

# The WCYR Advocate

## Williamson County Young Republicans

November, 2005

Joshua Edlin, editor

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### Next Meeting

The Christmas Party will serve as the December meeting.

### Announcements

- The WCYR Christmas party will be held on Saturday, December 10, at 7:00 PM. The party is being hosted by Brandon and April Ryan at their home. Drinks will be provided. Guests are asked to bring finger foods. RSVP to [wcgopyr@hotmail.com](mailto:wcgopyr@hotmail.com) by 12/5.

### The Price of Gas

The price of gasoline has generated plenty of anger over the past weeks. Politicians and pundits have accused the oil companies and service stations of price gouging, and the oil companies have responded with the defense that they didn't do it, the market sets the price. What is lacking in all of these discussions is a firm foundation in basic economics.

The key to understanding the rise and fall of gasoline prices revolves around what is meant by "market forces" and how they "set" prices.

For any good or service, there is a particular price that economists call the *equilibrium price*. The equilibrium price is defined as the price at which the quantity demanded equals the quantity supplied. If you set the price too high, otherwise known as gouging, then the quantity demanded drops and the product languishes on the shelves. Set the price too low and the quantity demanded outstrips supply, leading to shortages and the sort of gas lines all too common in the late '70s.

So how do providers change prices to achieve an equilibrium price that is unknown to them? If demand goes up or supply goes down, providers will instantly raise prices in anticipation. Some people might insist that this behavior is the definition of greed. Maybe it is. But that greed has important benefits for consumers. Due to higher prices, buyers are forced to cut back, ensuring that the pumps won't go dry.

If that were the whole picture though, providers could raise the price as high as they wanted. Fortunately, other forces act to drive the price downwards towards the equilibrium price. When surpluses exist, which might be caused by raising prices too high, providers lower the prices to sell off the surplus and maximize profits. However, if the elasticity of demand is low, as it is with gasoline, it may benefit providers to keep a surplus, allowing them to make more money off the higher prices than they would if they lowered prices to the equilibrium price.

The solution is the cornerstone of the capitalist system – competition. While Bill O'Reilly has been claiming that identical prices at different gas stations prove collusion, the reality may be very different. In fact, gas prices at the pumps may represent the most effective form of competition in use today. No other commodity has its prices displayed in foot-high numbers right in front of drivers. A station owner only needs to look out his window to see that his competition is undercutting him and stealing his customers. The lowest profitable price is achieved as competitors attempt to out-price each other.

## Upcoming Events

Dec 10 WCYR Christmas Party

## Service Opportunities

There are no currently outstanding requests for volunteers.

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So, if the market really is setting gasoline prices, we should be able to verify the predictions of economic theory.

In fact, immediately following the hurricane Katrina, economist Robert Lawson predicted that if demand elasticity were 0.3, higher than the 0.1 – 0.2 typically predicted, that gasoline prices would rise about 30%, which is just about what we saw. Given the assumed 0.1-0.2 figures, Lawson predicted that gas would hit \$3.75 – 5.00 per gallon. In other words, what we perceived as massive price increases were actually on the low end of economic predictions.

Economics predicts several results of increasing prices. For one, we should see an influx of gasoline into the areas with the highest prices. Indeed, we saw exactly this, as gasoline was redirected from the north and the west coast into the ravaged areas of Mississippi and Louisiana. Ultimately, the prices in those areas were lowered as supplies increased and prices in other areas rose as the supply was reduced, until finally the supply and demand of gasoline equalized across the country. Another expected result would be an attempt by oil companies to produce more gasoline. Again, this result can be seen in a dramatic spike in new oil exploration since Katrina hit.

In addition to these quite visible results, we can see plenty of evidence of a change in oil demand. Orders for hybrid cars are at never before seen levels. Bicycle purchases are at a high not seen since the oil crisis of the 1970s. Commuters are using mass transit in greater numbers.

Is all of this irrefutable proof that oil companies aren't price gouging? Of course not. It's possible that oil companies are in collusion to raise the price above equilibrium; after all, OPEC has been colluding for years on how much oil to supply. However, any serious analysis of gas prices can't avoid the fact that recent circumstances align quite well with economic predictions. So, rather than jump on the big oil conspiracy bandwagon, I think I'll put my money on the market. After all, I'd rather pay more for gas when I need it, than to go without because it was priced too low. ♦