

# WebMemo



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## Declining Energy Prices No Reason for Complacency

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Americans are finally getting a break on energy costs. Oil and gasoline prices have been dropping since mid-August, and heading into the winter heating season, natural gas is much cheaper than at this time last year. This good news for consumers has the added benefit of dimming the chances that Congress will enact several problematic energy policies it has discussed. But it may also weaken the prospects for some good ideas to increase domestic oil and natural gas production, and time is running short for the current Congress to take action.

### **A Welcome Decline**

Gasoline prices began the year at around \$2.20 per gallon and by July had increased to more than \$3.00. Rising oil prices, boosted by strong demand and geopolitical uncertainty over imports, were the biggest factor behind the increase. Concerns about hurricane damage and the new federal ethanol mandate also added to the upward pressure.

By the middle of August, the worst was over. Oil prices started to soften as fears of Iran-related supply disruptions eased. The market also benefited from the absence of hurricanes like last year's Katrina and Rita, which devastated oil and natural gas production in the Gulf of Mexico. In addition, ethanol, which experienced a massive price spike after the law requiring its use as a fuel additive took effect early this year, has finally come down in price, though it is still more expensive than gasoline. Consequently, the per-gallon price at the pump has been falling by more than a penny per day since mid-August.

Now that summer is over, demand will slacken and the tough summertime environmental specifications for fuel are no longer in effect. Barring a major geopolitical event, further declines at the pump are likely. Some experts predict that the \$2.00 mark will be tested in the months ahead.

Though less noticed, the drop in natural gas prices is also great news, especially as the cold weather months approach. Natural gas is the most widely used energy source for domestic heating, and prices last winter reached record highs, largely due to Katrina's impact on natural gas production in the Gulf.

But with Katrina-damaged production mostly back online and natural gas inventories at very high levels, prices should remain well below last year's levels. In fact, at around \$5 per thousand cubic feet, natural gas is about half the price as compared to this time last year. In addition, the drop in oil prices has led to declines in the cost of home heating oil, which should provide savings for homeowners in the Northeast, where this fuel source is widely used.

### **The Good and the Bad**

Cheaper energy directly benefits household budgets and the overall economy, and an indirect ben-

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[www.heritage.org/research/energyandenvironment/wm1225.fjm](http://www.heritage.org/research/energyandenvironment/wm1225.fjm)

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efit is that recent price drops also reduce the likelihood that Congress will enact any of a number of problematic and potentially counterproductive energy policies. For example, proposals to create new penalties for “price gouging,” to boost taxes on the oil industry, and to mandate further use of alternative fuels, are all among measures more likely to increase future prices than lower them.<sup>1</sup> Americans will benefit if the prospects for these policies declined along with energy prices.

On the other hand, cheaper energy may also stall momentum on several worthwhile policies—in particular, proposals that would expand domestic oil production. This includes measures to open up a small portion of Alaska’s Arctic National Wildlife Refuge (ANWR), America’s largest untapped onshore oil deposit.<sup>2</sup> The U.S. Geological Survey estimates that ANWR contains 10 billion barrels of oil, enough to increase known domestic reserves by 50 percent. And America’s territorial waters, 85 percent of which are currently off-limits to oil and natural gas production, have even more potential than ANWR. Legislation that would allow at least some offshore energy production (the House ver-

sion is much stronger than the Senate version) is currently pending.<sup>3</sup>

The temporary drop in prices is nice for consumers, but fundamentally little has changed in both oil and natural gas markets. The underlying forces—supplies barely adequate to keep up with growing demand and geopolitical uncertainty—will exist for the foreseeable future. The current declines should last for at least a few months, but a return to higher prices is likely without new energy policies. America still needs, over the long term, to make fuller use of its oil and natural gas resources.

### Conclusion

Falling energy prices are a source of savings for consumers and a source of relief for politicians facing reelection. But they should not feed complacency about the need to address the nation’s future energy needs in the little time remaining to this Congress.

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1. See, e.g., H.R. 5253, S. 1631, S. 2817.
  2. See, e.g., H.R. 5890.
  3. See H.R. 4761 and S. 3711.