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Gas Prices

The price of gasoline in the United States spiked in spring 2011, and consumers and businesses alike were forced to deal with costs sometimes above $4 per gallon. Given that I recall hauling our camper across the Midwest when prices peaked a bit higher than this, I notice it but did not think much about it until the media onslaught began. This made me think about why I was an outlier. That's not unusual for me, but it seems like a little advance planning can go a long way.

Nearly every country in the world places taxes on gasoline (or petrol). In the US these taxes are very low compared to similar taxes in Europe. This is one reason why fuel efficient cars have been much quicker to catch on in other parts of the world.

Volatility

Consumers see the price of gas every day as they drive their normal commute. It jumps out at them. If you ask how much a dozen eggs cost they probably can't tell you, but everyone knows the price of gas and if it has risen in the last week. Would gas station owners be better off not posting their prices? Would their sales go down, or would their reputation as honest local businessmen with stations convenient to neighborhoods keep their sales steady? We won't know until this strategy is tried, but I think it might just work.

So gas prices are in your face every day. How should you manage this cost as a consumer or a small business? In my opinion, gas prices cycle within a normal range while following an underlying secular trend. In my 2011 financial predictions I shared my thought that the normal range for oil prices are $80-$120 per barrel. Comparable gas prices might have a top end of $4.50 per gallon.

Consumers would sleep better at night if they thought of $4.50 per gallon prices as normal and planning accordingly. Instead of worrying about how the price might change from week to week, which freezes thinking and leads to conservative decision making, these prices would seem stable and lower prices would be a happy bonus. It is all about perceived prices and inflationary expectations. An alternative would be for the government to step in and maintain a $4.50 per gallon nominal cost (after taxes), but I tend to prefer the tax strategy where I get to keep the money.

Businesses have the same behavioral tendencies, leading to uncertainty and fear. Decision making would be much more useful if a stable yet conservative price was used for tactical planning. Of course for strategic planning purposes you will want to develop a number of scenarios that include a variety of gasoline prices, especially if your firm has a fleet and gas cost is material.

Longer Term Solutions

In the long run, oil will run out. With natural gas prices so low, we should be moving toward this alternative in parallel with efforts to use electricity to fuel cars. It is not clear to me that less of a carbon footprint is left when we burn coal to make electricity, but North America is awash in natural gas. In Omaha several public natural gas stations will open soon for those who have converted their vehicles. It seems like there should be more discussions of this methodology.

Another alternative is the European solution. They have added surcharge taxes to artificially increase the price of gas and lower demand. The US would need to make the tax high enough to affect behavior, beyond the normal range discussed earlier in this paper.

Related Material

I was interviewed on this topic by USA Today reporter Gary Strauss. You can find the article at http://www.usatoday.com/money/industries/energy/2011-05-19-gas-prices-poll_n.htm

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