

New oil price shock will finish off the U.S. economy

by Marsha Freeman and Anthony K. Wikrent

On Sept. 18, the price of crude oil futures contracts rose to their highest levels ever. The October contract on the New York Mercantile Exchange reached \$33.63 per barrel, while the price of Europe's benchmark North Sea Brent climbed above \$36 per barrel. This nearly \$15 per barrel price rise since a year ago renders unavoidable what has euphemistically been termed a "recession" in the United States. Sources in Europe say that the desperate shortfall of world refining capacity has yet to be felt, and forecast a sharp new rise in gasoline and heating oil prices sometime during October through November.

While the price of oil has been artificially low over recent years, which has masked a growing depression collapse of the physical economy, once the price of oil rises, the depression becomes painfully clear. The effects of the oil price rise will tear through various sectors of the economy in obvious and not-so-obvious ways.

The total of refined petroleum products supplied to U.S. end-users in 1989 was 17.24 million barrels per day (bpd). Of that, 62.9% went to the transportation sector, of which 42.5% or 7.33 million bpd was motor gasoline, almost all consumed for transportation. Another 18.3% or 3.15 million bpd was distillate fuel oil, more than half of which was diesel fuel consumed for transportation. Jet fuel accounted for 8.6% or 1.49 million bpd, all of which was consumed for air transportation.

According to Nancy Sidhu, an economist with Security Pacific Bank in Los Angeles, each \$5 per barrel increase in the cost of oil adds a cost on the U.S. economy of 0.3% of Gross National Product, forcing the U.S. to pay about \$60 billion more for its petroleum imports. Each 5¢ increase in the cost of gasoline increases the cost to consumers by about \$3.5 billion, which is just under 0.1% of disposable income. According to Sidhu, Security Pacific's macro-economic model showed that a \$5 per barrel increase reduced 1991 GNP growth by half a percent, with effects first seen in the fourth quarter of 1990 and first quarter of 1991.

A \$15 per barrel oil increase would wipe out present GNP growth. Mike Moran, chief economist of Daiwa Securities in New York, noted that \$25 a barrel "was enough, against the background of slow growth, to tip the economy into recession. If we had robust growth, we might be able to absorb it, but right now the economy is only growing at 1.5%

... with oil moving to \$25 a barrel, we are flirting with negative growth."

In reality, the doubling of oil prices will send certain sectors of the U.S. economy, such as air transport and trucking, which are already tottering on the edge of bankruptcy, over the edge. The cost to the consumer, particularly in home heating oil and gasoline bills, will mean another ratchet collapse in the fragile standard of living of the majority of Americans.

Transportation hardest hit

Transportation industries will be decimated, especially trucking and airlines. The U.S. trucking industry hauls slightly over one-third of U.S. domestic intercity tonnage and accounts for slightly over one-quarter of U.S. intercity ton-miles of freight. As of 1988, the U.S. trucking industry consisted of 39,609 Interstate Commerce Commission-regulated motor carriers, according to the American Trucking Association (ATA). These carriers operate about 1.2 million trucks—which will consume 462 million barrels of petroleum products this year. Assuming that the trucking industry will have to spend an additional \$15 for each barrel of oil for the remainder of this year, then the trucking industry's fuel bill has just soared by \$2.23 billion.

In 1988, the 39,609 trucking carriers earned \$57.4 billion in revenues, but only \$2.4 billion in operating income and \$1.24 billion in net income. In 1989, according to figures from the Regular Common Carrier Conference, operating revenues for the 55 largest American trucking companies were \$13.822 billion, with operating income of \$532.0 million and net income of \$259.4 million. Obviously, there is no way that the trucking industry can absorb the increased fuel prices. The industry is now in the process of obtaining approval for rate increases, and in some cases have already obtained them. But, as trucking industry representatives attempted to explain to the Interstate Commerce Commission on Sept. 9, the industry is already in ill health as a result of cut-throat price competition resulting from 10 years of deregulation.

