Lower Gas Prices Coming?

An October 25 article for CNBC predicted that gas prices, down significantly from where they were in April, would continue to slide by at least another 10 cents per gallon, perhaps more. That would bring the national average price, currently at $3.29 a gallon, closer to $3, with some places in the country enjoying even lower prices. Drivers in Missouri are already paying just $2.92 a gallon, and half the country "could soon find gasoline prices at the pump below $3 a gallon," according to Tom Kloza, chief oil analyst at GasBuddy.com.

Reasons for the slide abound. Gasoline demand usually drops in the fall, things are (for the moment at least) relatively quiet in the Middle East, and Superstorm Sandy drove gas prices higher a year ago. Crude oil prices have dropped from nearly $110 a barrel in April to under $98 as of October 30, and gas prices follow crude prices closely. Many refineries have closed temporarily to change over to winter blends which means that oil inventories have risen to compensate. Cars are more efficient and people are driving them less. And then there's the explosion in production thanks to fracking technology, which is fueling the "Great American Energy Boom", as economist Mark Perry calls it.

But what is the real cost of gasoline? Unleaded gas first hit the $1.00 a gallon level in 1998 and, adjusted for inflation since then, gasoline today, everything else being equal, should cost $1.44 a gallon. Instead, it's more than twice that, and consumers are feeling it. Back in 1998, consumers spent $1,000 a year on gas, or about two percent of their household income. Now they're spending more than $2,900 a year on gas, or about four percent of their income. What's going on?

It's helpful to know, first of all, that out of every 42-gallon barrel of oil, only 19 gallons of gasoline are produced. The rest goes into some 6,000 other products including golf balls, toothpaste, soap, aspirin, life jackets, guitar strings, shoes, soccer balls, panty hose, and Louis Vuitton knock-offs.

Secondly, although the U.S. production of crude is skyrocketing, the country still has to import between seven and eight million barrels of oil every day. And some of that comes from unfriendly countries far away who charge a lot for the privilege. Canada, a friendly, sells between two and a half and three million barrels to the United States every day, with the balance made up by Saudia Arabia (1.2 – 1.5 million), Mexico (0.8 – 1.0 million), Venezuela (0.8 million) and Kuwait (0.3 to 0.5 million), and others who charge higher prices.

And the new production coming on line from North Dakota, Pennsylvania, and Texas is costly to produce. The low-hanging fruit in the oil patch has been harvested and it now costs an estimated $75 a barrel to extract the new shale oil. Once it is extracted it must be transported, sometimes over long distances, to refiners. As production has exploded, so has rail car traffic, increasing from just 9,500 rail cars of oil in 2008 to over 400,000 in 2013. Not only is this more expensive, it is more dangerous.

And then, of course, there are the inevitable taxes. Buried in the cost of crude are the income taxes paid by the oil industry at every step of the way from explorers to producers to refiners to retail gas stations.

And then, the crowning indignity: All of that is taxed once again, both at the federal level (18.4 cents per gallon) and the state and local levels (averaging 30.4 cents per gallon) for a total averaging 49.5 cents per gallon at the pump.

If the price of gas does drop to $3 a gallon over the next few weeks and months, just 63 percent of it will go for the crude. The rest will go for refining, distribution, marketing and taxes. What's clear is that gas won't be going back to a dollar a gallon where it was in 1998.

A graduate of Cornell University and a former investment advisor, Bob is a regular contributor to The New American *magazine and blogs frequently at www.LightFromTheRight.com, primarily on economics and politics. He can be reached at badelmann@thenewamerican.com.*