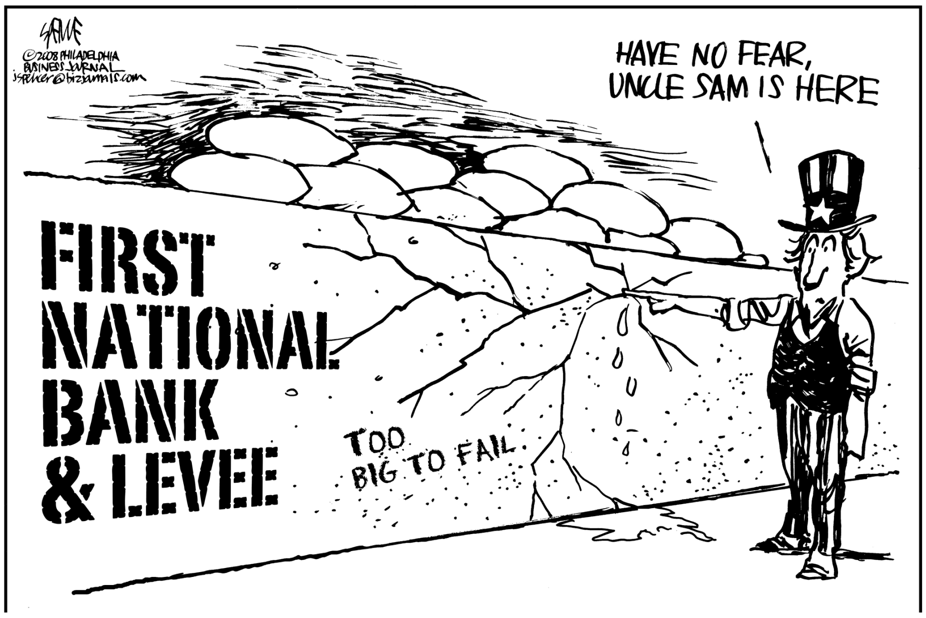
COMMENTARY



Mythbusting in a time of high gasoline prices

VIEWPOINT

ANDREW BROD

Oil prices have been rising steadily for six years, but only recently has the reality sunk in with consumers, business owners and politicians. Forking over $4 for a gallon of gasoline will do that. And now the media seem to be able to talk about little else. Mixed in with the keen insights are a few misconceptions.

We must conserve oil!

Nothing does a better job of revealing our collective ignorance about markets than calls for increased conservation when prices are really high. And yet that's precisely what well-meaning people are doing. Sen. John Warner, R-Va., has even called for the reinstatement of the federal 55-mph speed limit as a way to conserve gasoline.

This is silly. Calls for conservation fall on deaf ears when prices are low, and they're redundant when prices are high. For example, per-capita gasoline consumption in the first four months of this year was 17 percent lower than in the first four months of 2002, when prices had just started their upward trend.

To be sure, 17 percent is small compared to the near tripling of gasoline prices since 2002, but that's what happens with goods that are perceived as necessities. President Bush wasn't wrong when he said the nation is addicted to oil. But addicted or not, we are conserving, thanks to high prices.

The market isn't working!

Do high prices imply that oil markets are dysfunctional? We're hearing the usual populist accusations that Big Oil is preying on us, even though the oil companies would rather profit quietly and handsomely at $75 per barrel than deal with angry politicians and consumers.

Complaints about Big Oil are old hat. The new twist is claims that speculators are messing up oil markets. The CEOs of 12 major airlines recently sent e-mails to their frequent fliers asking them to lobby Congress to "stop oil speculation now!" Congress is listening and is looking into ways to limit "excessive" speculation in oil markets.

But oil prices are high precisely because markets are doing what they always do. Supplies are tight and demand is growing, especially in emerging economies, and the result is rising prices. Sometimes it's that simple.

Given low oil inventories, it's hard to justify blaming speculators. Speculation is pretty much defined as buying and holding in hopes of selling later at a higher price. This has to show up in rising inventories. But it's not.

In general, speculation promotes price discovery, i.e. it helps markets zero in on the right price.

The airline executives claim the opposite, that the problem is oil futures getting traded and retraded at ever higher prices. If so, they're describing a bubble. And the thing about bubbles is that they always burst. If the airline executives are correct, this problem will soon right itself.

We must start drilling!

There's no question that one solution to the problem of tight supply and burgeoning demand is more supply. But depending on the location, new offshore drilling may not produce significant quantities for 15 years.

Similar lags apply to investments in oil shale and tar sands. Does that mean those resources shouldn't be developed? Of course not. But none of them is a quick fix.

Besides, the amount of oil that will ever be produced by the United States is relatively small and will have little effect on globally determined oil prices. When you consider that we consume more than twice as much oil per person as other industrialized countries, it's clear that the real frontier is conservation. Fortunately, high prices are just the tool to make that happen.

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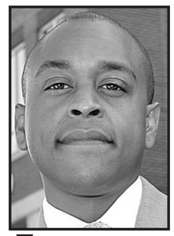
Current economy won't withstand hike on capital gains tax



GUEST COLUMN

ALGENON CASH

Recently, I watched with amazement as people lined up outside of a failed IndyMac Bank in California to withdraw their money.

I was 10 years old in 1989, during the savings and loan disaster. Thus, it's fair to say that the run on IndyMac was a milestone for my generation; an American bank has not failed since the early 1980s. Even the long-time warriors of Wall Street are not safe from the current crisis in the capital markets, which was proven when JP Morgan Chase was called in to bail out Bear Stearns, an 85-year-old investment bank.

Equity markets are in "bear" territory, in other words, 20 percent off the highs set in October 2007. Other financial institutions such as Lehman Brothers and Wachovia have virtually lost their market value and require more capital to aid in devaluing assets on the balance sheet and fatten reserves for future loan losses.

More than 30 years ago, Congress created Fannie Mae and Freddie Mac, government sponsored entities that own or guarantee $5.2 trillion in domestic mortgages, which equates to 50 percent of the total market. Investors are dumping their shares and bonds as they worry about the uncertainty in the real estate market and the ability of people to continue paying on their loans.

Without fresh capital, these mortgage giants will have a hard time buying and guaranteeing mortgages, which will cause even greater pressure in a weak housing market.

Pundits from CNN to Fox are busy convincing viewers that we should allow these institutions to take their "thumping" and clean out the markets. True, many investment banks took on too much leverage during the boom years, the amount of assets held by most firms is 30 times more than shareholder equity, or net worth. I agree these firms must reduce their leverage, but to do so, they have to raise more capital or sell assets.

Recent proposals to increase the capital gains tax rate, impose ordinary income tax rates on carried interest and raise taxes on the highest income earners comes at a terrible point in history. Doubling the capital gains tax rate at a time when the economic engines of this country, bank and corporations, are in desperate need for fresh capital will have dire consequences on a fragile marketplace.

We cannot rightfully call on the investors in our country to place capital in cash strapped institutions while simultaneously exposing them to more taxes on the money they earn from making these risky bets.

There are early indicators that real estate investors are uncertain about the agenda of the next administration and might begin to sell properties in a down market to take advantage of a favorable tax environment. More supply in a crippled housing market will only lead to further weakness. And as commercial property values slow and in some areas decline, more buildings for sale will begin to cause havoc in select markets.

Politicians call for change, but we will only see it when Congress reduces government spending and eliminates waste in the system. Reducing the corporate tax rate from 35 percent to 25 percent will help companies become more competitive against foreign counterparts and put Americans back to work.

Our elected leaders need to understand what many families are now learning — you have to spend less than you earn.

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