What the huge drop in gasoline prices means for America

By Brad Plumer

The large recent drop in oil prices worldwide has had one very immediate impact for consumers in the United States. Gasoline prices are sinking to levels that haven't been seen since 2010: As of December 2, gasoline prices averaged about $2.75 per gallon nationwide. And AAA projects that gasoline prices could fall an additional 10 or 20 cents in the weeks ahead.

Note that there's still a lot of regional variation across the US, largely due to differences in state taxes. Prices at the pump average $2.44 per gallon in Missouri but $3.05 per gallon in California (a state with high gas taxes and laws requiring cleaner-burning fuels). But in general, prices are going down for everyone.

This shouldn't be too surprising. Crude oil is the main component affecting the price of gasoline. Over the past few years, the price of Brent crude has hovered above $100 per barrel, and US gasoline prices averaged around $3.50 per gallon. But now that oil prices have fallen to about $70 per barrel, gasoline prices are falling, too.

This rise and fall isn't perfectly symmetrical, however. When oil prices spike, gasoline prices spike quickly. But when oil prices drop... well, retailers are a little slower to pass on savings to consumers. One 2010 study by the Federal Trade Commission found that gas prices rise four times faster than they fall.

How cheaper gasoline affects the United States

1) Huge savings for US drivers: Millions of Americans drive and refuel their cars weekly, with the average person spending about $2,600 on gas each year. When the price of gasoline drops, everyone suddenly has more money in their pockets to spend on other things. The effect is not unlike a big tax cut.

AMERICANS MAY START TURNING AWAY FROM FUEL-EFFICIENT VEHICLES

Economists at Goldman Sachs estimate that US households have already saved about $75 billion over the past six months from the fall in gas prices. If prices were to stay at current levels, the average annual savings would come to about $1,100 per household. That's going to have positive ripple effects on the broader US economy.

(By the way, falling oil prices also mean that jet fuel is now cheaper, though many analysts expect that airlines will use that windfall to boost their bottom lines, rather than passing on those savings to consumers. So American Airlines expects to reap about $422 million next quarter, but don’t expect vastly cheaper plane tickets.)

2) Americans may drive more and buy less-efficient vehicles. In recent years, high gasoline prices have spurred many Americans to use fuel more sparingly. Americans have been buying smaller, more efficient vehicles, and average fuel economy has gone up:

At the same time, overall driving has stagnated. But if gasoline is suddenly cheaper, those trends could reverse themselves. One 2012 study from the University of Michigan’s Transportation Research Institute found that when gas prices spike, consumers quickly go out and buy smaller, more efficient cars. But when prices drop, they go back to SUVs. This may seem a bit irrational —
a car can last 10 years or more, and the price of gasoline may not stay low for that long — but it seems to be a clear pattern. Indeed, there's already anecdotal evidence that this is happening. GM recently announced it was laying off 510 workers at two plants in Michigan that build small cars — because demand has slowed. The company also says it's starting to sell a few gas-guzzling Hummers again.

3) Obama's fuel-economy standards could come under pressure. Over the past few years, the Obama administration has enacted strict new fuel-economy standards for all automakers in the US.

Under the rules, companies are free to produce whatever mix of gas-guzzling SUVs and smaller, more efficient cars they choose each year. But the average fuel economy of their entire fleet must meet a certain threshold — or else the manufacturers have to pay a penalty. And that threshold is scheduled to rise to 54.5 miles per gallon by 2025:

But here's the catch: The rules only dictate what automakers must do. Consumers are free to buy whatever cars they want. And if they continue to buy larger, less-efficient cars, those automakers will have problems.

The EPA and National Highway Traffic Safety Administration are supposed to conduct a "midterm review" of these standards starting in 2017. If Americans aren't buying enough efficient vehicles, the automakers may have a case for relaxing the rules.

At the moment, the Obama administration doesn't seem worried. "I expect that we will continue to have more and more fuel-efficient vehicles, and people will still want them," said EPA head Gina McCarthy at a recent press event, according to The Detroit News. But this is definitely a story to watch in the months ahead.

Of course, it's also always possible that gasoline might not stay cheap. If, say, there's turmoil in Libya or Iraq or Nigeria, or if the drop in prices forces US oil producers to cut back dramatically on production, then prices could rise again. Predicting the future is tricky, but it's especially tricky with oil prices.

Who loses from lower oil and gasoline prices?

Cheap oil is obviously good news for people and countries who use oil and gasoline. But it's bad news for people and countries who produce it.

STATES THAT ARE DEPENDENT ON OIL PRODUCTION COULD TAKE A HIT

Oil-producing nations — including Russia, Saudi Arabia, Iran, Iraq, and so on — are seeing a huge hit to their bottom lines. Steven Mufson of The Washington Post estimates that the annual revenue of OPEC nations could shrink by $590 billion if prices stay this low. Russia, for its part, had been planning for $100-per-barrel oil in its 2015 budget. Now that prices are down to around $70, the country is likely to face a painful economic adjustment.

The price plunge also poses economic risks for US states that are particularly dependent on oil drilling — particularly Wyoming, Oklahoma, North Dakota, Alaska, and Texas. Lower prices means less revenue and economic activity. State governments dependent on oil revenue could take a hit to their budgets. And, in some areas, costly shale drilling projects could get shelved. (The International Energy Agency estimates that about 4 percent of US shale projects are unprofitable if oil prices sink below $80 per barrel, as is currently the case.)

On the whole, however, the US is still a net oil importer, so this benefits the nation at large. But it doesn't affect everyone in the same way.

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**Answer these questions on a separate sheet of paper. The first two questions can be answered in 1-2 sentences. The third question needs a full-page, well thought out response.**

1. Who is the intended audience for this article, and how do you know that?
2. What was the author’s purpose for writing this article, and how do you know that?
3. How have the lower gas prices affected you and your family? (You may want to ask your parents to help you with this one!)