

## ECONOMIC NEWS UPDATE

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### Two Cheers for High Oil Prices

“In times like these, it helps to recall that there have always been times like these,” says Paul Harvey, a leading radio commentator. A “great transformation [is] taking place around the world... a tectonic power shift... the world is very different,” writes Fareed Zakaria in his “The Post-American World.”

They’re both right. We have indeed seen economic downturns many times in the past, some severe, some shallow and short. We have gone through periods of rising oil and commodity prices, of a falling dollar, and of rapid technological change. So Paul Harvey is right.

But so is Fareed Zakaria. We are finally seeing the impact on the world economy of the emergence of China, India and other once-poor countries. The good news is that we have brought billions of people into the world trading system, enriching them so they can afford to eat regularly, and trade their bicycles for cars. The less good news is that the process of adjusting to this increased demand on the world

resources is proving painful, especially here in America.

Previous increases took the price of oil, and most especially of gasoline, to levels that were merely annoying. And anyhow proved to be temporary, as modest adjustments in fuel use and advances in technology combined with new supplies to ease price pressures. The current price spurt, which has taken gasoline prices to over \$4 per gallon -- half the level in the UK and other parts of the world, but previously unheard of in the US -- is different.

For one thing, it coincides with other pressures on the consumer, not least of them major increases in food prices. More important, consumers seem to have decided that the new higher gasoline prices are unlikely to prove to be a transient phenomenon. So they are changing their behavior.

The day of our SUVs is over, at least in good part. These vehicles sit, unloved and unsold, on dealers’ lots, and with them any hope that such as Ford and GM will be able to turn a profit in the foreseeable future. Ford, which sold 445,000 Explorers at the height of

that vehicle's popularity, will be lucky to sell 100,000 of the profit-generating SUVs this year. On the other hand, there are long waiting lists for the Toyota Prius, which is commanding premium prices, and other hybrids, including -- a Detroit bright spot -- the Ford Escape. Some experts calculate that at current prices, hybrids, which run on a combination of gasoline and electricity, make up for their higher prices in somewhere between two and three years for the average 15,000-mile-per-year driver.

Meanwhile, during the long period in which the vehicle fleet is turning over, consumer behavior is changing. Miles driven are down about 4%, and mass transit use is up 20%. Ride-sharing postings on the web are up 88% in the Virginia suburbs of the nation's capital, teleconferencing is on the rise, a Colorado IT consultant tells me she has switched to a motorcycle, consumers are trekking to the malls less frequently, rural community colleges are cramming classes into four-day schedules to save their non-rich commuting students hundreds of dollars per school year, and town governments are converting to 4-day workweeks. Shippers are consolidating loads so as to reduce the number of shipments as truckers, faced with a more than doubling of diesel-fuel prices to \$5 per gallon, tack on fuel surcharges. More is to come: Hewlett-Packard is quadrupling its video-conferencing facilities to eliminate 20,000 employee plane trips every year, according to The Wall Street Journal.

The rapid and immediate shift in behavior has caught operators of mass transit systems by surprise. Officials are scrambling to get more busses (a 20% increase in the current fleet of 127 is on

Atlanta officials' wish list, if they can get the funding), and to add rail cars to commuter trains -- with the notable exception of those constrained by budgets being eaten away by rising gasoline prices or declines in the sales tax revenues that fund many of mass transit systems. (Denver is a good example of the latter.) And the longer-term consequences of \$130 oil and \$4-\$5 gasoline will exceed those we are now witnessing. Businesses will schedule workloads to make it possible for employees to use mass transit or work at home; some consumers will find exurban living unbearably expensive relative to near-in town houses or urban apartments. Not that there will be an immediate exodus: after the current wave of adjustments, additional ones will take time, be more gradual, perhaps even imperceptible until we one day look back at the way it was.

There is a lesson here for politicians. For years successive presidents and congresses have railed against America's dependence on foreign oil: President Bush refers to America's "oil addiction". Recently, politicians who worry about the nation's dependence on foreign oil have forged an alliance with environmentalists who allege that the end of the world is neigh as a warming globe inflicts upon us floods and droughts, not to mention pestilence and a world devoid of polar bears. So they have increased mandated fuel-efficiency standards, forcing auto makers to include in their output mixes cars no one will buy; subsidized the production of ethanol from corn, adding to upward pressures on food costs; and spent billions subsidizing new power-generation technologies. With an effect that few will argue is proportionate to the cost.

Now comes the market, and does what politicians won't. Prices go up. Lo and behold, Jim Rogers, CEO of one of America's largest utilities, reports that thermostats are adjusted to cut electricity use; gasoline use falls as more and more consumers car-pool and switch to mass transit; and all of the things politicians have been trying to force consumers to do are getting done.

Unfortunately, politicians continue to pander to the short-term interests of voters, and remain adamantly opposed to allowing high prices to do what high prices do best: curtail demand and increase supplies. So they try to find ways of bringing prices down -- by brow-beating oil company executives, or promising to lower gasoline taxes, or begging OPEC to show mercy. In America, areas in Alaska and off-shore California, Florida and other states, remain closed to exploration and development, while politicians responsible for these bans rail against OPEC for not producing more oil.

Vladimir Putin, eager to stem the decline in Russia's oil production, is reducing the tax burden on his nation's oil companies to increase their incentive to drill and produce increasingly high-priced oil. America's politicians, the Democrats leading the way, want to raise taxes on US oil companies, never mind the supply-side effect of such a move. "Across the world," writes Zakaria, "economics is trumping politics." Unfortunately, the triumph of economics is not yet complete in Washington, D.C.

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