When the Subject is Gas, Politicians are Pumping a lot of Hot Air
by Andrew Brod
Greensboro News & Record, May 19, 1996

Mixing politics and economics makes for a strange brew sometimes. Congressional Republicans oppose an increase in the federal minimum wage because they claim it would distort labor markets. On the other hand, the recent run-up in gasoline prices has led them to call for a repeal of the 4.3 cent-per-gallon gasoline tax enacted in 1993.

The gas price increase has nothing to do with taxes but a lot to do with the workings of free markets. But while Republicans like markets when they work to the benefit of their constituents (such as employers of low-wage workers), they abandon that free-market religion when markets yield outcomes they don't like.

Overall, markets for crude oil and gasoline have served us well. Because of our continuing reliance on, if not addiction to, the automobile, producers have found new ways to discover oil, to extract it once they find it, and to refine it into gasoline. These developments have translated into lower costs for them and lower prices for us. After correcting for inflation, gasoline is quite cheap in historic terms, slightly cheaper than in the pre-OPEC-embargo 1960s and much cheaper than right after the 1979 Iran crisis.

Just in case Bob Dole reads this, let's try to understand that a 4.3 cent-per-gallon reduction will do very little. It *cannot* lower the price of gasoline by any more than 4.3 cents per gallon and it will probably lower it by a bit less. In spite of its dubious benefits, the repeal seems very important to Congressional Republicans, even as they pooh-pooh the proposed minimum-wage hike as pointless because it will have little effect on the incomes of the working poor. But economic ironies abound in an election year.

This is not to say that removing *all* taxes on gasoline wouldn't have a dramatic effect on gas consumption and at least some aspects of consumer well-being (though lost tax revenue would have to be made up somehow). Taxes account for a large portion of the price of gas, though not nearly as much as in most European countries. But that hasn't changed over the last few months.

Why has the price of gasoline risen? The simple fact is that crude oil is more expensive now than just a few months ago. We can't blame this on collusion by big oil firms or large oil-producing countries, contrary to the fears of conspiracy theorists like Bill Clinton, who has asked the Justice Department to investigate possible collusion among oil firms. Then who's the dastardly culprit? The market. When the prices of raw materials go up, firms try to pass along the cost increase to consumers (though they generally can't succeed completely). That's one way markets work.

Many integrated oil firms pump crude oil out of the ground as well as refine it into gasoline and other products. In other words, many of the sellers of crude oil are also its buyers. We wouldn't expect an integrated oil firm, when it acts as a seller, to exploit itself when it acts as a buyer, so we can't reasonably attribute the price run-up to greedy oil producers. In fact, while the price of crude is up about 17 cents per gallon since January, the price of gasoline is up an average of only about 14 cents per gallon nationwide.

The weather is one of the big causes of the increase in crude oil prices. It was a long and cold winter in the Northeastern U.S., a region that tends to burn a lot of heating oil, another end-product of crude oil. This naturally drove up the demand for heating oil, and by the time the long winter ended, oil refiners' inventories of crude oil were quite low. But then the quick onset of warm weather around the country and the resulting early arrival of the summer driving season led to a supply crunch: not enough crude oil in refiners' tanks for them to satisfy the increased demand for gasoline.

The supply crunch was exacerbated by the small inventories oil refiners tend to maintain these days as a way to lower costs. In normal times, this practice keeps gasoline prices low, and we never know it's there. In times of short supply, it can aggravate price increases. Is this a reasonable trade-off? I think so.

Uncertainty about world oil supplies hasn't helped. Concern over whether the U.N. will allow Iraq to sell crude oil on world markets has refiners wondering about potentially lower crude prices in the future: why buy now if the price will fall later?

Such things happen from time to time when society allocates its resources via markets. Sometimes prices rise; sometimes they fall. When Iraq invaded Kuwait in late 1990, oil prices shot up amid supply uncertainty. Politicians fumed, consumers fretted, but prices fell soon afterward as new supplies quickly became available. Something similar will happen now. In a few weeks, prices will fall as the supply crunch vanishes and refiners get hold of the crude oil they need to profit from our thirst for gasoline. Markets are good at solving such problems, though I predict nobody in the House or Senate will mention it.

Once the price falls again, the only thing left from the current debate may well be the repeal of the 4.3 cent tax, something which seems likelier with each day. By mid-summer, the price of gasoline will have fallen by 10 cents per gallon or more without any help from Congressional Republicans, but Bob Dole and his partisans will claim that the tax repeal was what did it. Never mind that a 4.3 cent-per-gallon tax reduction *cannot* reduce the price by more than 4.3 cents per gallon; politicians know the power of fervent assertion. We voters usually let them get away with it.

Of course, Republicans haven't cornered the market on economic silliness. Bill Clinton's release of crude oil from the federal government's strategic reserves will accomplish no more than Bob Dole's call to repeal the gas tax. It just seems worse when Republicans do it because they claim to be the party that supports free enterprise and free markets.

Maybe this is all just another example of our love-hate relationship with markets. Our secular religion tells us that free markets are an integral part of the American way of life. But if our sacred gas prices rise, all bets are off.