To shale and back

By Paul Krugman
March 10, 2020 – *The New York Times*

Monday's market rout wasn't just about the coronavirus. It was also, in part, about oil: Saudi Arabia and Russia, the world's two biggest oil exporters, have gotten into a price war. Oil demand has fallen because of the coronavirus; the Saudis wanted Russia to participate in production cutbacks to sustain the price. Russia refused, so the Saudis are ramping up production instead, sending oil prices plunging. And investors are worried about the negative economic impact of this plunge on the United States.

But wait. If you're of a certain age, you remember a time when high oil prices were bad for the U.S. economy, low oil prices good. The oil shocks of 1973 and 1979 were major drivers of what were, at the time, the two worst recessions since the Great Depression. Even the smaller oil price shock associated with the first Iraq war played a role in the 1990-1 recession.

Indeed, Donald Trump, whose view of the world often seems to be frozen in the 70s — remember, his vision of "American carnage" is all about inner-city crime, which is way down, and has no room for surging deaths of despair in the heartland — hasn't gotten the memo. Yesterday he tweeted that falling oil prices are good for consumers, which is strictly speaking true but not the main economic point.

But these days the economics of oil prices have flipped on their head. Oil plunges hurt the U.S. economy far more than they help.

Why? Part of the answer is that we're no longer worried about inflation. In the 70s, when higher oil prices drove up consumer prices, the Federal Reserve would grow concerned about a wage-price spiral and raise interest rates — hence "stagflation," the combination of inflation and higher unemployment. And some conservatives still imagine that we're living in that world: Back in 2011, when rising oil prices sent inflation temporarily higher, people like Paul Ryan pressured the Fed to raise rates.

Nowadays, however, underlying inflation is low, and the Fed focuses on "core" inflation, correctly ignoring blips in inflation caused by oil prices.

And even as we've stopped worrying about oil-driven inflation, thanks to the rise of fracking, oil-price-related investment has become a major driver of the U.S. economy. It's a significant share of total business investment, but more to the point, it's highly volatile and actually accounts for most of the major swings in investment in recent years.

Notably, falling oil prices after 2014 caused an investment decline that in turn led to the mini-recession of 2015-6, which probably played a role in the election of Donald Trump.

Also, energy companies have taken on a lot of debt, which at current oil prices they won't be able to repay. So the oil plunge is a major driver of increased financial stress, which is showing up in things like a drastic widening of interest rate spreads between business and government borrowing.

So it's not just the virus roiling markets. This may also be a case where oil wells don't end well.