UW Economist: High Prices at the Pump to Last for Months

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As President Bush Tuesday called for temporarily halting deposits to the nation's strategic petroleum reserve to make more oil available for consumer need and has ordered investigations into whether the price of gasoline has been illegally manipulated, a University of Wyoming economist says fuel prices traditionally do not fall until at least Labor Day.

"Right now, we are seeing about a 20-30 cent increase over last year's prices. This increase reflects unease over the situation in the Middle East. Assuming that situation does not change markedly, I think prices this summer will run somewhere between 25-50 cents higher than last summer," says Charles Mason, professor in the UW Department of Economics and Finance. "But the 'feds' releasing significant quantities from the emergency reserve will mean that near-term prices would be reduced somewhat."

As of Tuesday nationally, the price of unleaded fuel was $2.91 per gallon, according to the American Automobile Association (AAA) daily fuel gage report. Mid-grade fuel prices averaged $3.09 per gallon and premium $3.21, according to AAA figures.

The talk of gas prices climbing to $3.50-$4 per gallon this summer may have Wyoming residents bracing for the worst-case scenario, but Cowboy State residents are enjoying the lowest gas prices among the 50 states. As of Tuesday morning, unleaded averaged $2.54 per gallon, according to AAA figures, while mid-grade was at $2.65 and premium

$2.82. Five states are reporting regular unleaded gas at more than $3 per gallon, with Hawaii the highest at $3.23.

Mason says the market for crude oil is dominated by a small number of state-run enterprises collectively know as OPEC, accounting for a large chunk of the supply. He adds that two factors control the recent spike in prices at the pump -- uneasiness in the Middle East and the demand for fuel in summer months.

“There is considerable nervousness about the situation in the Middle East. It seems that the money men in the oil business think there is a decent chance of some sort of conflict in that region, principally related to Iran,” he says. “Going back to the two Gulf Wars, in each case we saw large price increases just before the start of hostilities, which persisted throughout the hostilities. Some sort of conflict involving Iran would likely have a similar effect here. So, anticipation of potential conflict is an important contributing factor.”

Mason says the second issue is the traditional increase in demand that takes place during summer months -- higher fuel demand generally translates into higher prices at the pump.

“This happens every year, with prices starting to rise in late spring. But it cannot explain large wedges in price between this year and last at or about the same time -- those changes would have to come from somewhere else, such as fears of armed conflict in the Middle East,” he says.

“There are other minor contributing factors such as fears of hurricanes and possible constraints related to refining capacity, but I doubt these play much of a role. As with anticipated increases in summer driving, they do not strike me as new effects, so I don’t see how they can explain recent price surges,” Mason adds.

Unless the volatile situation in the Middle East eases and no disaster strikes in the United States, such as Hurricane Katrina a year ago, Mason doesn't expect gas prices to drastically fall until the end of summer.

"The things that might lead to lower prices would be a political resolution of the tension involving Iran, or rather large increases in OPEC's production," he says. "But as a general rule, prices peak in middle August and prices traditionally fall after Labor Day."

Source: University of Wyoming