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Tomgram: Michael Klare, Barreling into Recession

The latest economic news is striking. The U.S. economy has come to a "virtual standstill." The bubble has burst and, with anxious global markets registering the shock, other bubble economies worldwide continue to shudder at the possibility that American consumers might be forced to rein in their decade-long buying spree of imported goods.

Though any reader of newspaper business pages has surely noticed that oil news, oil deals, and oil prices have been front and center, the role of oil in our new economic moment has been underemphasized of late. It's hard even to remember -- now that the price of a barrel of crude oil has hit the $100 mark and still hovers around $91 -- that, in the week after September 11, 2001, oil was still under $20 a barrel. Think of this as another modest accomplishment of the Bush administration, helped along by its rash war in Iraq, which actually took oil off the market. In a mere six years, we've gone from the era of cheap oil to the era of pricy petroleum or "tough oil", with a new spike at the gas pump expected as early as this spring. The results are now there for all to see -- in growing misery at home as well as stunning global financial and power shifts.

Michael Klare has long been ahead of the curve. In the late 1990s, he was already writing about "resource wars" in the coming century; as that century dawned, his next book, *Blood and Oil*, arrived; and now, just in time for a new global era, his latest book, Rising Powers, Shrinking Planet: The New Geopolitics of Energy, is ready to appear. You could say that he saw much of this coming and here he offers us an assessment of the missing role that energy played in the bursting of the American bubble. *Tom*

Something Had to Give

How Oil Burst the American Bubble
By Michael T. Klare

The economic bubble that lifted the stock market to dizzying heights was sustained as much by cheap oil as by cheap (often fraudulent) mortgages. Likewise, the collapse of the bubble was caused as much by costly (often imported) oil as by record defaults on those improvident mortgages. Oil, in fact, has played a critical, if little commented upon, role in America's current economic enfeeblement -- and it will continue to drain the economy of wealth and vigor for years to come.

The great economic mega-bubble arose in the late 1990s, when oil was cheap, times were good, and millions of middle-class families aspired to realize the "American dream" by buying a three (or more) bedroom house on a decent piece of property in a nice, safe suburb with good schools and various other amenities. The hitch: Few such affordable homes were available for sale -- or being built -- within easy commuting range of major metropolitan areas or near public transportation. In the Los Angeles metropolitan area, for example, the median sale price of existing homes rose from $290,000 in 2002 to $446,400 in 2004; similar increases were posted in other major cities and in their older, more desirable suburbs.

This left home buyers with two unappealing choices: Take out larger mortgages than they could readily afford, often borrowing from unscrupulous lenders who overlooked their overstretched finances (that is, their "subprime" qualifications); or buy cheaper homes far from their places of work, which ensured long commutes, while hoping that the price of gasoline remained relatively low. Many first-time home buyers wound up doing both -- signing up for crushing mortgages on homes far from their places of work.

The result was metastasizing exurban home developments along the beltways that surround major American cities and along the new feeder roads that now stretched into the distant countryside beyond. In some cases, those new homeowners found themselves 30, 40, even 50 miles or more from the urban centers in which their only hope of employment lay. Data released by the U.S. Census Bureau in 2004 showed that virtually all of the fastest growing counties in the country -- those with growth rates of 10% or more -- were located in exurban areas like Loudoun County, Virginia (35 miles west of Washington, D.C.) or Henry County, Georgia (30 miles south of Atlanta).

At the same time, cheap oil and changing consumer tastes -- pushed along by relentless advertising campaigns -- led many of the same Americans to trade in their smaller, lighter cars for heavy SUVs or pickup trucks, which, of course, meant only one thing -- a significant increase in oil consumption. According to the Department of Energy, total petroleum use rose from an average of 17 million barrels per day in 1990 to 21 million barrels in 2004, an increase of 24% -- most of it being burned up on American roads.

Let the Good Times Roll (into the Exurbs)

In 1998, when the bubble was taking shape, crude oil cost about $11 a barrel and the United States produced half of the petroleum it consumed; but that was the last year in which the fundamentals were so positive. American reliance on imported petroleum crossed the 50% threshold that very year and has been rising ever since, while the cost of imported oil hit the $100 per barrel mark this January 2 for the first time, an all-time record (though the price was once briefly higher, as measured in older, less inflated dollars).

When that steady price climb, combined with growing dependence on imported petroleum, was translated into the new exurban landscape the economic bubble began to shudder. As a start, there was that ever-increasing outflow of dollars needed just to pay for all those barrels of crude and the resulting surge in America's foreign-trade deficit.

Consider this: In 1998, the United States paid approximately $45 billion for its imported oil; in 2007, that bill is likely to have reached $400 billion or more. That constitutes the single largest contribution to America's balance-of-payments deficit and a substantial transfer of wealth from the U.S. economy to those of oil-producing nations. This, in turn, helped weaken the value of the dollar in relation to key foreign currencies, especially the euro and the Japanese yen, boosting the cost of other imported foreign goods and so threatening to fuel inflation at home.

Meanwhile, two critical developments kept the cost of oil rising: a dramatic increase in global demand, largely driven by the emergence of China and India as major consuming nations; and a pronounced slowdown in the expansion of global supply, due mainly to a dearth of new discoveries and recurring political disorder in key oil fields already in production. This meant that American energy consumers -- including all those long-distance commuters with crippling mortgages and gas-guzzling SUVs -- had to compete with newly-affluent Chinese and Indian consumers for access to ever more costly supplies of imported petroleum. Something had to give.

