Hitting the breaks: $4 gas could slow economic recovery, study says

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A significant jump in gasoline prices from the current $3 to $4 a gallon has the potential to slow Indiana's economy, where the unemployment rate currently is about 9.8 percent, says a new Ball State University study.

"The Effect of Higher Fuel Prices on Indiana's Economy," a report from Ball State's Center for Business and Economic Research (CBER), finds that $1 per gallon and $25 per barrel price increases would depress economic activity by about 2 percent, increase the unemployment rate by roughly 1.3 percent and lower state tax revenues by about one half of one percent or about $68 million.

"There are projections that these price increases could occur by later this spring, and if so, we would have a repeat of a similar price surge that occurred from the summer of 2007 to summer of 2008, initiating the recession," warned Michael Hicks, CBER director. "Fortunately, this effect will be less painful during an economic recovery than it was at the start of the last recession. But a gasoline price increase of this amount will slow the recovery in Indiana."

Hicks points out that from June 2007 to June 2008, the average gasoline price in U.S. cities rose from $3.05 to $4.06. During the same period, the unemployment rate in Indiana rose from 4.5 percent to 5.6 percent.

While part of this increase could be attributed to a slowing of new home construction and higher interest rates — both factors in the bursting of the nation's housing bubble —CBER's analysis of monthly data from 1978 through the present finds that a $1 change in gasoline prices is associated with a 1.3 to 1.5 percent increase in the unemployment rate.

"Even with advances in energy efficient vehicles, public transportation and alternative fuels, we remain very dependent on petroleum and an increase in its price slows the U.S. and Indiana economies," Hicks emphasized.

Price surge started with the recession
The study found that the '07-'08 gas price increase came with a recession that preceded by 10 months of the September 2008 stock market decline.

In Indiana, the effect of higher gasoline prices was especially problematic in some regions due to the state's concentration of automotive and recreational vehicle-related manufacturing.

Hicks notes that the last major layoff in Elkhart County in northern Indiana happened in August 2008, a full month prior to the collapse of Lehman Brothers and the sharp national increase in unemployment.

"Any increase in gasoline prices today will have very similar effect," he said. "While we are a nation in economic recovery, with a more fuel efficient vehicle stock than in 2007, the overall consequences of a similar gasoline price increase will be indistinguishable from the 2007-2008 period."

Provided by Ball State University