

RUNNING ON EMPTY: THE EFFECTS OF HIGH GASOLINE PRICES ON SMALL BUSINESSES

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UNITED STATES

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WEDNESDAY, MAY 9, 2012

HOUSE OF REPRESENTATIVES,
COMMITTEE ON SMALL BUSINESS,
Washington, DC.

The Committee met, pursuant to call, at 1 p.m., in room 2360, Rayburn House Office Building. Hon. Sam Graves [chairman of the Committee] presiding.

Present: Representatives Graves, Chabot, Tipton, Ellmers, Walsh, Barletta, Velázquez, Schrader, Cicilline, and Hahn.

Chairman GRAVES. We will call the hearing to order. Good afternoon, everyone. I want to thank you all for joining us for this hearing and I want to thank our witnesses for appearing today and agreeing to testify on an issue that just will not seem to go away, and that is higher fuel prices.

Few things have such broad effects on consumers, the economy, and small businesses as high fuel prices. The price of gasoline often determines where and when consumers are going to shop and what it costs a small business to deliver products and services and the costs of purchasing materials and other inputs necessary from business operations. When consumers have less money to spend and small businesses are forced to shift resources to fuel purchases or pay higher prices for inputs, weaker economic growth is often the result.

Last Friday, the Department of Labor reported that the unemployment rate remains above eight percent and the economy has created far fewer jobs than expected. This figure does not even count the millions of long-term unemployed Americans who have given up trying to find work. That is not included in official statistics, nor does it account for the millions of underemployed Americans.

While there are many factors to explain the weak economy and job growth, high fuel prices are a contributing factor. And given the importance of energy prices to the health of small businesses and the economy, this Committee has taken particular interest in the effects of high fuel prices on small businesses and the role they can play in helping solve the problem of high energy prices, create jobs, and enhance our nation's energy security.

This hearing continues that trend and we are fortunate to have with us today a panel of witnesses who can provide the Committee with important insight into the causes of high fuel prices and how they affect small businesses. With that I will turn to Ranking Member Velázquez for her opening statement.

Ms. VELÁZQUEZ. Thank you, Mr. Chairman. As our economic recovery gains steam, this Committee must focus on removing obstacles to small business growth. One key hurdle is volatility in gas prices. With prices for petroleum and gasoline rising one day and plummeting the next, it can be very difficult for small firms to plan and make prudent investment decisions. In particular, when there is a rapid run-up in gas prices, small firms feel the pinch. Indeed, three-quarters of small businesses note that rising energy prices will have a negative impact on their businesses. There have been even estimates that for every \$10 increase in the price of a bottle of oil, \$29 billion is sucked out of the economy. That is money which could have gone toward growth and job creation. When energy prices are high, small firms face tough choices. Do they raise prices for their products to upset gasoline costs? Or do they alternatively postpone hiring in order to compensate for rising expenses? None of these are good options. It is my hope that the Committee can explore solutions for the effects energy costs have on entrepreneurs.

When it comes to gas prices there is not just one reason that can be solely blamed for the volatility; instead, a range of factors feed into this unpredictability. Instability in all regions can result in significant supply disruption as we have seen with recent events in the Middle East and North Africa. Oil supply disruptions can be further compounded by a reduction in refinery capacity, meaning that even when oil supplies remain steady, less gasoline is available on the market and prices remain high.

These supply-based factors certainly contribute to rising gas prices. However, there is also strong argument to be made that excessive speculation is also to blame. Certainly, energy futures markets play a valuable role by enabling energy consumers like airlines or railroads to hedge against price fluctuations. However, today the largest actors in these markets are no longer energy consumers. Instead, market activity is dominated by players concerned only with betting on whether prices rise or fall. When these speculators hold such influence that they can single-handedly affect overall pricing, then it is questionable whether the future markets are functioning correctly or serving as a consumer with consumers and small businesses paying for bad bets.

Just as a range of factors are driving up gasoline prices, there is no single solution that will solve the problem alone. Instead, we need a multi-prong approach that addresses supply, consumption, and speculation. We can start by leaving in place the Wall Street Reform Law that was enacted last Congress. By giving the Commodity Futures Trading Commission more power to prevent unscrupulative behavior, this law will stop some of the deceptive practices we have previously seen. Other short-term steps might include releasing oil from the strategic petroleum reserve, instituting a gasoline tax holiday, and expanding the use of oil shale. All of these ideas have drawbacks and advantages and all of them merit further discussion.

Over the long term we need to reduce demand and boost supply. Helping small businesses become more energy efficient should be a priority. Achieving that goal makes businesses more profitable while lowering energy prices for everyone. There will also need to

be discussions about expanding our energy supply through either fossil fuel exploration or expansion of renewable fuels. Entrepreneurs have always been on the cutting edge of developing new energy sources, and they should have a voice on how we proceed in this area as well.

As consumers prepare for another summertime driving season, we can expect gas prices to remain volatile. For small businesses, unpredictable fuel costs can at best stunt job growth and at worse result in layoffs. It is my hope that today's discussion yields insight on how to help small business firms overcome these problems now while laying the groundwork for long-term energy security.

And with that I want to take this opportunity to thank all the witnesses for being here today. I yield back. Thank you, Mr. Chairman.

Chairman GRAVES. With that we will hear from our witnesses. You each have five minutes. The way the lights work is it is green and when you have a minute left it turns yellow and then red when time is up.

STATEMENTS OF ROBERT McNALLY, PRESIDENT, THE RAPIDAN GROUP, LLC; JAMIE SMITH, FRANCHISEE, MR. ROOTER PLUMBING, BALTIMORE, MARYLAND, TESTIFYING ON BEHALF OF THE INTERNATIONAL FRANCHISE ASSOCIATION; C. COOKIE DRISCOLL, OWNER, C. COOKIE DRISCOLL, INC., FAIRFIELD, PENNSYLVANIA, TESTIFYING ON BEHALF OF THE NATIONAL SMALL BUSINESS ASSOCIATION; MICHAEL GREENBERGER, LAW PROFESSOR AND DIRECTOR, UNIVERSITY OF MARYLAND CENTER FOR HEALTH AND HOMELAND SECURITY, BALTIMORE, MARYLAND

Chairman GRAVES. And our first witness is Bob McNally. He is the founder and president of the Rapidan Group, an independent energy and consulting market advisory firm. And prior to forming the Rapidan Group, Bob served on both the White House Council of Economic Advisors and the National Security Council during the Bush Administration.

Mr. McNally, I appreciate you being here and look forward to your testimony.

STATEMENT OF ROBERT McNALLY

Mr. McNALLY. Thank you, sir. Chairman Graves, Ranking Member Velázquez, Members of the Committee, thank you for the opportunity to testify. I have spent the bulk of my career analyzing energy oil markets and economic policymaking and as was mentioned, served in the White House NIC and NSC. I currently run a small businesses called the Rapidan Group. I do not represent any entity. The views are entirely my own.

The subject of today's hearing is gasoline prices which have risen sharply now six years out of seven and pose a special burden for our country's small businesses. But before then, gasoline as pretty boring. If you think about it, from the 70's until recently, if it was a Disneyland ride, the pump price is sort of like It's a Small World—gentle, uneventful, not really noticeable. But since 2005, it has been It is a Small World. Excuse me, Space Mountain. Gut wrenchingly volatile, scary. And today, as pump prices resume

their ascent, Americans, especially small businesses, are wondering why are we on Space Mountain and how are we going to get off?

Let me come right to the point. Gasoline prices are driven by crude oil prices. Crude oil prices are driven by a global market. Official data reports show that global market is tight. Demand is historically high and strong in the global market—not in the United States, in the global market. Supply is disappointingly small. Commercial inventories outside of North America are low. Numerous supply interruptions as was mentioned have occurred and OPEC's spare capacity which we will talk about today is much lower than estimated a few months ago and too low for comfort.

And earlier this year a rash of refinery closures in the Northeast, the U.S. Virgin Islands and Europe and tensions surrounding Iran's nuclear program contributed to a risk premium or a fear premium on the price of crude.

It is crucial to understand that crude oil prices are naturally very volatile. To help suppress this natural volatility throughout history since the mid-1800s, late 1800s, producers have held back spare production capacity to temper down that volatility. Spare capacity is supply from fields that can be quickly tapped to act as a shock absorber when demand is strong and disruptions occur, avoiding the otherwise normal large swings in prices we would see.

Since the late 1980s, OPEC has used spare capacity to try and stabilize prices, but over the last seven years or so, OPEC's spare capacity is showing that red line on that chart has fallen and remains much too low to stabilize the market, especially given geopolitical risks. The reason is a mix of voracious, relentless demand growth in fast growing Asia and the Middle East on the one hand and disappointingly small net supply growth on the other. While experts differ, many see this strong demand, weak production, tight spare capacity predicament lasting for the foreseeable future. And if so, oil prices are going to keep on gyrating and so are fuel prices.

There is no short-term silver bullet for our predicament. Using the SPR to smooth gasoline prices absent the severe supply disruption would be deeply unwise and counterproductive. The SPR and Department of Energy are not well suited to stabilize global oil prices. Reserves are too small relative to market flows. Information is too poor, and the SPR interventions have and would be politicized. If Washington sold SPR crude every time gasoline prices rose, we will end up with no SPR, more volatile prices, and less protection when a severe supply interruption occurs.

It would also be a mistake to misdiagnose the problem of gyrating oil prices as one of manipulation, distortion, or undue influence of financial market participants. Officials have repeatedly investigated the role of the financial market participants in recent oil price behavior and concluded that supply and demand fundamentals played a major role. This includes an interim interagency report headed by the CFTC in 2008. Leading academics also note there is no compelling data or analysis that shows the actions of financial market participants have caused the major price swings we have seen in recent years.

In the future, small businesses will need to hedge more in response to gyrating oil prices. They will need access to bigger and

deeper financial markets where producers and consumers can transfer price risk to those willing to take it. We are now seven years into the Space Mountain era of gasoline prices. It is time to get beyond blame games and on with solutions. OPEC oil companies, industry, investors, EPA, consumers, geopolitical trends, central banks, poor data, all this play a role. But the real reason is we have a tidal wave of demand, humanity's largest ever demand, humanity's largest ever demand, surge for oil is colliding with a supply constraint. We may not like the laws of economics but we will have to live with them. It is past time to enact easy common sense steps like improving data to bolder ones such as vastly increasing domestic and international supply, moderating demand, and strengthening a resilience to price gyrations. We should act quickly and resolutely as if the vitality of our small businesses, our standard of living, and our national security depended on our success. Thank you.

Chairman GRAVES. Our next witness is Jamie Smith. Mr. Smith owns and operates a small 10-employee Mr. Rooter Plumbing franchise located in Baltimore, Maryland. He is testifying today on behalf of the International Franchise Association. Mr. Smith, I appreciate you being here. Thank you.

STATEMENT OF JAMIE SMITH

Mr. SMITH. Thank you. Chairman Graves, Ranking Member Velázquez, and members of the Committee, thank you for your invitation to testify today at today's hearing on the effects of gasoline prices on small businesses.

My name is Jamie Smith. I am a franchisee of the Mr. Rooter Plumbing Corporation. I am the owner and general manager of Mr. Rooter Plumbing of Greater Baltimore and a member of the International Franchise Association.

I believe my experience as a small business owner and my struggles with rising fuel prices are representative of the small business community today. Many businesses are struggling to incorporate these increased costs into business plans that are already strained by decreased revenues due to the slow economic recovery. My business offers heating and plumbing solutions to the Greater Baltimore and Maryland area and I employ 10 plumbing and office professionals.

My current fleet of five service vehicles uses an average of 1,200 gallons per month of gasoline, and the cost of this fuel equals approximately 10 percent of my total revenue.

Since opening my operation in 2010, I have seen a 29 percent increase in my fuel costs at a time when my revenues have declined. In an effort to offset rising fuel prices, I have added an \$11 fuel surcharge to all of my service calls; however, many customers have refused to pay this charge and several potential customers disapproved so vehemently of this practice that they refuse to consider Mr. Rooter of Baltimore for their future plumbing and heating needs.

My other option is to absorb these increased fuel costs which directly affects my bottom-line while my business is trying to stay competitive in a challenging economic environment. Being a small business owner I cannot leverage economies of scale to keep costs

down like larger businesses can. My company services several counties with only five vehicles as opposed to larger competitors who have 30-plus vehicles and smaller, more defined territories that require less travel.

All the extra travel required for my company makes fuel prices a risky exposure for my business. Policy members at all levels of government should be focused on reducing and stabilizing the cost of gasoline and other fuels, not through taxes and disincentives to consume fuel but through increased production and efficiency.

I recently wrote to my governor, Martin O'Malley, to protest his proposal to make gasoline subject to the Maryland state sales tax. This would obviously increase the cost of gasoline and have an immediate and severe impact on small businesses such as mine. I think that a focus on new taxes, especially when it comes to energy consumption, is the wrong approach. Small businesses are desperate for government action to alleviate the burden of this drastic cost increase, and I ask that policymakers invest our tax dollars on strategies that would increase domestic energy production, conserve our existing resources, and promote safe and efficient alternative energy sources.

I support projects that would lower the cost of gasoline while adding jobs and improving the economy. I enjoy having the freedom to own and operate my franchise business and to provide a fulfilling place for my fantastic team of Mr. Rooter employees to work. However, if policymakers do not begin to embrace new energy policies, I believe the country will see an increase in small business failures. Meeting obligations such as payroll and other overhead expenses while continuing to endorse soaring energy costs and diminishing profits is unsustainable for any business. I ask that state and federal policymakers take immediate and decisive action to help small businesses do what they do best—create jobs and drive the American economy.

Thank you for the opportunity to testify before the Committee, and I look forward to answering any questions you may have. Thank you.

Chairman GRAVES. Thank you very much, Mr. Smith.

Our next witness is Cookie Driscoll. Ms. Driscoll has owned and operated her horse farm in Fairfield, Pennsylvania, for more than 18 years. And she will be testifying on behalf of the National Small Business Association. Ms. Driscoll, thank you for being here.

STATEMENT OF C. COOKIE DRISCOLL

Ms. DRISCOLL. Thank you, Chairman Graves, Ranking Member Velázquez, and members of the Committee.

My name is C. Cookie Driscoll and I am the owner of two small businesses. Whodathunkit Farm and C. Cookie Driscoll, Inc., both of which are located in Fairfield, Pennsylvania, just across the Maryland state line in Adams County. My farm is a full care boarding and learning facility, and my other business offers a line of gift items targeted toward the equestrian and pet industries, as well as promotional products, like pens and mugs, embroidered shirts. I am also on the board of trustees of the National Small Business Association, which is the oldest small business advocacy organization in the United States.

I would like to thank you for inviting me to testify today about the effects of gasoline and diesel prices on small businesses, particularly my farm. I am very grateful that you are aware of and addressing the negative impact unstable and increasing gasoline prices are having on small businesses across the country.

My farm is on 12 acres and includes a nine stall barn, three paddocks, and an outdoor arena for lessons and training. I bought the farm—there has got to be a better way to say that—I bought the farm on March 20, 1997, and began accepting boarders and students. Because of the limited paddock area, I feed the horses concentrated feeds which are commonly known as oats or sweet feed, and hay pretty much year-round. Over time I watched my expenses increase dramatically. The cost of fuel affects every aspect of running a horse farm, no matter how big or small. The farm equipment used to plant, spray, harvest, and transport the feed all use diesel fuel, which is now more costly than gasoline.

Currently, the cost of diesel fuel in our farming community varies from 4.15 a gallon to roughly 4.39 per gallon. And gasoline varies between 3.69 a gallon and approximately 3.9 per gallon. These high prices and the volatility of these prices have a significant impact on my bottom-line, including the cost of feed which has risen exponentially over the past few years. And if that is not bad enough, the use of corn to make fuel now has forced the price of corn up and corn is used in almost all feed concentrates on the farm. Of course, we feed more than the blended concentrates that use corn and other grains. We feed a lot of hay and again, every aspect of the price of hay is tied into the price of fuel from planting, to cutting, raking, baling, and now even the packaging. The big round bales are either wrapped in a plastic mesh or in a solid plastic wrap, both made from petroleum products.

With the unusual rain patterns that we have experienced over the past few years, the hay crops have been adversely affected in many areas around the country. Because of that we often have to travel much farther to buy suitable hay, adding transport costs to an already expensive staple on the farm.

But I do not just depend on bailed hay to feed the horses. Hay is used as the base ingredient in the pelleted feeds that contain the corn and oats and other grains. So no matter where the crop fails, feed manufacturers have the added cost of trucking the hay in to produce the concentrates we use. These costs are then passed on to us.

And of course, after the horses have enjoyed the benefit of the feed, the manure either has to be spread or hauled away, again using fuel. Bedding for the horses is either usually wood shavings or straw. My cost for packaged wood shavings went from \$2 per bale to \$6 for the packed and \$6.50 for the pelleted shavings. These increases came about partly because of the housing industry coming to a screeching halt and partly because of the cost of fuel, again hauling the timber, milling, collecting the shavings, and transportation uses diesel fuel and the packaged shavings are also packaged in plastic bags. So when the cost of fuel goes up it affects the price of bedding.

If the horses on the farm are being shown, the price of fuel can determine how far away the owner is willing to travel to campaign

a horse and how often they will compete. The commercial horse transportation companies have had to increase their per mile rate significantly, which is another cost passed on to small businesses like mine. The same goes for horses that are racing. Breeding operations typically have to transport the mares to the stud farms, adding expense to the operation with no guarantees that one trip will accomplish the desired outcome.

There just is not much about managing a horse farm that is not affected by the price of fuel. Even the veterinarians and farriers have to charge trip fees to cover their travel expenses when they come to tend to the horses. But for those enthusiasts who are determined to keep their horses, it is worth it. If they have to, they will take a second job to cover the cost and many do.

In addition to being a small business owner, I am also a member of the National Small Business Association and serve in a leadership capacity on the board. I can tell you that without question my issues are not unique to my business or my industry. We are all hurting from the volatile and rising gas prices. As such, NSBA recently adopted a new energy and environmental policy and will continue to take an active role in advocating on behalf of small businesses in these areas and urging lawmakers and regulators to consider the burden that any energy or environmental policy or rule would have on small farms.

In short, we believe that any energy or environmental policy should have five primary objectives: (1) Ensure clean air and water; (2) promote adequate and affordable energy; (3) End U.S. reliance on foreign energy; (4) simplify regulatory requirements and accelerate the approval process. And finally, support federal and energy research dollars for small firms.

I beg of you to please keep in mind that the impact of rising and volatile gas prices is not isolated to a horse farm. Cattle farms, pig farms, and even poultry operations are dramatically affected by the price of fuel just like I am. These costs go so far beyond the cost of transporting the livestock.

And finally, I want to thank you for allowing me to testify on such a critical issue for America's small business community. It was an honor to address all of you, and I welcome any questions you might have.

Ms. VELÁZQUEZ. Mr. Chairman, it is my great pleasure to introduce Professor Michael Greenberger. Professor Greenberger is the founder and director of the Center for Health and Homeland Security at the University of Maryland and a professor at the School of Law. After leaving private practice, he served as the director of the Division of Trading and Markets at the Commodity Futures Trading Commission. Most recently, Professor Greenberger served as the technical advisor to the United Nations Commission of Experts on Reforms of the International Monetary and Financial System and the International Energy Forums independent expert group on reducing worldwide energy price volatility. Welcome, sir.

STATEMENT OF MICHAEL GREENBERGER

Mr. GREENBERGER. Thank you. Thank you, Chairman Graves. Thank you, Ranking Member Velázquez. It is an honor to be here and I congratulate you on holding this important meeting.

I practiced law for 25 years before I went into the government and academia and I was very actively involved in supporting small business efforts and considered it to be an important part of both my professional life and interests. And I agree that small businesses have been very badly hurt by gasoline prices, but it is unfortunate that it is not just small businesses; it is the economy as a whole, Chairman Graves, as you alluded to in terms of unemployment that we see across the board.

