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Running on empty: Failing to address high gas prices

By Andrew Holland, senior fellow, American Security Project - 04/17/12 03:36 PM ET

The average price of regular gasoline around the country is $3.92 per gallon. This is the third time in four years that prices have spiked above $3.90 per gallon. Today, the American Security Project released a new report "Cause & Effect: U.S. Gasoline Prices" that looks more deeply at the root causes of today's high gasoline prices, and punctures some of the assertions and rhetoric that both political parties use about gas prices.

While Republicans offer legislation to expand domestic production of oil or remove regulations on energy production, Democrats call for tightening regulations of oil market manipulation and a release of oil from the Strategic Petroleum Reserve. Unfortunately, the global nature of the oil market means that none of these solutions will actually work to meaningfully and durably reduce gasoline prices.

It is true that the Republican policy of increasing domestic production of oil, by either opening up new federal lands for leasing or by reducing taxes or regulations on oil production, could produce more oil here at home. However, we should not expect that new production to reduce prices. The last five years should be an object lesson in this: domestic production of oil has increased by 20 percent since March, 2007, while U.S. consumption has dropped 12 percent. If changes in U.S. productionwere as important as Republicans or the oil industry makes it out to be, weshould have expected that time period to see a rapid fall in gasoline prices. Unfortunately, we know that the opposite happened.

The reason is because the U.S. is only a small part of a global oil market. Our domestic oil boom increased production by one million barrels of oil per day over the last five years, but -- even with a fall in American demand for oil – that was overwhelmed by global demand growth of 3.7 million barrels per day in that same time period.

Likewise, the policies of Democrats would also prove ineffective. Cracking down on “market manipulation” or “speculation” will not lower prices. Limiting financial speculation in oil markets could remove the ability of traders to drive prices up – but it also removes the ability of short-selling traders to drive prices back down. Moreover, in our age of globalization, limits on speculation in the U.S. would only drive trades to foreign centers like London.

Another short-term fix that will do little is releasing oil from the Strategic Petroleum Reserve (SPR). Last year’s release of oil from the SPR in response to the revolution in Libya reduced prices for a short time, but markets quickly adjusted and prices were higher within weeks. In addition, we should be careful about how we use our reserves: a release in the face of high prices would limit the ability of the government to respond in future cases of actual disruptions in supply, like a war.

There is one policy that will drive down gas prices in the short term, but neither party is talking about it: lifting the threat of conflict with Iran. Heightened sanctions on Iran are making it much more difficult for them to sell their approximately 2 million barrels per day of exports, but Iran’s threat to world oil markets does not lie solely with the oil it produces. They have threatened actions to block the Strait of Hormuz to sea traffic in response to an attack by either Israel or the U.S. This could stop over 15 million barrels per day (17 percent of total world supplies) of oil from reaching world markets – a catastrophic shock to global oil supplies. Just the threat of conflict has caused speculators to bid up the price of oil. If that risk premium were removed, prices would swiftly drop. So, in the short-term, the most effective policy to reduce gasoline prices is to find a diplomaticsolution to the Iranian nuclear crisis.

Over the longer term, the best response to price spikes is to develop alternatives to oil. Luckily, America can do this; we’re developing and commercializing the technology now that can reduce or replace the oil we need for transportation. Next generation biofuels, new electric vehicles, and increased fuel efficiency are succeeding in reducingAmerica’s dependence on oil. We need to sustain and accelerate these trends so that the next time the global price of oil spikes, it goes unnoticed by consumers here in the U.S.

Holland is a Senior Fellow for Energy and Climate at the American Security Project, which recently published “Cause and Effect: U.S. Gasoline Prices.”

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