

Oil Price Shocks: Past, Present and Future

Dr. Larry Kimbell

Former Director

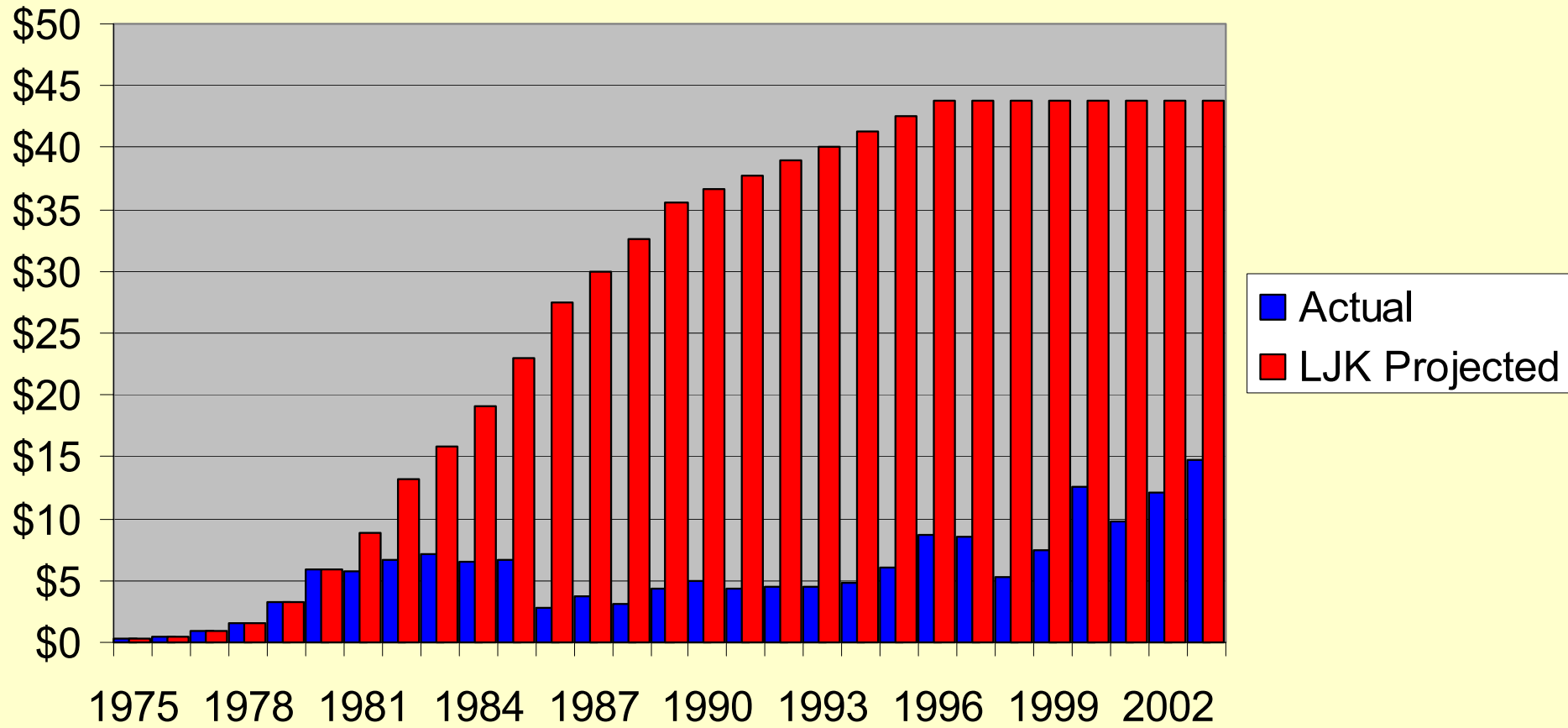
UCLA Forecast

Presented at a Conference
Economic Forecast Center
J. Mack Robinson College of Business
Georgia State University
Atlanta, Georgia
November 17, 2004

Unexpected Price Changes Hurt

- ◆ Price Increases Obviously Hurt Because
 - Many budgets are squeezed
 - Fuel inefficient capital stocks made obsolete
- ◆ But Price Drops Can Hurt too
 - A California utility almost went broke because OIL PRICES FELL!
 - Mexicans borrowed too much when I told them in 1981 oil would sell for \$86/bbl.
 - Oil exporters generally fared poorly because they over borrowed expecting rosy futures.

