tires.

Questions for Policymakers

While debating this issue, try to keep these questions in mind. How pressing an issue is gas prices for the US, especially now that they are significantly lower? How should the recent drop in prices affect US policy? What should your target price per gallon be? What actions will most effectively lower gas prices? How will the legislation deal with current proposals and recent policies? Will the legislation focus on the short run or will it take into account the long run as well? What happens if it is ineffective or makes the situation worse? How should the US handle the fact that most of its oil comes from abroad, making it difficult to affect the supply?

Conclusion

Gas prices are both a pressing and complex issue. Americans are concerned and want the government to offer a solution; however, government policy towards gas prices is a complicated issue with differing approaches from Democrats and Republicans. They both agree that the solution must come by decreasing demand for oil, but Republicans and Democrats disagree over the long-term **viability** of increasing the supply and cannot agree on what policies will be most effective. This means that compromise and negotiation in Congress are crucial to solving this critical problem that faces both the United States and the world.

Viability—*quality of being practicable, workable.*

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