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Obama's Oil Ploy

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As gasoline prices have soared to $4 a gallon, putting a pinch on consumers' wallets and President Obama's approval ratings, the president has been casting about for a convenient scapegoat. He's found one in oil market speculators, whom he charges with driving up the price of crude oil and gasoline.

In response to speculators' supposedly sinister machinations, Obama this week urged Congress to crack down on speculation by stepping up surveillance of energy futures traders and increasing the penalties for those convicted of manipulating Congress. No doubt the move will convince Obama's supporters that he is "doing something" to bring down gas prices. In truth, the crackdown on oil speculation, not unlike Obama's recent campaign for a "Buffet rule" tax on millionaires, is little more than a cheap political ploy. Laws are already in place to regulate market manipulation, making Obama's crackdown largely symbolic. The bigger problem, though, is that there is little connection between rising oil and gas prices and speculation in energy futures markets.

That's not to say that oil speculation has no effect whatsoever on gasoline prices. But since those prices are ultimately determined by the laws of supply and demand, the only way that oil speculation can influence gas prices is by impacting the supply of oil and gasoline available. Thus, if oil producers expect prices to rise in the future, they may keep oil from the market in the hopes of selling it at a premium. That in turn could lead to diminished supply and increased prices at the pump.

Unfortunately for Obama's anti-speculation crusade, there is no evidence that this scenario is actually happening. Cato Institute scholars Jerry Taylor and Peter Van Doren observe that if speculation were having the effect on gas prices that Obama claims, we would see a buildup of inventory among crude oil producers. Instead, crude inventories have remained within the normal range. Even more significant is that gasoline inventories, rather than increasing, have actually been decreasing at a faster-than-average rate. Consequently, Taylor and Van Doren note, "there's no evidence that speculators are reducing the supply of crude or gasoline through increased storage." To be sure, inventory rates might not be a meaningful indicator if producers were instead curbing production in anticipation of future price increases. Yet there is no evidence that this is happening, either.

As it happens, there are external factors limiting the supply of oil on the global market. But the true culprit is not oil speculation but geopolitics. Oil analysts point out that due to disruptions in production in strife-torn countries like South Sudan, Yemen and civil-war-engulfed Syria, at least a half a million barrels of oil a day are being withheld from the global market. A precipitous drop in crude oil production in Libya following a complete shutdown last year has cut the global supply by another 2 percent. Combine that with a fall in spare oil capacity and the result is a 20 percent increase in oil prices just since December. Prices may rise even more as a policy that President Obama (along with most Republicans) has supported – new sanctions on Iran intended to curb its nuclear weapons program – goes into effect.

Obama's strategy of blaming speculators for price increases is thus a serious misdirection, ignoring the role that global politics, and his own policies, have on oil prices. But it's actually worse than that. Not only does a crackdown on oil speculators miss the true causes of the problem but it risks making it worse. According to energy consultancy HIS, a crackdown on speculation – for instance by enforcing the Volcker Rule limiting speculation in the Dodd-Frank Act – could send ripple effects throughout the economy, lowering energy production, increasing gasoline prices, and killing jobs. HIS points out that many oil refineries depend on their banks' futures strategies to protect them against fluctuations in oil prices. If those refineries are denied access to the banks' capital because the banks can't speculate on oil futures, the refineries could be forced to close. That would mean that more gasoline would have to be imported from abroad, raising gas prices. And high gas prices, as Obama well knows, are a drag on employment and economic growth.

It's tempting to think that increased domestic production could bring down oil prices. But even then, analysts say, the benefits would be long term rather than immediate. Permitting more U.S. oil fields, as Obama has refused to do, would clearly increase domestic production, but the lead times between discovering oil and putting it into production can stretch into years and even intodecades. Meanwhile, oil boom states like North Dakota have an outdated pipeline and a lack of infrastructure that makes it difficult to collect, process and transport extracted oil and gas. "Drill, baby, drill!" may be a good political slogan, but in the near-term at least, it's not a solution to high gas prices.

Still, it's a vast improvement on Obama's strategy of targeting a non-problem. Given that high gasoline prices correlate with voter discontent, it's not surprising that the president would make reducing prices a top priority. But the crackdown on oil speculators won't achieve that result and should be seen for what it is: a triumph of election-year politics over sound energy policy.