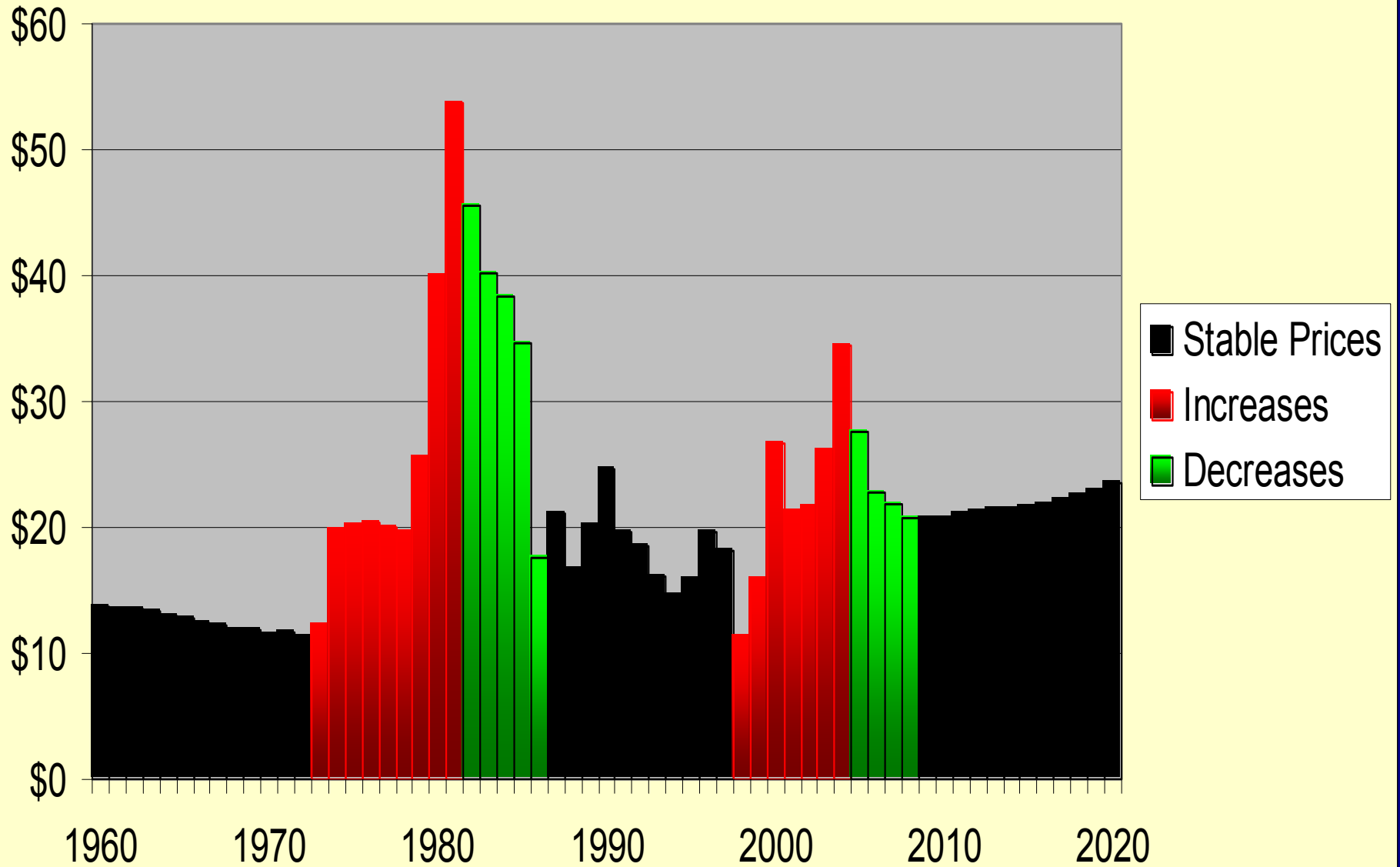
Import Payments by U.S. to Mexico for Crude Oil Actual and Projected in Billions of U.S. Dollars



Why Current Oil Price Shock is NOT Causing a Recession

- ◆ Oil price increases are smaller in the current episode than in 1973-1981.
- ◆ Last time *income tax rates were rising rapidly* as general inflation was pushing people into higher brackets; this time the *Bush tax cuts* have more than *offset the higher energy costs*.

