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Oil Megadeal Signals a World of Low Inflation

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The merger of Exxon Corp. and Mobil Corp. is the largest corporate combination in history, but its real significance may be something else. It's a potent symbol of a world in which the greatest economic

ESSAY

threat of the 1970s—double-digit inflation—has been thoroughly put to rest.

Think of Exxon-Mobil as the third oil shock of the postwar era. The first one came in 1973, with the Arab oil embargo and the quadrupling of oil prices. The second came in 1979, coinciding with the fall of the shah in Iran.

Yesterday's announcement of the Exxon-Mobil combination marks the end of the age of OPEC that began exactly 25 years ago. The merger punctuates the waning power of Big Oil everywhere around the globe.

By far the most important contrast is on the inflation front. The quadrupling of oil prices in 1973 triggered double-digit inflation in America for years. Big Oil, especially in the form of the Organization of Petroleum Exporting Countries, became the specter haunting the world economy. Serious analysts saw oil reaching $100 a barrel. The major international financial event of the era was the recycling of "petrodollars" to the developing world.

Today, a quarter-century later, oil prices have crashed, and are probably headed lower (The price of a barrel is sinking toward $10). In inflation-adjusted terms, gasoline is cheaper at the pump today than it was 25 years ago. The OPEC oil cartel is in disarray. And the offspring of John D. Rockefeller's busted-up Standard Oil are recombining today, not from strength, but from the logic of weakness: excess supply of product, insufficient demand, and a terrifying weakening of prices, down 40% in just a matter of months.

Actually, as the U.S. consumer price index has headed down below 2%, perception is growing that the magic moment of price stability may be at hand. If, as some economists believe, official figures overstate inflation by one percentage point or more, U.S. inflation is near zero already.

If anything, it's fear of deflation that has worried some sectors of the economics community.

How quickly price increases died. It's difficult to remember, perhaps, that only a couple of years ago, the "inflation is dead" school of economics was under vicious attack. When British economist Roger Bootle published a book titled "The Death of Inflation" in 1996, he was skewered by many reviewers. Someday in the future, his verdict may seem premature. But today, there is only one word to describe Mr. Bootle's book: prescient.

Indeed, inflation has been so thoroughly whipped that whole sectors of the world economy have passed quickly from inflationary, to disinflationary, to noninflationary, and then to a deflationary state.

Japan suffers true deflation—that is, overall falling prices. Germany's producer price index has turned negative. And while many services (haircuts, school tuition) still climb in price, much of the world has come to regard steady, double-digit annual declines in prices as perfectly normal. Or, they expect more bang for the same buck—the way consumers expect computing power to double every 18 months.

The urgent question: Can producers adjust to this new world order? Are the major oil companies, and the major auto companies, up to the tasks of slashing costs in the face of supply gluts and insufficient demand?

Some optimists think so. This may be an enormous change in psychology, yet some economists believe that producers are already adjusting to an era of flat or even falling prices.

"If we fell into deflation tomorrow, no catastrophe," says James Paulsen, chief investment officer at Norwest Investment Management in Minneapolis. "For 15 years, corporations have been living with deflation. The oil companies certainly have learned."

One way the world's largest oil companies deal with falling prices will be to cut thousands of jobs. Indeed, these kinds of reductions have probably held down wage gains throughout much of the 1990s, as workers nervous about their jobs have been reluctant to push for a larger pay envelope.

Yet there is far more at work here. Economists still quibble over the role of technology in boosting productivity within companies, but more and more of these economists are concluding that the productivity payoff from technology is finally at hand. The Exxon-Mobil merger will certainly be a test of all this, from technology used in exploration to the information systems so crucial to the combined company's far-flung distribution outlets.

The prospect of falling commodity prices is terrible for commodity producers, whether in Russia, in Asia or in the steel mills or pork-packing plants of the U.S. But for any business that can maintain its selling prices as it pays less for raw materials, the result is higher profit.

At Fifth Third Bancorp. in Cincinnati, executive vice president Stephen Schrantz says he has encountered this same situation again and again among his corporate borrowers.

"I ask them if they are passing along the lower costs to their customers, and they say 'not yet'" with a twinkle in their eye, Mr. Schrantz reports.

On the other hand, at a consumer level, the idea of bargain-hunting and beating down prices has turned into a religion of sorts in the 1990s. Most recently the zeal for a deal has been fueled by the extraordinary growth of the World Wide Web, with comparison shopping for books, cars, music disks, computers and airline travel, among other things.

Online shopping shows every sign of exploding in the years ahead as more retailers open sites and more consumers venture onto the Web. (Online traders can buy Exxon or sell Mobil stock for a fraction of the costs of even a year ago.)

For investors, a forecast of low inflation means the Federal Reserve has ample room to keep cutting short-term interest rates, if necessary.

If the past is prologue, it means the Fed can help prop up markets if necessary, reducing the risk of a serious tumble in the U.S. stock market, which is overvalued by many traditional measures. These optimistic investors may be wrong, sooner or

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The Progeny of Standard Oil

John D. Rockefeller formed the Standard Oil of Ohio on Jan. 10, 1870. By the early 1900s, he controlled up to 85% of the U.S. oil industry, inspiring the first antitrust laws. In 1911, the Supreme Court ordered the Standard Oil Co. to dissolve into 34 companies. Here's where they are now:

John D. Rockefeller

1911	NOW
Standard Oil Co. (California) **Standard Oil Co.** (Kentucky)	**Chevron Corp.**
Galena-Signal Oil Co. **Cumberland Pipe Line Co.** **Southern Pipe Line Co.**	**Ashland Inc.** (Both pipe lines were shut down and later sold.)
Prairie Oil & Gas Co. **Atlantic Refining Co.**	**Atlantic Richfield Co.**
Standard Oil Co. (Kansas) **Standard Oil Co.** (Indiana) **Standard Oil Co.** (Nebraska)	**Amoco Corp.**, which has agreed to be acquired by British Petroleum PLC
The Standard Oil Co. **Solar Refining Co.**	Formerly Sohio, now part of **British Petroleum PLC**, which is acquiring Amoco
South-West Pennsylvania Pipe Lines **National Transit Co.** **South Penn Oil Co.** **Eureka Pipe Line Co.**	**Pennzoil Co.**
Continental Oil Co.	**Conoco Inc.**, a unit of DuPont Co. that recently sold 30% of Conoco in an initial public offering
The Ohio Oil Co.	A unit of **USX Marathon Group**
Standard Oil Co. (New York) **Vacuum Oil Co.**	**Mobil Corp.**, to be acquired by Exxon in $75.6 billion transaction
Anglo-American Oil Co. **Standard Oil Co.** (New Jersey)	**Exxon Corp.**, to acquire Mobil Corp.
Indiana Pipe Line Co. **Buckeye Pipe Line Co.** **Northern Pipe Line Co.** **New York Transit Co.**	A unit of **Buckeye Partners L.P.**
Union Tank Car Co.	A unit of **Marmon Group**
Chesebrough Mfg. Co. Consolidated	A unit of **Unilever N.V.**

Companies that either were dissolved or liquidated:
Swan & Finch Co., Waters-Pierce Oil Co., The Crescent Pipe Line Co., Washington Oil Co., Colonial Oil Co., Borne Scrysmer Co.

Sources: Chevron Corp., WSJ reports