

Economics of Prices

An independent view of nuclear power – see below.

Human Events
May 30, 2006

Here's what one reader wrote: "Williams, I can understand how the destruction of Hurricane Katrina and Middle East political uncertainty can jack up gasoline prices. But it's price-gouging for the oil companies to raise the price of all the gasoline already bought and stored before the crisis." Several other readers made similar allegations. Such allegations reflect a misunderstanding of how prices are determined.

Let's start off with an example. Say you owned a small 10-pound inventory of coffee that you purchased for \$3 a pound. Each week you'd sell me a pound for \$3.25. Suppose a freeze in Brazil destroyed half of its coffee crop, causing the world price of coffee to immediately rise to \$5 a pound. You still have coffee that you purchased before the jump in prices. When I stop by to buy another pound of coffee from you, how much will you charge me? I'm betting that you're going to charge me at least \$5 a pound. Why? Because that's today's cost to replace your inventory.

Historical costs do not determine prices; what economists call opportunity costs do. Of course, you'd have every right not to be a "price-gouger" and continue to charge me \$3.25 a pound. I'd buy your entire inventory and sell it at today's price of \$5 a pound and make a killing.

If you were really enthusiastic about not being a "price-gouger," I'd have another proposition. You might own a house that you purchased for \$55,000 in 1960 that you put on the market for a half-million dollars. I'd simply accuse you of price-gouging and demand that you sell me the house for what you paid for it, maybe adding on a bit for inflation since 1960. I'm betting you'd say, "Williams, if I sold you my house for what I paid for it in 1960, how will I be able to pay today's prices for a house to live in?"

If there's any conspiracy involved in today's high gasoline prices, it's a conspiracy of cowardice and stupidity by the U.S. Congress. Opening a tiny portion of the coastal plain of the Arctic National Wildlife Refuge in Alaska to oil and gas production, according to the U.S. Geological Survey's mean estimate, would increase our proven domestic oil reserves by approximately 50 percent. The Pacific, Atlantic and eastern Gulf of Mexico offshore areas have enormous reserves of oil and natural gas, but like the Alaska reserves, they have been put off limits by Congress. Plus, the U.S. Office of Naval Petroleum and Oil Shale Reserves estimates the world supply of oil shale at 1.6 trillion barrels, of which 1.2 trillion barrels are in the United States.

Because of costly regulations and political restrictions, U.S. nuclear energy production is a fraction of what it might be. Nuclear power creates 75 percent of France's electricity, nearly 50 percent of Sweden's and only 20 percent of ours. Nuclear energy is very safe. That's something to keep in mind when we hear of tragic deaths of coal miners. There would be fewer mining deaths if we used less coal and more nuclear power for electricity generation.

You say, "What about the effect on prices of all those oil company profits and CEO pay and retirement benefits?" If Congress mandated that CEOs work for zero pay, gasoline prices would fall by less than a penny. If Congress mandated that oil companies earn

zero profit, gasoline prices might fall by 10 cents; of course, we'd have to worry about gasoline availability next year.

CEOs tend to be cowards when dealing with politicians and environmental extremists, but I have a recommendation that requires only a modicum of courage. At each gasoline station they should put up photos, perhaps videos, of penguins, caribou, polar bears and other critters frolicking along Alaska's coastal plain. Then have a voice-over or caption reading:

Don't be selfish. Your paying \$3, \$4 and \$5 a gallon for gas keeps these critters happy and their play space clear of oil rigs.