INSTITUTE FOR ENERGY RESEARCH

Bernanke Denies Culpability in Oil Prices

In a speech on June 7 in Atlanta at the International Monetary Conference, Fed chair Ben Bernanke downplayed the U.S. central bank's role in rising oil and gasoline prices. Inasmuch as I recently testified before a Congressional subcommittee saying that Bernanke's policies *have* been (partially) to blame, I want to point out the weaknesses in Bernanke's attempt to shift the blame. Nobody can know exactly how *much* the Fed has boosted the pain at the pump, but it's probably much worse than Bernanke is willing to admit.

The Fall in the US Dollar

As I pointed out in my oral remarks and written testimony, there are two main mechanisms through which Fed policy could be driving up oil prices. The first mechanism is that the Fed's "quantitative easing" programs have weakened the dollar versus other currencies. Because oil is a fungible, internationally-traded commodity, it has to cost basically the same price in every currency, once we adjust for exchange rates. Therefore, when the dollar falls against other currencies, oil necessarily gets more expensive for Americans than for other people.

Bernanke gave two main responses. First, he claimed that the fall in the dollar is no big deal. As an E&E Daily article[1] reported:

> Federal Reserve Chairman Ben Bernanke yesterday moved to dispel an intensifying GOP claim that his central bank's monetary policy is partly to blame for the current climb in oil and gas costs.
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> In a speech at the International Monetary Conference in Atlanta, the Fed chief parried the arguments by "some" who link the central bank's increase in the monetary supply -- and the resulting dip in the dollar's trade-weighted value -- to inflation in the price of commodities such as oil. While the studiously apolitical Bernanke did not mention the GOP by name, Republicans lately have ramped up their rhetoric linking the weak dollar to high pump prices that are squeezing consumers (*E&E Daily*, May 17).

> Noting that oil prices are up 160 percent since February 2009, while the dollar has fallen just 15 percent, Bernanke added that "the dollar's decline can explain, at most, only a small part of the rise in oil and other commodity prices."

Now this is an interesting defense, if you think about it. The fall of the dollar against other currencies since the implementation of the Fed's "rescue" policies can explain *57 cents* of the price at the pump, as calculated by the Joint Economic Committee. In other words, if the dollar were currently as strong against other currencies as it was at the announcement of the first round of "quantitative easing," then oil prices would be lower (quoted in dollars) and gasoline prices would be about 57 cents cheaper per gallon.

Most Americans would agree that 57 cents per gallon is a rather significant impact. Yet Bernanke's excuse above is to say, "Gasoline prices have gone up a heck of a lot more than 57 cents since I began flooding the world with dollars. So clearly I shouldn't get *all* the blame for high gas prices." As I said above, this is a rather odd defense.

Are the Critics Reversing Cause-and-Effect?

Yet Bernanke has one other card to play: He claims that the dollar is falling against other currencies *not* (just) because the Fed has injected some $1.6 trillion into the financial sector over the last 36 months, but rather because the trade deficit has mushroomed—largely because of rising oil prices!

In other words, Bernanke is saying that oil prices around the world—regardless of which currency you quote them in—have gone up sharply over the past two years. Since Americans have to import so much oil, this factor causes our trade deficit to widen. And a widening trade deficit means (other things equal) that the dollar falls against other currencies. So, in this way, Bernanke is trying to blame the weak dollar on high oil prices, rather than the other way around (as his GOP critics allege).

The major problem with *this* prong of Bernanke's defense is that the Fed could be driving up oil prices directly. In other words, it's not just some fluke coincidence that oil prices around the world (in any currency) have risen sharply, at the same time the Fed has embarked on an incredible expansion of (what economists call) the monetary base. (For those who are unfamiliar with the scale of the Fed's actions, look at this chart. It is shocking.)

Why might the Fed's pumping in of more than a trillion dollars cause oil prices to rise? One answer is that investors the world over are worried about the value of their money. With so much liquid funds sloshing around the financial sector, where should investors put their wealth, to protect it from a possibly collapsing dollar? They don't want to put it in real estate, obviously, but the stock market is also dubious because the economy is on the ropes.

In this environment, many investors think that a good chunk of their overall portfolio should be in commodities, the idea being, "No matter what happens to the banks and Wall Street, people still need wheat and oil."

This interpretation is plausible, because commodities *in general* have soared over the last two years. In other words, it's not simply oil that's skyrocketed. Since the crisis first struck in the fall of 2008, for example, gold and silver prices are up 80 percent and 210 percent, respectively. Surely that doesn't merely reflect the "fundamental" demand going up in India and China—more people giving jewelry as gifts? Surely people are flocking to gold and silver to protect themselves from a possible surge in dollar price-inflation.

Conclusion

Ben Bernanke hasn't exonerated himself. He simply takes it for granted that commodity prices have nothing to do with monetary policy, when there is plenty of circumstantial evidence—as well as common sense—saying that the two may have an intimate relationship.

In any event, American policymakers besides Ben Bernanke have options to provide immediate relief to motorists. For one thing, they could reduce the 18.4-cent per gallon federal tax on gasoline. More generally, they could expedite the permitting process and allow the development of American energy resources.

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[1] Elana Schor, "Bernanke blasts back against GOP charges on gas prices," E&E Daily, June 8, 2011.