Chairman Graves, it is a real pleasure for me to see you today because, you may relieve me of this view, but I have viewed you as a champion in the kinds of things that I have been concerned about. I remember when natural gas was at a world record high of \$15 per million BTU in December 2005. You stepped to the floor of the House of Representatives and added a provision with Congressman Barrow on the Democratic side to assist the CFTC in controlling excessive speculation in the natural gas markets. Congress gave the Federal Energy Regulatory Commission, and I know Congressman Joe Barton, then chair of the Energy Committee, had a large role in this. The Federal Energy Regulatory Commission was given strong anti-manipulation authority in the natural gas markets. They have used it vigorously. They had used it up until about a month ago and natural gas was recently at a ten-year low.

I want to make it clear I do not discount supply-demand as being an important factor and I agree that we have to search for ways to increase supply and reduce demand. And clearly, there are different market fundamentals at work in natural gas. But with natural gas going down, when it was at \$15 per million BTU down to \$1.70 four or five weeks ago is really quite remarkable. You may attribute that partly to supply-demand. I attribute it to your efforts to get the Federal Energy Regulatory Commission to be a cop on the beat beating back speculators in these markets.

Now, the price of oil, which, as has been explained, is a key determinant of the gas, was at \$65, July 2007; \$147, July 2008; \$30, December 2008; \$75, July 2007; and, when according to my testimony the CFTC was unable to cobble together enough votes to employ the anti-speculation efforts of Dodd-Frank. January 2011, the price went from 85 to 110. President Obama then convened an anti-manipulation interagency task force and it dropped from 110 to 75. The task force was found not to be doing its work and it goes back up to 110.

And recently, with the uncovering of the Chesapeake situation, where the CEO of Chesapeake was not only producing oil and gas but running a hedge fund betting on the price of oil and gas, that is a ripe situation where the hedge fund can be manipulating prices with its parallel corporate institution, the company, and involve itself in wash trades which are felonious conduct. Now, I am not saying that happened, but it certainly is an avenue for investigation.

My principal point is I am not offering you a silver bullet to bring gas prices way down, but I think there is a silver bullet and a risk-free process to attempt to bring the price down, what has been conservatively estimated by Goldman Sachs with analytics by Forbes Magazine about 50-some cents a gallon of gas. I personally believe it will go down a lot more. The key problem here is that

there are betting vehicles in this market. There is an estimated half trillion dollars being passively bet by hedge funds, mutual funds, private equity, pension funds on the upward direction of commodity staples. The purveyors of those funds, principally Goldman Sachs and Morgan Stanley, then turn around and go into the futures market and offset their betting exposure. They only want to make money on the transaction fees. They do not want to take bets on the price direction, so they may hold, in the futures markets, many times, many times the actual supply of oil in the world. Now, how do they do that? They have contracts that promise to supply and deliver. They let them expire. They convert them. That is called the "Goldman Roll." And just continue this process down the road.

So it is this gambling that they are offering, a casino, with a pre-emption in the statute against state gaming laws that puts a half trillion dollars in not to production, not to owning the underlying commodity, but to bet on the upward direction of the price. The casino goes into the real market and buys exorbitant amounts of long futures contracts that send a false demand signal into the market. My view is the casino, the gambling, should be stopped. If I am wrong about this, all we will have lost are casinos. If I am wrong about this, the \$500 billion will be put into production and ownership of commodity. I am not against speculation. I think speculation is fine. I am against passive gambling. And we have an estimated half a trillion dollars gambling going on and that has real impact in these markets. It should be stopped. There is legislation that is being prepared in the House and will be prepared in the Senate to stop the gambling.

As I pointed out in my testimony, there has been on this issue substantial bipartisan concern about speculation. I point to several 2008 votes taken in the House that are bipartisan in nature. One is 402 to 19; one is 288 to 133. I think that we can in a bipartisan way approach a solution which will not completely solve the problem, but which will afford important relief to the American consumer. Thank you.

Chairman GRAVES. Thank you very much, Professor Greenberger.

For my opponents out there who say that I have not done anything in Congress, I appreciate what you said about my legislation being what caused natural gas prices to go down. I wish that I could say the same. I think it is extraordinarily—I do not know what the word is—I think that is a huge overstatement on your part.

Mr. GREENBERGER. So you are disabusing me of my admiration?

Chairman GRAVES. But I am glad I got that on record and I will put it in my next commercial. I appreciate that.

Mr. GREENBERGER. I will be happy to help you.

Chairman GRAVES. Now, I am a supply and demand guy. That is what I am. And the fact of the matter is when you have speculators in the market that obviously take opposite positions and when you have a futures market and oil, natural gas, whatever the case may be is a commodity just like corn and soybeans which I have the majority of my experience in, wheat. You know, when you have consumers or you have even suppliers that are hedging, try-

ing to lock in whatever price that they want, you also have to have an opposite position on that which the speculators usually tend to fill that position. But my point is, too, speculators make money whether the price is going up or down. They bid on the trend. And I do not believe that they drive the price. Now, I do believe that speculation is the cause of volatility, which is what my legislation sought to address, has tried to slow down volatility. In fact, I tried to put price stops in just like we have in farm commodities. That ended up being a part of it to try to slow down volatility.

But supply and demand, the fact of the matter is supply and demand is what drives the market. And while I would like to claim credit for gas prices, natural gas prices being so low, I do believe it is the fact of we had an extraordinarily mild winter and so demand was very low. And we have some of the largest production given some of the new areas that we have found. We have a huge supply right now of natural gas. And I think that is what contributes to long-term pricing structure.

Now, when it comes to crude oil, which is what the intent of this hearing is, again, I am a supply and demand guy and I believe in supply and demand. And when you increase supply, and if we can increase supply in the United States, it is going to have a dramatic effect. Even if that supply is not going to come to fruition for 10 years, you talk about how you start opening up those regions, it is going to have a huge impact on the supply issue out there and it is going to drive prices down. But I think it is very, very—and I would very much be interested in your comments on, you know, on what I have to say about in terms of, you know, the volatility. Speculation contributes to volatility. But it does not contribute to overall price trends. And the fact of the matter is, and I would like your comments on that, too, speculators make money whether the price is going up or going down. They bet on that trend.

Mr. GREENBERGER. Chairman Graves, the crude oil market today, the futures market, is 80 percent speculative, 20 percent commercial. When it said to small businesses you go in and hedge, they are not going in to hedge. Farmers I am sure in your constituency will tell you it is too volatile to hedge. You control a contract with four to seven percent of the value. On about Labor Day 2008, I believe the price of oil went up about \$19 one day and down about \$18 the next. You cannot hold that contract on four percent margin. The commercials, and you should talk to people in the Commodity Market Oversight Coalition made up of heating oil dealers, the New England Fuel Institute, Petroleum Marketers Association, the airlines, the truckers, they all believe that when you have a futures market that is 80 percent speculation and 20 percent commercial, you are not having those speculators help the commercial. They are counterparties to each other.

Now, you say they make money when the price goes up or the price goes down. They offer \$500 billion of bets. You can only bet the price will go up. To offset those bets they have to buy long. Now, the fact that there is an opposite side to that bet, it is like there is an opposite side to the stock market bets, too. But stock market prices just do not go flat; they can be volatile. When there are more people trying to buy it than sell it, yes, people will sell it but the price goes up. If you took that \$500 billion out of this

futures market, it would decrease not only the price of crude oil because the betting is on a basket of commodities. Natural gas, by the way, is only four percent of it. Oil products are a huge percent of it, but so are farm prices. And you go talk to farmers or related industries and they will tell you, small farmers, they cannot use futures as a hedging vehicle. The market has passed them by. They are not hedging. And what does that mean?

Chairman GRAVES. I completely disagree with you. Absolutely emphatically disagree.

Mr. GREENBERGER. Well, I appreciate that.

Chairman GRAVES. And in every futures transaction you have to have an opposite position. If an option is exercised, you have to have an opposite position.

Mr. GREENBERGER. For every stock sale you have to have an opposite position, but stocks go up and down. And if people are buying Apple—

Chairman GRAVES. We are not talking about the stock market.

Mr. GREENBERGER. Well, it is the same market fundamental in futures contracts.

Chairman GRAVES. Mr. McNally, I would appreciate your comments.

Mr. MCNALLY. As I said, since the late 1800s, producers and consumers have understood that oil prices tend towards wild gyrations. And we should differentiate here between volatility day-to-day, week-to-week, and then gyrations, huge swings. Economists call it low price elasticity of supply and demand in the short run. Plain English, you have got to use oil. If the price of chicken goes up, you buy meat. If the price of gasoline goes up, you still buy gasoline. So you need big price changes to effectuate little changes in demand.

And that is why throughout history there have been three groups that have tried to suppress this volatility on the producer side. Rockefeller and standard oil in the late 1800s, which we busted up in 1911, and then we were the most effective OPEC. We, the United States, the Texas Railroad Commission, Seven Sisters locked up, stabilized the price of oil for 30 years. We handed it over to OPEC in 1972. The chairman of the Texas Railroad Commission, they met every month to set production quotas just like OPEC has, and he called it a damned historic occasion. Why? Because for the first time in 30 years the U.S. did not hold any spare back. We let it all go because demand was outstripping our net supply growth and OPEC took over. In 2008, it was the first time we saw since March of 1972 the spare capacity holder, now Saudi Arabia, no longer Texas Railroad Commission, run out of spare capacity in peacetime. You can read the DOE reports from earlier this year. If we are looking at a very tight market with a very low shock absorbing buffer with Iran possibly for the summer a risk that is being alluded to by comments from senior officials such as Secretary Panetta, people are going to speculate on prices going a lot higher. And I think it is important to differentiate and define speculation very carefully. If I am having a picnic near the railroad tracks on a sunny day with my family and I see two train cars coming down that railroad track heading towards each other, I am going to speculate on a train wreck. I am not causing the train

wreck but I will speculate with high conviction we are about to have a train wreck and I want to move my family away from the railroad tracks.

And that similarly goes into price formation and oil. Oil prices are driven by supply and demand as you said in terms of data and the best we can perceive them. There is a lot of work to do to improve that I think we would all agree. But also expectations of future supply and demand and supply risk. And we are in a tight and fearful market. And as long as this market remains tight and fearful we are going to see high volatility, or as I prefer to call it, gyrations in prices. Thank you.

Chairman GRAVES. Ms. Velázquez.

Ms. VELÁZQUEZ. Mr. McNally, renewable fuels are becoming more popular, not only because they are environmentally friendly but also because they are becoming more cost competitive when you consider the rising prices of petroleum. How does the fact that oil is over \$100 a barrel affect the buyability of renewable fuels as a solution to our problems?

Mr. MCNALLY. Ranking Member Velázquez, the main renewable fuel that competes with oil we thought would be corn. And then we were hoping cellulosic ethanol. And as my colleague on the panel mentioned, for various reasons we think that maybe the boom in driving corn into our gasoline pool may have contributed to rising food prices and has other unintended consequences. But corn ethanol is competitive at \$100 and more. The problem is, and this is the problem with the price gyrations which I think we all would agree are a horrible thing. At \$100 it makes sense to burn corn and ethanol, and it may make sense to invest in cellulosic ethanol and other more advanced and less—more environmentally friendly forms of renewable energy. The problem is when we go as we did from 147 in the middle of 2008 to \$30 a barrel, you do not know what to do. At \$30 a barrel, at \$40 a barrel, corn ethanol probably does not make sense. Certainly, cellulosic does not. So it is those wild gyrations in prices which keep people from deciding whether to buy an F-350 truck or a Leaf or invest in cellulosic or buy oil in the ground.

Ms. VELÁZQUEZ. So what is your message then, expanded domestic energy production?

Mr. MCNALLY. The comprehensive answer, that would be a very important part of it.

Ms. VELÁZQUEZ. But it has been found that it could take up to between five to 10 years. Right?

Mr. MCNALLY. Right.

Ms. VELÁZQUEZ. So what then relief will small businesses have if they have to wait 10 years to get the relief?

Mr. MCNALLY. As we all said, and my colleagues said, there is no short-term solution, unfortunately. I wish I had a magic wand to wave. There is no short-term solution.

Ms. VELÁZQUEZ. So what you are telling me is that expanded domestic energy production is not the sole answer.

Mr. MCNALLY. Not the sole answer. A very important part of the answer but not the sole answer.

Ms. VELÁZQUEZ. Mr. Greenberger, do you have any comments?

Mr. GREENBERGER. Look, as I said before, I agree with Chairman Graves that supply-demand has some relevance here. The CEO of Exxon Mobil has said the market fundamentals mean that the price should be between \$60–70. Goldman Sachs has said there is a 56 cent speculative premium here per gallon. It is fine for people to move away from a running train. There are plenty of speculative avenues. You can buy oil production companies. You can buy the oil itself. You can buy futures contracts on oil. But what you cannot do is open a casino and have people passively bet that the price will go up, and then like a bookie, lay off your risk in the real futures market. What I am saying is even if I am wrong, those who say yes, we want to keep the casinos going, we want gambling, we want to preempt state gaming laws, why do you not meet me half-way and let state gaming laws apply to this? It is pure passive gambling. It has no productive result. It is destroying the economy.

And as to the Saudis, I was an advisor to the International Energy Forum. Twenty oil producing countries, including the Saudis, and 20 oil consuming countries, Western Europe and the United States. There was virtual uniform agreement that the market had become financialized. In March, the Saudi king and oil minister said they would increase production by 25 percent to offset potential interference with the Strait of Hormuz. The price went up the next day. The president threatened to release strategic—

Ms. VELÁZQUEZ. All right. And the prices went down.

Mr. GREENBERGER. And the price went up. The more supply we are offering, the price goes up. In July 2008, the Saudis, at the request of Vice President Cheney, increased production. The price went up \$5 the next day. That is not market fundamentals. That is not speculation. It is betting and gambling. If you want to leave the status quo, you have to tell your constituents I approve of people passively gambling on the upward price direction and the casinos then affecting the bets by swamping the market with long crude oil contracts, 10 times the size of the world's—

Ms. VELÁZQUEZ. Let me follow up with another question to Mr. McNally. The St. Louis Federal Reserve recently released a report indicating speculation was the second largest contributor to oil prices accounting for nearly 15 percent of the rise. So how do you reconcile what you said before with this report?

Mr. McNALLY. I do it by noting we have sort of a battle of the Federal Reserve Banks. The Federal Reserve Bank of Dallas also issued a report looking at the data and refuted that and came to a different conclusion and said there is a very little role from financial market participants. So we can probably spend all day arguing about those reports but I would just point out the commodity futures trading commission in 2008 led an interagency task force composed of the Departments of Treasury, Energy, Agricultural, Federal Reserve, Federal Trade Commission, and the SEC. And they looked at 2008, the period we have talked about, and concluded the price behavior was due to supply and demand fundamentals. And I could read to you from Department of Energy Reports and international agency reports from earlier this year ad nauseam showing that it is really supply and demand and not financial market participants that are responsible for the price behavior.

Ms. VELÁZQUEZ. Thank you. Professor Greenberger, do you think it is merely a coincidence that the unprecedented growth in commodity index trading occurred at the same time as a boom in commodity prices?

Mr. GREENBERGER. No, I do not think it is a coincidence, and there have been three bipartisan reports from the Senate Permanent Subcommittee on Investigations on crude oil, natural gas, red wheat, each of which concluded that the commodity index business, which started in 2004 at \$13 billion and is now estimated to be \$500 billion, if you look at charts, that is where the bubble started. And yes, the bubble bursts from time to time. And by the way, when it bursts, all these small businesses who were advised to hedge; Goldman and Morgan were telling airlines when the oil was at 150 to hedge against the price of 200. At the end of the year the price was 30. Those airlines took a beating and small businesses do not hedge anymore because of those kinds of beatings.

Ms. VELÁZQUEZ. Thank you, Mr. Chairman. Thank you.

Chairman GRAVES. Mr. Walsh.

Mr. WALSH. Thank you, Mr. Chairman. Thanks for calling this hearing.

This is a big issue and we are forgetting about you two rock bones right there in the middle, the small businesses who are impacted by this. We are engaged in an important policy discussion but you are living this. And so I apologize if you two get shunned a little bit today but I very much appreciated your testimony because you, small business men and women will turn this country around. And we here in Washington make it too darn difficult for you to do that.

I get so tired of hearing this line that, you know, if we only increase supply, our domestic supply could take five to 10 years. We said that five to 10 years ago. We said that 10 to 15 years ago. We said that 20 to 25 years ago. And Mr. Greenberger, respectively, I hear your argument on speculation. I respect it to a large degree, but you so dismiss—

Mr. GREENBERGER. That is not true.

Mr. WALSH. But you so dismiss basic supply and demand. It is like we look for a bad guy in every debate we have up here and the other side tends to demonize big bad oil, not understanding that 95 percent of the oil produced in this country comes from independent oil companies. This administration does not have an energy policy. And so he again, the president again clearly a few months ago made up his mind, Professor Greenberger, that he was going to jump on that bad guys and go after speculators to make up for an utter lack of a policy.

Mr. McNally, this notion of we cannot start drilling tomorrow all over the place because we have an abundance of areas where we could impact supply, but we may not see the effects of that for three or four or five or six or ten years. Is that true? If this country aggressively and energetically decided to snap their fingers and go after all of the supplies, all of the oil supplies we have, could you see some more short-term impact on prices?

Mr. McNALLY. Short-term I think market participants would want to see real barrels show up. So I would be cautious in expecting too much of a price decrease even if we were to waive a wand

and open up everything in the very, very short-term. Unfortunately, I wish it were not the case but unfortunately in the short term there is very little we can do. However, what I described, we are living with the consequences of five to 10 years of bad dreams, if you will, bad surprises. Two billion people want to drive. We are not increasing supply as we used to. The Persian Gulf is a mess. We are living with that now. What we do know with our own resources under the ground, we can start creating good surprises so that in the next three to five to seven years maybe we can find ways to increase production to diversify further out of the Persian Gulf, to find ways to scale up a cellulosic or maybe other ways, make battery cars work better. So we live with the consequences of surprises and trends that develop over the previous five to seven to 10 years. We absolutely need to right now work on making the next three to five to seven years ones where the surprises are good ones.

Mr. WALSH. Professor Greenberger refers to this difference between speculators and gamblers. How do you see that distinction? Do you see a distinction?

Mr. McNALLY. Yeah, I do not see that at all. What we have are the oil price and oil markets, exchange markets and the derivatives markets are composed of physical consumers and producers of oil who want to transfer their price risk to those willing to bear it, which include speculators. What Mr. Greenberger is also talking about though are these passive long only investors. These are folks, pension funds, university endowments, you and me, where we want to put a part of our portfolio into commodities, a basket of commodities that includes oil. Now, the CFTC has looked at this very closely because there is no question this money has come into the market, that is for sure. But the CFTC has looked into it and they have disaggregated careful data and they show, for example, in early 2008, as oil prices were lurching up to that \$147 high, passive investors were actually selling their oil futures. And I would be happy to point that out for the record in that CFTC report.

So the folk who try to figure out if it is the rooster causing the sun to rise or the rooster just sort of crowing, you know, in coincidence with the sun rising, looking at Granger causality tests and all kinds of math and speaking Greek and everything, the folks who poured into that who were unbiased, who have the information, have not yet said or not concluded that these investors, whether it is these passive long-only folks just buying and holding, or speculators who buy and sell have distorted or manipulated or influenced the price of oil.

Mr. WALSH. And Mr. Chairman, let me just close with this. Ms. Driscoll and Mr. Smith, it is our job here to make life easier for you so that you can be productive and profitable and grow businesses and hire people. There is not a lot we can or should do here. Often, the things we do here make things worse. We have an abundance of oil on our land and around our shores. It makes sense for us, I think, and I hope you agree, to go after those resources in as sensitive and as reasonable a way as we can to make life easier for you two. Thank you for coming.