Real Price of Crude Oil (2000\$/bbl)

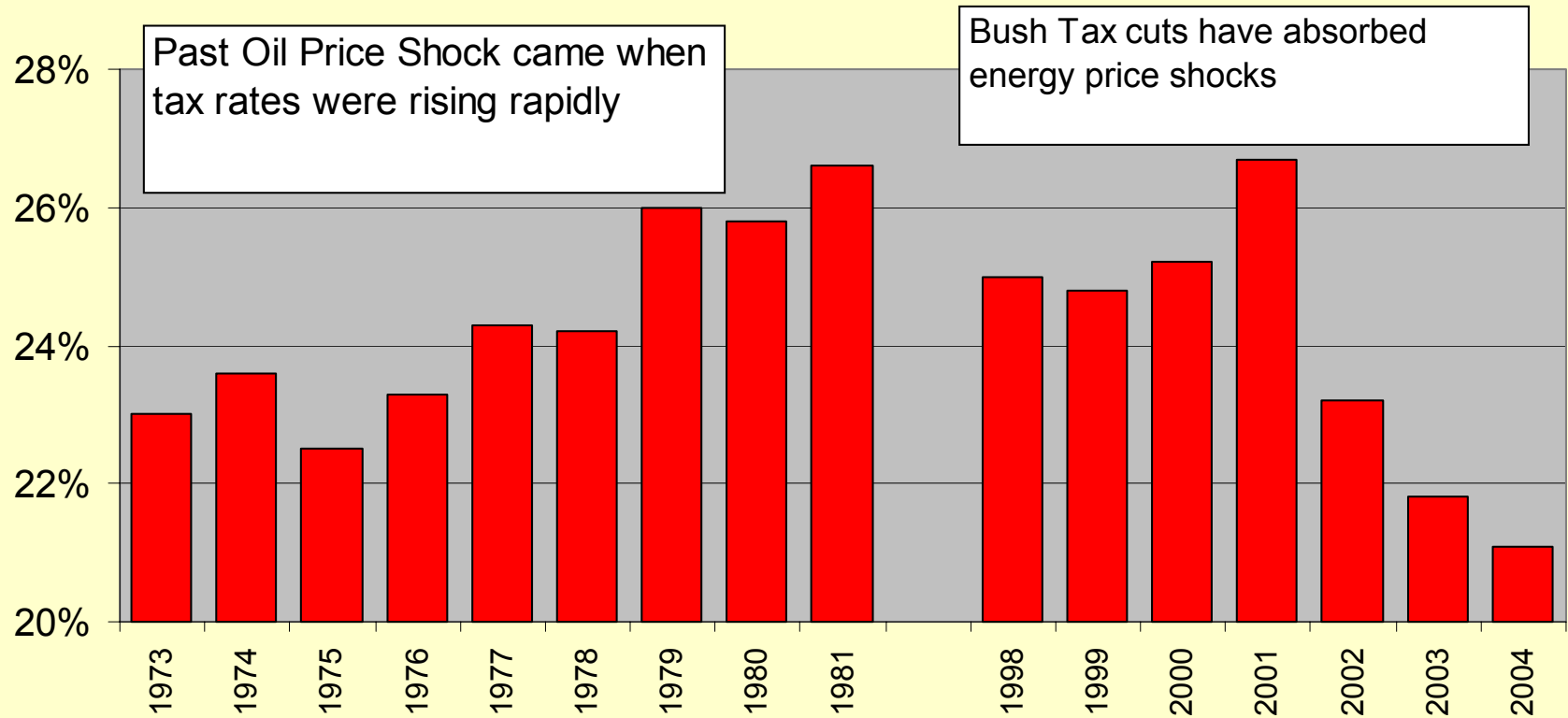


2 Episodes of Oil Price Shocks *(Year 2000 \$ per barrel)*

1973	\$12.21	
1981	\$53.74	<i>Four-fold increase</i>
1988	\$16.62	<i>Drop to one-third</i>
1998	\$11.27	
2004	\$34.36	<i>Three-fold increase</i>
2008	\$20.71	<i>Drop to two-thirds</i>

