Rising Oil Prices Threaten to Make European Recession Worse

Windmills in the Netherlands pumped water out of the polders and allowed a very productive nation to literally claim land from the North Sea. Energy production, as we think of it today, is profoundly liberating because it removes the need for humans to work as draft animals.

When the industrial revolution exploded in England and, very soon thereafter, in Northern Europe and America, energy was at the heart of the change. Steam engines had been around, as toys, since the Greek inventor Hero came up with a model in ancient Egypt; however, James Watt gave the world a steam engine that made efficient use of the coal or wood that created heat for the engine.

Soon Americans were getting into the act. Robert Fulton initiated the first successful commercial steam ship line in 1807. His steam ship, dubbed “Fulton’s Folly” by critics, was actually the beginning of windless ocean travel, which would make it possible to transport otherwise exotic fruits like bananas and grapefruit to Boston and New York. The internal combustion engine was an expensive toy until refined oil products provided a cheap and abundant supply of fuel. Drilling for oil was a giant leap for the prosperity of Americans.

Innovation and risk taking in the energy industry, particularly in the oil and gas industry, have benefited the whole world. Today, some American oil prospectors believe that if radical environmentalists simply left them alone, places such as North Dakota could produce enough fossil fuels through fracking, which is the fracturing of shalestone deep underground to obtain natural gas trapped in the stone, to pay enough in royalties to almost pay off the national debt. And surely cheap fossil energy would make many of our domestic industries more profitable and allow them to create truly productive jobs in our economy.

Another effect of unleashing energy production in America, such as drilling wells, mining coal, or building nuclear power plants, is that the price of energy worldwide would stabilize and become relatively cheap. Lower fossil-fuel costs may be necessary to prevent the unwinding of the world’s economy. There is a compelling argument that if energy costs remain uncertain and spike high, Europe — an important customer for our goods and a continent whose economic stability affects American business — may slip into a depression.

Neil Dutta, an economist at Bank of America, said that high oil prices were an “unambiguous negative” on the world economy, and he warned that Europe could fall into an even deeper recession if prices moved higher. The Union Bank of Switzerland, one of the biggest banks in Europe, estimates that for every $10 increase in the price of a barrel of oil, the European economy suffers a hit in GDP of between .2 and .3 percent. A second big bank, the Deutsch Bank, calculates that if oil prices rose by 50 percent, not unthinkable in the current global energy market, that the price rise would reduce GDP in the eurozone by .4 percent.

In fact, rising oil prices have replaced the Greek sovereign debt crisis as the main point of concern in the eyes of some economic analysts viewing Europe today. Despite a reduced demand for energy caused by a weak economy, energy costs continue to be a concern. Rob Dobson at Markit, a data company that conducts economic surveys, said: “If this combination of rising costs and weak demand persists, sustaining output growth and job creation will become increasingly difficult.” Carsten Fritch of Commerzbank said that it’s possible that reduced demand for energy could reduce oil costs on its own, but, "We would need a demand slump across the board like in 2008 to see a sharp price decline, especially given price-supporting factors such as supply risks and ample liquidity.”

Some European economic analysts are counting on improvements in the American economy to give a boost to Europe despite rising energy costs. Jacques Cailloux, chief economic at the Royal Bank of Scotland, put it this way: “So far there is no sign that these higher [energy] prices are getting in the way of an improving trend in the United States consumer confidence currently supported by a better labor market.”

Americans who are living through the Obama recession, however, might take issue with Cailloux’s analysis — as unemployment, underemployment, and inflation continue to wear down Americans. America needs lower energy costs as well to sustain any type of economic recovery. Increasing the supply of cheap fossil-fuel energy, which is within the reach of American businessmen ready to invest their money if government would let them, will clearly do a great deal to improve the consumer confidence of those Americans on whom Cailloux is placing so much trust. (How confident will American consumers be if gas prices reach five dollars a barrel?)

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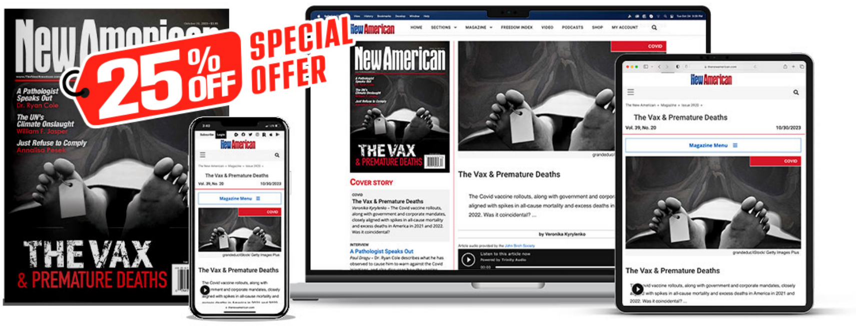

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