Thank you, Mr. Chairman.

Chairman GRAVES. Mr. Barletta.

Mr. BARLETTA. Thank you, Mr. Chairman.

Mr. Greenberger, one of the biggest national security concerns is our dependency on foreign oil obviously. Many scientists have argued that our nation has more natural gas than Saudi Arabia has oil. And in my home state of Pennsylvania—

Mr. GREENBERGER. My home state, too.

Mr. BARLETTA. It is a very exciting opportunity where our state could be, I believe a leader in solving some of America's energy concerns.

A 2010 Penn State study found that Marcellus shale could generate nearly \$19 billion in economic value per year and 200,000 jobs by 2020 in Pennsylvania alone. Could you comment on a potential impact of natural gas from Marcellus shale and helping small businesses decrease their energy costs and the impact of an energy policy, whether it be natural gas—and I am talking about transportation fuel—natural gas, automobiles, or natural gas to liquid fuel?

Mr. GREENBERGER. Well, I agree with your premise and before Mr. Walsh leaves I just want to say for the fourth time I do not discount supply-demand. I have made that clear several times. What I am talking about is a premium over supply-demand.

Mr. WALSH. Do me a favor, before you leave today make sure you expound upon what we can do when it comes to supply and demand.

Mr. GREENBERGER. I will definitely—

Mr. WALSH. What we control.

Mr. GREENBERGER. I can definitely do that. And I think that the Pennsylvania situation is a prime example with the natural gas resources.

Now, I will tell you something. What I am not an expert on is the environmental concerns. I know there are many environmental concerns, but I have got to tell you, I grew up in Scranton, Pennsylvania. Do you know Scranton, Pennsylvania?

Mr. BARLETTA. It is in my district.

Mr. GREENBERGER. Really? Great. Are you from Hazelton?

Mr. BARLETTA. I am.

Mr. GREENBERGER. Okay.

Mr. BARLETTA. Former mayor.

Mr. GREENBERGER. Okay. Well, you know that area. And anything that would make that area more productive, we depended, as you know, on hard coal, anthracite coal, and I grew up—when I was born, Scranton had 150,000 people. It now has about 50,000 people. I definitely believe that these resources—North Dakota is the same thing—need to be explored and developed. They are being explored and developed. On my theory of supply and demand, I do not think the price going from \$15 per million BTU down to \$1.70 is unrelated to supply-demand. Those kind of experiences have an effect. But it is not completely explained by supply-demand. You cannot go from \$15 to \$1.70 and having the FERC bringing manipulation cases collecting \$200 million against the Amaranth. Thirty million dollars against the Amaranth director and that not affect the price. We need to see that same aggressiveness in the other commodity markets and we are not, but to me the experience that you are talking about is one of great hope for us and again I say

I believe supply-demand is important and I would look for every possibility. My concern and expertise is that there is at least a 50 cent per gallon premium—I believe it is maybe even more—that American consumers are putting into their purchase of gasoline that is completely and totally unnecessary. The price of oil dropped \$5 in two days from 103 to 98 when it was discovered that Chesapeake had within its corporate structure a hedge fund that was betting on the price of oil. And by the way, government regulators did not discover that; Reuters discovered that. Where are the government regulators? They are asleep.

And the final point I would make, it is said that President Obama was slow to get on the bandwagon. I agree with that because John McCain got on this bandwagon when he ran for president two weeks before President Obama did. In June of 2008, McCain said the cause of the explosion in crude oil is excessive speculation and I am tired of hearing about a 2008 CFTC report that has been discredited even by the bipartisan House Agriculture Committee and then being told that St. Louis's Fed's report of last week or the Dallas Fed's report is meaningless. There are 50 studies—Princeton, Texas A&M, Stanford, London School of Economics, Nouriel Roubini, Paul Krugman. There are 50 studies—they are not uniform—saying this is a gambling problem. And there is a difference between gambling and speculating. We should stop the gambling.

Mr. BARLETTA. And do you feel if we explored for more natural gas, what effect would that have on supply and demand of oil?

Mr. GREENBERGER. There is obviously not a complete crossover use. If there were you would see the price of oil go down. But it has impacted the price of natural gas. As I said, it has gone down from \$15 per million BTU, a world record high, to \$1.70, which is a ten year low. Part of that is stopping speculation, but it is not the main part. Part of that is the kind of production that you were talking about in Pennsylvania and other states which is the hope for the future of the American economy.

Mr. BARLETTA. Thank you.

Chairman GRAVES. Mr. Tipton.

Mr. TIPTON. Thank you, Mr. Chairman. I would like to start today by being able to submit an article for the record that ran in Monday's Washington Examiner Op-Ed column. It is a joint op-ed that you and I wrote, Mr. Chairman, which states that red tape is strangling America's energy supply. In the op-ed, we point out that one in 10 business owners say energy is his or her single largest cost ranking it ahead of wages, material, and other investments. Additionally, another 25 percent claim energy is its second or third largest expense. Policies by this administration, like failing to approve the Keystone pipeline are driving up gas prices and prohibiting us from developing American energy.

Just last month I introduced H.R. 1381, the Planning for American Energy Act of 2012. Under the legislation, the nonpartisan energy information administration provides the projected energy needs of the United States over the next 30 years to the secretary of interior and the secretary of agriculture on what they will base for the four-year production plans. My "all of the above" energy plan requires that wind, solar, hydropower, geothermal, natural

gas, oil, coal, and shale minerals needed for energy development be included in those plans. Enacting this plan will develop our resources here in America and assist with lowering gas prices and lessening our dependence on volatile foreign energy sources.

I would like to probably start out with Ms. Driscoll, since you have not had any questions coming up, we know what is going on in the Middle East right now. If all of a sudden we do not have that flow of oil coming out of the Middle East, would you expect our prices to go up in this country?

Ms. DRISCOLL. If I base my expectations on historical data, yes. I should hope that we could generate enough fuels here in the United States to meet the need but I keep hearing—

Mr. TIPTON. So you and Mr. Smith, you are small business people. I am a small businessman as well. You rely on a supply coming in. So would it be sensible for the United States of America, rather than continuing to say we cannot do it because it is five to 10 years down the road, to finally take those reins in our hands to be able to create energy certainty for the United States of America? Would that give you a little bit of consolation and certainty from your businesses if you knew that that supply was not going to be cut off and as a byproduct you are going to be creating American jobs on American soil and developing American energy resources? Would that make sense to you?

Ms. DRISCOLL. It is a start. It is a start. I would hope that we could do it with a heavy emphasis on the safety of the American people with the processes used to harvest that fuel. That has got to be a primary concern that runs in conjunction. Yes.

Mr. SMITH. Absolutely. I agree. You know, we need some stability to this at some point for American businesses. So, you know, as a businessperson, right now I have to watch every dollar I spend because I do not know what is coming next. And so I have to hold off on hiring or cut back on hours that someone is working to make sure that I can keep my overhead down to make up for things like gasoline prices rising.

Mr. TIPTON. So is it accurate, Mr. Smith, that because of the failures of this administration to be able to develop an energy policy for this country, you are having to direct your resources in areas that you would rather be putting to productive use like creating jobs, expanding your business, and expanding your bottom-line?

Mr. SMITH. I mean, you know, I truly believe that, you know, right now with the—I think most people call it the gridlock or the red tape—that is not happening—to make sure that we have some sort of plan in place to, you know, help the economy, help businesses, help families, you know, with the rising costs of fuel and the unknown of what fuel will bring in the future.

Mr. TIPTON. I know in my district in Colorado we continue to hear the stories of struggling families that are paying 3.80, 3.90 a gallon and they are making a choice—do they fill up half the gas tank and buy a little bit of food or what are they really going to do? So this is about policy. And I would like to maybe expand this discussion just a little bit when we are talking about the futures market because I think that we neglect to point out the failure of this administration to be able to stand up for the strength of the

U.S. dollar. We saw under the Reagan administration with the strong U.S. dollar we can have economic prosperity.

Mr. McNally, on the world oil markets, is that based off of the value of a U.S. dollar?

Mr. McNALLY. The role of the dollar and expectations of future dollar exchange rates and inflation rates is one factor that plays a role in forming oil prices.

Mr. TIPTON. So the weak American dollar is actually driving up costs to American consumers. Do we have any data to see how that relates as opposed to some of the speculative market in terms of the cost to consumers and businesses?

Mr. McNALLY. I am not aware of government studies that have done that. I am sure banks maybe have looked at that. So that is not something in the government sphere which I am aware of.

Mr. TIPTON. I am sorry, Mr. Chairman, my time has expired. Thank you.

Chairman GRAVES. Ms. Ellmers.

Ms. ELLMERS. Thank you, Mr. Chairman. And my questions are for Ms. Driscoll and Mr. Smith as well as business owners. It is so important that we understand how the rising price of energy is affecting our businesses and how that in turn affects you, the community, and the cash flow of your businesses. So what I would like to do, Ms. Driscoll, if I could start with you and then I am going to ask a couple of questions and if both of you could answer.

There again, you know, as fuel prices have been rising and, of course, you know, some have come down a little bit, and of course, I am talking about gas prices, as they have fluctuated what did this do to the ability of your business and your cash flow? How do you manage that?

Ms. DRISCOLL. The first thing I did was lay off people which absolutely broke my heart to do that. I went from full-time employees and I put them in a part-time situation. And I am now doing everything. So it is really unfortunate. After I had laid off people and then put them into part-time and no more, then I would at least bring them along to trade shows and work with me in that capacity or when I was showing horses I would bring them along in that capacity to work for me for the day. But with the fuel prices, what I pay to get to the show is probably double what I was paying them to come along as grooms. So it certainly affected the job market in my region.

Ms. ELLMERS. Sure. You know, I would agree. Each month my fuel bill comes in. I never want to open it. I hate to see what that number is as it does continue to grow, you know, every month. Even though we have had a recent decline it is still significantly up from, you know, January 2011.

So I look at things like I have reduced hours on employees. I have replaced employees with part-time people. So I really have to watch the overhead portion of my business and cut back wherever I can. So at times it means that I do not take a paycheck. So usually that is the first cut that happens, is my ability to make any money. And then and that point I have to look beyond that and see what to do. And right now, while I would love to see growth, we do not see it in the plumbing industry. Being a part of Mr. Rooter Plumbing, we are a national, you know, franchise. International

franchise. And so I hear of the other business owners that I speak to that are laying off people, you know, as we speak. The past few months they have been laying people off. And so energy is a huge expense for us, you know, and the fuel costs.

Along that line, basically my question is how has it affected your bottom-line? And I guess probably the easiest way to say that is are you better off today than you were four years ago? So Ms. Driscoll?

Ms. DRISCOLL. Being one to conserve words, the answer to that is no. Absolutely not. I do not take a paycheck anymore either. You find ways. And I truly believe that small business owners are our own worst enemy. We find a way to get it done anyway, and as a result it gives the impression that it is really not that bad for us. And it is. I do not think I have taken a paycheck in about two and a half years. It is very frustrating and it is difficult for me to add new products to the line. It is difficult for me to campaign a horse that really should be out on the road being seen. I have cut back on some of those things knowing that the end result is I am not going to get as good sales. But you have to cut. It is a very frustrating situation. I have to do things that I know are not good for my business.

Ms. ELLMERS. Thank you. Mr. Smith.

Mr. SMITH. Yeah. And, you know, I would say in a small business, it is like a small family. So every time we have to lay someone off if it is not a large corporation that sends in an H.R. person; you are laying off your friend, you know, that you have worked with for years and you know their families. So it takes a much more enormous toll on us outside of just the financial. We are also dealing with people, you know, and our friends and making impacts to their lives because of decisions we need to make to keep our business open.

Ms. ELLMERS. Thank you. This is the story we keep hearing over and over again. Back in my district last week I met with some business owners and one of the stories which is heartbreaking, literally, in order to keep their business open, their small business, one of my friends has actually taken another job to keep the doors open on the business. They have gone through all of their savings, their retirement, selling their home and moving into a townhouse. And this is what they have had to do to keep those doors open. And it is what we do as Americans. So with that, Mr. Chairman, I yield back.

Ms. VELÁZQUEZ. I would just like to say, Mr. Chairman, it is evident that, you know, one role of this Committee is to help create a climate that is conducive to help small businesses do what you do best. That is creating jobs. And one area where this Congress can be effective is in the area of energy policy and we have not acted on any comprehensive energy bill reported out of the House of Representatives. Thank you.

Chairman GRAVES. I appreciate it. I want to thank you all for coming today. And unfortunately, we lose sight a lot of times in the debate over what causes energy prices to rise and fall. We lose sight of what it really does to small businesses and to consumers and to people out there. So I appreciate everybody here coming in and testifying. We are in the middle of a vote series so we are

going to go ahead and close down the hearing. But thank you all very much.

And I would ask unanimous consent that members have five legislative days to submit statements and supporting materials for the record. Without objection, so ordered.

And with that the hearing is adjourned.

[Whereupon, at 2:11 p.m., the Committee was adjourned.]

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“Space Mountain” Pump Prices

Testimony of Robert McNally
 President, The Rapidan Group
 Committee on Small Business
 Hearing on Gasoline Prices
 May 9, 2012

Chairman Graves, Ranking Member Velázquez, members of the Committee, thank you for the opportunity to provide testimony to you on gasoline prices and their impact on the economy. I appreciate your calling this hearing on the crucial topic of rising gasoline prices, and I am honored that you have asked me to share my perspective and views.

I approach this subject with twenty-one years of professional experience analyzing and participating in energy markets and policymaking. I have spent the bulk of my career analyzing the global oil market, energy, and economic policymaking. I also served as Special Assistant to the President for Economic Policy on the White House National Economic Council from January 2001 to June 2003 and Senior Director for International Energy on the National Security Council from January 2003 to June 2003. I am currently an independent analyst and do not represent any entity. The views expressed here are entirely my own.

The subject of today’s hearing is rising gasoline prices, which hurt small businesses and imperil our economic recovery. Before evaluating the factors that contribute to the most recent rise, it is worth considering that gasoline price upswings are becoming more frequent and consumers are wondering why this is the case. As Michael Levi and I wrote last summer in *Foreign Affairs*¹:

For most Americans, from the late 1970s until just a few years ago, following the price of gasoline was like riding the Disney World attraction It’s a Small World: a shifting but gentle, basically unremarkable, experience. But since 2005, it has felt more like Space Mountain--unpredictable, scary, gut-wrenchingly volatile. Between January 2007 and July 2008, the price of a barrel of oil rose from \$50 to more than \$140; by the end of 2008, it had crashed to just over \$30; less than a year later, it had breached \$80 again. In early 2011, on the back of strong global demand and the political turmoil in the Middle East and North Africa, oil sold for over \$120 a barrel. Today, as prices continue to swing wildly, most Americans are wondering why they are on this ride and how to get off.

In 2012 we find ourselves again on the upswing, with pump prices having made all-time highs in March for that time of year. Gasoline prices are rising mainly because crude oil prices are rising, though the shutdown of refinery capacity in the US, Europe, and Caribbean have also played a role.

Crude oil prices are rising mainly because demand for oil is outstripping net supply growth, requiring price increases to ration consumption. Geopolitical disruptions and risk add to the problem. President Obama has recently underscored the role these supply-demand and geopolitical events lay in rising fuel prices. On February 23, 2012 he said, “If we’re going to take control of our energy future and can start avoiding these annual gas price spikes that happen every year -- *when the economy starts getting better, world demand starts increasing, turmoil in the Middle East or some other parts of the world* -- if we’re going to avoid being at the mercy of these world events, we’ve got to have a sustained, all-of-the-above strategy that develops every available source of American energy.” [Emphasis added.]

President Obama also aptly summarized *ongoing role* strong demand for oil will play in driving oil prices higher:

Over the long term, *the biggest reason oil prices will probably keep going up is growing demand in countries like China and India and Brazil*...In five years, the number of cars on the road in China more than tripled -- just in the last five years. Nearly 10 million cars were added in China in 2010 alone -- 10 million cars in one year in one country. Think about how much oil that requires. And as folks in China and India and Brazil, they aspire to buy a car just like Americans do, those numbers are only going to get bigger.² [Emphasis added]

As demand for oil outstrips net supply growth, the market becomes “tight.” By tight I mean spare capacity is unusually low. Spare capacity is potential oil production that can be started up in 30 days and sustained for at least three months. As noted below, normally oil supply is very slow to respond to price changes because of long investment lead

¹ “Crude Predicament: The Era of Volatile Oil Prices,” *Foreign Affairs*, July/August, 2011, see attachment.

² Energy remarks by President Barack Obama, February 23, 2012.

times. But by holding spare or quickly-producible production, suppliers can add supply quickly when demand is strong relative to production or disruptions occur. Adding quick supply from spare capacity prevents the need for big price swings to balance the market. For the past thirty years, spare capacity has been the primary tool by which OPEC has attempted to stabilize global oil prices and reassure market participants that geopolitical disruptions could be offset. Nearly all spare capacity is held by Saudi Arabia.

It is crucially important to realize spare capacity has been unusually low since 2003, with the exception of the Great Recession in 2009 when OPEC producers cut production. At present, EIA noted spare capacity is "quite modest by historical standards, especially when measured as a percentage of global oil production and considered in the context of current geopolitical uncertainties, including, but not limited to, the situation in Iran."³ Please see Figure 1 for EIA's estimate of geopolitical and unplanned disruptions in global oil supply and Figure 3 illustrating historical spare capacity and geopolitical disruptions and risks.

The combination of low spare capacity and high disruption risk adds a risk premium on to the price of oil.

Unfortunately, there are no effective policy options to counter the *short-term* crude and fuel price volatility caused by a fundamentally tight and fearful global oil market. Using the Strategic Petroleum Reserve to counter short-term price volatility - absent a severe supply interruption - would not only be irresponsible, but also counterproductive. Blaming oil price behavior mainly on financial market participants misdiagnoses the problem. And the prescription - unnecessarily burdensome or restrictive regulations or controls - would needlessly increase the cost of energy on small businesses and consumers without addressing the causes of underlying price gyrations.

There are longer term policies that can reduce future price volatility and enable small businesses and consumers to adjust to it in the medium and longer term. They range from improving the quality of data in order to reduce the uncertainty that contributes to volatility, facilitating large and well-regulated financial markets so companies exposed to oil price risk can hedge, and improving the funding and focus of energy-related research and development. A crucial step is to increase oil supply everywhere: In a tight market and especially when spare capacity is otherwise low, every extra barrel of supply on the margin counts and can help reduce future price volatility.

I would like to now elaborate on some of these points.