Tax Cuts have Eased the Oil Price Shock This Time

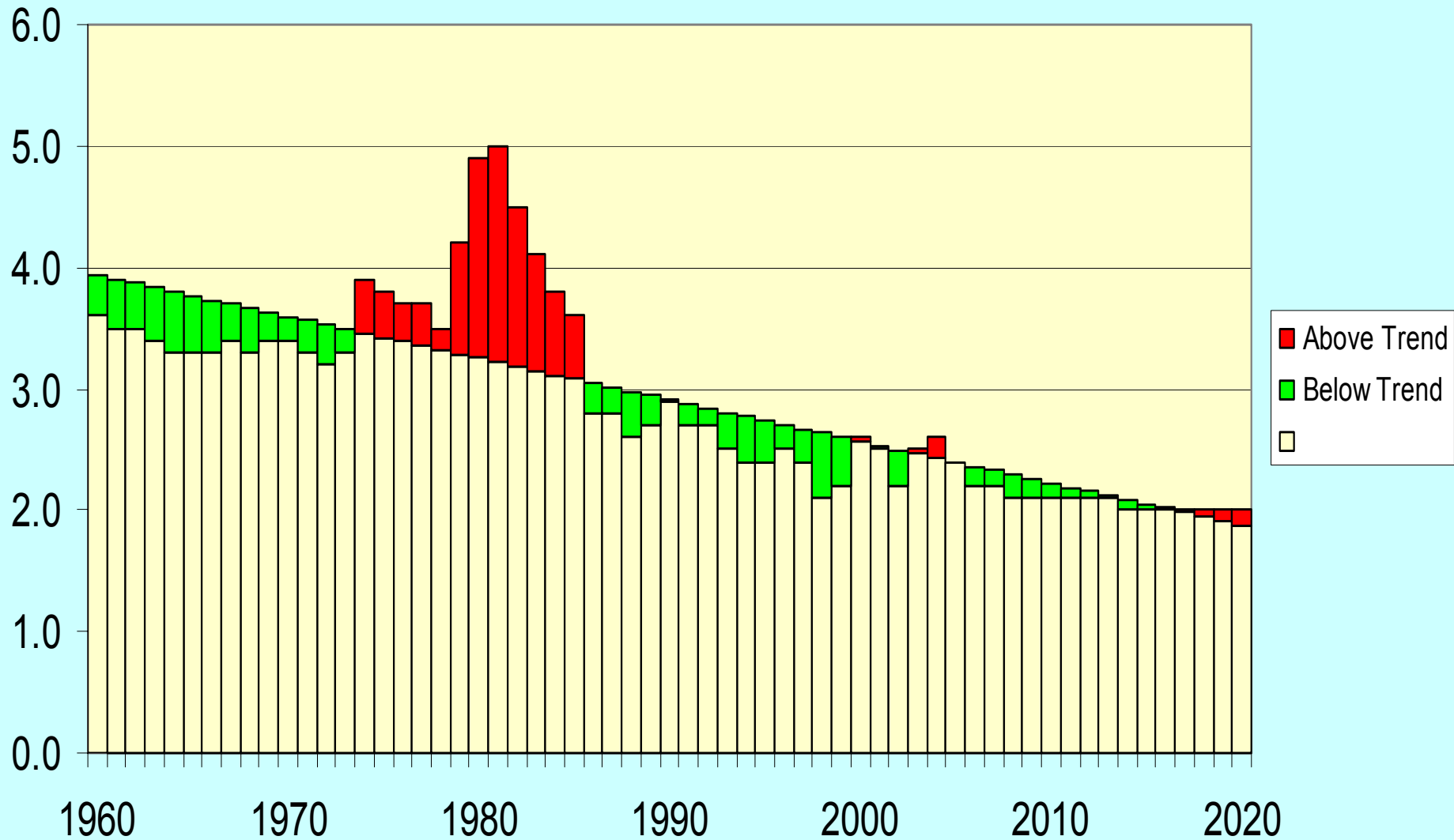
**Average Effective Income Tax Rates
Federal, State and Local Combined**