They received little sympathy: ICC chairman Edward Philbin and vice-chairman Karen Phillips—who was a member of the Senate Commerce Commission when trucking deregulation was pushed through in 1980—instead purveyed

the line that the fundamental problem in the industry is "over-capacity."

Reflecting the ill health of the trucking industry, new sales of heavy trucks in the U.S. have registered 12 consecutive months of double digit declines, with sales of Class 8 trucks (33,000 pounds or over)—the truck type that moves the vast majority of the nation's truck freight—leaving sales for the year down 16.8% from the same period of 1989. The oil price shock will help sink this ailing industry as new sales shrivel even more.

Over the past two months, the price airline companies pay for jet fuel has doubled, to close to \$1 per gallon. Fuel accounts for approximately 20% of an airline's operating cost, and as such, is the industry's highest operating expense after labor. Within days of the start of the Iraqi invasion of Kuwait, many commercial airlines announced fare increases as pass-ons to customers of the expected fuel price hikes. But declining passenger traffic and a weakening financial position have left little hope that fare increases can bail out the industry.

The jump in oil prices will potentially hike annual costs to airlines for fuel from about \$9 billion to about \$14 billion per year. According to the Air Transport Association, each \$1 increase in the price of a barrel of crude oil increases the cost of gallon of jet fuel by 3¢. That means a cost increase of almost \$500 million per year per penny increase.

According to the ATA, in the first quarter of this year, the airline industry lost \$600 million. In the second quarter, the industry turned a profit, but it was not enough to make up for the first quarter's losses. Industry analysts expect a consolidation (i.e., rationalization, or cartelization) among the nation's 25 air carriers. It is unlikely that a consolidation will improve either service or safety, in an industry that already ranks as one of the worst in the world in passenger preference and service.

Electric power more oil-dependent

The oil shock of 1974 created a situation in the United States which had never existed before: The price of delivered electric power increased for the first time since the 1880s. Some utilities dependent upon oil had to raise rates by over 30%, but learning a hard lesson, the electric utilities planned to decrease their use of imported petroleum. At the time of the 1974 price hike, 17% of all electricity was generated through the burning of oil. As nuclear power plants were only just starting to come on line by the time of the 1979 Iran embargo, the utilities were still 16% dependent upon oil.

At the current time, however, nuclear power is producing nearly 20% of U.S. electricity, and oil only 5.6%, mainly for peaking and not baseload capacity. As nuclear plants came on line, the delivered cost of electric power resumed its historical decline. Today the utilities use about 731,000 barrels per day of oil, which is only 0.5% of total national oil use.

But in the past three years, the use of oil in the electric utility industry has actually *increased* by 34%, up from 546,000 barrels per day in 1987. The inability of the utilities to build nuclear or baseload coal-fired plants due to financial, environmental, and regulatory sabotage, has pushed them into adding virtually only peak power capacity. It is estimated that 50% of the new capacity coming on line in the next five years will be oil- or natural gas-fired. According to the U.S. Council for Energy Awareness, this could push oil use up from today's level by *2 million additional barrels per day*.

The use of imported oil by the electric utilities is geographically specific, concentrated on the east and west coasts, with New York being the most oil-dependent. The New York City-based Consolidated Edison Company is 41% oil-dependent, and the nearby Long Island Lighting Company (LILCO), 63%. In New York, which has the highest electric rates in the country because of its imported oil bill, the trade-off between oil and nuclear can be directly drawn. If Gov. Mario Cuomo and the anti-nuclear lobby in and around the state had allowed the Shoreham nuclear plant to operate when it was completed five years ago, it would be reducing the amount of oil the Long Island Lighting Company has to import by nearly 8 million barrels per year, saving nearly a quarter of a billion dollars.

