Can the 'New Economy' Really Survive Expensive Oil?

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Most people never think about it. It is dark, thick, comes in barrels, and people consume thousands of gallons on Friday evenings. No, not Guinness. Oil – black gold. Your whole life, whether you are aware of it or not, is shaped by petroleum.

The bad news is that at the time of writing the barrel price of black magic has nearly quadrupled since 1999. And that means you and your family -- and your workplace -- are about to bear the costs of an oil shock. Pundits say that the 'new economy' can shrug it off. Software has taken over from steel mills, they say, so there is nothing to worry about.

Well, William Gates may have changed our desktops, but like other citizens of the western world Bill drives into work, drinks from plastic cups, wears acrylic clothing, takes endless airplane flights, receives packages by UPS, lives in a warm house, works in a cool office, and gets hot pizzas delivered by automobile. He, I and you live on a petroleum-powered planet.

Although the start of an economic slowdown -- on both sides of the Atlantic – has been becoming more evident every month, many remain relaxed. They have swallowed the myths about petroleum and western society.

Myth 1. We are less dependent on oil these days.

Sorry, you are the weakest link. Goodbye.

The world is actually more dependent on petroleum than at any time in history. The globe went through 20 million barrels a day in 1960 and 60 million barrels in 1980. Today consumption exceeds 70 million barrels every twenty four hours.

This is not just because new nations are industrializing. A quarter of a century ago, the United States consumed 16 million barrels of black gold each day; now it swallows 19 million barrels. The European countries like France, Germany and the UK get through more petroleum, not less, than in the early 1970s. Half of the European Union's entire energy currently comes from petroleum.

Yes, we produce more national output for every unit of oil. This often-repeated fact misses the point. Western society throws away the potential advantage of greater energy efficiency by consuming far more goods than our parents' generation did. Our lifestyles burn oil like there is no tomorrow.

Most especially, oil has a monopoly in transportation. Trains, trucks, automobiles, ships, planes – all run on petroleum. We are over a barrel. In the United Kingdom, Transport consumes as much energy as Industry and Services combined. Indeed it is this dependence on oil for moving goods and people that left us stationary in September 2000's fuel tax demonstrations. There could have been no better experiment: without petroleum a modern society grinds to a halt.

Myth 2. Oil price shocks now have minor effects on growth and jobs.

Look at the data. Since the Second World War, whenever the barrel price of crude oil has trebled, the world economy has trembled. Oil shot up in price in 1973, 1979 and 1990. Recessions started right afterwards. Coincidence?

There are good reasons why oil shocks hurt. When raw materials become more expensive, costs rise. Profits drop; firms begin to go out of business; people lose their jobs. The price of oil matters also because of its importance in plastics, medicines, chemicals, clothing, pesticides, paint, and thousands of other things we take for granted.

Myth 3. Oil shocks do not matter much these days because there are lots of energy sources.

The price of oil shapes all other energy prices, including your gas and coal bills. A little-reported fact is that the price of natural gas is up by

50% this year. Oil prices also govern electricity prices. The ripples from oil price shocks spread wide.

Myth 4. The oil price rises of 2000 have done little harm.

As I pointed out in the Financial Times in the autumn of 1999, statistical work tells us that the lag from an oil price movement to an output or unemployment movement is about 18 months. The price of oil reached its minimum, of nine dollars a barrel, around January 1999. On cue, the economies on both sides of the Atlantic have slowed since the middle of the summer of this year, and Euroland and US unemployment rates have begun to run approximately flat. Let's wait and see what happens through 2001 before getting confident.

Myth 5. At least there is nothing to worry about in the long run.

Sorry to worry you, but geologists currently predict that global oil production will peak around the year 2015. American domestic oil production has been falling steadily since the 1970s (a fact they prefer not to publicise). The real problem is that it is now harder to increase the world flow of oil than most realise. And the evidence shows that the rate of new oil discovery is comparatively unresponsive to movements in oil prices. So high prices may not help that much.

There is also is a wild card in the pack. It is large and written in Chinese symbols.

China has five times the population of the United States, but currently few cars. Remarkably, the US has 135 million vehicles and China only 4 million.

The average US citizen consumes 25 times as much oil as the average Chinese citizen. Yet China is industrialising now.

Just do the math, as the Americans say….