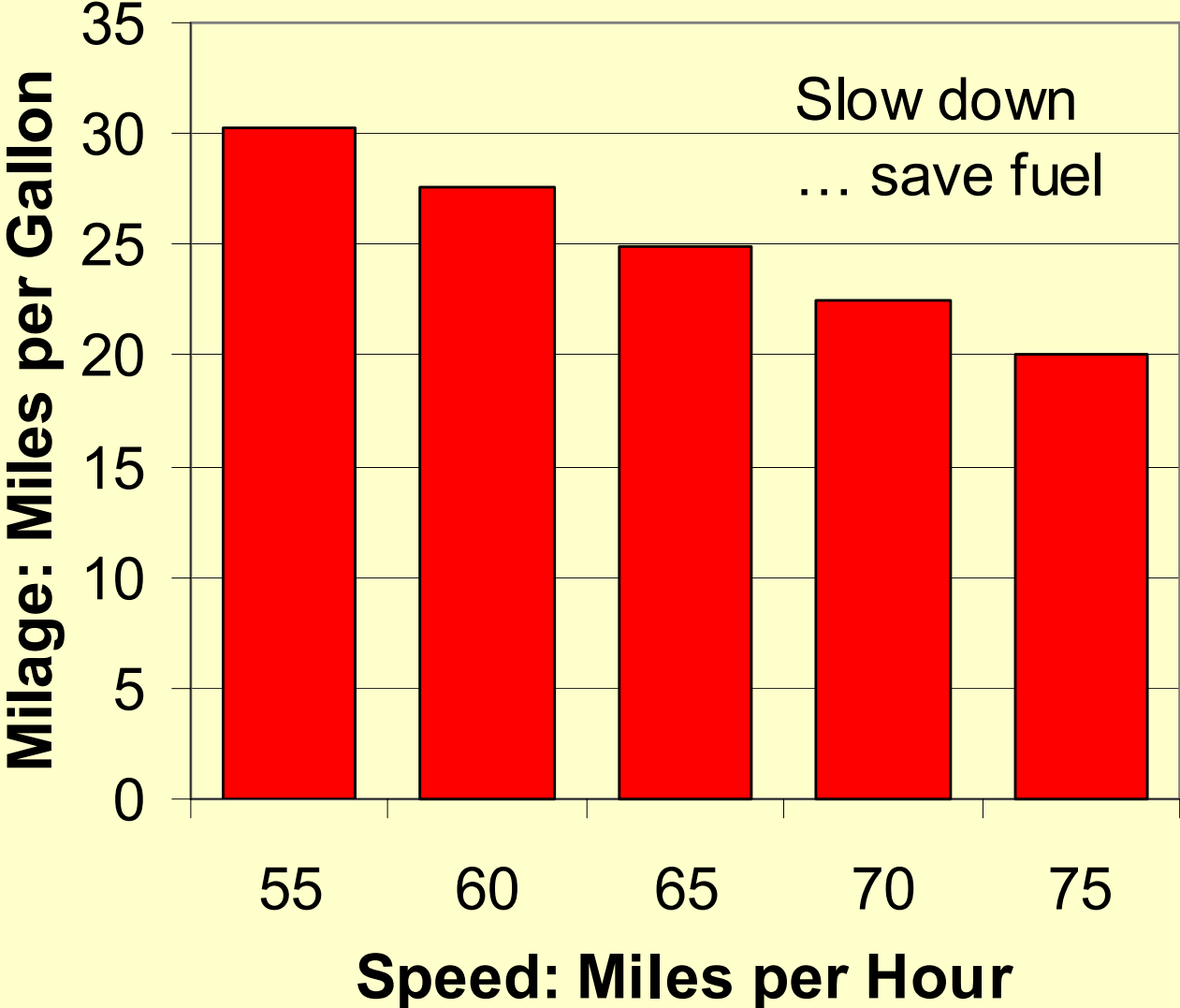
Favorable Factors in the Outlook

- ◆ Energy costs have become a smaller share of our budgets
- ◆ We *can* quickly start saving energy:
 - Drive slower can start today, save 20%
 - Drive less, ride a bike, stop skiing
 - Turn down thermostats
- ◆ But habits won't change without proper incentives--so raise U.S. gasoline taxes like they do in Europe

