

# Gasoline Prices in the U.S. in Perspective

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## Introduction

With the run-up in gasoline prices the past few years, I've heard plenty of complaining that gasoline is too expensive. I will try to show why this is a slightly ridiculous complaint to make.

First off, keep in mind that the price you pay at your local gas station is largely set through market forces. If the oil companies were really so powerful that they could arbitrarily raise prices just because they were greedy and didn't like you, they would have done so during the bust in the late nineties, when the price was at \$0.21 per liter, rather than the more recent \$0.82.

Retail gas stations in particular compete quite vigorously, and they generally do not see the kind of profits that the large oil companies recently made. The retail stations likely make more money when prices are *falling*, when customers are paying less attention to the price.

Second, remember that in a free country such as this, no one is forcing you to buy gas in the first place. We all make decisions about where we live and work, what kind of transportation to use, and what kind of compromises we will accept. The fact that you continue to buy gasoline indicates that you still think it's worth the money.

## Costs of the car culture vs. what you pay

When you spend \$10 on a book, you are giving the publisher and the author the money in exchange for the trouble that they took to write the book, print it, and give it to you. When you buy gasoline, you give money to a company in exchange for parting with the fuel that they owned. However, there is an important difference.

For you to read the book does not cost society anything. In contrast, when you drive down the road in your car, you incur additional costs on society beyond what you have paid for. Cars cause an immense amount of air pollution and contribute to global warming. They are noisy. They kill a quarter of a million people around the world every year. Vast amounts of land are devoted to roads and parking facilities (just look at how much space, next time you are at a major intersection), and this infrastructure must be built and maintained. Oil revenue also props up governments that support terrorism or that repress their people.

Economists call these kinds of costs "externalities". Government can help balance the cost of these externalities if they adjust prices through taxes—if driving a car a certain distance

causes \$100 worth of pollution, for example, the government can charge people \$100 to drive that distance. The cost to the driver would then match the cost to society, and everything is fair.

The easiest ways for the government to charge people for the right to drive are through mechanisms such as tolls, registration fees and taxes, and gasoline taxes. In my view, the amount that drivers are actually charged is much less than the actual cost of the externalities. It follows, then, that each of us is getting a free pass when it comes to using our cars—the government is actually subsidizing your trip by not charging you its full cost.

### **The fairness of a high gas price**

It has been suggested that charging a much higher price for gasoline would place an undue burden on those who use it “responsibly” or who “need” to drive. It is those who “waste” gas who should pay for it.

Any economist would be able to explain why it is hard to define what a “need” is and what constitutes “waste”, but I will let that slide for this essay. Suppose we accept that everyone should be entitled to do some driving, but that we should still have higher prices to signal the true cost of driving. Is there a way to have high prices without penalizing people who only drive a little? Certainly.

The government could simply allot a certain amount of gasoline to each person so that they can get to work, but then allow people to buy more gas at a high price if they want to drive a Hummer or drive places they don't “need” to go. For example, suppose the government hands each person 50 liters of gas per month, but then taxes gasoline so that the price is \$2 per liter (\$7.56 per gallon). That way, “responsible” people would buy an efficient car and use the 50 L carefully. If someone wanted to “waste” gas, they could do so, but they would pay for it. The revenue from the tax could pay for the allotment.

Now, it might be a lot of work for the government to deal with the logistics of giving 300 million people their monthly allotment of gasoline, so we could just do it indirectly as so: if gas is \$2/L, and we want to give 50 L to each person, why don't we just give everyone \$100 a month and let them buy the gas themselves? In fact, they wouldn't even have to buy gas with the money if they didn't want to. If they only needed 25 liters, they could use the rest of the money for something else.

There are a couple of ways that the government could give everyone \$100 a month or \$1200 a year. If the income tax rate is 25%, then that is the amount of money the government collects when you earn \$4800. So, if we ignore for a moment the people who don't work, we could in effect give everybody 50 liters of gasoline a month at \$2 per liter if we just allowed people to skip paying taxes on \$4800 of their income every year...which is exactly what the government

does. The standard deduction for 2004 was \$4850. The government already gives you free gasoline! So what is there to complain about?

### **What is the point?**

Basically, there are a few points I'm trying to make from the above arguments and the hypothetical example.

- 1) Your driving incurs a cost on society that you are not paying, so complaining about the price that you do pay makes little sense.
- 2) Prices can be readily manipulated by the government to correct market failures (externalities).
- 3) Gasoline should be taxed so that it is much more expensive than it already is, to bring the price of driving in line with its cost.
- 4) A higher price for gas would not be unfair, even for responsible users or for the poor—they already get enough benefits from society to make up the difference.
- 5) If you don't like the idea of taxes causing high gas prices, just think of it this way. They government needs to get revenue somehow. If it taxes income, it penalizes people for working. If it taxes gasoline, it penalizes people for using a non-renewable resource that contributes to global warming and that supports rich, spoiled Saudi princes and distasteful Venezuelan presidents.

### **What is gasoline really worth? What's the alternative?**

Gasoline contains an enormous amount of energy—but cars use a large amount. One liter of gas can send a car perhaps 12 kilometers (maybe 10-12 minutes of driving in suburbia). That same amount of energy could propel a bicycle about 350 kilometers, which is the distance between Washington, DC and New York City. Americans consume a vast quantity of resources with their car-reliant lifestyle.

That reliance will probably be challenged in my lifetime, because the oil really will start running out. Even the über-optimistic Exxon Mobile Corporation does not predict oil production past 2030—within the timeframe of a mortgage taken out today. So, expect to remember today's cheap gasoline with fondness.

We built the car culture in one century, and I expect it to change significantly in the next. If Americans lived closer together and used transit, biking, and walking, we would save money, be healthier, have a cleaner world, and suffer fewer fatal accidents. There could be worse fates.

If we spent billions of dollars doing these things instead of "fighting terrorism", we would save many more American lives and improve our quality of life.

So no, I don't complain about high gas prices.