Rising gas cost fuels worries: Businesses brace for consumer cutbacks. Georgia would take a bigger hit than much of the U.S., expert says.

Michael E. Kanell, 23 January 2011

As gasoline prices steadily scaled the slope to $4 a gallon, they paused briefly to shove business off a cliff at Stevi B’s.

In that summer of 2008, consumers seemed to be shunning the Marietta-based pizza chain --- just as the restaurants’ bills were climbing, said Scott Knight, vice president of operations.

"I remember double-digit sales declines," he said, recalling the reluctance of customers to drive and the rise in the price of ingredients, both because of higher gas prices.

Now, Knight is worried again.

During the past six months, the average cost of regular gas in metro Atlanta has ascended from $2.50 to about $3.02, according to AtlantaGasPrices.com.

Many experts expect further price hikes. Most notable among pessimists is former Shell Oil president John Hofmeister, who has predicted $5-a-gallon gasoline by the end of this year.

But even a jump that stops short of $4 a gallon could rattle the sluggishly expanding economy --- especially in metro Atlanta.

Expensive energy crimps consumer spending, pads the price of other commodities, squeezes profit margins and pushes companies to find cheaper ways to do business.

Stevi B's, for example, has contracts that lock in the cost of cheese, sugar and flour for at least a few months.

But there is not much the restaurant can do about its customers' finances --- or their will to keep spending. Americans consume more than 140 billion gallons of gasoline each year --- roughly 5 billion of it in Georgia, according to the Energy Information Administration.

Each $10 per barrel increase in the price of oil means another 25 cents per gallon at the pump, said James D. Hamilton of the University of San Diego. "So $10 per barrel in the price of crude takes away about $35 billion from consumers' ability to spend on other goods and services."

Over time, people try to adapt. The price level that was a shock becomes just another number, so gas prices cresting past $3 a gallon are no longer the stuff of panic.

Yet, if prices keep climbing, that can reshape economic behavior, said Rajeev Dhawan, director of the Economic Forecasting Center at Georgia State University.

"The issue isn't the absolute value. It's people's expectations about the future. When they are nervous about the future, they hold back on purchases of big-ticket items."
And like a tightrope walker in a wind, the economy is in greater danger when it is moving slowly, he said.

The price increase itself has a positive side, said economist Jeff Humphreys, director of the Selig Center for Growth at the University of Georgia. Prices are climbing because of higher demand that comes from economic growth. Whatever the cause, high oil prices could turn the slow recovery back into a painful retreat, he said. "I don't know what the tipping point is. But Georgia is more vulnerable than the country as a whole."

The state has no oil production, so it reaps nothing from higher prices. Moreover, the economy depends on energy-intensive sectors like airlines, logistics and trucking.

And --- especially in metro Atlanta --- commutes are long, said Lisa Margonelli, author of "Oil on the Brain" and a fellow at the New American Foundation.

"Extrapolating from government estimates, I'd guess that an average Atlanta commuter driving an average car is spending an extra $35 a week on their commute today over the average," she said. "At $3.75 a gallon, they'll need an extra $55 a week."

That would force many people to choose: If they need to drive, they will have to spend less money on something else. That means less money in the local economy and more going to oil producers abroad.

That's not good for the economy, which is why most dramatic boosts in oil prices since World War II have been followed by an economic slump.

Steep recessions in 1974, 1980 and 1981 were directly pegged to oil prices. Downturns in 1990 and 2001 also came as oil prices were climbing.

More recently, the housing meltdown that touched off the Great Recession in late 2007 came after oil prices had tripled.

That recession intensified, threatening for a time to reach Depression depths after global oil prices in 2008 soared to $146 a barrel.

Congressional investigators later pegged the frenzied heights of that market to speculators. But fundamentals of supply and demand always matter, and as the economy sagged so did demand --- and oil prices crashed.

Since then, demand has rebounded --- nearly all of the increase coming from developing countries, especially India and China.

So the current price increase cannot be blamed on a disruption --- a hurricane in the Gulf of Mexico, say, or a Middle East crisis, said John Kingston, global director of news for Platts, an energy information company. "It's been very much a demand story."

What about supply? Is it ample enough to meet that demand and keep prices from spiking?

Global oil production is not much higher than it was five years ago, which raises questions about the ability of the market to handle a continued surge in demand. Some experts say the world may be feeling its way through a period of "Peak Oil," unable to push daily production any higher.
And that would be a recipe --- at least until alternatives emerge --- for dramatically higher energy prices.