Rising oil prices have important and negative impacts on our macroeconomy

EIA aptly summarized the impact of rising oil prices on the macro economy:

- When the prices of petroleum products increase, consumers use more of their income to pay for oil-derived products, and their spending on other goods and services declines. The extra amounts spent on those products go to foreign and domestic oil producers and, if wholesale margins increase, to refiners. Domestic producers may pay higher dividends and/or spend more on oil discovery, production, and distribution. Foreign producers may spend some or all of their extra revenues on U.S. goods and services, but the types of goods and services they buy will be different from those that domestic consumers would buy. How quickly and how much domestic and foreign oil producers spend on U.S. goods and services and financial and real assets will be critical in determining the effects of higher oil prices on the aggregate economy.
- Oil is also a vital input for the production of a wide range of goods and services, because it is used for transportation in businesses of all types. Higher oil prices thus increase the cost of inputs, and if the cost increases cannot be passed on to consumers, economic inputs such as labor and capital stock may be reallocated. Higher oil prices can cause worker layoffs and the idling of plants, reducing economic output in the short term.
- Because the United States is a net importer of oil, higher oil prices affect the purchasing power of U.S. national income through their impact on the international terms of trade. The increased price of imported oil forces U.S. businesses to devote more of their production to exports, as opposed to satisfying domestic demand for goods and services, even if there is no change in the quantity of foreign oil consumed.
- Changes in oil prices can also cause economic losses when macroeconomic frictions prevent rapid changes in nominal prices for final goods (due to the costs of changing "menu" prices) or for key inputs, such as wages. Because there is resistance on the part of workers to real declines in wages, oil price increases typically lead to upward pressure on nominal wage levels. Moreover, nominal price "stickiness" is asymmetric, in that firms, unions, and other organizations are much more reluctant to lower nominal prices and the wages they receive than they are to raise them. When a nominal increase in oil prices threatens purchasing power, the adjustment process is slowed, with multiplier effects throughout the economy.
- Finally, higher oil prices cause, to varying degrees, increases in other energy prices. Depending on the ability to substitute other energy sources for petroleum, the price increases can be large and can cause macroeconomic effects similar to the effects of oil price increases.⁴

³ <http://www.eia.gov/analysis/requests/ndaa/>

⁴ http://205.254.135.24/oiaf/aco/otheranalysis/aco_2006analysispapers/cfhop.html

Rising oil prices as well as volatile oil prices pose special burdens for small business

Small businesses are the powerhouse of the US economy. Rising oil prices hurt them directly by increasing input costs, such as fuel, and reducing the purchasing power of their customers. And higher fuel prices feed into higher prices of many goods and services, including food and materials. These wholesale cost increases get passed along to small businesses, who must then contend with difficult choices as to whether to absorb or pass them along.

It would be easier for small businesses to adapt to higher oil prices if they were stable. *Gyrating oil prices are even worse because they increase uncertainty about future fuel costs and sales prospects, which can delay decisions on hiring and expansion.* The main challenge facing small businesses and the US economy is not high oil prices, but gyrating ones.

Recent gasoline price increases are due to tight global supply demand fundamentals, some downstream or refinery-level challenges, and geopolitical risk

EIA has noted that “[t]he single biggest factor in the price of gasoline is the cost of the crude oil from which it is made.”⁵ Crude price increases earlier this year were followed by gasoline price increases of similar magnitude and were due to unexpected tightening in global supply demand fundamentals, lower than expected OPEC spare capacity, and considerable geopolitical disruptions and disruption risk, especially related to Iran. Citing from EIA’s February 29 report:⁶

EIA estimates that the world oil market has become increasingly tight over the first two months of this year. Oil prices have risen since the beginning of the year and are currently at a high level. Global liquid fuels consumption is at historically high levels. While the economic outlook, especially in Europe, remains uncertain, continued growth is expected. Unusually cold weather in Europe contributed to tighter markets by increasing the demand for heating oil, particularly during February. With respect to supply, the world has experienced a number of supply interruptions in the last two months, including production drops in South Sudan, Syria, Yemen, and the North Sea. Both the United States and the European Union (EU) have acted to tighten sanctions against Iran, including measures with both immediate and future effective dates. There is some evidence that these measures may already be causing some adjustments in oil supply patterns. For example, there is emerging evidence that some shipments of Iranian crude oil under existing contracts are being curtailed due to the unwillingness of U.S. and EU insurance providers to cover them, even though the EU sanctions only require existing oil contracts to be completely phased out by July 1, 2012.

Finally, spare crude oil production capacity, while estimated to be higher than during the 2003 to 2008 period, is quite modest by historical standards, especially when measured as a percentage of global oil production and considered in the context of current geopolitical uncertainties, including, but not limited to, the situation in Iran.

As shown in Figure 3, commercial oil inventories in OECD countries *outside North America* are low.

As shown in Figure 4, a conflict that would block the Strait of Hormuz would dwarf any disruption in modern history and rattle traders’ nerves, contributing to a risk premium (see Figure 4).

In addition to the pressure imposed by rising crude prices, gasoline prices rose earlier this year on reports of an unusually large shutdown of refineries serving the US market. As EIA noted,⁷ in September, 2011 two Pennsylvania refineries amounting to 27% of East Coast refining capacity closed. If a third, planned Pennsylvania refinery closure is included, East Coast refinery capacity is set to fall 52% within one year. In addition, the Hovensa refinery in the US Virgin Islands closed, as did refineries in Europe that supply the US with gasoline. This rash of refinery closures is expected to considerably tighten the East Coast gasoline market and sparked buying of gasoline futures starting in January. Going forward, and irrespective of underlying crude oil prices, the East Coast – the nation’s largest gasoline market – will need to pay higher prices for long-haul imports, competing for waterborne barrels in South America, where gasoline demand is rising sharply.

In recent weeks and days, crude oil prices and gasoline prices have dropped due to renewed worries about slower economic growth, some indications of softening in global supply-demand fundamentals such as unseasonal inventory builds in March, and a perceived reduction in geopolitical tensions concerning Iran.

Crude oil price volatility is here to stay, and wider fuel price swings will unavoidably result

To understand why oil prices are have been gyrating in recent years we must consider a couple of economic concepts. First, oil as a commodity exhibits what economists call a very low price elasticity of demand. In plain English, this means supply and demand are very slow to respond to price shifts. Oil is a must-have commodity with no large scale substitutes; when pump prices rise, most small businesses have little choice in the near term but to pay more rather than

⁵ http://www.eia.gov/energyexplained/index.cfm?page=gasoline_factors_affecting_prices

⁶ *The Availability and Price of Petroleum and Petroleum Products Produced in Countries Other Than Iran*, EIA, February 29 2012

⁷ *This Week In Petroleum*, EIA, January 19, 2012

buy less. And on the supply side, it takes years to develop new resources, even when the price incentive to do so rises sharply. Commodities with such low short term demand and supply responsiveness tend to have big price swings.

Oil's tendency toward booms and busts has vexed oil producers and consumers since the beginning of the modern oil market in the mid-1800s. In response, various oil producers have tried to stabilize prices by controlling production. Standard Oil, the Texas Railroad Commission and the "Seven Sisters" (major western oil companies) succeeded at stabilizing prices by controlling supply, partly by holding spare production capacity back from the market and using it to balance swings in supply and demand. The 1967 Arab oil embargo did not lead to a major oil disruption or price spike, partly because the United States had spare capacity in reserve and increased production to make up for lost Arab producer exports. The 1973 Arab oil embargo did lead to an oil price spike, mainly because the year before – in March 1972 to be exact – the United States ran out of spare capacity.

OPEC took over control of the global oil market from the US and the Seven Sisters in the early 1970s. Since the mid-1980s, OPEC's main tool to stabilize prices has been holding and using spare production capacity. If demand jumped unexpectedly or if supplies were suddenly disrupted, OPEC producers with spare capacity, especially Saudi Arabia, would release more oil, reducing the need for prices to swing in order to balance supply and demand.

But the 2004-2008 period marked the first time since 1972 that capacity nearly ran out⁸ absent a major supply disruption or conflict in the Persian Gulf. As in 1972, the reason was demand was racing faster than production. But today, no new cartel is waiting in the wings to satisfy global crude appetites. In 2008, market balance was achieved by sharply rising oil prices along with a sharp decline in demand induced by the financial crisis. While many in Washington, Paris, Riyadh, and Beijing publicly blamed financial market participants, energy experts and economists pointed instead to strong demand for a price inelastic commodity running up against a finite supply.

Going forward, OPEC may still exert some control over when falling oil prices make a bottom. The cartel can and likely will still take oil off the market to keep prices from falling or to raise them afterward, as it did in late 2008 and 2009.

But OPEC's ability – really, Saudi Arabia's ability – to prevent damaging price *spikes* has eroded. Therefore, a replay of the mid-2000s is more a question of when than if. Recently, non-OPEC supply growth and OPEC spare capacity were revised sharply down, suggesting the tightening trend may be underway, though an economic downturn may still soften up the global oil market and cause oil prices to fall.

In general, global GDP growth remains oil intensive, driven by voracious consumption in fast-growing Asian and Middle Eastern markets. While world GDP grows strongly, non-OPEC supply growth is not expected to rise fast enough to meet incremental oil demand, requiring OPEC producers to increase production. But OPEC is not investing enough in total production capacity to meet demand growth and still maintain the *minimum* 4-5 mb/d spare capacity buffer needed to assure market participants it can respond to disruptions or tighter-than-expected fundamentals by adding supply. Saudi Arabia, the main spare capacity holder, says it will hold only 1.5 to 2.0 mb/d of spare capacity, and most other OPEC countries hold little if any back in spare.

Taken together, voracious demand and constrained supply trends mean the world can experience 4% GDP growth or double digit crude oil prices, but probably not both. As OPEC fails to cap rising prices, price increases large enough to ratchet down demand will enforce the iron law that at the end of the day the world cannot consume what it cannot produce.

Soaring global demand and constrained supply growth is causing OPEC to lose its spare capacity cushion and therefore its ability to stabilize oil prices. While intuitively OPEC losing control may seem like a good thing, it actually means global oil prices, and therefore fuel prices small business face, are going to swing much more wildly in the future, at times high enough to contribute to recessions as they did in 2008.

Lower import dependence is welcome but will not insulate motorists from gyrating fuel prices

Higher US and hemispheric oil and gas production is great news for our economy and energy markets. If the investment and regulatory climate allows industry to realize the full supply potential, it will mean more jobs, improved resilience to supply disruptions, and a lower current account deficit. Our companies and workers will have opportunities to take advantage of these same techniques and technology to unlock unconventional oil and gas resources abroad.

But the good news must be viewed in perspective. Even if we were entirely self-sufficient in oil, our pump prices would still move up and down with global crude oil prices. Oil is fungible, widely traded, and priced in a global market. A crude price shock anywhere is transmitted to pump price changes everywhere.

⁸ Many market participants believe Saudi spare capacity was completely exhausted in the summer of 2008, despite EIA data indicating less than 1 mb/d was remaining. Generally, private market participants tend to believe official estimates of spare capacity are overstated.

Therefore our gasoline and diesel prices are and will remain strongly linked to trends and developments in the global oil market, not our import share. As leading oil expert Daniel Yergin wrote in a recent Washington Post editorial, “[t]here is only one world oil market, so the United States – like other countries – will still be vulnerable to disruptions, and the sheer size of the oil resources in the Persian Gulf will continue to make the region strategically important for the world economy.”⁹

Financial market participants contribute to the formation of prices but there is no evidence they are distorting or manipulating them

Spot and futures oil prices are determined in a global market by numerous physical and financial participants. Physical participants are in the business of producing and consuming energy, and include producers such as oil companies and users such as airlines. Financial market participants range from hedge funds to longer term investors such as pension funds and typically do not have physical exposure to energy production or consumption.

Futures markets exist primarily because physical participants wish to hedge or transfer price risk to financial market participants willing to bear it. Producers may wish to sell their production forward and lock in prices. Consumers may wish to lock in their future purchase price.

Financial speculators assume price risk other market participants wish to avoid. The active participation of financial investors in oil futures and derivatives markets is legal and desirable, as it enables energy consumers and producers to transfer price risk and protect against price swings. They also help bring information to the market and can smooth price swings.

If there were no speculators, there could be no hedging. Without hedging, energy producers and consumers could not manage their oil price risk, which would increase uncertainty, risk aversion, and ultimately the cost of producing and consuming energy in the economy.

There is considerable focus in the public policy debate on the role of speculation in affecting oil prices. It is crucial to define speculation and differentiate it from manipulation (or distortion).

Speculation is basing purchases or sales based on anticipated price moves. Both physical and financial market participants speculate. For example, a trucking fleet owner who must buy large quantities of diesel fuel decides not to lock in a future sales price using futures or derivatives is effectively speculating that future prices will not rise.

Manipulation or distortion involves activities that cause prices to diverge from levels justified by market conditions. There is no compelling evidence that any group of market participants, including financial ones, are distorting oil prices. In order to “distort” or “manipulate” prices, financial market participants would have to hoard physical supply and take advantage of weak or broken convergence between paper and physical markets. There is no evidence of such hoarding or weak paper-physical convergence in the global oil market.

Moreover, in recent years both prices of exchange-traded commodities such as oil, which include financial speculators, and commodities that are not exchange-traded, and there for not include financial speculators, have risen more or less in tandem (see Figure 5 below).

In the past years, many US and international regulators, energy officials, and independent academics have investigated the role of financial market participants and oil prices. The overwhelming view of official investigations and analyses holds that supply and demand fundamentals and not financial market participants were the primary drivers of oil prices.¹⁰ This conclusion was reached in a 2008 interim report by an interagency task force headed by the Commodities Futures Trading Commission and consisting of representatives from the Departments of Treasury, Energy, and Agriculture as well as the Federal Reserve, Federal Trade Commission, and the Securities and Exchange Commission.

The view that supply-demand fundamentals explain price behavior and not the actions of financial market participants is also supported by most leading independent academics.¹¹

The reality is we will need bigger and deeper financial markets because wild price gyrations are going to increase demand for hedging, including by small businesses. In the new “Space Mountain” era of gyrating oil prices, there will be greater demand by energy consumers and producers to buy insurance from oil price swings and therefore a bigger need for financial market participants to provide that insurance. As Michael Levi and I wrote last summer:

⁹ Daniel Yergin, “Oil’s new world order,” Washington Post, October 28, 2011.

¹⁰ Medium Term Oil and Gas Markets 2012, International Energy Agency, p. 29. See also “Energy and Financial Markets Overview: Crude Oil Price Formation,” EIA, May 5, 2011; Box1.4, IMF World Economic Outlook, September 2011, pp 56-60; Dallas Federal Reserve, October 2011.

¹¹ <http://dallasfed.org/research/ocstt/2011/cf1110.html>; and “Interim Report on Crude oil, Interagency Task Force on Commodity Markets, CFTC, July 2008.”

¹² Fattouh, Bassam, Lutz Killian, and Lavan Mahadeva (2012). “The Role of Speculation in Oil Markets: What Have We Learned So Far?” Discussion Paper, Centre for Economic Policy Research.

Policymakers should help facilitate more hedging by encouraging the development of well-regulated financial markets: the point is to relieve those who are exposed to price risks today—from motorists to airlines and other oil-intensive industries—and transfer those risks to speculators, who are more willing and better able to bear them. The Dodd-Frank financial reform legislation of 2010 took some helpful steps in this direction, such as requiring that most transactions be conducted on regulated exchanges and that the Commodity Futures Trading Commission collect and publish better data on a wider range of transactions.

Officials should take care not to go too far, however, and prescribe overly harsh limits on speculative bets in energy futures, and other costly barriers for firms that need to hedge. A blanket crackdown on hedging and speculation would only increase firms and consumers' exposure to volatility, by shrinking financial markets and chasing hedging to less transparent and less regulated venues.¹²

The activities of financial market participants should be well policed for manipulation and fraud. The CFTC and other regulators police actively against instances of fraud or manipulation in financial markets, and recently imposed position limits under Dodd-Frank are intended to prevent excessive speculation, though there is no clear cut way to identify when speculation becomes "excessive."

The CFTC is working carefully to build a solid foundation for appropriate position limits in futures and over-the-counter markets, which requires an enormous amount of data collection. If the CFTC is overly hasty or incautious, it could subject the position limits rule to legal challenge or inadvertently chase financial market activity to other, less transparent or well-regulated venues.

Strategic stocks should not be used to smooth gasoline prices

As it becomes clearer that OPEC can no longer cap oil and therefore gasoline prices, clamor for the United States to use its strategic reserves to moderate prices will rise. Absent a severe supply disruption, this would be deeply unwise. If the US tries to use strategic stocks to keep gasoline prices stable, it is likely to end up with neither strategic stocks nor gasoline price stability. There are several points to consider:

- Strategic stocks are finite and too small to have a lasting impact on oil prices. In a 90 million barrel per day market prone to large, unexpected swings in supply and demand, sporadic SPR withdrawals of 1 to 3 million barrels a day which last only a few days are unlikely to influence global fundamentals and therefore prices other than in the very short term, if at all.
- Officials do not have sufficient information to know when or how much oil to add or subtract from the global market to keep prices stable, and could well run out of supplies before they managed to flatten prices. Good data on global oil market supply and demand is lacking, and the best data are available only with lags measuring calendar quarters and years.
- Even if the US had sufficient information, decisions on when to use the SPR would be influenced by political pressures and factors rather than economic ones.
- Using the SPR would induce private companies to hold lower stocks, and OPEC could offset the impact by cutting production, as seen after President Clinton ordered an SPR stock draw in September 2000.
- Frequent, capricious frittering away of strategic stocks in a futile attempt to influence global oil prices would increase market uncertainty and price volatility.

¹² "A Crude Predicament: The Era of Volatile Oil Prices," Robert McNally and Michael Levi, *Foreign Affairs*, July/August 2011

Figure 1. Estimated Unplanned Production Disruptions Among non-OPEC Producers, October 2011 - April 2012

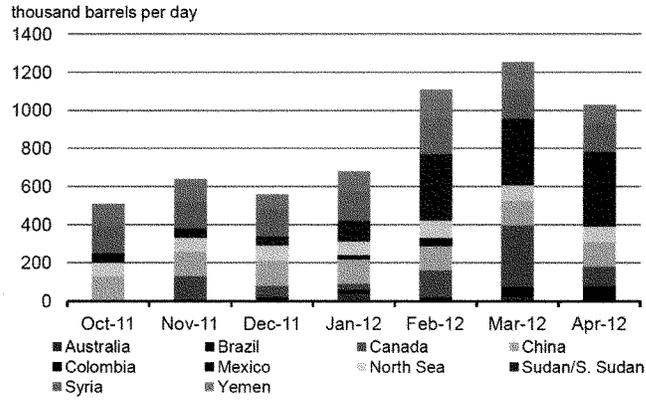


Figure 1

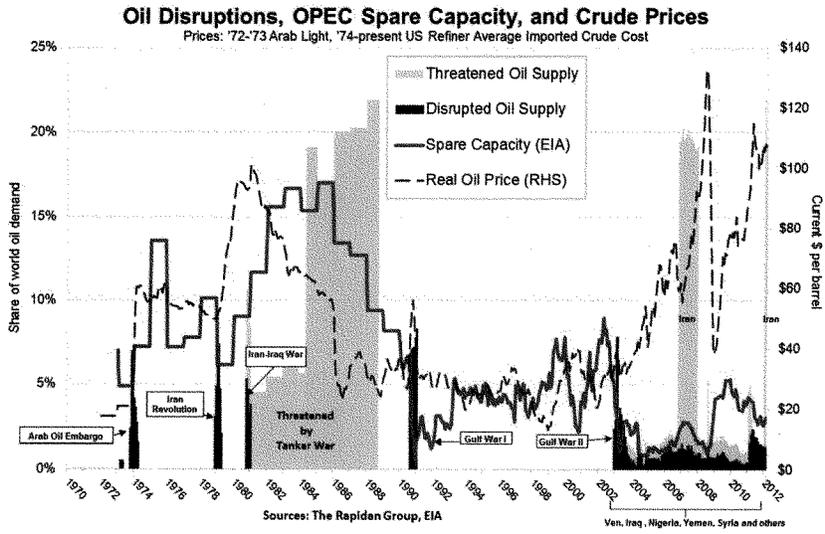
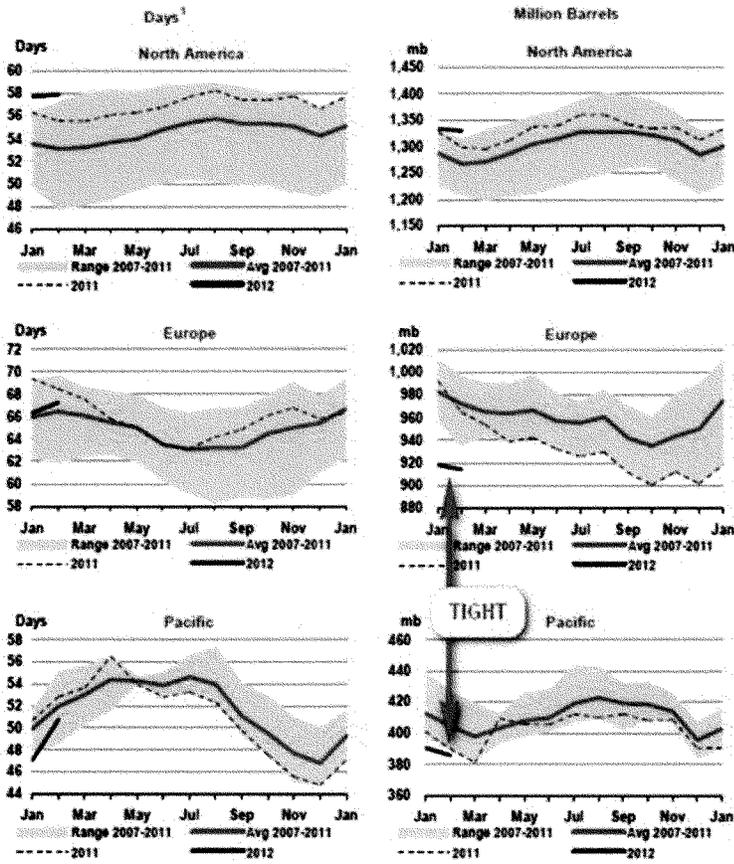