Chemical industry can't pass on costs

According to Owen Keane of the Chemical Manufacturers Association, the U.S. chemical industry used 2.5 million bpd oil equivalent of energy, 45% of which was crude oil, or 1.125 million bpd of oil in 1989. About 95% of that crude oil is used as feedstock, mostly for the production of three major primary derivatives: ethylene, propylene, and butalyne.

The total energy bill (fuel and feedstocks) for the chemical industry is about \$20 billion a year, of which half is for oil. The Chemical Manufacturers Association has estimated that a \$10 increase in the price of a barrel of oil would cost the chemical industry another \$7.5 billion each year.

The industry manufactures over 60,000 products, and many would not be greatly affected by an increase in the price of oil. However, some products, such as ethylene glycol, used in antifreeze, are 80-85% oil derived and would have to increase 20-25% in price to recover a \$10 price increase in a barrel of oil. According to Ronald Whitfield, vice president of Charles River Associated, Inc., in Boston, \$25 per barrel oil forces ethylene prices up about 15%, to 27.6¢ a pound, while propylene prices are forced up 16%, to 18¢ a pound. Further along the production process, prices for low-density polyethylene will be forced up 17%, to 39¢ a pound, and the price of crystal molding grade polystyrene will rise 21%, to 47¢ a pound.

Overall, Keane stated, if the additional energy cost of \$7.5 billion were to be successfully passed through, chemical industry products would have to increase about 4% in price

on average. In 1989, the industry's estimated operating income was \$25.93 billion. Thus it appears that the industry can absorb the price increase, as it might well have to. Keane noted that the chemical industry has begun a number of new projects in recent years to increase capacity, but now demand is slackening due to recessionary factors. Keane stated that "the supply-demand factors facing the chemical industry would work against any major passing through of increased energy costs."

Agriculture may be the most vulnerable

A rise in oil prices will substantially affect every aspect of growing, processing, and delivering food. Petroleum-based fuels used directly for farm equipment in grain production, for example, are only \$8 per acre of a total \$150 per acre operating cost, but every other aspect of agriculture depends upon energy inputs as well. Drying and storing grains, for example, requires another \$4-5 per acre of production of mainly natural gas and oil-derived liquid petroleum gas.

A recent study by the Congressional Research Service stated that while agricultural production accounted for only 3-4% of total U.S. energy consumption, the entire food and fiber industry—production, processing, packaging, and distribution—represents 15-20% of energy consumption.

In a report issued on Sept. 11, the U.S. Department of

Agriculture estimates that if oil prices stay around the \$30 per barrel level, farm production expenses can be expected to increase by \$1.7 billion over previous \$20 per barrel oil estimates, for 1991. If oil were to go to \$40 per barrel, the increase could top \$2.6 billion.

Agriculture is distinct from other sectors of the economy. The USDA states, "Net farm income would drop as farmers are unable to pass cost increases directly to the consumer." The increase is initially borne by the producer, who can only get a set price for his commodity at market. Therefore, for the section of farmers already at financial risk, such increased production costs could be impossible to absorb.

In the last two oil hoaxes, animal production was very hard hit, due to increases in the costs of heating (fuel) and cooling (electricity) the farm facilities, and increases in feed from rising transportation prices. The USDA report states that "higher transportation costs raise meat distribution costs, which would be passed on to consumers and back to livestock producers."

Overall, the USDA projects a 1-2% rise in food prices accompanying a \$30 or \$40 per barrel price for oil, primarily from higher transportation costs.

This higher cost of food translates into fiscal year 1992 increases of about \$170 million for food stamps, and increases in the cost of school lunch programs.

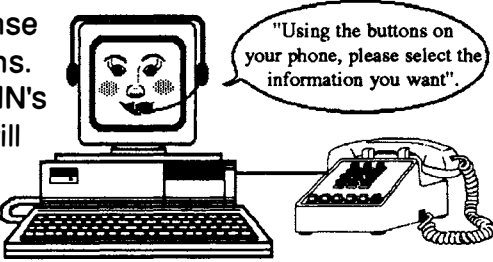
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