Featured Views

Published on Wednesday, March 24, 2004 by the Guardian/UK

The Perfect Storm That's About to Hit

Rising Oil Prices and a Weak Dollar could Shatter the Global Economy

by Jeremy Rifkin

The average nationwide price of a gallon of gasoline in America reached a record high of $1.77 this month. The steady spike in prices has left analysts wondering if this is a harbinger of even more dramatic increases as motorists head into the spring and summer months. Get ready for what might become the economy's version of the perfect storm later this summer. The devastation could quickly spread to the UK and the rest of the world, with dire consequences for the global economy. The first hint of what might be in store came last month when Opec announced its decision to withdraw 1m barrels of crude oil a day from the market. Opec is worried about the weakening value of the dollar: it has lost one-third of its value in just under two years. Since Opec sells oil for dollars, the oil-producing countries are losing precious revenue as the value of the dollar continues to erode. And because oil-producing countries then turn around and purchase much of their goods and services from the EU and must pay in euros, their purchasing power continues to deteriorate. (The euro is currently valued at $1.23.)

How will the weaker dollar affect oil prices? Philip K Verleger, the dean of US oil market analysts and a visiting fellow at the Institute for International Economics, suggests that "oil-exporting countries may decide to adjust their price band to reflect the falling value of the dollar". If the dollar continues to slide, he warns, we could see oil prices rising from the current $38.18 a barrel to a record high of $40 by midsummer.

There are other dark clouds on the horizon. US crude oil inventories are at the lowest point since the mid 70s, and the retail gasoline market is operating with little reserve margin as we move into the summer months, where more travel will increase demand. The dwindling oil reserves are made worse by the White House decision to replenish the strategic petroleum reserve, further reducing the amount of gasoline available.

Verleger says gasoline could climb as high as $3.50 a gallon before leveling off at $2 by the autumn. How high prices eventually soar could depend on still other factors, including potential oil disruptions in Venezuela and the Middle East. There is also the prospect that one or two major refineries might fail during peak demand this summer - not that unusual when increased consumer pressure forces refineries to produce at peak capacity without taking the time for proper maintenance.

Here is where events potentially begin to feed off each other, creating the conditions for the perfect storm for the economy. If the price of oil increases to $40 a barrel with an accompanying rise in gasoline prices, the already weak economic recovery could stall.

How then do we lower the price of a barrel of oil? We'd have to strengthen the value of the dollar so that Opec would not be forced to raise prices to compensate for the deteriorating value of the currency. But the dollar's value is declining because of America's growing debt. The IMF is so concerned about US debt - the result of rising budget deficits and trade imbalance - that it issued a report warning that if steps weren't taken to reverse the trend, it could threaten the financial stability of the world economy.

An ever-weaker dollar makes foreign investors less interested in financing the mushrooming US debt. The US could raise interest rates, making it more attractive for foreign investors, but that would mean higher interest rates for US companies and consumers, which could dampen the already weak recovery and send us back into a recession in the US and around the world.

So we have all the conditions coming together to create the perfect economic storm: record oil prices triggering a restriction in US economic growth and an increase in the federal budget deficit, accompanied by further erosion in the value of the dollar - with increased budget deficits and the diminished value of the dollar leading in turn to higher interest rates to convince foreign investors to lend the US additional money, followed by a further retraction of the US economy as rising interest rates lead to a drop in domestic investment and consumption. The cascade of events touches off a tsunami that engulfs the rest of the global economy, submerging the world in deep recession.

As long as the US and global economy are increasingly dependent on an ever-dwindling supply of oil from the Middle East, the conditions for a perfect economic storm will continue to haunt us. The solution, in the long run, is to wean the world off its dependency on oil. That would require much tougher fuel efficiency standards, greater energy conservation measures, support of hybrid vehicles and a switch to renewable sources of energy. Short of that, expect the storm clouds to gather in intensity.

· Jeremy Rifkin is the author of 'The Hydrogen Economy' and president of the Foundation on Economic Trends in Washington DC

###

Printer Friendly Version E-Mail This Article