Figure 2

Regional OECD End-of-Month Industry Stocks
 (in days of forward demand and millions barrels of total oil)



IEA Oil Market Report, April, 2012

Figure 3

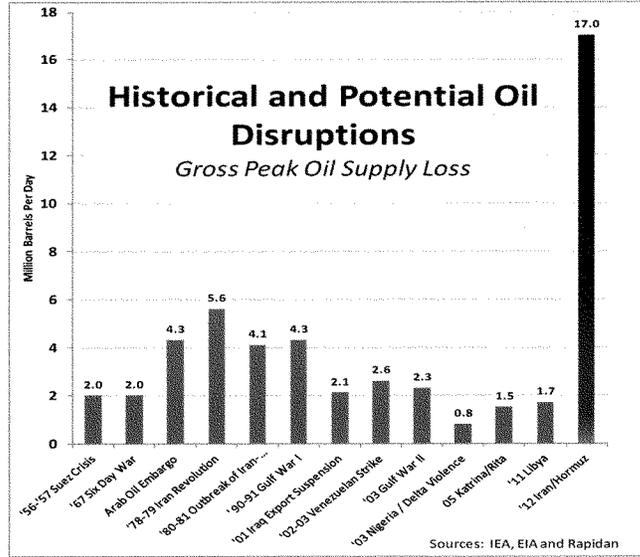
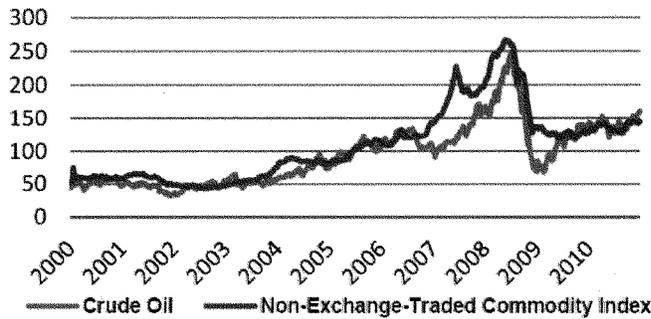


Figure 4

Figure 1: Price of Non-Exchange Traded Commodities and Price of Crude Oil



Source: Computations of the authors based on data in the *IEA Oil Market Report*, March 15, 2011.

Reprinted with permission from Fattouh, Kilian, and Mahadeva (2012)

Figure 5

**TESTIMONY OF JAMIE SMITH
OWNER & GENERAL MANAGER
AT MR. ROOTER PLUMBING OF GREATER BALTIMORE
BEFORE THE**

U.S. HOUSE OF REPRESENTATIVES COMMITTEE ON SMALL BUSINESS
“Running on Empty: The Effects of High Gasoline Prices on Small Businesses”

MAY 9, 2012

Chairman Graves, Ranking Member Velázquez, and members of the Small Business Committee, thank you for your invitation to testify at today’s hearing. I am honored to have the opportunity to speak with you regarding the current crisis of rising gas prices and their effect on the small business community. I believe my role as a small business owner qualifies me to provide testimony on the topic of rising gas prices.

My name is Jamie Smith and I am a franchisee of the Mr. Rooter Corporation. I am the Owner and General Manager of Mr. Rooter Plumbing of Greater Baltimore, and a member of the International Franchise Association. My business offers heating and plumbing solutions to the Greater Baltimore, Maryland area and I employ 10 plumbing and office professionals. My current fleet of five service vehicles uses a combined total of 1,200 gallons of gasoline per month, which equates to approximately 10% of my revenue. To alleviate this burden on my business and all small businesses, I ask that American policymakers immediately invest our tax dollars in strategies for increased energy production, conservation of our existing resources and promoting alternative energy options like natural gas and hybrid electric vehicles.

Since opening my operation in 2010, I have seen a 29% increase in fuel prices, at a time when my sales and revenues have declined. In an effort to offset the rising fuel charges, I added an \$11 fuel surcharge to all service calls, but many customers refuse to pay this charge. In fact, some potential customers disapprove so vehemently of this practice that they refuse to consider Mr. Rooter of Greater Baltimore for their future plumbing and heating needs.

As a small business owner, I cannot leverage economies of scale to absorb cost increases like larger corporations. Absorbing these costs drastically affects my bottom line. My company also services several counties with only five vehicles which mean my vehicles are traveling greater distances to reach our customers than larger plumbing operations with 30+ vehicles and smaller, more defined territories that limit distance traveled.

I wrote to my Governor, Martin O’Malley, to protest his proposal to make gasoline subject to the Maryland state sales tax. This would obviously increase the cost of gasoline to the economy’s most fragile sector, the small business. I used to think that having a small business was the American dream, but now it appears to be the American nightmare. When it comes to energy consumption, I think that a focus on new taxes is the wrong answer. State and Federal policymakers should be focused on increasing the production of domestically produced energy solutions

I support projects that would lower the cost of gas while helping the economy. I enjoy having the freedom to own and operate my small business and providing a fulfilling place for my fantastic team of Mr. Rooter employees to work. However, if policymakers in Washington do not begin to embrace new energy policies, I believe you will begin to see an increase in small business failures. Meeting obligations such as payroll, energy consumption and other overhead expenses with diminishing profits, becomes unsustainable.

Thank you for this opportunity and I look forward to answering any questions from the Committee.



**TESTIMONY OF
C. COOKIE DRISCOLL
WHODATHUNKIT FARM
VICE CHAIR OF MEMBERSHIP FOR THE
NATIONAL SMALL BUSINESS ASSOCIATION**

**AT A HEARING BEFORE THE
U.S. HOUSE COMMITTEE ON SMALL BUSINESS**

“EFFECTS OF GASOLINE PRICES ON SMALL BUSINESSES”

MAY 9, 2012

Chairman Graves, Ranking Member Velazquez, and Members of the Committee, my name is C. Cookie Driscoll, and I am the owner of two small businesses, Whodathunkit Farm and C. Cookie Driscoll, Inc., both of which are located in the Fairfield, PA., just across the Maryland state line in Adams County. My farm is a full care boarding and learning facility and my other business offers a line of gift items targeted toward the equestrian and pet industries as well as promotional products like pens, mugs and embroidered shirts. I also am on the Board of Trustees of the National Small Business Association (NSBA), the oldest small-business advocacy organization in the U.S.

I would like to thank you for inviting me to testify today about the effects of gasoline and diesel prices on small businesses, particularly my farm. I am very grateful that you are aware of, and addressing the negative impact unstable and increasing gasoline prices are having on small businesses across the country.

My farm is on 12 acres and includes a nine stall barn, three paddocks and an outdoor arena for lessons and training. I bought the farm on March 20, 1997 and began accepting boarders and students. Because of the limited paddock area, I feed the horses concentrated feeds (commonly known as oats or sweet feed) and hay pretty much year-round. Over time, I have watched my expenses increase dramatically.

The cost of fuel affects every aspect of running a horse farm, no matter how big or small.

The farm equipment used to plant, spray, harvest and transport the feed all uses diesel fuel which is now more costly than gasoline. Currently, the cost of diesel fuel in our small farming community varies from \$4.15 per gallon to roughly \$4.39 per gallon and gasoline varies from \$3.69 per gallon to approximately \$3.99 per gallon. These high prices and the volatility of these prices have a significant impact on my bottom line, including the cost of feed which has risen exponentially over the past few years. And, if that isn't bad enough, the use of corn to make fuel now has forced the price of corn up and corn is used in almost all feed concentrates on the farm.

Of course, we feed more than the blended concentrates that use the corn and other grains. We feed a lot of hay and, again, every aspect of the price of hay is tied into the price of fuel, from planting, to cutting, raking, baling and now even packaging. The big round bales are either wrapped in a plastic mesh or solid plastic wrap, both made from petroleum products. With the unusual rain patterns that we've experienced over the past few years, the hay crops have been adversely affected in many areas around the country. Because of that we often have to travel much farther to buy suitable hay, adding transport costs to an already expensive staple on the farm. But I don't just depend on baled hay to feed the horses. Hay is used as the base ingredient in the pelleted feeds that contain the corn, oats, and other grains. So, no matter where the hay crops fail, feed manufacturers have the added cost of trucking the hay in to produce the concentrates we use. These costs are then passed on to us.

And of course after the horses have enjoyed the benefit of the feed, the manure either has to be spread or hauled away, again using fuel.

Bedding for the horses is usually either wood shavings or straw. My cost for packaged wood shavings went from \$2 per bale to \$6.00 for the packed and \$6.50 for the pelleted shavings. These increases came about partly because of the housing industry coming to a screeching halt and partly because of the cost of fuel. Again, hauling the timber, milling, collecting the shavings and transportation uses diesel fuel. And the packaged shavings are also packaged in plastic bags, so when the cost of fuel goes up, it affects the price of the bedding.

If the horses on the farm are being shown, the price of fuel can determine how far away the owner is willing to travel to campaign a horse and how often they will compete. The commercial horse transportation companies have had to increase their “per mile rate” significantly which is another cost passed on to small businesses like mine. The same goes for horses that are racing. Breeding operations typically have to transport the mares to the stud farms, adding expense to the operation and with no guarantees that one trip will accomplish the desired outcome.

There just isn't much about managing a horse farm that isn't affected by the price of fuel. Even the veterinarians and the farriers have to charge trip fees to cover their travel expenses when they come and tend to the horses. But for those enthusiasts who are

determined to keep their horses, it's worth it. If they have to they will take on a second job to cover the cost, and many do.

In addition to being a small-business owner, I am also a member of the National Small Business Association and serve in a leadership capacity on the Board. I can tell you that, without question, my issues aren't unique to my business or my industry. We all are hurting from volatile and rising gas prices. As such, NSBA recently adopted a new energy and environmental policy and will continue to take an active role in advocating on behalf of small businesses in these areas and urging lawmakers and regulators to consider the burden that any energy or environmental policy or rule would have on small firms.

In short, we believe that any energy or environmental policy should have five primary objectives: 1) ensure clean air and water; 2) promote adequate and affordable energy; 3) end U.S. reliance on foreign energy; 4) simplify regulatory requirements and accelerate the approval process; and support federal energy research dollars for small firms.

I beg of you to please keep in mind that the impact of rising and volatile gas prices is not isolated to a horse farm. Cattle farms, pig farms, and even poultry operations are dramatically affected by the price of fuel just like I am. These costs go so far beyond the cost of transporting the livestock.

Thank you for allowing me to testify on such a critical issue for America's small business community. It was an honor to address all of you and I welcome any questions you might have.

Running on Empty: The Effect of High Gasoline Prices on Small Businesses

Testimony
of
Michael Greenberger
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University of Maryland
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United States House of Representatives
Small Business Committee
Rayburn House Office Building, Room 2360
Washington, DC
Wednesday, May 9, 2012, 1:00 PM EST

I. Excessive Speculation is Needlessly Driving Up the Price of Oil and Other Essential Commodities and Increasing Volatility in Commodities Markets

Over the past five years the price of a barrel of West Texas Intermediate (“WTI”) crude oil has radically changed: from \$65 in June 2007;¹ to a world-record high of \$147.17 in mid-July 2008;² to a low of \$30 in December 2008;³ to \$75 in July 2009; to \$110 in April 2011;⁴ to \$76 in October 2011;⁵ and to \$106 as of May 1, 2012.⁶ Since the beginning of this month, the price of crude oil has dropped almost \$9 and is now at around \$97 a barrel—a remarkably fast price decrease. Needless to say, gasoline prices (a key derivative of crude oil) have risen and fallen accordingly.

There is widespread recognition that a continued and sustained increase in gas prices will undermine the country’s fragile economic recovery, especially the viability of small businesses with their limited capital resources to withstand the price shocks, thereby raising the specter of a renewed recession with a substantial further increase in unemployment.

The majority of experts have concluded that the extreme volatility in crude oil prices is not completely related to corresponding changes in market fundamentals.⁷ A host of prominent economic studies from, *inter alia*, Stanford, Princeton, Texas A&M University, and the London School of Economics, as well as analysis by such prominent market observers as Nouriel Roubini from the Stern School of Business at New York University, have concluded that the five year volatility in the price of crude oil is due in no small part to *excessive speculation* (i.e., far

A brief biography of Professor Greenberger is attached as Appendix B hereto.

¹ See U.S. Energy Information Administration, *Petroleum and Other Liquids: Cushing OK WTI Spot Price* (May 4, 2012), available at <http://www.eia.gov/dnav/pet/hist/LeafHandler.ashx?n=PET&s=RWTC&f=D>.

² Financial Markets Group Planning Division, *West Texas Intermediate (WTI): Medium Term Trend Reversal?*, Alpha Bank (July 18, 2008), available at http://www.alpha.gr/files/infoanalyses/Commodities_TechVista_20080718.pdf.

³ U.S. Energy Information Administration, *supra* note 1.

⁴ See LiveCharts.com, *WTI Crude Oil Price History (April-May 2011)*, available at http://www.livecharts.co.uk/futures_commodities/oil_prices_historical.php?type_symbol=future_s_wi&start=240.

⁵ See LiveCharts.com, *WTI Crude Oil Price History (October-November 2011)*, available at http://www.livecharts.co.uk/futures_commodities/oil_prices_historical.php?type_symbol=future_s_wi&start=120.

⁶ See LiveCharts.com, *WTI Crude Oil Price History (March-May 2012)*, available at http://www.livecharts.co.uk/futures_commodities/oil_prices_historical.php.

⁷ See Henn, Marcus, *Evidence On the Negative Impact of Commodity Speculation by Academics, Analysts and Public Institutions* (March 28, 2012), available at http://www2.weed-online.org/uploads/evidence_on_impact_of_commodity_speculation.pdf (listing nearly one hundred studies and commentaries that conclude that excessive speculation is affecting the prices of staple commodities).

too much speculation) by non-commercial institutions in the crude oil derivatives markets.⁸ There are well over 50 studies and commentaries to this effect,⁹ including a recent report by the St. Louis Federal Reserve that concludes, “speculation accounted for about 15 percent of the measured rise in oil prices from 2004 to mid-2008.”¹⁰

Supply and demand for crude oil (and for food supplies) have, for most of the last five years, remained in equilibrium and there is near unanimous agreement that there is now no shortage in the global supply of oil.¹¹ The disconnect between oil prices and supply/demand fundamentals was evidenced in mid-March of this year when, on nearly the same day, the Saudi King promised to increase crude oil production by as much as 25 percent to make up for any shortfalls from a threatened (but never acted upon) Iranian oil boycott¹² and President Obama strongly hinted that the United States might very well release crude oil from the Strategic Petroleum Reserve,¹³ but the price of crude oil went up!¹⁴

The disconnect between crude oil prices and market supply and demand—oil prices rising when supply increases—combined with clear evidence of physical withholding of oil from energy markets—undercuts ongoing attempts to explain high energy prices purely in terms of market fundamentals.¹⁵ For example, Nobel Prize-winning economist Paul Krugman, who originally remained steadfast in his belief that crude oil prices were dictated by market fundamentals, ultimately embraced the argument that excessive speculative activity is driving up

⁸ For a full citation to the many studies and commentary showing that excessive speculation (and not market fundamentals) is causing bubbles in commodity staples, see Appendix (App.) A, item 1 at pp. 8-9; see also *id.*, item 3 at pp. 7, 9.

⁹ *Id.* at p. 8.

¹⁰ Fawley, Brett, Luciana Juvenal & Ivan Petrella, *When Oil Prices Jump, Is Speculation To Blame?*, St. Louis Federal Reserve, available at <http://www.stlouisfed.org/publications/re/articles/?id=2232>.

¹¹ App A., item 10.

¹² Daya, Ayesha, *Saudi Arabia Can Raise Output 25% If Needed, Naimi Says*, BLOOMBERG (March 20, 2012), available at <http://www.bloomberg.com/news/2012-03-20/saudi-arabia-can-increase-oil-output-25-if-needed-naimi-says.html>.

¹³ Mably, Richard, *U.S., Britain Set to Agree on Emergency Oil Stocks Release*, REUTERS (March 15, 2012), available at <http://www.reuters.com/article/2012/03/15/us-oil-reserves-idUSBRE82E0UM20120315>.

¹⁴ See LiveCharts.com, *WTI Crude Oil Price History (February-March 2012)*, available at (February-March), available at http://www.livecharts.co.uk/futures_commodities/oil_prices_historical.php?type_symbol=future_s_wi&start=30; see also App. A, item 6 at pp. 6-7 (noting that investment vehicles used by speculators in the oil market are also used in agricultural commodity markets; food prices move in synch with oil prices and price bubbles in agricultural commodities markets have caused starvation in developing countries).

¹⁵ See Robert J. Samuelson, *The Fallacy of Blaming Oil ‘Speculators’*, WASHINGTON POST (May 2, 2012), available at http://www.washingtonpost.com/opinions/the-fallacy-of-oil-speculation/2012/05/02/gIQAk7bkwT_story.html (arguing that price volatility in the oil markets is caused by small shifts in supply and demand).

the price of oil.¹⁶ As Krugman observed: “Last year I was skeptical about claims that speculation was central to the price rise . . . this time there’s no question: speculation has been driving prices up.”¹⁷

Also, when the price of a barrel of crude oil was reaching \$110 in April 2011, the CEO of ExxonMobil testified to the Senate Finance Committee that market fundamentals only justified a price of \$60 to \$70 a barrel, thereby recognizing that supply/demand did not justify the then-existing high price.¹⁸ By October 2011 the bubble in the oil markets temporarily burst and the price did in fact drop to close to the \$60 to \$70 price range.¹⁹

Indeed, President Obama has on at least on four occasions—June 22, 2008 (during his presidential campaign when crude oil was approaching its world-record high of \$147 a barrel),²⁰ April 20, 2011 (when crude oil spiked to \$110 a barrel),²¹ on March 8, 2012 (when the price of a barrel of crude oil had again spiked, increasing from the October 2011 low of \$76²² to \$106),²³ and on April 17, 2012²⁴ (as gas prices at the pump approached \$4 per gallon)²⁵—expressed an abiding concern that the repeated and extreme spikes in crude oil and gasoline prices were due to speculative malpractices by large financial players in the oil market. The President then analogized the present market disruption in crude oil and gasoline prices to the manipulation of the electricity market on the West Coast in 1999 and 2000 by Enron and its market allies.