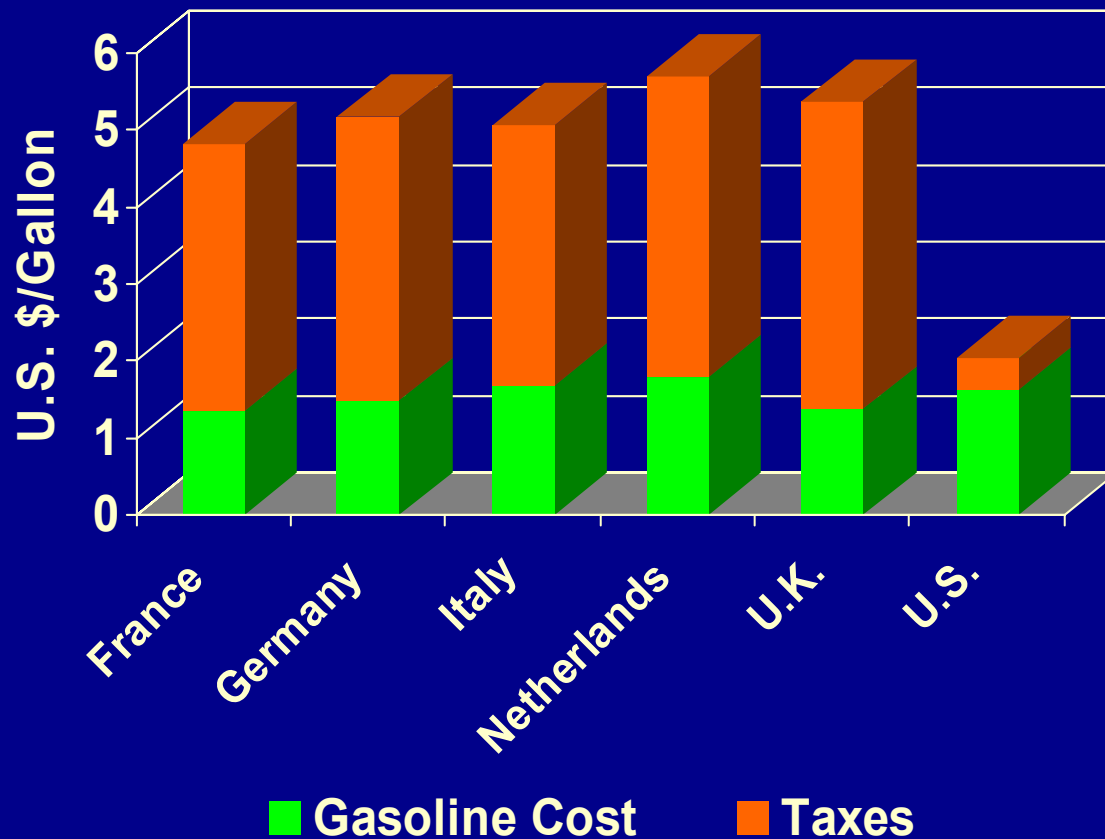
Gasoline and Motor Oil Expenditures As Shares of Total Consumer Spending



