Beyond Partial Explanations:
Oil, Capital, and the Global Financial Crisis of 2008

1 Post-growth economics
1.4 Financial and monetary reform for sustainability

Extended Abstract

A number of macroeconomic studies published since the global financial crisis of 2007-2008 have identified rising global oil prices as a primary trigger for that event, particular in its effect on US consumer demand. While the historical correlation between oil price rises and recessions is strong, the mechanics of oil's influence on the global economy are strongly debated in the macroeconomic literature. Adding to the confusion is the unclear reciprocal impact of the global economy, and especially its financial and monetary systems, on the price of oil.

In this review we parse several leading economic explanations of the oil price spike in the years leading up to the 2008 crises, dividing them into two basic groups: those explanations that begin with the global financial system and its impact on oil prices (see for example, Erceg [2011] and Caballero [2008]), and those that take physical oil supplies as their point of departure (see Hamilton, 2009). We do not find the evidence for oil as a primary causal factor in the global economic crisis unequivocal: scattered evidence in the housing and automobile markets aside, there is no conclusive narrative that ties rising oil prices, and the stress it put on consumers, to the global financial collapse and ensuing recession. One way to adjudicate this may be to separate out analytically what made the 2007-2008 recession different from a normal economic contraction.

That is, while there is a well-known dynamic between peaking oil prices and peaking economies, did oil have anything to do with the turmoil in financial markets that amplified this recession—and did the macroeconomic factors that led to this turmoil have any effect on oil markets and their historic peaks in the 2000s? Households in the US especially were building up large and increasing debt loads, while interest rates were rising steadily in the pre-crisis period. Oil (as represented by gasoline payments per week) may have contributed to the collapse of these debt loads, but as in any highly levered situation, the debtors were already fragile. It stands to reason a number of disturbances could have made household finances unsustainable, triggering a wave of mortgage defaults.

A more interesting question, to us, is how oil and energy in general contributed to the fragile global financial situation, rather than as a "cost-push" to households in the US. The structure of the world's financial system is interconnected with its energy system in many obvious and a few not-so-obvious ways, as they have co-evolved over hundreds of years of capitalism (Bernanket et al. [1997] provides an interesting example. To get at the role of oil (energy) in the global financial crisis, we must look far beyond consumer prices at the pump.

The two categories of explanation we review, monetary and supply, in general have complementary aspects that suggest they may be significant pieces of a larger picture. Whether one focuses on global imbalances, "easy money" policy, or pegged currency blocs, on the monetary side—or on increasing global demand on the physical side—an integrative answer that slots these explanations into a coherent whole seems both within reach, and a worthwhile research program. In this study we present the first outlines of what such an explanation might look like, and its implications for the question of oil's effect on the global economy.

In conclusion, we argue for a view of the economy that handles complexity in a more nuanced way. We would choose not to separate causes so cleanly in a complex system, but perhaps make ourselves and our analyses comfortable with systemic causation, and relative weighting of factors in a probabilistic manner.

References

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Summary

In this review we parse several leading economic explanations of the oil price spike in the years leading up to the 2008 crises, dividing them into two basic groups: explanations that begin with the global financial system and its impact on oil prices, and those that take physical oil supplies as their point of departure. We do not find the evidence for oil as a primary causal factor in the global economic crisis unequivocal. The two categories of explanation we review, monetary and supply, have complementary aspects that suggest they may be pieces of a larger picture. Whether one focuses on global imbalances, "easy money," or pegged currency blocs—or on increasing global oil demand—an integrative answer that slots these explanations into a coherent whole seems within reach. In conclusion, we argue for a view of the economy that handles complexity and systemic causation in a more nuanced way.