

Re: International Pricing Policy

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- *From:* "Wayne Niddery [TeamB]" <wniddery@xxxxxxxxxxxxxxxx>
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I.P. Nichols wrote:

But that doesn't explain the almost perfect correlation between the refiner's cost of crude oil and the price of gasoline.

I already addressed that in a previous post – and the correlation, while most definitely there, is not **that** perfect either.

If you break down the cost structure of gasoline into delivery, distribution, taxes, rents, refiner's operating costs, refiner's cost of crude oil, etc. you will see that the only really significant variable is the cost of crude oil while the other items tend to remain more or less fixed.

As I posted before, when the price of crude goes up, it is perfectly natural that everyone along the chain, up to the gas stations, are going to try to maintain their own profit margins by raising the prices accordingly. So to the extent this happens, yes you are going to see that very direct correlation of prices. However it is able to take place only because **the market will bear it** – the price can go up a fair bit at the pump without significantly affecting demand.

If the pump price were really sensitive, say a 5 cent/gallon increase caused a 10% drop in gallon sales, **you would not see the pump price budge** no matter how high crude prices went. However, the result of that would be that at some point, people in the chain would be taking a loss, and the first to go would be many gas stations.

A few months ago, prices rose suddenly quite a bit around the Toronto area. The reason was because a local refinery had a fire and had to be shut down for a while. That by itself was not a huge problem, and would've only affected prices a tiny bit. But at the very same time train engineers decided to go on strike, so there were no gas tankers available to bring supplies to Toronto from anywhere else, that was the far bigger problem.

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The pump price went up about 60 cents / (U.S.) gallon. Many stations ran out and could not get refilled often enough (waiting for supplies to be *trucked* in). The price rose because the demand remained but there were insufficient supplies to satisfy it.

The price of crude never changed.

Once the strike was over and supplies were able to start flowing again, prices immediately came back down to previous levels.

Wayne Niddery – Winwright, Inc (www.winwright.ca)

"We've all heard that a million monkeys banging on a million typewriters will eventually reproduce the entire works of Shakespeare. Now, thanks to the Internet, we know this is not true." – Robert Wilensky

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