Most recently, on April 17, 2012, the President, while proposing a \$52 million plan to expand the CFTC’s market manipulation surveillance and enforcement capabilities and increase the civil and criminal penalties for manipulating commodities markets and urging further work

¹⁶ Krugman, Paul, *Oil Speculation*, N.Y. TIMES (July 8, 2009), available at <http://krugman.blogs.nytimes.com/2009/07/08/oil-speculation/?scp=2&sq=speculative%20trading%20in%20oil&st=cse>.

¹⁷ *Id.*

¹⁸ Lenzner, Robert, *ExxonMobil CEO Says Oil Price Should Be \$60 To \$70 a Barrel*, FORBES (May 14, 2011), available at <http://www.forbes.com/sites/robertlenzner/2011/05/14/exxon-mobil-ceo-says-oil-price-should-be-60-70-a-barrel/>.

¹⁹ U.S. Energy Information Administration, *supra* note 1.

²⁰ Bohan, Caren, *Obama Vows to Crack Down on Oil Speculation*, REUTERS (June 22, 2008), available at <http://www.reuters.com/article/2008/06/22/us-usa-politics-obama-energy-idUSN2243134220080622>.

²¹ Mason, Jason, *Obama Blames Speculators for Rising U.S. Fuel Prices*, REUTERS (April 20, 2011), available at <http://www.reuters.com/article/2011/04/20/us-usa-energy-obama-speculators-idUSTRE73J1NN20110420>.

²² See LiveCharts.com, *supra* note 5.

²³ See LiveCharts.com, *supra* note 6.

²⁴ See *id.*; see also LiveCharts.com, *supra* note 5.

²⁵ See Cooper, Helene, *As Gas Prices Cast Cloud, Obama Calls for Scrutiny on Market*, N.Y. TIMES (April 17, 2012), available at <http://www.nytimes.com/2012/04/18/us/politics/obama-urges-oil-market-scrutiny-as-gas-prices-cast-cloud.html>.

by the Justice Department's gas price task force,²⁶ said, U.S. production is up and U.S. consumption is down.²⁷ In fact, the world's supply of oil is sufficiently stable that at the end of March the President found tighter oil sanctions could be imposed on Iran without affecting market fundamentals.²⁸

President Obama And Members of the House and Senate Have In the Past Successfully Tamped Down Excessive Speculation in the Crude Oil Market

Legislative efforts to curb excessive speculation and manipulation in staple commodity markets have long garnered strong bipartisan support in Congress. In 2005, when natural gas reached world record prices, Chairman Graves partnered with Congressman Barrow (D-Ga) to sponsor market reform measures included in the CFTC Reauthorization Act of 2005 (H.R. 4473).²⁹ The bill aimed to strengthen the CFTC's ability to detect and prevent manipulation in the natural gas market by increasing recording requirements for large traders as well as civil and criminal penalties for market manipulation.³⁰ Indeed, the pricing crisis in natural gas, led the Republican controlled Congress to pass the Energy Policy Act of 2005, which gave the Federal Energy Regulatory Commission ("FERC") co-extensive jurisdiction with the CFTC for manipulation in the natural gas futures markets.³¹ In July 2007, Representatives Graves and Barrow again co-sponsored legislation (H.R. 3009) that would require traders who hold large

²⁶ See Obama, Barack, President of the United States, *Remarks by the President on Increasing Oversight on Manipulation in Oil Markets*, The White House (April 17, 2012), available at <http://www.whitehouse.gov/the-press-office/2012/04/17/remarks-president-increasing-oversight-manipulation-oil-markets> [hereinafter President Obama]; see also Cooper, *supra* note 25.

²⁷ See President Obama, *supra* note 27; see also Cooper, Mark, *Consumer Federation of America, Excessive Speculation and Pain at the Pump The Never-ending Story: Fixing the Long-Term Fundamentals and Addressing the Short-Term Problems Go Hand-in-Hand* (manuscript with author) ("Consumption is down by ten percent (2 million barrels per day). Domestic oil production is rising for the first time in over three decades. In addition, biofuel production is now equal to over ten percent of domestic crude oil production. Combined, the increase in production equals 1.2 million barrels per day, or about 7 percent of consumption. Imports are down to a level not seen since the mid-1990s. The downward trend of imports is greater than at any time since the price spikes of the 1970s. Spare refinery capacity is up.").

²⁸ Jackson, David, *Obama to Proceed With Iran Oil Sanctions*, USA TODAY (March 30, 2012), available at <http://content.usatoday.com/communities/theoval/post/2012/03/ap-obama-to-proceed-with-iran-oil-sanctions/1#.T3pbozEgef4>.

²⁹ App. A, item 18.

³⁰ *Id.*; see also, Alistair Barr, *Bill Limiting Natural Gas Speculation to Be Introduced*, MARKETWATCH (April 13, 2005), available at <http://www.marketwatch.com/story/bill-limiting-natural-gas-speculation-to-be-introduced>.

³¹ Energy Policy Act, Pub. L. No. 109-58, 119 Stat. 594 (2005), available at <http://www.gpo.gov/fdsys/pkg/PLAW-109publ58/pdf/PLAW-109publ58.pdf> ("It shall be unlawful for any entity, directly or indirectly, to use or employ, in connection with the purchase or sale of natural gas or the purchase or sale of transportation services subject to the jurisdiction of the Commission, any manipulative or deceptive device or contrivance[.]").

positions in the natural gas market to report these positions to the CFTC.³² At the time, Chairman Graves argued that prices in the natural gas market were “being driven by speculation and manipulation of the markets” and that Congress needed to act to prevent consumers from paying more for natural gas.³³

FERC’s aggressive investigation and prosecution of excessive speculation and manipulation in natural gas markets has kept natural gas prices at or near a ten-year low. The agency has made stopping market fraud and manipulation “an enforcement priority”³⁴ by passing regulations that ensure market transparency³⁵ and by rigorously enforcing its enhanced anti-manipulation regulations under the Energy Policy Act of 2005. In 2006 FERC sought penalties and disgorged profits of over \$290 million³⁶ in connection with the alleged manipulation of natural gas markets by traders at Amaranth Advisors LLC.³⁷ FERC settled with Amaranth, but

³² *Lawmakers See Need to Put Limits on U.S. Electronic Energy Markets*, PUBLIC POWER WEEKLY 5 (July 23, 2008), available at <http://www.nxtbook.com/nxtbooks/navlor/appaWeeklyDemo/index.php?startid=5>.

³³ *Id.*

³⁴ Federal Energy Regulatory Commission, *Prohibition of Energy Market Manipulation* (April 21, 2011), available at <http://www.ferc.gov/enforcement/market-manipulation.asp> [hereinafter *Prohibition of Energy Market Manipulation*]; see also Scott DiSavino & Jonathan Leff, *Energy Regulators In New Push to Quash Manipulation*, REUTERS (April 12, 2012), available at <http://mobile.reuters.com/article/topNews/idUSBRE83B06Z20120412> (reporting that “[e]mboldened energy market regulators are mounting an aggressive new campaign to stamp out a once-common trading practice” and that FERC “is leading the charge with advanced enquiries into several big energy firms and banks”).

³⁵ See Clearly Gottlieb, *FERC’s New Focus on Transparency and Protecting Against Manipulation of Natural Gas Markets* 1 (Jan. 17, 2008), available at <http://www.cgsh.com/files/News/c30a1328-e321-4d45-a060-5d6a0bf6c3c6/Presentation/NewsAttachment/2c55bc4e-18c3-4e6e-a3db-6061618857c8/10-2008%20Natural%20Gas%20Alert%2020080117.pdf> (commenting that FERC regulations require a broad range of market participants to report annually specified information related to their natural gas trades, such as the total volume of transactions for the previous year and the volume of transactions that were priced according to a particular pricing mechanism, like by reference to next-day gas price indices or to next-month gas price indices); see also Phillip Moeller, Commissioner at the Federal Energy Regulatory Commission, *Transparency Provisions of Section 23 of the Natural Gas Act* (April 19, 2007), available at <http://www.ferc.gov/media/statements-speeches/moeller/2007/04-19-07-moeller-M-1.pdf> (“I am confident that the proposed daily postings by the intrastate carrier will allow the Commission and other market observe[r]s to identify and remedy potentially manipulat[iv]e activity more actively by tracking price movements.”).

³⁶ *Id.*

³⁷ See Federal Energy Regulatory Commission, *FERC Orders \$30 Million Fine Against Former Amaranth Trader* (April 21, 2011), available at <http://www.ferc.gov/media/news-releases/2011/2011-2/04-21-11-G-1.asp> (explaining that traders at Amaranth allegedly amassed large amounts of NG Futures Contracts, which they then sold at one time in order to increase the value of the significantly larger short positions maintained by Amaranth in natural gas swaps).

continued proceedings against Brian Hunter, a former Amaranth trader, and eventually fined Hunter \$30 million for his involvement in the manipulation scheme.³⁸ In 2011, FERC brought manipulation cases against Atmos Energy (for attempting to avoid FERC's posting and bidding requirements in order to create a long-term, noncompetitive discounted rate release)³⁹ and BP (for fraudulently trading physical natural gas and for trading points in order to increase the value of its financial positions).⁴⁰ FERC's relentless enforcement of its enhanced anti-manipulation rules has paid off: in April of this year natural gas futures closed at their lowest price since September 2001.⁴¹

Members of Congress have also repeatedly and successfully intervened to highlight and blunt the adverse impact of excessive speculation on the crude oil markets. On June 26, 2008, as oil prices were reaching their world-record high, the House passed H.R. 6377 by a vote of 402-19. The bill required the CFTC to act pursuant to its authority under the Commodity Exchange Act of 1936 and declare an "emergency" in the oil market and impose special limits on excessive speculative activity in crude oil futures markets.⁴²

On July 15, 2008, S. 3268 was introduced by Senate Majority Leader Reid. That bill would have imposed tough congressionally driven limits on excessive speculative activity in the crude oil futures markets.⁴³ On July 25, 2008, that bill received 51 votes in favor with 93 Senators present, a majority of the Senate, but not enough to invoke cloture.⁴⁴ Despite the bill's defeat, certain Republican Senators voted for cloture and others indicated that they might support the legislation in the future.

On September 28, 2008, the House passed H.R. 6604, which imposed tough speculative position limits in the crude oil futures markets by a vote of 283-133.⁴⁵ Also, on July 31, 2008,

³⁸ *Id.*

³⁹ See Federal Energy Regulatory Commission, *Staff Notice of Alleged Violations* (Aug. 12, 2011), available at <http://www.ferc.gov/enforcement/alleged-violation/notices/atmos.pdf> (alleging that Atmos violated section 1c.1 of FERC's anti-manipulation regulations).

⁴⁰ See Federal Energy Regulatory Commission, *Staff Notice of Alleged Violations* (July 28, 2011), available at <http://www.ferc.gov/enforcement/alleged-violation/notices/bp-america.pdf>.

⁴¹ Powell, Barbara, *Natural Gas Sinks Amid Supply Glut: Commodities at Close*, BLOOMBERG (April 19, 2012), available at <http://www.businessweek.com/news/2012-04-19/natural-gas-sinks-amid-supply-glut-commodities-at-close>.

⁴² Wisconsin AgConnection, *House Passes Legislation Requiring CFTC to Curb Oil Market Speculation* (June 27, 2008), available at <http://www.wisconsinagconnection.com/story-national.php?id=1516&yr=2008>.

⁴³ ThomasNet, *ATA Applauds Senator Reid and Other Sponsors of S. 3268* (July 21, 2008), available at <http://news.thomasnet.com/companystory/ATA-applauds-Senator-Reid-and-other-sponsors-of-S-3268-547049>.

⁴⁴ Govtrack.us, *On the Cloture Motion (Motion to Invoke Cloture on S. 3268)* (July 25, 2008) available at <http://www.govtrack.us/congress/votes/110-2008/s184>.

⁴⁵ Press Release, House Committee on Agriculture, *House of Representatives Approves Bill to Strengthen Oversight of Futures Markets* (Sept. 18, 2008), available at <http://agriculture.house.gov/press/PRArticle.aspx?NewsID=375>.

under the bi-partisan leadership of Senators Wyden (D-Oregon) and Grassley (R-Iowa), a Senate Finance discussion draft was circulated, which would have taxed profits from passive speculative crude oil futures as ordinary income.⁴⁶

The combination of Congress's efforts in 2008 led speculators to fear that legislators would soon pass legislation to limit the financialization of commodities markets and, as a result, passive betters in commodity index instruments abandoned these markets in droves. The mass exodus of passive betters from the crude oil market precipitated a radical drop in the price of a barrel of crude oil: the price dropped from its July 2008 world-record high of \$147 a barrel to \$30 a barrel by December of that year.

In the winter of 2009 when financial institutions realized that Congress would in fact not pass legislation stopping excessive speculation, the price of oil once again spiked. Oil prices rose for 54 days in a row in the spring of 2009 and by July 2009 the price of a barrel of crude oil reached \$75.⁴⁷ By late that summer, the legislation that later became the Dodd-Frank Act began making its way through Congress. It was made clear that that legislation aimed to impose tough new limits on excessive speculation in commodity derivatives markets and to strengthen the hand of the CFTC by allowing the agency to more easily bring market manipulation cases. Indeed, by the time Dodd-Frank was signed into law crude oil prices had stabilized for almost 18 months—prices fluctuated between \$75 and \$85 a barrel.

II. Crude Oil and Gasoline Prices Continue to Spike Unnecessarily as Implementation of Dodd-Frank Falters at The CFTC

In January 2011, the CFTC proposed its position limits rule under Dodd-Frank to curb excessive speculation in commodities markets. However, the agency staff's effort to dramatically limit excessive speculation in commodity markets was met with fierce opposition.⁴⁸ Three of the five CFTC commissioners expressed strong reservations about setting tough limits on excessive speculation. This highly publicized reluctance to impose rigorous position limits on excessive speculation as Dodd-Frank had intended unleashed the price of crude oil from the \$75-\$85 price range that it had been trading at since the summer of 2009 and caused the price of a barrel of oil to soon reach \$110.

On April 21, 2011, President Obama stated that the price spike in oil was not a result of market fundamentals (which as usual were in equilibrium), but the result of crude oil market manipulation by non-commercial speculators. He therefore convened a Department of Justice-led inter-agency task force to investigate that manipulation. As a result of threatened prosecutions, by October 2011 the price of crude oil was back down to around \$75—a price that, according to

⁴⁶ Press Release, Sen. Ron Wyden, *Wyden-Grassley Staff Proposes Level Playing Field for Oil Trade* (July 31, 2008), available at <http://wyden.senate.gov/newsroom/press/release/?id=681fc35e-e834-4b2d-b7dd-8b1e0e0828b1>.

⁴⁷ See App. A, item 6 at p. 4.

⁴⁸ Rampton, Roberta & Sarah Lynch, *CFTC Advances Position Plan, More Hurdles Ahead*, REUTERS (Jan. 13, 2011), available at <http://www.reuters.com/article/2011/01/13/financial-regulation-limits-idUSN1328349420110113>.

statements made by the CEO of ExxonMobil in April 2011, accurately reflected market fundamentals.

However, on October 19, 2011, the CFTC issued its final position limit rule by a mere 3-2 vote with Commissioner Dunn voting in favor of the rule but stating on the record that he thought the rule would do more harm than good.⁴⁹ The difficulty of obtaining a third vote in support of the final rule meant that the final position limits were high and the final rule sent a fresh signal to speculative financial forces that they need not fear Dodd-Frank. As soon as the limited nature of that rule was made clear, the price of crude oil rose dramatically once again, going from \$75 at the time the rule was finalized⁵⁰ to almost \$110 by February 2012 over a mere four month period.⁵¹

III. Congress and the Executive Branch Must Take Specific and Prompt Steps to Permanently End the Economic Pain Caused by Excessive Speculation in Commodities Staple Markets

As things now stand, three factors are clear.

First, Dodd-Frank's attempt to have the CFTC convert the statute's clear intent to limit substantially excessive speculation in commodity staples futures markets has been stymied. Rigorous position limits have been defeated by fierce and overwhelming lobbying before the CFTC—lobbying that has removed the possibility of a third vote in support of a tough limits on excessive speculation.

Second, the President's inter-agency task force has the potential to have a significant ameliorating affect on inflated crude oil prices. After the President convened the investigative inter-agency task force in April 2011, the price of a barrel of crude oil dropped from \$110 to \$76 (in October 2011). The President was prescient to reconvene that task force in March 2012 when confronted with the weak agency position limit rule, because the United States was then and is now faced with yet another crushing crude oil price bubble. Even the mere threat of criminal sanctions would cause speculators to pull back from these markets as they did after the task force was first convened in April 2011.

Without effective position limits on excessive speculation, the only option for immediate relief from rising gas prices is a tough investigation into market manipulation of the crude oil markets (as FERC has repeatedly done in the natural gas markets) led by the Department of Justice. History has shown repeatedly that even a simple, but clear, announcement by federal prosecutors of a serious investigative program will have an immediate ameliorative effect on commodities prices that are alleged to have been manipulated. That prosecutorial road now appears the best path to take in order to bring relatively quick relief to the American public and

⁴⁹ App. A, items 14 & 15.

⁵⁰ See LiveCharts.com, *supra* note 5.

⁵¹ See LiveCharts.com, *WTI Crude Oil Price History (February-March 2012)*, available at http://www.livecharts.co.uk/futures_commodities/oil_prices_historical.php?type_symbol=futures_wi&start=30.

to end rising gas prices as these prices constitute a major threat to the United States's economic recovery, including in the small business community.

In fact, the recent media scrutiny of Chesapeake Energy—"a powerhouse in the vast U.S. [energy] market"⁵²—and its CEO Aubrey McClendon suggests that efforts to restore transparency to commodity trading may, in and of themselves, decrease the price of crude oil. Reuters reported that McClendon had managed a hedge fund that traded in oil and natural gas futures for four years while he was chairman and CEO of Chesapeake and directed the company's own oil and natural trades as well as its energy production.⁵³ This revelation is by itself a red flag for possible market manipulation⁵⁴ (e.g. raising the possibility that Chesapeake and McClendon's hedge fund executed classic manipulative and highly illegal trades between each other)⁵⁵ and, in and of itself, proves the ongoing need for rigorous government oversight of commodities markets in general and the crude oil markets in particular. In the week after Reuters released its Chesapeake/McClendon report on May 2, 2012, crude oil prices dropped by \$8 a barrel.⁵⁶

Third, the process of having Congress legislate broadly while allowing regulatory agencies to implement statutes with specificity appears to be flawed in the area of futures market reform. Those with large financial resources are overwhelming the regulatory process and have unending funds for lawsuits that challenge the CFTC's actions. The Senate effort in July 2008 with S. 3268 demonstrates that clear-cut limits on speculation enacted within a statute by Congress without resort to federal agency rulemaking is highly effective.

Accordingly, Congress should immediately and on an emergency basis enact legislation that bans the use of the two most damaging investment vehicles for speculation in commodity staples derivatives markets: commodity index swaps and exchange traded funds that are premised on synthetic bets on commodity futures price directions.⁵⁷

Both of these investment vehicles allow wealthy speculators to bet passively on the upward direction of a synthetic "basket" of energy and food commodities that is heavily weighted toward crude oil. Persons who take and place these bets do not own any commodities. In this sense, these bets are like bets on a horse race. With regard to commodity index swaps, you can only bet that the price of the basket of commodities will go up. The betting on the upward price direction and the hedging of those bets in the real commercial-oriented futures

⁵² App. A, item 17.

⁵³ *Id.*

⁵⁴ *Id.*

⁵⁵ Driver, Anna & Brian Grow, *Special Report: Chesapeake CEO Took \$1.1 Billion in Shrouded Personal Loans*, REUTERS (April 18, 2012), available at <http://www.reuters.com/article/2012/05/02/us-chesapeake-mcclendon-hedge-idUSBRE8410GG20120502>.

⁵⁶ See LiveCharts.com, *supra* note 6 (indicating that on May 2, 2012, the price of a barrel of crude oil was \$105 and on May 8 the price was \$97).

