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OPINION:

Blame Big Government, Not Big Oil, For Gas Prices

Federally Mandated "Reformulated Gas" Has Had A Particularly Harsh Effect On Gas Prices This Summer

By James Plummer of Consumer Alert

WASHINGTON—If you drive a car or are otherwise sentient, you've noticed that gas prices are up, way up, this year. The effect has been most pronounced this summer in the upper Midwest, where at their peak, gas prices topped two dollars a gallon.

Why has this happened? Can consumers hope for a return to last year's prices in the near future? Economists realize demand for gasoline is extremely inelastic in the short term—that is, it takes a while for consumers to adjust gasoline consumption habits to changing supplies and prices.

This makes sense. People's transportation decisions, such as how far from work to live, how to commute, what car to buy and how to travel, were made under different gas-price and oil-supply conditions. Consumers cannot change these choices instantly, but over time they can adjust to price signals.

The supply problem ties into the administration's foreign and domestic policies. Abroad, the Organization of Petroleum Exporting Countries has stuck to production quotas in order to drive up the world price of oil.

Some researchers contend the administration works with OPEC to adjust production levels, and therefore prices, for domestic and international political goals. Hence the somewhat-successful efforts to get Saudi Arabia to open up the spigots a bit by election time.

Meanwhile, new domestic oil operations are dead on arrival. New drilling operations are forbidden in the "Arctic National Wildlife Refuge" in Alaska—an area, mostly tundra, the size of several states.

Yet oil-extracting technologies have improved dramatically in the last couple decades and do little-to-no damage to local habitats. The Clinton- Gore administration has also declared a moratorium on new offshore oil drilling (with the occasional exception for companies allied with longtime Gore patrons Occidental Petroleum).

In recent testimony before a House subcommittee, Jerry Taylor of the Washington-based Cato Institute noted the short-term price elasticity of gas is minus .05; that is, for every 1 percent hike in the price of gas, consumers will buy just one-twentieth of 1 percent (.05 percent) less gas.

If gas supplies fall by about 2.5 percent, consumers need to buy 2.5 percent less gas for the market to balance. Since 2.5 percent is 50 times .05 percent, prices have to be 50 percent higher before consumers will cut gas purchases by 2.5 percent.

If prices didn't rise as much, given the lessening supply, you would see the gas lines of the 1970s return, as demand for gas at a certain price outpaced supply.

This effect played out in miniature this summer at service stations that offered gas at reduced promotional rates, backing up cars and snarling traffic.

The costs of industry regulation are also passed onto consumers. "Reformulated gas" has had a particularly noticeable effect on prices at the pump. EPA mandates that different areas of the country use different kinds of "Phase II" gas to cut back on emissions by mixing fuel with certain oxygenates.

EPA insists Phase II mandates should "only" raise prices by 5 to 8 cents a gallon. But bureaucrats ignore that such mandates have balkanized the gas market, leaving prices much more vulnerable to spot shortages as refineries hustle to cover for pipeline problems and phase-in of new regulations.

The Chicago-Milwaukee area was particularly vulnerable this summer as Phase II was phased in. Besides pipeline troubles, this area uses the notoriously over-subsidized and inefficient oxygenate ethanol, made from corn.

Ethanol, a cash cow to political donor and agribusiness giant Archer Daniels Midland, must be blended at the last minute with yet another gasoline blend to keep the whole thing from making a bigger mess than regular gasoline.

It took a while for enough refineries to switch over to this blend— they only make one at a time—further affecting supply and raising prices.

The more widely used oxygenate MTBE has been found to cause water pollution; EPA may actually rethink it.

In addition, the Chicago-Milwaukee area has unique tax properties. State, local and federal taxes are a large factor in the price of gas. The federal tax now stands at 18 cents a gallon. Recent efforts to cut that figure have died in Congress.

Wisconsin has one of the highest state gas taxes, a staggering 33 cents a gallon. Illinois even charges a percentage sales tax on top of the per-gallon gas tax, though this rate has been temporarily lowered. Supply, regulation and taxes—these are the three big determinants in how much consumers pay for gas.

Governments control these factors, and sound policy can give consumers some relief at the pump. As it stands now, our balkanized gas markets have dwindling stocks on the East Coast and in California, portending price troubles later this year.

The federal government should respect and encourage a free market in oil and shed nonsensical and costly regulations on oil and gas. Both state and federal governments should slash gas taxes back to what is needed to maintain road systems and scrap the biennial highway bill porkfest. That's an energy policy consumers can live with.

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