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What Obama Can Do About Gas Prices

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President Obama visits oil and gas production fields located on federal lands outside Maljamar, N.M., on March 21. Photograph by Pablo Martinez Monsivais/AP Photo

It's commonly understood among those with knowledge of how markets work that there's little government can do about gas prices. Even we have written as much. But is that really true? No, according to Michael Greenberger, a former director of the division of trading and markets at the U.S. Commodity Futures Trading Commission.

Greenberger asserts that a ban on two obscure financial products would reduce speculation by removing as much as half a trillion dollars from the oil futures market. That would bring down demand, lowering the cost of a barrel of oil and, presumably, the price at the pump. Greenberger spelled out how it would work in testimony before the House Democratic Policy and Steering Committee.

The products are called commodity index swaps and synthetic ETFs. A commodity index swap works like this: You bet that an assortment of commodities will go up in price. That is, if you're a pension, mutual, or hedge fund manager and have millions of dollars to invest on a single trade—these products aren't

available to retail investors. Since they can only bet the price will go up, that purchase puts upward pressure on the price of the commodities. The investment bank taking the bet—the swap was brought to the oil markets by Goldman Sachs and Morgan Stanley in 2004, but today other banks offer them, too—is shorting the market. So to lay off its risk, the bank goes long on a futures contract, putting additional upward pressure. The bank makes its money on fees, so provided it can hedge, it's agnostic on price.

With $400 billion or more in commodity index swaps floating around, that's a lot of pressure. Greenberger says synthetic ETFs, notes sold on the basis of price and without the purchaser owning the underlying product, have the same effect. Some speculation is considered a good thing—it provides liquidity, which reduces dangerous volatility—and conventional wisdom is that a smooth-functioning commodity market should be 70 percent commercial players, 30 percent speculators.

That ratio is now reversed: Upwards of 70 percent of the oil futures market consists of market players who have no intention of actually taking delivery of the oil. Greenberger isn't alone in believing speculation significantly affects price. Forbes cites a Goldman Sachs report attributing about $23 of the current barrel cost to speculation.

Stanford's Ken Singleton, who studies commodity index swaps, says the solution isn't Greenberger's ban but more transparency about speculation, including having the CFTC release information it collects but doesn't make public. Even with a ban, says Greenberger, "you could still own the physical commodity, invest in energy companies, and buy energy futures. We'd just be closing the casino."