Fuel Economy vs Speed



Taxes Make Gasoline Prices Higher in Europe

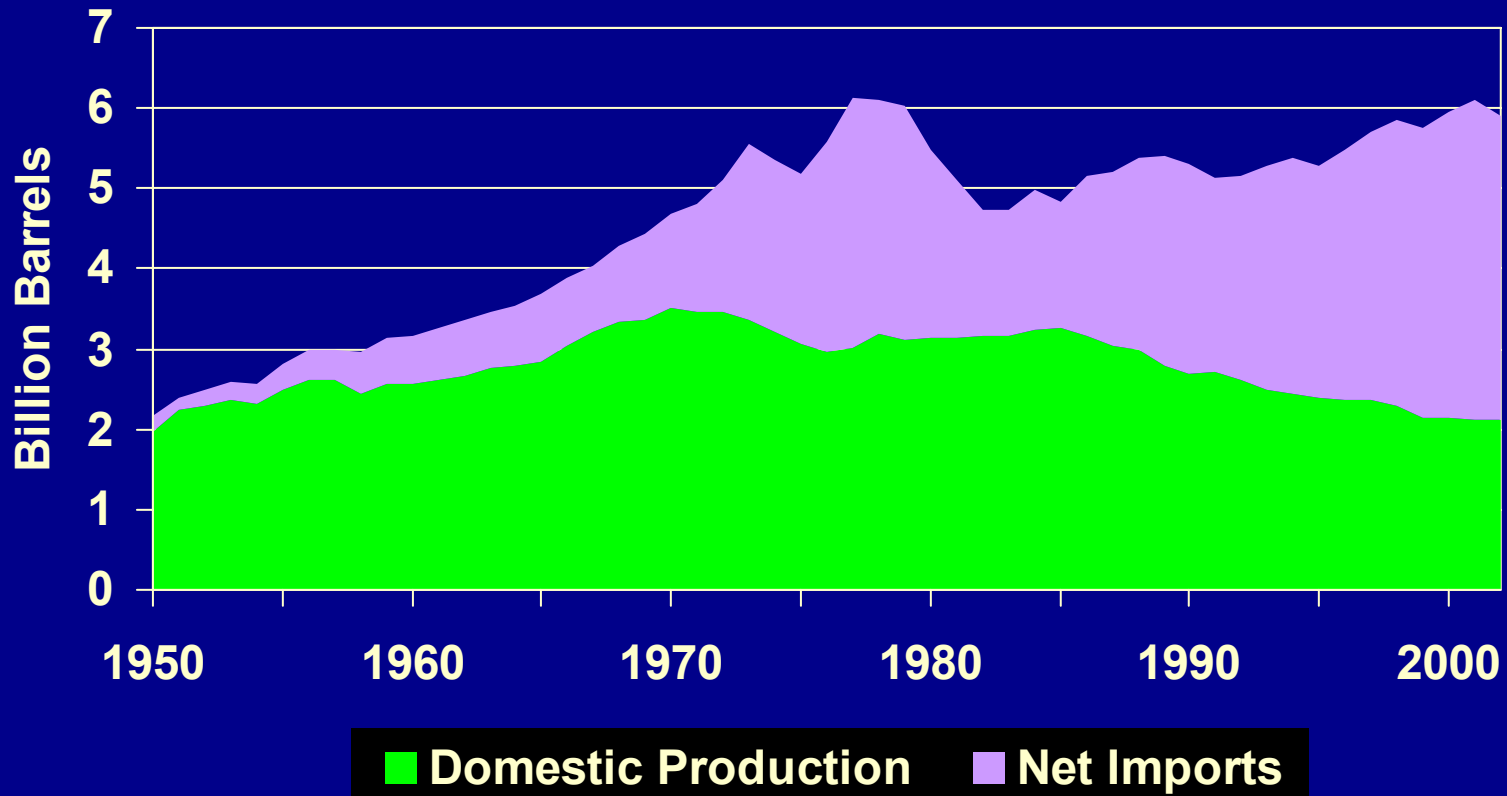


Source: EIA, Weekly Petroleum Status Report
(Average for Jan-May 2004)

