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### How Oil Prices Affect Gas Prices

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#### How Do Oil Prices Affect Gasoline Prices?:

[Crude oil prices](#) make up 66% of the price of gasoline. The rest of what you pay at the pump depends on refinery and distribution costs, corporate profits, and Federal taxes. Usually, these costs remain stable, so that the daily change in the price of gasoline accurately reflects oil price fluctuations.



(Credit: Mark Renders / Getty Images)

In 2012, oil prices hit \$100 a barrel in mid-February, two weeks earlier than in 2011. Right on cue, gas prices rose to \$3.50 a gallon (national average). High oil prices were triggered by fears of an attack on Iran, which continued to build nuclear capacity.

Occasionally, however, distribution lines are disrupted or are down for maintenance. This can increase the price of gasoline even when oil prices are down. In 2011, for example, the Mississippi River floods led to [high gas prices](#), even though oil prices dropped. (Source: Energy Information Administration)

#### What Causes High Oil Prices?:

Like most of the things you buy, [oil prices](#) are affected by supply and demand. More demand, like the summer driving season, drives higher prices. There is usually less demand in the winter, since only the Northeast U.S. uses heating oil. However, oil prices are also affected by [oil price futures](#), which are traded on the commodities exchange. These prices fluctuate daily, depending on what investors think the price of oil will be going forward.

#### What Affects Oil Supply?:

[OPEC](#) is an organization of 12 oil-producing countries that produce 46% of the world's oil. In 1960, they formed an alliance to regulate the supply, and to some extent, the price of oil. These countries realized they had a non-renewable resource. If they competed with each other, the price of oil would be so low that they would run out sooner than if oil prices were higher.

OPEC's goal is to keep the price of oil at around \$70 per barrel. A higher price gives other countries the incentive to drill new fields which are too expensive to open when prices are low.

The U.S. stores 700 million barrels of oil in the [Strategic Petroleum Reserves](#). This can be used to increase supply when necessary, such as after [Hurricane Katrina](#). It is also used to ward off the possibility of political threats from oil-producing nations.

The U.S. also imports oil from non-OPEC member Mexico. This makes it less dependent on OPEC oil. [NAFTA](#) is a free trade agreement that keeps the price of oil from Mexico low, since it reduces trade tariffs.

#### What Affects Oil Demand?:

The U.S. uses 20% of the world's oil. Two-thirds of this is for transportation. This is a result of the country's vast network of Federal highways leading to suburbs built in the 1950s. This decentralization was in response to the threat of nuclear attack, which was a great concern then. As a result, the country has not developed the infrastructure for a national mass transit system.

The [European Union](#) is the next biggest user, at 15% of the world's oil production. [China](#) only uses 10%, but its use has grown rapidly. (Source: BP Statistical Review of World Energy, CIA World Factbook)

#### What Else Affects Oil Price Futures?:

Oil futures, or [futures contracts](#), are agreements to buy or sell oil at a specific date in the future at a specific price. Traders in oil futures bid on the price of oil based on what they think the future price will be. They look at projected supply and demand to determine the price. If traders think demand will increase because the global economy is growing, they will drive up the price of oil. This can create high oil prices even when there is plenty of supply on hand. That's known as an [asset bubble](#). This happened in [gold](#) prices during the summer of 2011. It happened in the stock market in 2007, and in housing in 2006. When the housing bubble burst, it led to the [2008 financial crisis](#). (Article updated February 20, 2012)

#### Oil and Gas Prices FAQs:

- [Why Are Gas Prices So High?](#)
- [How Are Oil Prices Determined?](#)
- [Would a Boycott Reduce Gas Prices?](#)
- [What Is the Outlook for Crude Oil Prices?](#)
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