⁵⁷ For a full explanation of the deleterious effect of these passive investment vehicles for speculation, see App. A, item 1 at pp. 9-10, 15; *id.*, item 3 at pp. 7; *id.*, item 8 at pp. 12-13, 16.

market by big banks and other large financial institutions sends continuous false “demand” signals to the markets, causing commodity prices—despite the supply/demand equilibrium—to rise and spot prices to follow suit.

In this respect, the Halt Index Trading of Energy Commodities Act⁵⁸ (“HITEC”) introduced by Representative Ed Markey on April 27, 2012, and co-sponsored by Representatives Barney Frank and Rosa DeLauro, represents a bold and important first step toward ending excessive speculation in commodities markets. The bill would prevent commodity index funds that trade in crude oil, natural gas, or derivatives thereof, from engaging in transactions with investors who are not bona fide hedgers.⁵⁹ Importantly, HITEC identifies commodity index funds as the main cause of speculative activity in staple commodities markets⁶⁰ and asserts that speculative activity has “added nearly \$1.00 to the per gallon price of gasoline.”⁶¹ The bill’s impact on speculative activity will likely be significant: oil prices dropped from \$105 to \$98 dollars a barrel in the week after the legislation was introduced⁶² and is now at its lowest point since the beginning of 2012.⁶³ This mimics the drop from a world record high in July 2008 of \$147 to \$30 that December in the wake of strong bi-partisan legislative efforts in between those two months.

In addition to causing unnecessary spikes in commodity staples, commodity index funds and exchange-traded funds have proven to be bad investments. As one financial analyst explained: “The next time someone tries to sell you a commodities fund based on the Goldman Sachs Commodities Index, smile and say, ‘Sorry, but I’m from Earth, and you’re from planet *I Love Lucy*. Let’s revisit this discussion in an alternate universe.”⁶⁴

A comprehensive legislative ban on commodity index swaps and exchange traded funds that are premised on synthetic bets on commodity futures price directions (which now consist of hundreds of billions of dollars in passive betting) would not prevent speculation in energy markets. In fact, persons who wish to do price directional bets will have other less deleterious investment avenues to pursue. They can buy or short stocks in companies that produce the commodities. They can buy the actual commodities. Or, they can buy long or short contracts in

⁵⁸ Halt Index Trading of Energy Commodities Act of 2012, H.R. _____, 112th Cong. (2012).

⁵⁹ Natural Resources Committee (Democrats), *Markey, Frank, DeLauro Go After Wall Street Oil Investment Products*, Press Release (April 30, 2012), available at <http://democrats.naturalresources.house.gov/press-release/markey-frank-delauro-go-after-wall-street-oil-investment-products>.

⁶⁰ Halt Index Trading of Energy Commodities Act, *supra* note 62 (“Almost all of this increase in speculation has been caused by a surge in trading commodity index funds.”).

⁶¹ *Id.*

⁶² See LiveCharts.com, *supra* note 6.

⁶³ Khan, Chris, *Oil Price Drops to Lowest Point of 2012*, ASSOCIATED PRESS (May 7, 2012), available at http://hosted.ap.org/dynamic/stories/O/OIL_PRICES?SITE=AP&SECTION=HOME&TEMPLATE=DEFAULT.

⁶⁴ Permanent Subcommittee on Investigations of the Committee on Homeland Security and Governmental Affairs, *Excessive Speculation in the Wheat Market* (June 24, 2009) at 102.

the futures markets. Of course, these alternative and traditional avenues of investment require financial sophistication—they do not comport with the ease of walking up to the “commodity staples betting window” and placing a bet with a big Wall Street bank.

Thus, I would heartily endorse a strict legislative ban on passive investment vehicles that trade in crude oil and other staple commodities, leading the “casinos” to offset those bets by buying long in the corresponding futures markets, thereby creating paper contracts calling for the making or taking of delivery of commodities that far exceed the world inventory of those products.

Further, betting synthetically on the upward direction of commodity staple prices does not put money into energy or agricultural production. Rather, such betting puts money in the hands of the “casino.” Today’s commodity derivatives markets are overrun with speculation. A smooth functioning commodity staple futures market that adheres to supply/demand fundamentals normally comprises of 70 percent commercial and 30 percent speculative transactions. Today’s futures markets are, however, 80 percent speculative and 20 percent commercial.⁶⁵ Having these commercial hedging markets being driven by four fifths of those who do not care about the price consumers pay for commodities is the very meaning of “excessive” speculation.

Indeed, these markets are so volatile that (as the 20% commercial participation figure suggests) many commercial businesses are abandoning hedging because futures markets are completely unpredictable. One need only look at the drop in crude oil prices from \$147 to \$30 in less than six months in 2008 to know that commercial hedging is not for the faint of heart. Having businesses abandon commercial price hedging means that consumer prices unnecessarily increase.

Again, Dodd-Frank did not ban speculation. As was true of the New Deal Congress that passed the Commodity Exchange Act of 1936, Dodd-Frank merely bans “*excessive* speculation.”⁶⁶ In other words, Dodd-Frank bans speculation that exceeds what the commercial users of these markets need to obtain market liquidity.⁶⁷

As I mentioned in my March 28, 2011, comment letter to the CFTC, banning excessive speculation is a “no lose” proposition.⁶⁸ All that such a ban would do is stop gambling in commodities markets—gambling that does not add to market liquidity (because it is “excessive”) or to the production of the underlying commodity.

Even if one has doubts about the effectiveness of such a ban, no harm can come to the economy by stopping *excessive* speculation on commodity prices. The ban will close casinos—

⁶⁵ Letter to Chairman Gensler, and Commissioners Chilton, Wetjen, Sommers, and O’Malia by Senator Bernie Sanders et al. (March 4, 2012), *available at* <http://www.sanders.senate.gov/imo/media/doc/CFTCPositionLimitsLetter.pdf>.

⁶⁶ See generally App. A, item 1 at p. 5.

⁶⁷ *Id.*

⁶⁸ *Id.* at p. 3.

nothing more. And, if the experts are to be believed (those who have produced over 50 academic studies and commentaries on this point),⁶⁹ a ban on excessive speculation would cause commodity prices to drop to the point where they would be dictated entirely by supply/demand market fundamentals.

Small business, as would be true of the economy as a whole, would thrive under those circumstances.

⁶⁹ App., item 1 at pp. 8-9.

Appendix A**Citations to Select Works Referred to in Testimony**

1. Comment Letter by Michael Greenberger to David Stawick, Secretary of the Commodity Futures Trading Commission, *Position Limits for Derivatives* (March 28, 2011), available at http://www.michaelgreenberger.com/files/Greenberger_PL_comment_letter-0328.pdf (arguing that rigorous position limits would combat excessive speculation in commodities markets).
2. Comment Letter by Better Markets to David Stawick, Secretary of the Commodity Futures Trading Commission, *Position Limits for Derivatives* (March 28, 2011), available at <http://comments.cftc.gov/PublicComments/ViewComment.aspx?id=34010&SearchText=better%20markets> (arguing that stringent position limits would combat excessive speculation in commodities markets and reduce the price of commodities).
3. Michael Greenberger, *Commodity Swap Position Limit Rule May Help Return Price-Risk Management*, BLOOMBERG BRIEF 7 (Oct. 28, 2011), available at http://www.michaelgreenberger.com/files/Final_Draft_Sent_Nov15.pdf (explaining how the Commodity Futures Trading Commission's final rule on position limits may reduce excessive speculation in commodities markets).
4. Michael Greenberger, *Business Day Live*, N.Y. TIMES (March 26, 2012), available at <http://video.nytimes.com/video/2012/03/26/business/100000001452780/business-day-live-march-26-2012.html> (discussing how speculators' activities are increasing the price of oil and the Department of Justice's failure to investigate manipulation in the oil market). Commentary begins at 4:40.
5. Michael Greenberger, *High Oil Prices Must Be Subject of Criminal Investigation*, REAL NEWS NETWORK (March 28, 2012), available at http://therealnews.com/t2/index.php?option=com_content&task=view&id=31&Itemid=74&jumival=8131 (arguing that manipulation, not supply and demand, is increasing the price of crude oil and other essential commodities and explaining how an investigation into manipulation in commodities markets would reduce the price of energy and food).
6. Testimony of Michael Greenberger before the Commodity Futures Trading Commission, *Excessive Speculation: Position Limits and Exemptions* (Aug. 5, 2009), available at http://www.michaelgreenberger.com/files/CFTC_AFR_Sign_On_Testimony_August_3.pdf (discussing how rigorous position limits would curb excessive speculation in commodities markets).
7. Truth-O-Meter, *Sherrod Brown Says Excessive Speculation Is Driving Gas Prices, Perhaps by 56 Cents a Gallon*, POLITIFACT (May 2, 2012), available at <http://www.politifact.com/ohio/statements/2012/may/02/sherrod-brown/sherrod-brown-says-excessive-oil-speculation-drivi/> (confirming the truth behind claims that excessive speculation is increasing oil prices).
8. Javier Blas, *Saudi Arabia Moves to Calm Oil Market*, FINANCIAL TIMES (March 19, 2012), available at <http://www.ft.com/intl/cms/s/0/49ec22cc-71ea-11e1-8497-00144feab49a.html#axzz1qtDEb7dC> [registration required] (reporting that Saudi Arabia and other oil-producing countries like Iraq and Kuwait plan to increase their oil exports to offset the impact of U.S. and European sanctions on Iran).
9. Ali Naimi, Minister of Petroleum and Mineral Resources in Saudi Arabia, *Saudi Arabia*

- Will Act to Lower Soaring Oil Prices*, FINANCIAL TIMES (March 28, 2012), available at <http://www.ft.com/intl/cms/s/0/9e1ccb48-781c-11e1-b237-00144feab49a.html> [registration required] (promising to mitigate rising oil prices by increasing oil production).
10. Matthew Robinson, *Oil Falls as Saudi Arabia Seeks to Calm Markets*, REUTERS (March 20, 2012), available at <http://www.reuters.com/article/2012/03/20/us-markets-oil-idUSBRE82B04920120320> (reporting that Saudi Arabia promises to increase oil production and insists that “there is no supply shortage in the market”).
 11. Annie Lowrey, *Obama Finds Oil in Markets Is Sufficient to Sideline Iran*, N.Y. TIMES (March 30, 2012), available at <http://www.nytimes.com/2012/03/31/business/global/obama-to-clear-way-to-expand-iranian-oil-sanctions.html?scp=3&sq=president%20obama%20oil%20prices&st=cse> (reporting that President Obama announced that there is sufficient oil in world markets to allow countries to reduce their reliance on Iranian oil).
 12. Robert Lenzner, *Speculation In Crude Oil Adds \$23.39 To The Price Per Barrel*, FORBES (Feb. 27, 2012), available at <http://www.forbes.com/sites/robertlenzner/2012/02/27/speculation-in-crude-oil-adds-23-39-to-the-price-per-barrel/> (discussing Goldman Sachs’s recent conclusion that oil prices are driven, in part, by speculation).
 13. Javier Blas, *Oil Futures Spark Debate on \$100 Level*, FINANCIAL TIMES (March 28, 2012), available at <http://edition.cnn.com/2012/03/27/business/oil-futures-fall/index.html> (reporting that a forward contract for crude oil to be delivered in December 2018 is \$30 cheaper than the spot price for oil, which is \$125 a barrel).
 14. Asjlynn Loder & Silla Brush, *CFTC Votes 3-2 to Approve Limits on Commodity Speculation*, BLOOMBERG (Oct. 18, 2011), available at <http://www.businessweek.com/news/2011-10-18/cftc-votes-3-2-to-approve-limits-on-commodity-speculation.html> (discussing former Commissioner Michael Dunn’s vote for the Commodity Futures Trading Commission’s final position limits rule).
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 16. Silla Brush, *Former CFTC Commissioner Dunn Joins Patton Boggs Law Firm*, BLOOMBERG (Feb. 7, 2012), available at <http://www.bloomberg.com/news/2012-02-07/former-cftc-commissioner-dunn-joins-patton-boggs-law-firm.html> (reporting that former Commissioner Michael Dunn joined the Washington law and lobbying firm of Patton Boggs LLP as a senior policy adviser).
 17. Schneyer, Joshua, Jeanine Prezioso & David Sheppard, *The CEOs Secret Hedge Fund*, REUTERS 1 (May 2, 2012), available at <http://graphics.thomsonreuters.com/12/05/ChesapeakeMcClendon.pdf> (reporting that the CEO, and former chairman, of Chesapeake Energy Corp., Aubrey McClendon, managed a hedge fund and secured loans from Chesapeake subsidiaries and that may have created a conflicts of interest and even allowed McClendon to manipulate energy markets).
 18. Dittrick, Paula, *CFTC Reauthorization Suggests Energy Trading Rules Changes*, OIL AND GAS FINANCIAL JOURNAL (March 1, 2006), available at <http://www.ogfj.com/articles/print/volume-3/issue-3/features/cftc-reauthorization-suggests->

- [energy-trading-rules-changes.html](#) (reporting on the market reforms proposed by Representative Graves and Barrow).
19. Graves, Sam, Representative, *Stop Rising Gas Prices From Killing Small Business*, POLITICO, (March 4, 2012), available at <http://www.politico.com/news/stories/0312/73592.html#ixzz1uDPGMglE> (“One of the biggest threats now to our recovery is gas prices, which have consistently increased over several weeks. The nationwide average jumped to roughly \$3.76 a gallon, according to the motorist group AAA. It was \$3.46 a gallon only a month ago.”).

Appendix B**Michael Greenberger: Brief Biography**

Michael Greenberger is a professor at the University of Maryland Francis King Carey School of Law and the Founder and Director of the University of Maryland Center for Health and Homeland Security (CHHS). At the School of Law, Professor Greenberger teaches, *inter alia*, a seminar on Futures, Options and Derivatives.

In 1997, Professor Greenberger left private law practice to become the Director of the Division of Trading and Markets at the U.S. Commodity Futures Trading Commission (CFTC), where he served under CFTC Chairperson Brooksley Born. In that capacity, he was responsible for supervising exchange traded futures and derivatives. He also served on the Steering Committee of the President's Working Group on Financial Markets, and as a member of the International Organization of Securities Commissions' Hedge Fund Task Force.

Professor Greenberger has often been asked to testify before Congressional committees, regulatory agencies, and investigatory committees pertaining to the regulation of financial derivatives, including the impact of poorly regulated derivatives on the high price of commodity staples. For a full description of Professor Greenberger's testimony, writings, lectures and media appearances pertaining to derivative regulation, see www.michaelgreenberger.com.

Professor Greenberger has recently served as the Technical Advisor to the United Nations Commission of Experts on Reforms of the International Financial System; and on the International Energy Forum's Independent Expert Group on reducing worldwide energy price volatility.

Prior to entering government service, Professor Greenberger was a partner for over 20 years in the Washington, D.C. law firm of Shea & Gardner, where he served as lead litigation counsel before state and federal courts of law nationwide, including the United States Supreme Court.

Professor Greenberger is a Phi Beta Kappa graduate of Lafayette College and the University of Pennsylvania Law School, where he served as Editor-in-Chief of the Law Review.

Mr. Robert McNally

1. Mr. McNally, on page two of your testimony you suggest that among the policies that can reduce price volatility in the oil markets includes “improving the funding and focus of energy-related research and development.” Do you support a government role in funding these activities?

Mr. Robert McNally

1. Mr. McNally, on page two of your testimony you suggest that among the policies that can reduce price volatility in the oil markets includes “improving the funding and focus of energy-related research and development.” Do you support a government role in funding these activities?
 - A. Yes I believe there is a government role in funding energy research and development, although such funding should be reallocated from funds currently spent on mature but uneconomic technologies toward research and development for alternative technologies at an early stage of development. Such a shift in government funding for energy research and development could unlock technological advances that could enable private companies to find and develop new and larger energy supplies, both hydrocarbon and non-hydrocarbon based, and commercialize energy efficiency technologies. Increasing energy supply, improving energy efficiency and reducing oil’s dominance in the transportation fuel market would over time help lower pump price volatility.



America's small business advocate

Energy and Environmental Regulation

Energy and environmental policies should not place a disproportionate burden on small firms

NSBA urges lawmakers and regulators to consider the burden any energy or environmental policy or rule would have on small firms. Such policies should have five primary objectives:

Ensure Clean Air and Water: Firms do not have the right to unilaterally and adversely affect the health of others by polluting common resources such as the air or water. Reasonable regulation to secure clean air and water and to protect public or private land is desirable. We should be good stewards of the earth. Additionally, agencies should be required to engage in a retrospective review of existing regulation to ensure that they remain the least costly means of accomplishing the desired result.

Promote Adequate and Affordable Energy: Adequate, reliable and affordable energy is a key factor in promoting economic growth and international competitiveness. Moreover, keeping heating, transportation and electricity costs reasonable is a central factor in promoting a high standard of living for the American people. Policies should promote rather than impede adequate, reliable and affordable energy, including the promotion of alternative sources of energy such as wind, solar, hydro-electric, and geothermal, among others. Accordingly, we should pursue an "all of the above" strategy to achieve adequate and affordable energy from stable and reliable sources while preventing adverse health effects from pollution and ensuring small firms are not discriminated against.

End U.S. Reliance on Foreign Energy: Reliance on unstable, unreliable and hostile foreign energy sources makes the U.S. economy vulnerable and is likely to lead to economic disruption. Policies should promote, and not impede, domestic energy exploration and development. To the extent that domestic energy sources are not adequate, then every reasonable measure should be taken to purchase our energy from allied trading partners. Policies should promote international energy infrastructure projects with allied nations rather than less stable or reliable partners.

Simplify Regulatory Requirements and Accelerate Approval Process: Energy and environmental regulations often place a disproportionate burden on small, entrepreneurial businesses because the costs of large firms complying with federal requirements with respect to a large project does not have as large an impact on unit costs as smaller firm compliance with respect to smaller projects. Regulatory costs do not usually increase linearly with project size because there are certain fixed costs associated with any compliance. Further, in the current regulatory environment, it can take many, many years and involve tremendous cost to get energy projects through the regulatory gauntlet. The solution to this problem is to simplify regulatory requirements and accelerate the regulatory approval process to reduce costs and increase certainty. Regulatory impediments increase the cost of securing energy and delay energy production.

Support Federal Energy Research Dollars for Small Firms: Federal policy should ensure that small firms have adequate access to federal energy research dollars. Small firms have consistently proven that they are equally or more cost effective than large firms or universities in using federal research dollars. Small, entrepreneurial firms are the primary source of dynamism and innovation in the U.S. economy. Reasonable and adequate federal research and development funding is a key component of their success.

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A Crude Predicament

The Era of Volatile Oil Prices

Robert McNally and Michael Levi

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A Crude Predicament

The Era of Volatile Oil Prices

Robert McNally and Michael Levi

FOR MOST Americans, from the late 1970s until just a few years ago, following the price of gasoline was like riding the Disney World attraction *It's a Small World*: a shifting but gentle, basically unremarkable experience. But over the past few years, it has felt more like *Space Mountain*—unpredictable, scary, and gut-wrenchingly uneven. Between January 2007 and July 2008, the price of a barrel of oil rose from \$50 to more than \$140; by the end of 2008, it had crashed to just over \$30; less than a year later, it had breached \$80 again. In early 2011, on the back of strong global demand and the political turmoil in the Middle East, oil sold for over \$120 a barrel. Today, as prices continue to swing wildly, most Americans are wondering how they got on this ride and how to get off.

Over recent years, Americans have grown accustomed to considerably higher oil prices than those of the 1980s and 1990s. But they have not yet come to terms with sustained swings in global crude oil prices. High prices are easy enough to explain. Voracious demand in emerging economies is colliding with constraints on production. Old oil fields are producing less, and new fields are more expensive

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to develop. Governments with access to cheaper resources have restricted investment in new supplies, for various reasons. Faced with popular discontent, petrostates in the Middle East and North Africa, for example, are spending their oil revenues on trying to placate their burgeoning populations with subsidized food, gasoline, and other necessities.

