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OP/ED (OPINIONS) 5/27/2014 @ 4:00AM | 556 views

Obama's Keystone XL Dithering Is Keeping Gasoline Prices High

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GUEST POST WRITTEN BY

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There are few issues today on which Americans from different political parties agree. A recent Pew Research poll (<http://www.people-press.org/2014/03/19/keystone-xl-pipeline-divides-democrats/>) shows that one issue does elicit strong bi-partisan agreement by a margin of 2 to 1: construction of the Keystone XL Pipeline's northern leg. Despite an overwhelming majority of Americans supporting the pipeline, President Obama has delayed construction for more than two years, and the U.S. Senate passed a bill last week excluding the pipeline entirely.

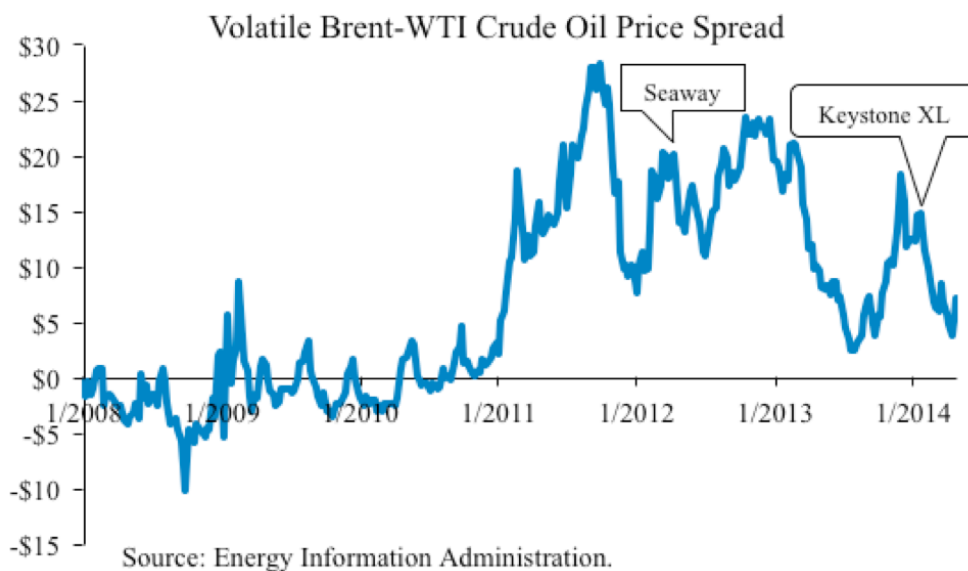
Although it's rarely acknowledged, the Keystone XL Pipeline—by stabilizing and securing domestic oil supply—could play a role in providing U.S. energy security and lowering gasoline prices.

The retail price of gasoline begins with the two benchmarks for the price of crude oil. The two globally recognized market prices are the West Texas Intermediate (WTI) crude oil held at Cushing, Oklahoma and Brent crude oil sourced from the North Sea.

Historically, these two benchmarks were closely aligned until early 2011 when geopolitical tumult surrounding the stormy “Arab Spring” in the Middle East decreased the supply of Brent crude. Simultaneously, burgeoning oil production made possible by fracking in the U.S. drove up the supply of WTI, raising the price of Brent relative to WTI.

Without adequate pipeline infrastructure from Cushing to the Gulf Coast, a bottleneck soon developed that prevented a lot of WTI crude from reaching refineries along the Gulf Coast, leaving a glut of oil parked in Oklahoma.

This changed the Brent-WTI price spread. From January 2008 to December 2010, the average spread was slightly negative, meaning WTI was more expensive on average than Brent. Since January 2011, however, the spread has averaged \$14, which rose to nearly \$30 per barrel by late 2011 and closed on May 13th with Brent priced \$7 higher at \$109 per barrel (*see figure below*).



A portion of the declining price spread results from movement of the WTI held at Cushing now possible by reversal of the direction of the Seaway pipeline (<http://fuelfix.com/blog/2013/01/11/seaway-expands-to-reduce-midwest-glut-as-oil-flows-to-gulf/>) from Cushing to Freeport, Texas in June 2012 and completion of the Keystone XL's southern leg (<http://fuelfix.com/blog/2014/01/22/transcanada-begins-oil-deliveries-through-keystone-xl-southern-leg/>) from Cushing to

Nederland, Texas in January 2014.

A persisting bottleneck for WTI, however, has altered the relationship between the price of crude oil and the price of gasoline in the US. Approximately 30 percent of the nation's refining capacity is located along the Gulf Coast. With WTI held hostage at Cushing and with ample supply of imported crude accessible along that coast since 2011, refiners have paid the higher Brent crude price than WTI and sold gasoline at an elevated price to recoup the higher cost of imported crude.

According to the Energy Information Administration (EIA), the price of oil makes up approximately 55 percent of the price of each gallon of gas. Because the prices of Brent and WTI were so close before 2011, economists could use either oil price to project essentially the same gas price. However, with the recent reliance on Brent crude by refiners along the Gulf Coast, the Brent price better projects the future price of gasoline.

Economist James Hamilton provides an online [calculator](http://econbrowser.com/archives/2012/07/update_on_us_gas) (http://econbrowser.com/archives/2012/07/update_on_us_gas) at Econbrowser.com that forecasts the gasoline price using the Brent crude price. The recent Brent price of \$109 per barrel suggests the gas price should be \$3.56 per gallon, which is about five cents lower than the U.S. average gasoline price at Gasbuddy.com (<http://www.gasbuddy.com/>).

Because oil prices are determined globally, oil supply disruptions, demand, and loose monetary policy around the world all contribute to oil price changes. Discrete geopolitical events also create volatile oil prices. These events motivate traders to purchase oil futures contracts today as an insurance policy to mitigate the risk of supply disruptions in the future. Economists measure this factor as "precautionary oil demand."

A recent example is the confrontation between Russia and Ukraine that began in early February. Since then, both oil benchmark prices are up around 3 percent contributing to an 11 percent rise in the price at the pump.

The higher oil price of course explains a significant part of the recent rise in the price of gasoline. Other factors include more expensive gasoline blends required in the summer and increased export of petroleum products. Exports, mainly in the form of gasoline and diesel to Latin America, rose 25 percent over the last year.

The Keystone factor also matters. If President Obama approved construction of the Keystone XL's northern leg, more of the relatively cheaper WTI oil could reach refineries along the Gulf Coast. This would reduce the risk premium that geopolitical instability attaches to oil prices and thus lower the gasoline price.

Unleashing this country's vast energy resources requires sufficient infrastructure, processing capacity, and upstream production. Full construction of the Keystone XL Pipeline could insulate the North American market from increasing geo-political instability in key oil producing nations.

Keystone XL makes the emerging North American energy axis real and could check Vladimir Putin's petro-power. Eliminating the risk of geopolitically driven supply disruptions in oil imports means enhanced U.S. energy security. It also could mean a lower price at the pump, making the wallet of every American who uses gasoline smile.

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