As the oil import bill kept rising, the value of the dollar kept falling, and inflationary pressures kept building, the country's central bankers responded in classic fashion by raising interest rates. This naturally resulted in substantially higher monthly payments for homeowners with variable-rate mortgages. For many families already stretched to the limit, this would prove the final blow. Forced to default on their mortgages, they then precipitated the subprime crisis by, in effect, puncturing the bubble.

Even then, the economy might have had a chance had that crisis not come in tandem with the $100 barrel of oil. By December, consumers were cutting back on nonessential purchases, producing the most disappointing holiday retail season since 2001. When questioned, many indicated that the high cost of gasoline and home-heating fuel had forced them to economize on Christmas gifts, winter vacations, and other indulgences. "If gasoline prices go up, that means there's less to spend on everything else," said David Greenlaw, chief U.S. fixed-income analyst at Morgan Stanley.

The high price of gasoline was bad news for another pillar of the economy as well: the auto industry. While Japanese companies were busy rolling out hybrid vehicles and small, fuel-efficient conventional cars, Detroit stuck doggedly to its now-obsolete business model of producing large SUVs and light trucks, which had, in recent years, been the source of most of its profits. Once the price of oil went stratospheric, of course, Americans predictably stopped buying the gas guzzlers, signing what looked like an instant death certificate for an improvident industry. In 1999, for example, Ford sold more than 428,000 mid-sized Explorer SUVs; in the first 11 months of 2007, the equivalent number was 126,930 Explorers (and even that puts a gloss on the corpse, as November was one of the worst months in recent automotive history). An auto industry in decline naturally means that many ancillary industries will be facing contraction, if not disaster.

Popping the Bubble

Then came January 2. Although oil retreated from the $100 mark by the end of that day on the New York Mercantile Exchange, the damage had been done.

Websites

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Asia Times

Stocks on the New York Stock Exchange plummeted, suffering their worst loss on a New Year debut since 1983. Gold, meanwhile, soared to an all-time high -- a sure indication of international anxiety about the vigor of the U.S. economy.

Since then, stock market panics have hit major financial centers around the world. Only a dramatic last-minute decision by the Federal Reserve to reduce overnight lending rates by three-quarters of a point before the markets opened on January 22 averted a further, potentially catastrophic slide in stock prices. Many analysts now believe that a recession is inevitable -- possibly a long and especially painful one. A few are even mentioning the "D" word, for depression.

Whatever happens, the American economy will eventually emerge from this crisis significantly weaker, largely because of its now-inescapable dependence on imported oil. Over the past decade, this country has squandered approximately one and a half trillion dollars on imported oil, much of which has been poured down the tanks of grotesquely fuel-inefficient vehicles that were conveying drivers on ever lengthening commutes from the exurbs to employment in center cities.

Today, a large share of this money is deposited in so-called sovereign-wealth funds (SWFs). Americans should get used to that phrase. It stands for giant pools of wealth that are under the control of government agencies like the Kuwait Investment Authority and the Abu Dhabi Investment Authority. These SWFs now control approximately $3 trillion in assets, and, with more petrodollars pouring into the petro-states every day, they are projected to hit the $12 trillion mark by 2015.

What are those who control the sovereign-wealth funds doing with all this money? For one thing, buying up choice U.S. assets at bargain-basement prices. In the past few months, Persian Gulf SWFs have acquired a significant stake in a number of prominent American firms, giving them a potential say in the future management of these companies. The Kuwait Investment Authority, for example, recently took a $12 billion stake in Citigroup and a $6.5 billion share in Merrill Lynch; the Abu Dhabi Investment Authority acquired a $7.5 billion stake in Citigroup; and Mubadala Development of Abu Dhabi purchased a $1.5 billion share in the privately-held Carlyle Group.

These acquisitions are just a small indication of a massive, irreversible shift in wealth and power from the United States to the petro-states of the Middle East and energy-rich Russia. These countries, notes the International Monetary Fund, are believed to have raked in $750 billion in 2007 and are expected to do even better this year -- and each year thereafter. What this means is not just the continuing enfeeblement of the American economy, but an accompanying decline in global political leverage.

Nothing better captures the debilitating nature of America's dependence on imported oil than President Bush's humiliating recent performance in Riyadh, Saudi Arabia. He quite literally begged Saudi King Abdullah to increase the kingdom's output of crude oil in order to lower the domestic price of gasoline. "My point to His Majesty is going to be, when consumers have less purchasing power because of high prices of gasoline -- in other words, when it affects their families, it could cause this economy to slow down," he told an interviewer before his royal audience. "If the economy slows down, there will be less barrels of

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[Saudi] oil purchased."

Needless to say, the Saudi leadership dismissed this implied threat for the pathetic bathos it was. The Saudis, indicated Oil Minister Ali al-Naimi, would raise production only "when the market justifies it." With that, they made clear what the whole world now knows: The American bubble has burst -- and it was oil that popped it. Thus are those with an "oil addiction" (as President Bush once termed it) forced to grovel before the select few who can supply the needed fix.

Michael Klare, author of Resource Wars and Blood and Oil, is a professor of peace and world security studies at Hampshire College. His newest book, Rising Powers, Shrinking Planet: The New Geopolitics of Energy, will be published by Metropolitan Books in April 2008.