The volatility of oil prices requires a different explanation. Textbook economics says that prices rise and fall in order to balance supply and demand. In the oil market, however, supply and demand are extremely slow to respond to price shifts, which means that prices can undergo big swings before a balance is restored. Oil is a must-have commodity with no exact substitutes; when prices rise, most consumers have little choice in the near term but to pay more rather than buy less. It takes years to develop new resources, and it is difficult to turn production on or off on short notice. When new supplies (usually years in the making) threaten to flood the market or a sudden drop in demand (for example, due to a recession) leaves sellers without ready buyers, prices can plunge before producers start shutting the taps. Oil prices naturally tend toward extremes.

Yet these extremes have long been kept in check. From the inception of the modern oil market in 1859 until recently, producers have employed a variety of tools to stabilize prices, including vertical integration and market-share agreements. Since the mid-1980s, spare production capacity has been the only tool available. If demand jumped unexpectedly or if supplies were suddenly disrupted, OPEC producers with spare capacity, especially Saudi Arabia, would release more oil, obviating the need for prices to swing in order to balance supply and demand.

Now, much of OPEC's influence is gone. Saudi Arabia and its partners no longer consistently hold the large volumes of spare capacity they once did. And there are no ready replacements waiting in the wings. The oil market is in for a rocky ride, with major economic and geopolitical consequences: underinvestment in the development of energy, greater economic sensitivity to geopolitical unrest in oil-producing regions and shipping lanes, and a higher risk of recessions. The United States will find it impossible to eliminate price swings in the coming years, and so it will need to learn to live with them as best it can.

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GOOD TILL THE LAST DROP

TRADITIONALLY, OIL producers were able to find new oil faster than demand for oil grew. As a result, price busts would wipe out profits and investments—followed by rises in demand and then booms. Producers thus sought to put a floor on prices by holding oil off the market. In addition, in order to limit competition and ensure healthy demand, they also sought to cap prices, adding extra oil to the market in tighter times. In the early 1930s, Washington, other Western governments, and international oil companies took control of supplies—and prices. Blessed with massive low-cost resources, Texas played a pivotal role by holding as much as 25 percent of its production capacity in reserve. (Conventional wisdom has it that about five percent of global supplies provides a robust buffer against surprise developments in the market.) During the June 1967 Arab-Israeli war, for example, the Railroad Commission of Texas, which regulates the Texan oil industry, helped blunt the effects of an Arab oil embargo by drawing on its spare capacity. But in 1972, faced with surging demand in the United States, the chair of the commission was forced to order full production throughout the state. Thus, when the 1973 Arab-Israeli war triggered another Arab embargo, Texas, which was already operating at full tilt, was unable to produce more oil on short notice. Prices soared.

Then, OPEC took the reins, and influence over oil prices shifted to the Middle East. For the next three decades (except briefly during the Gulf War), OPEC held the requisite spare capacity or more. Whenever surprisingly strong demand threatened to outstrip supply and send prices shooting up, OPEC released extra supplies to give the market some breathing room. For example, after demand surged in 2000 on the back of Asia's recovery from the 1997–98 financial crisis and the dot-com boom, OPEC drew on its spare capacity to increase production. In 2003, following a general strike in Venezuela, civil unrest in Nigeria, and the U.S.-led invasion of Iraq, OPEC, led by Saudi Arabia, increased production by 2.5 million barrels per day, about ten percent of its usual output.

Saudi Arabia had been able to maintain substantial spare capacity during the last quarter of the twentieth century because global

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demand growth was moderate and supply was growing in most major producers outside OPEC. The Saudi government allowed its competitors to expand their market shares, content to keep some of its supplies in ready reserve and act as the central banker of oil—and thereby make itself an indispensable partner of the United States in the Middle East.

But a decade ago, its grip began to falter. In early 2003, when the invasion of Iraq took about a million barrels of oil off the market, Saudi Arabia had to fill the gap. But then, despite major investments in supplies, it was unable to replenish its spare capacity to prewar levels because of voracious demand from the developing world and a lack of supply growth outside OPEC. It, as well as other producers, had to choose between meeting burgeoning demand and taking oil off the market to hold in spare capacity. It chose the former, hoping to stave off a spike and then a crash in prices. Ultimately, however, its production increases were insufficient.

With producers nearly tapped out amid strong demand, it took a brutal spike in prices in 2008—prices rose by 67 percent within six months—along with a global economic recession, to finally bring demand in line with supply. Demand dropped by three million barrels a day, or about four percent, between the first quarter of 2008 and the first quarter of 2009. This enabled OPEC to cut production and restore some meaningful spare capacity to the system, albeit temporarily. As the global economy recovers, and supply growth starts to become sluggish again, spare capacity will dwindle once more.

A repeat of the boom-bust pattern is now more likely than not. The International Energy Agency, the U.S. Department of Energy, and many experts estimate that Saudi Arabia and its OPEC partners are not investing enough in production capacity today to meet both increasing demand and the five percent threshold for reserves. This is largely because Saudi Arabia, historically the main holder of OPEC's spare capacity, is both less able and less willing to play the part. Saudi officials say they plan to keep as spare capacity only 1.5–2.0 million barrels of oil a day, or less than two percent of global demand.

As they regularly note, holding extra capacity is expensive. For example, the Manifa oil field, Saudi Arabia's next big project to shore up production capacity and prevent its spare capacity from dropping

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even further, will cost about \$16 billion just to build and will add only 0.9 million barrels per day of capacity. Despite such efforts to expand production, Saudi Arabia remains worried about oversupplying the market and thus depressing prices, and so it is likely to aim low in its planning for spare capacity. It worries that if demand grows more slowly than anticipated—demand growth in Asia is much tougher to predict than it used to be—or other countries' supplies turn out to be larger than expected, it will be saddled with low prices or massive amounts of unused investment.

Just as Saudi Arabia's ability to hold spare capacity is declining, its incentives to do so are waning, too. With U.S.-Saudi ties having frayed over the last decade, Riyadh's motivation to continue contributing to its security partnership with the

With insufficient spare capacity left in OPEC, the oil market is in for a rocky ride.

United States by maintaining spare crude capacity has diminished. In the past, Saudi Arabia held spare capacity partly as a way of disciplining OPEC: spare capacity allowed it to threaten to punish cartel members by flooding the market if they cheated on their quotas. It also allowed Saudi Arabia to align itself with the United States by countering calls for higher oil prices by price hawks such as Iran and Venezuela. But today, Riyadh is less certain about the strength of its alliance with Washington and may thus be less willing to incur the costs and risks involved in contributing to the U.S.-Saudi partnership in these ways.

To be sure, Saudi Arabia and OPEC will maintain some influence over oil prices in the future. They can prop them up in the short term by capping production and in the long term by limiting investment in new supplies. But they will not be able to consistently put a lid on prices. U.S. officials have forecast low spare capacity through 2012 (their projections do not extend any further), and the International Energy Agency anticipates that between 2013 and 2016, OPEC's spare capacity will be below the five percent threshold. Some developments could ease the pressure on supplies: a slowdown of economic growth in Asia; improved security in Iraq, leading to increased production there; political change in Iran or Venezuela that allowed international capital and technology to flow into those countries' oil sectors. Yet

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any of these changes would take many years to translate into large increases in supplies. The development of alternative technologies for transportation, the faster adoption of fuel-efficient vehicles, and the greater use of natural gas in the transportation sector could also change the picture. But such transitions would also take many years, if not decades.

There are no other producers capable of stepping into Saudi Arabia's shoes. Only Russia and the United States produce volumes comparable to Saudi Arabia's. (According to the International Energy Agency, in 2010, Russia produced about 10.4 million barrels per day; Saudi Arabia, about 8.1 million barrels per day; and the United States, 7.8 million barrels per day. Iran, the world's fourth-largest producer, accounted for only 3.7 million barrels per day.) But Russian oil, which is more expensive than Saudi low-cost oil, is ill suited to serve as spare capacity, and Russia has also shown little interest in cooperating with other producers to help stabilize prices. Nor is there any prospect that the United States will step back into the swing-producer role it played half a century ago, when it held huge low-cost reserves and was not massively dependent on imported oil.

A MORE DANGEROUS WORLD

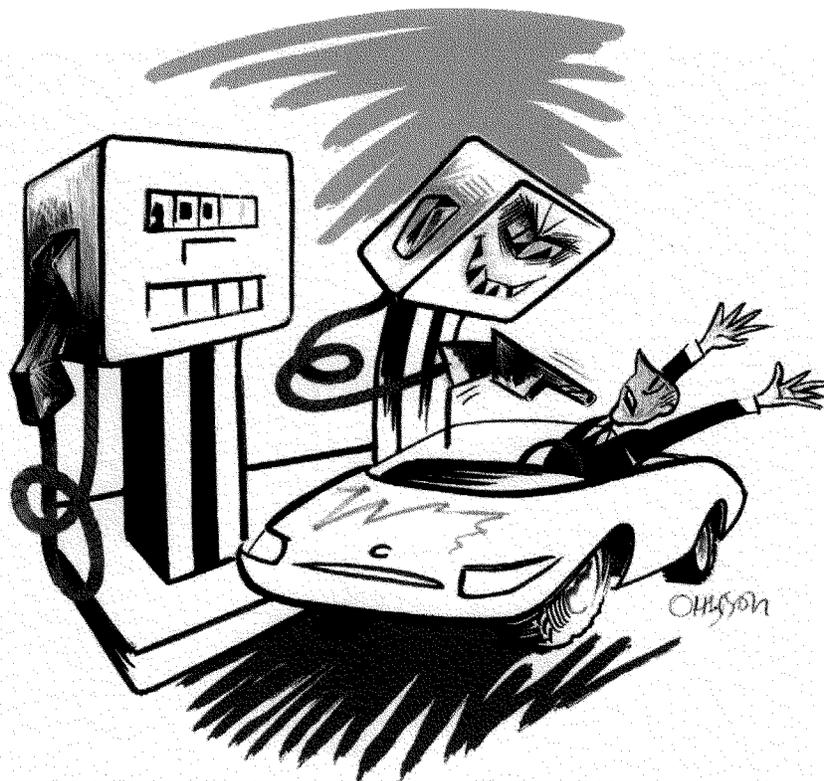
THE WORLD will be stuck with wild price swings for the foreseeable future. Already, the consequences for economics and geopolitics are stark. Big shifts in oil prices complicate economic decisions. Companies in many sectors avoid investing in new facilities and equipment that may be profitable at low oil prices but are all but useless if prices soar. Individual consumers are buffeted as their disposable incomes drop when their gasoline and home heating bills rise. Basic decisions become more difficult: it is not so easy to choose whether to buy a gas-guzzling SUV or a hybrid Prius if you do not know whether gasoline will cost \$3 a gallon or \$5 in a few years. Airlines, petrochemical producers, and other oil-intensive industries also face much greater uncertainty about costs and profits. Companies that make investments on the basis of low oil prices and are later forced to pay more wind up cutting back on spending elsewhere, depressing the entire economy.

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Greater oil price volatility will also bedevil macroeconomic policy officials and central bankers. Policymakers may have to compensate for depressed demand by lowering interest rates or pursuing fiscal stimulus. On the other hand, rapidly rising oil prices could fuel inflation, prompting monetary policy officials to raise interest rates, which could further hamper economic growth. The precise causal links between oil prices and the well-being of national economies are murky and much debated, but as the economist James Hamilton has noted, all but one of the 11 recessions the United States has experienced since World War II were associated with a rapid increase in the price of oil. U.S. policymakers will inevitably worry that greater swings in oil prices will translate into greater macroeconomic volatility and respond accordingly.

Developing economies, many of which are particularly dependent on oil, will also be hurt. And their attempts to insulate themselves from price volatility will have global reverberations. These states have historically subsidized gasoline and diesel prices at home in order to shield their citizens and domestic companies from international volatility. But these subsidies have had pernicious effects on prices worldwide. With prices kept artificially low in the parts of the world with subsidies, the burden of adjusting to the mismatch between global demand and global supply has fallen on the smaller subset of consuming countries that do not have subsidies. There have been some tentative moves away from gasoline and diesel subsidies in the last few years, most notably in China and India, because these incentives have placed unsustainable strains on government treasuries. The G-20 has also launched an effort requiring its members to develop plans to phase out inefficient subsidies in the medium term. But further reforms may stall in the face of renewed price swings and popular demand for protection; in the worst cases, recent improvements might even be reversed.

Low levels of spare capacity will also complicate U.S. foreign policy. The smaller the spare capacity, the bigger the threat of a price spike from any political disruption. These higher stakes will put pressure on the United States—still the indispensable nation when it comes to providing global stability—to intervene in conflicts that threaten even relatively small volumes of oil, whether in West Africa, the Middle



East, or Central Asia. Similarly, as U.S. policymakers ratchet up pressure on Tehran over Iran's nuclear program, they are considering crimping Iran's crude oil exports. But with OPEC's spare capacity now barely larger than Iran's exports, that strategy could send oil prices spiraling upward—even if Iran did not threaten the Strait of Hormuz and even if the United States and its allies released oil from their strategic reserves.

LEARNING TO SWING

GREAT OIL price swings are here to stay, and there will be little refuge from their pernicious consequences. Nonetheless, there is much that the U.S. government can do to avoid the worst. No one

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measure can transform the situation, but by pressing for change on many fronts at once, the United States can limit its vulnerability to volatile prices.

A sensible and prudent approach would start by ensuring that the market has as much information about supply and demand as possible. More reliable data would dampen short-term volatility by reducing uncertainty and facilitate timely investments in production capacity, limiting the amplitude of price extremes over the long term. Industrialized countries should start by getting their own houses in order, improving the quality, timeliness, and frequency of their oil market data. (The United States and Japan are the only major countries whose governments collect and publish reasonably timely, accurate, and broad data on their own oil supplies and demand.) They should then push for more comprehensive and timely data on spare capacity and production trends from the OPEC states, which have historically been tightlipped, by arguing that a change in approach would benefit OPEC itself. The oil market is increasingly distrustful of the numbers published by OPEC members, and if that trend continues, these states will lose more of whatever leverage over prices they still have. More information sharing may be their only chance of preserving their influence.

Because of rapidly increasing consumption in Asia, the U.S. government should also seek to draw Asian governments into international efforts to share data on consumption, stockpiles, and production, by allowing these states to join the International Energy Agency (which provides such services for members of the Organization for Economic Cooperation and Development) or another institution. The secretive Chinese government has been particularly reluctant to participate in such arrangements so far. But as its oil consumption balloons, China increasingly stands to gain from tamping down volatility, too.

Yet price swings will persist. In order to help consumers and companies deal with unpredictable oil prices, the United States should encourage more hedging through the financial markets. This idea may trouble those who blame speculators for price swings, but careful studies by the U.S. Energy Information Administration and the U.S. Commodity Futures Trading Commission have found

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that medium-term and long-term price shifts are primarily a function of changes in global supply and demand. Policymakers should help facilitate more hedging by encouraging the development of well-regulated financial markets: the point is to relieve those who are exposed to price risks today—from motorists to airlines and other oil-intensive industries—and transfer those risks to speculators, who are more willing and better able to bear them. The Dodd-Frank financial reform legislation of 2010 took some helpful steps in this direction, such as requiring that most transactions be conducted on regulated exchanges and that the Commodity Futures Trading Commission collect and publish better data on a wider range of transactions.

U.S. officials, both in Congress and in the executive branch, should take care not to go too far, however, and prescribe overly harsh limits on speculative bets on energy futures or set other costly barriers for firms that need to hedge. A blanket crackdown on speculation would only increase the exposure of firms and consumers to volatility by shrinking financial markets and chasing hedging to less transparent and less regulated venues.

As it becomes clearer that OPEC has lost control, people will clamor for the United States to use its strategic reserves to moderate prices. But it would be unwise for Washington to use these supplies for purposes other than responding to substantial supply disruptions, such as those caused by turmoil in a major oil-producing country or a critical shipping lane. Officials are unlikely to know when and how much oil to add to or subtract from the global market in order to keep prices stable, and they could exhaust the country's strategic reserves before they managed to flatten prices. (Unlike a central bank, which can always print more money, the U.S. Strategic Petroleum Reserve can quickly bring online only a finite amount of extra oil.) The use of strategic reserves would also introduce new uncertainty—as well as greater economic vulnerability—into the market by giving both companies and consumers less reason to limit their own exposure and by deterring

Demand-side policies, such as taxing gasoline and diesel, must be at the core of any serious strategy for coping with volatile oil prices.

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the buildup of private stocks. At the same time, Washington should reinvigorate efforts to draw the new major oil-consuming states, such as China, into coordinating their policies on strategic reserves. Now that China is finally building strategic reserves, it should share the burden of responding to disruptions with the United States and others. A coordinated policy would make the world better able to respond to supply disruptions and thus limit unnecessary price swings.

The United States will also need to redouble its efforts to discourage subsidies to consumers. The G-20 initiative to reduce subsidies has been a third-tier priority for U.S. economic policymakers, partly because they see it as an element of climate policy. But curbing subsidies would help blunt volatility, and thus improve economic performance; therefore, even policymakers who care more about economic growth than greenhouse-gas abatement should embrace it. Progress will be difficult, however, because subsidies are fundamentally rooted in the domestic politics of the countries that pursue them and fall outside the United States' leverage.

Policies that aim to increase global oil supplies, and thus reintroduce a modicum of spare capacity to the market, will be equally challenging. Efforts to promote security in Iraq, address Tehran's nuclear program, and encourage positive political evolution in Iran and Venezuela could not only remove regional security threats but also significantly increase global oil supplies. (The logic behind each of these efforts is not primarily determined by energy policy, but their potential payoffs in terms of energy policy should inform U.S. strategy.) The U.S. government should also encourage countries with large, low-cost oil reserves to invest in more production capacity. (Although Saudi Arabia's recent decision to speed up investment in the Manifa offshore project is encouraging, it will not fundamentally change the situation.) But persuading producers to spend more on new supplies will be an uphill battle both because increased volatility has made them more cautious investors and because they may face limits on how much their production can expand. Although all these initiatives are tall orders, given the potential benefits, they are well worth a try.

The United States has much more leverage at home. With the risk of price spikes high, it should help insulate its economy by encouraging more domestic oil production. Smart U.S. policy could

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help promote domestic production: regulations that are cost-effective, clear, and consistent, and that ensure environmental protection, are essential. Similarly enlightened policy on natural gas could also pay dividends in the long term, especially if it helped transform the transportation sector.

Ultimately, however, demand-side policies must be at the core of any serious strategy for coping with volatile oil prices. The goal should be to help consumers protect themselves from fluctuating oil prices while accelerating investment in fuels and technologies that can scale up and eventually displace oil. The transition away from oil in the transportation sector will take decades, but it is inevitable and it can be hastened. The U.S. government should reallocate funds currently spent on mature energy technologies toward research and development for alternative technologies at the early stages of development. In the context of serious fiscal reform, it should also gradually raise taxes on gasoline and diesel (while compensating for those hikes by lowering payroll taxes). This shift would not only discourage consumption (while rewarding work); it would also shield consumers from price volatility: if taxes accounted for a larger fraction of the pump price of gasoline and diesel, swings in the underlying price of crude would be less consequential. Such taxes have been politically toxic in the past, but they may be more palatable than many of the other options that would be considered in any serious budget debate.

Wild fluctuations in global oil prices are here to stay. The economic and national security implications are stark, and the United States has little choice but to adjust and absorb some of the blows. Policymakers can neither banish big oil price swings nor reasonably hope to wean the United States off oil in the foreseeable future. But the right policies can improve the country's economic resilience and minimize the geopolitical complications of this new and challenging time. 🌐