Insight

Domestic Oil Policies Do Impact Oil Prices

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As of this writing, the national average price of gasoline is $3.93 per gallon as we head into a summer driving season that will ratchet up pressure on prices even further. Gas prices are a particularly important economic indicator because they impact the prices of all other goods: Anything that is shipped becomes more expensive as the price of transportation rises, so that relatively small changes in fuel costs can have drastic implications across the economy. And the fact that the demand for gasoline is quite inelastic in the short term means that it doesn't take much to trigger a change in fuel costs.

The very nature of the gasoline and oil markets — the incessant price fluctuations, predictable seasonal changes in demand, and the fact that it's a commodity that stores well — have made these markets attractive for speculators.

Oil speculation is essentially the process of betting on future prices. People who anticipate needing a good deal of oil in the future and want to guard against the uncertainty of higher prices can enter into a contract that — for a fee — allows them to lock in a price today. While some people use futures contracts to hedge against future prices, others actively offer to take the risk, and those people we call speculators.

If a speculator expects prices to rise in the future, he will make large investments in oil today that he may then sell at the later, higher price. For those with the means, there is much money to be made in this way, and the actions of speculators can and do influence the world price of oil. The expectation of higher prices leads to greater consumption which, like any increase in demand, leads to higher prices, creating a self-fulfilling prophesy.

It works the opposite way as well: If speculators began to anticipate prices falling in the future, they would want to sell their shares sooner rather than later, since delaying will force them to accept lower prices. This would result in an immediate increase in supply, which would in turn bring down prices today.

For this reason, the policies of any incumbent administration should be aimed at lowering the public's expectation of high gas prices. Putting aside the question of whether President Obama's energy policies are logically sound, it is impossible to deny that he has come to be viewed as "anti-oil." This perception, fair or otherwise, is in no small part contributing to the high gas prices at present.

The argument that the market for oil is a global one, and that no single country can influence prices by simply drilling and producing more may be technically correct, but it ignores the role of market expectations, which the White House plays a major role in setting. Increases in domestic production may not in themselves be large enough to influence global supply, but the optics of a country the size of the United States aggressively pursuing energy independence could certainly make speculators begin to think that future prices may fall — and act accordingly, which would in turn reduce current prices.

This November, voters will be forced to make a choice between two candidates. History has shown us that regardless of ideology or party affiliation, most Americans will ultimately base this decision on their level of personal comfort and satisfaction. Those who have decent jobs and a reasonably high disposable income will tend to favor the incumbent, while those struggling to stay out of debt while providing for their families will demand new leadership. If gas prices continue to go up, effectively raising the cost of living in the midst of an already sluggish recovery, the president may soon find that his battle for reelection has turned sharply uphill.

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