The Oil Drum: Australia & New Zealand
DISCUSSIONS ABOUT ENERGY AND OUR FUTURE

More On Oil, The Future And You

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Topic: Policy/Politics

Crikey has been continuing their series on Oil, The Future And You - part 3 included this segment from an economist at UBS (I'll spare you the Professor from the Institute of Public Affairs, who never rose above the level of pure dogma).

> **Adam Carr, senior economist at UBS**
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> Have we entered a new energy era of high-price oil? Are the days of $AU1/litre petrol gone for good?
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> It would certainly appear that way. It's difficult to see petrol prices returning to the $1 mark amidst concerns over peak oil, rapid industrialisation and a sharp acceleration in concerns over climate change (and thus the prospect of enviro taxes). At the secular level it's probably reasonable to say therefore that any return to $1 petrol would be relatively short-lived. Yet can we completely overlook the rapid rise in oil prices and put that all down to fundamentals? I doubt it. No-one really resists the idea that long-term energy prices will be higher than they were during the 1990's. What is less clear is from what level can things be justified by fundamentals?

> **As a policy response, how useful is lowering a fuel excise or removing the GST in combating the rising price of oil, both in the short and long term?**
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> This has been getting a lot of press lately and almost without exception the focus of analysis has been at the consumer level. Commentators have consistently overlooked the fact that businesses use oil/petrol as well and in many instances it is a considerable cost. If you can accept the possibility that at $1.60, petrol prices may have temporarily overshot, then reducing tax distortions can go a long way in helping ease what may prove to be a temporary burden (acknowledging the secular upward trend) of higher oil prices (and higher interest rates). Slowing the rise in the oil price (offsetting what could be an element of speculation) allows firms time. Much needed time to adapt to thevene longer-term fundamental factors driving energy prices higher. High taxes and high interest rates do nothing to help Australian businesses compete in the global arena.
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> **What sort of policies should a nation like Australia be developing to cope with high-priced oil?**
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> The government and RBA should be focussing intently on second-round wage effects and only those. There is little a small open economy such as Australia can do to influence global price movements and the very obvious impact this is having on domestic inflation. So the focus should be on wage growth. This is important because in the medium term

you don't get a sustained generalised inflation break-out if wages are contained. If wages remain contained then rising fuel and oil prices act like a tax on consumption. People have less money to spend elsewhere and so higher petrol prices act to dampen growth. At the same time it makes little sense to crunch the economy now with rate hikes because global oil prices are high -- high oil prices under restrained wage growth will already act to slow growth. Hiking rates just add to that slowing momentum and makes for a very poor policy response. Policy makers need to be more tolerant of inflation (so ensuring the cure isn't worse than the disease) but with an explicit threat that if unions or others start to make unreasonable wage demands then the consequence of that will be immediate rate hikes.

Can you sketch a picture of the Australian economy when petrol is $5/litre and rising, considering things like food, infrastructure, the family budget and inflation?

If petrol prices rose that sharply, the nation would be in the grip of a very severe stagflation. Transport costs would skyrocket leading to a kind of domino effect of higher prices across the aboard -- think taxi fares, think costs of transporting food, clothes etc that would be passed on. It may even be the case that with household budgets being squeezed and unable to pay higher prices, that the provision of some goods and services evaporates as it increasingly becomes cost ineffective for firms. In the early phases of the rise and because core inflation would continue to rise, many would misread this price action as being demand driven (at least initially) and would argue that the RBA should continue to hike rates (and this would be a real possibility), further adding to the burden of business and households. Eventually, the political pressure for wage increases would be immense. After time and under the strain of higher rates and petrol -- growth would be sharply lower, firms would go out of business, unemployment rates would rise, yet inflation would still prove very difficult to contain. You would have to assume at some point that the global economy would falter, petrol consumption would drop and the price would come down -- but we'd all be a lot worse of for it.