More optimistic experts, including the U.S. Energy Information Administration, argue that new sources of oil are being found. And there is at least a near-term cushion --- extra, unused capacity among OPEC countries, especially Saudi Arabia, Kingston said. "I would say that the supply is there to make sure that a price spike doesn't happen."

Not everyone feels reassured.

Gail Tverberg of Kennesaw, a board member at The Oil Drum, one of the most-watched oil sites on the Web, said that there is no independent way to confirm that data.

"I think OPEC is lying about its spare capacity," she said. "And if oil supply remains flat, we've got a problem."

Oil prices can flow through the economy, adding a layer of cost to many services and products, both manufactured and agricultural, said James Hansberger, managing director of the Atlanta-based Hansberger Group of Morgan Stanley Smith Barney.

Moreover, oil prices are part of the larger price picture --- affected by the value of the dollar, the injections of money into the economy by the Federal Reserve as well as the bets by investors.

"It's not just about energy," Hansberger said.

Whatever the causes, rising prices put pressure on many kinds of businesses --- everyone wants someone else to bear the burden, he said. "It's going to be interesting to see which firms can pass on higher commodity prices. The ones that cannot will see lower profitability."

Companies with more competition will have a harder time raising prices. They are likely to look for ways to become more efficient or to take less profit --- or both.

And companies with smaller profits likely will do less investment, building and hiring.

Some companies, like Delta Air Lines, protect themselves from price spikes by making contracts that set prices for future purchases. Other companies add surcharges to their services when energy prices rise.

UPS, the Sandy Springs-based package delivery company, started adding a fee to account for fuel price hikes about a decade ago, said spokeswoman Susan Rosenberg.

Starting next month, the company will add 6 percent to charges for ground deliveries and 10 percent to air service, she said. "We felt that this is an effective way to manage. It does help us to deal with volatility in both directions."

The stakes are huge. UPS drivers log about 2 billion miles a year and its airline is the world's ninth largest. In 2009, the company spent about $2.4 billion on fuel. In 2008, the year of the oil spike, UPS fuel costs were more than $4.1 billion.

But then, the direct impact of oil in America is mostly about wheels and wings: two-thirds of oil is used for transportation, according to the EIA.
So as the price of oil rises, consumers may try to cut back on driving, buy higher mileage vehicles and telecommute. Yet most of the things they buy, wear and eat are still getting to them in vehicles run on oil-based fuel.

If trucking companies absorb higher prices, they become less profitable and may hire less or pay employees less. But if the companies pass price hikes along, Americans will pay more.

Brown Trucking is caught in that squeeze, said CEO Brian Kinsey.

The Lithonia-based company racks up more than 6 million miles each month carrying paper, packaging, plastics, auto parts, pharmaceuticals, chemicals and food products.

Brown buys more than 1 million gallons of diesel each month, Kinsey said. "I have budgeted for an increase of 10 cents a gallon each quarter, and it's already gone up 50 cents."

Fuel surcharges offset most of the price increases, but they don't help when trucks have to make a return trip empty. Moreover, there are a lot of trucking companies, so Brown can't raise prices too much.

"In general, for want of a better word, we are eating 10 to 15 percent of the increase," Kinsey said. "If the price goes higher, assuming nothing else changes and the economy isn't imploding, that will mean margin compression."

Less profit is something he can cope with, so long as business is growing. If it isn't, he won't be focused on fuel prices, he said. "If the general economy takes a nose dive, then I've got other issues."

**Drag on economy**
Dramatically climbing oil prices have often been a factor in tipping the economy into recession --- or sometimes intensifying a downturn already under way.

<table>
<thead>
<tr>
<th>Dates of rising gas prices</th>
<th>Price increase</th>
<th>Recession started</th>
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<tbody>
<tr>
<td>May 1973 – June 1974</td>
<td>43 percent</td>
<td>November 1973</td>
</tr>
<tr>
<td>October 1978 – January 1980</td>
<td>64 percent</td>
<td>January 1980</td>
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<tr>
<td>December 1989 – October 1990</td>
<td>44 percent</td>
<td>July 1990</td>
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<tr>
<td>February 1999 – June 2000</td>
<td>77 percent</td>
<td>January 2001</td>
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**Bad influence**
Gasoline prices seem to have played a role in the Great Recession.

From November 2003 to May 2007, when the Atlanta housing market fell: Gas prices rose 109 percent.

From June 2007 to July 2008, as the recession started and intensified: Gas prices rose 33 percent.