Unfavorable Factors

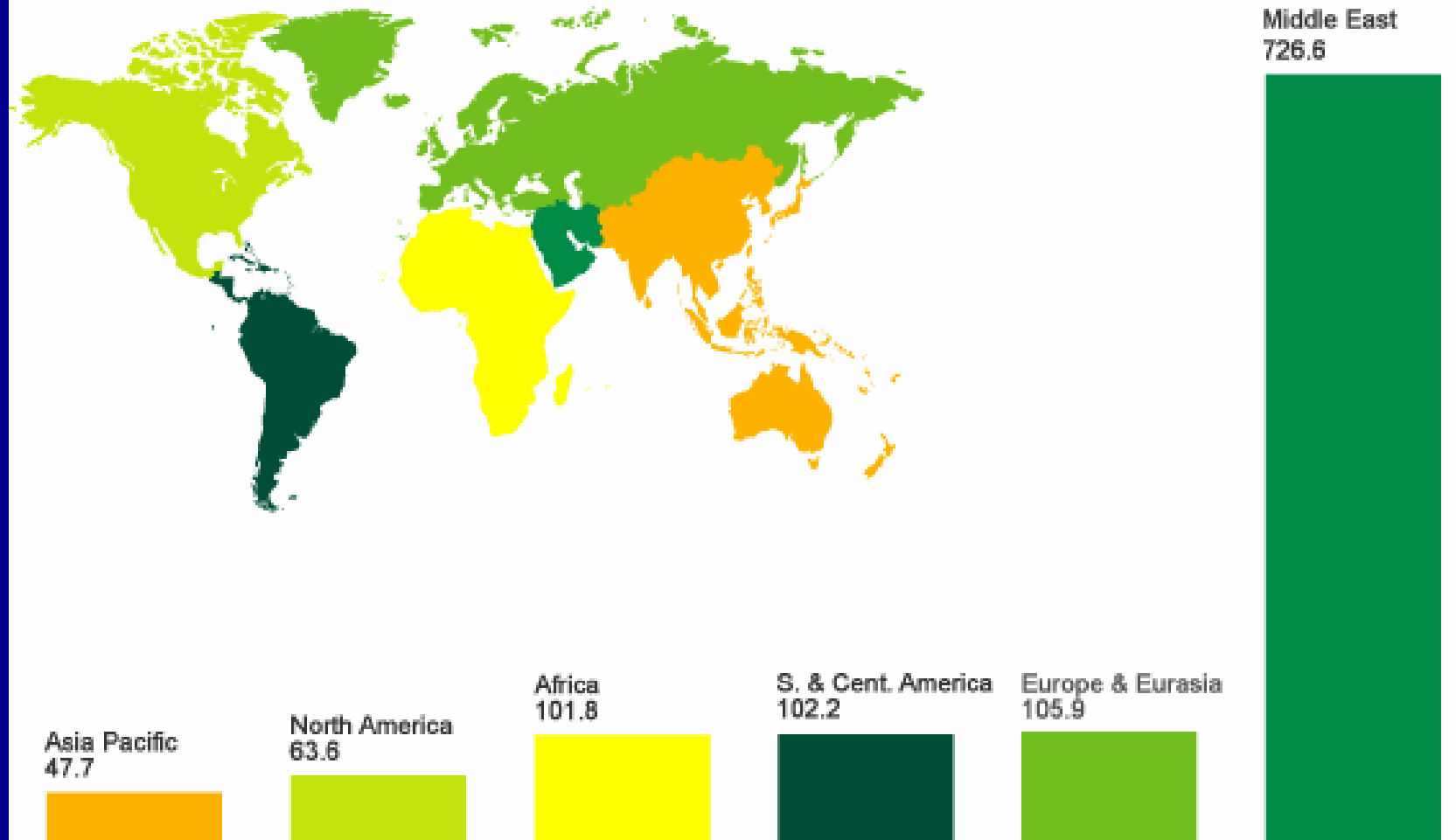
- ◆ Greater dependence on imported crude oil
- ◆ World oil reserves will become even more concentrated “near Baghdad”
- ◆ Developing Asian countries (e.g., China) will demand a much larger share of Persian Gulf oil in 20 years.

Falling Production and Rising Demand Create Increased U.S. Dependency on Imports



World Oil Reserves Concentrated in the Middle East

Proved oil reserves at end 2003
Thousand million barrels



Risks in the Outlook: Bin Laden's Game Plan

- ◆ Al-Qaeda bombs WTC, stirs anger in U.S.
- ◆ Provokes U.S. to attack a terrorist-supporting country, viz., Iraq.
- ◆ Militant Islamists throughout Middle East rally to support bin Laden; he leads overthrow of Saudi royal family, other Persian Gulf sheikdoms.
- ◆ Then he helps insurgents win war in Iraq; conquers Kuwait.
- ◆ Becomes “King” of countries with 400 billion barrels of oil reserves, valued at \$40 trillion.
- ◆ Is worth 1000 times Bill Gate's fortune.