Gasoline Prices and a Lesson in Murky Internet Populism

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Article:

The Internet is fast becoming the way America talks to itself. Its low cost and relative anonymity are lubricants that encourage communication, but not necessarily high-quality communication. The result is the stream of jokes, spam, urban myths, and political polemics with which many of us are all too familiar.

So it's not often that one encounters an e-mail about applied economics. And yet that's exactly what came across my computer desktop recently.

It was one of those e-mails which had been forwarded and reforwarded, as evidenced by the number of greater-than signs arrayed along the left margin. The original author of the e-mail claims to have hit upon the solution to the problem of high gasoline prices. The solution? A boycott, sort of.

The author says, "we consumers need to take action. The only way we are going to see the price of gas come down is if we don't buy it." So far, so good. But then the author admits, "that's not really a practical option since we all have come to rely on our cars. But we CAN have an impact on gas prices if we all act together."

How can we accomplish this? By refusing to buy gasoline from the two largest companies, Exxon and Mobil. A parenthetical remark, which one suspects was added by a later contributor, notes that these two companies have merged. (How long has this thing been circulating?)

The e-mail goes on to claim that if Exxon Mobil (as the merged company calls itself) isn't selling gasoline, the company will have to lower its prices. Because it's the industry leader, the other oil companies will follow suit and lower their prices too.

Let's ignore the fact that Exxon Mobil is the industry leader because it sells a lot of gasoline, and if it doesn't sell gasoline it won't be the industry leader. The e-mail ends with the usual appeal to "send this to at least 10 people." So suppose everyone did pass this message on to others. Could this plan, if implemented by the masses, work? It seems so simple.

The quick answer: Nope.

The e-mail's clarion call is for us to reallocate our gasoline purchases, not to reduce them. Not much of a call to arms, is it? But an overall reduction would be too painful, since "we all have come to rely on our cars."

That means there would be no reduction in the aggregate demand for gasoline. But if the demand for gasoline doesn't fall, then the only way price can fall is if something increases the supply of gasoline. The question du jour: could this plan affect gasoline supply?

Let's assume the other oil companies, BP Amoco and Shell and all the rest, are operating at or near capacity, at both the retail and refining stages. If they aren't, they could absorb the extra demand for their gasoline without significantly affecting price. So by making this assumption I'm giving the plan at least a chance of working.

Imagine that the bulk of Exxon Mobil's customers switch to BP Amoco and the rest. If BP Amoco tried to handle its increased business with its own resources, it would be pushing up against its capacity limitations. For example, it could run its refineries 24 hours a day instead of 16, but no more than that.

The result would be a rising cost of each additional gallon of gasoline produced. And yes, that would indeed have an effect on prices at BP Amoco stations. But it would be an upward, not a downward, effect.

Most likely, BP Amoco wouldn't go it alone like that. Why put that kind of pressure on your own resources and be subject to rising marginal costs when there's excess capacity elsewhere in the industry? I'm referring, of course, to the suddenly slack capacity at erstwhile industry leader Exxon Mobil, which we're assuming would be having trouble finding buyers for its gasoline. It would be cheaper for BP Amoco to buy gasoline from Exxon Mobil, taking advantage of Exxon Mobil's lower marginal refining costs, than to refine the gasoline itself.

The e-mail's author claims that this partial boycott would force Exxon Mobil to lower its retail prices. But the company wouldn't do so, because it could do better by selling its gasoline to BP Amoco.

Now, maybe it would take a while for Exxon Mobil and the other gasoline retailers to set up these transactions and actually transfer the gasoline. Maybe in the short run Exxon Mobil would lower its prices. But it would be a short-run effect at best, because the overall market demand for gasoline would be unchanged. After all, nobody's talking about driving less. Besides, if Exxon Mobil caught wind of this plan (and you can bet the company is aware of that e-mail), it could start making appropriate arrangements ahead of time.

The bottom line is that the plan outlined in that e-mail would not work, at least not in the way intended. If it were to have any effect on gasoline prices, it would be to push them *up*, not down. But that shouldn't be a surprise. Why should we expect gasoline prices to fall as a result of a demand-side plan that doesn't reduce demand?

The subtext of that e-mail is that gasoline prices are high because of capricious behavior on the part of greedy oil companies. It's not us! It's them! This is economic populism at its finest. It's a simple and convenient theology, and it's found in abundance on the Internet, but it's usually wrong.

Gasoline is much cheaper now than 20 years ago, if one corrects for inflation. True, gasoline prices have swung upward recently, but there are reasons for this that have nothing to do with caprice or conspiracy.

Refining capacity in the U.S. has remained virtually constant for the last 15 years and is well below its high-water mark of the early 1980s. Capacity utilization rates have been over 90 percent for nearly 10 years, so the oil companies are working that capacity very hard. Gasoline inventories are low, and some recent cold winters led refiners to use more of their crude oil to produce heating oil and less to make gasoline. And that crude oil is expensive, as OPEC is managing (for now) to maintain discipline and keep prices high. Finally, the demand for gasoline has been soaring, fueled by those historically low prices and the still-expanding economy.

There's no quick fix to the problem of high gasoline prices. The real demand-side solutions will require addressing such tough issues as suburban sprawl, fuel-mileage standards, and mass transit. In comparison, this call for a no-pain boycott has no more substance than the usual jokes and urban myths we get via the Internet.

But if you're still yearning for a sure-fire grassroots strategy to lower gas prices, I have one in mind: trade in those SUVs for fuel-efficient cars, and drive less.

My plan may not be easy, but it's simple.