

High-Priced Oil: The *Real* Costs

EVERYONE is blaming the current round of inflation on high oil prices. Wrong: High oil prices can indeed force consumers to spend more on gasoline, at the expense of other purchases. But they can't trigger a rise in the general price level — inflation — unless someone pumps money into the economy so that (to use an oldie but goodie from the economists' lexicon) there's more money chasing the same goods.

If you want something to blame for inflation, don't look at oil prices; look at the billions the Federal Reserve and US Treasury are pouring into the economy.

The cost of saving the financial system is the run-up in inflation (plus any losses taxpayers will take if some collateral the Fed accepts from the banks proves not to be worth the paper the signatures are written on).

Another myth: We're running out of oil. Oil production is constrained by several forces, none of them due to God's failure to put enough of the black gold under our feet. Several important sources of supply are in political turmoil. In Nigeria, for one, security problems have shut down about 20 percent of the nation's 2.5 mil-



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lion barrels of capacity. In Iraq, for another, political paralysis and terrorists have kept production at less than half of its potential, and prevented new exploration.

Politics is stifling output in Russia, too: Foreigners who invest in the oil industry face Vladimir Putin's "heads I win, tails you lose" game: Find nothing and you lose your money; find substantial reserves and the state squeezes you until your shareholders' pips squeak. Little surprise that Russian oil output dropped in this year's first quarter.

In Mexico, President Felipe Calderon wants to revive Petroleos de Mexico (Pemex), the world's third-largest oil producer, by contracting with foreign companies to introduce modern methods of extracting more from existing fields and finding new ones. But opponents have already delayed the legislation in Congress — and promise protest marches, highway blockages and other disruptions if it passes.

Meanwhile, in Saudi Arabia, the royal family has announced that it won't expand capacity. The oil is there, but with production now yielding about \$120 per barrel, there's no incentive to find more

— for new production might drive down prices as demand for oil from the slowing US economy drops.

Sources tell me that there is a lot more oil to be found in Kuwait, too — oil that could be produced at less than \$10 per barrel. But the royal family — the one that hid out in swank London hotels while our troops saved their nation from Saddam Hussein — is reluctant to allow Westerners with needed technology to explore for oil.

Production is falling in Venezuela, where President Hugo Chavez's cronies are inadequate substitutes for the technicians they've replaced — and foreign investors are reluctant to trust hundreds of millions in exploration dollars to a regime that treats signed contracts as the first step in a negotiation.

Here in America, Congress alternates between calls for "energy independence" and refusals to allow drilling in what it considers environmentally sensitive areas in Alaska and offshore California and Florida.

There's more, but you get the idea.



Calderon: Mex prez's oil reforms stymied.

There's a lot of oil out there to be found and produced. We might have reached the age of peak panic about oil supplies, but not of peak oil.

High oil prices and the greenhouse gasses produced by using oil do have important geopolitical consequences. These \$100+ prices have led to a massive flow of wealth, and hence power, from consuming to producing countries.

If oil were still priced at \$40 a barrel, Russia wouldn't have the wherewithal to revert to its bullying foreign policy, and US banks wouldn't be going hats-in-hand to Arab capitals in search of new capital.

And if oil didn't produce so-called greenhouse gasses when propelling cars and heating homes, there'd be no massive subsidies for ethanol production — so acreage wouldn't be diverted from growing food to growing fuel, and today's run-up in food prices would be less steep.

So oil indeed matters. But not in the ways we most often think.

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