SECULAR STAGNATION POST CORONAVIRUS, AND OIL :
JUST STAGNATION ? REALLY ?

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SECULAR STAGNATION ANTE-COVID-19

Recently, Professor Larry Summers on the IMF website gave once again his opinion regarding the much debated question of "secular stagnation" [1].

As well-known advocate of the very concept of modern secular stagnation[2], Prof. Summers focuses his famous line of thought on the structural disequilibrium between saving (the "saving glut") and investment (the "investment dearth"). He affirms that : "*So structural changes in the economy have operated both to raise saving and to reduce investment. "*

Let's put aside Prof. Summers' blog fairy tales on the wonders of the digital world, with his many references to gizmos such as "Uber" ; "iPhone" ; "Airbnb" and the likes[3].

In the present billet, I shall underline two points from Prof. Summers secular stagnation rhetoric, that are linked to present – and past[4][5]- real and only magic wand : ENERGY.

1. OIL INVESTMENT (capital expenditure: CAPEX)

On the investment side of his equation (saving > investment), Prof. Summers explains that : "*This trend is reinforced by the observation that the amount of saving required to purchase a given amount of capital goods has declined sharply as the relative price of equipment, especially in the information technology (IT) space, has sharply declined."*

It makes sense for IT, but IT is just a small part of global productive investments. In his article, there are few inputs regarding brick-and-mortar or industry investments. The only one is about oil capital expenditure (CAPEX). Prof. Summers claims that : *"Fracking for oil and natural gas requires far less capital than traditional drilling techniques, and IT makes targeting of exploration much easier, further reducing investment demand. "*

This "*far less capital*" is nonsensical, and this statement has no connection with reality, be it the world of oil industry ; or the world of oil investors. One could hope that the former director of the National Economic Council (2009–2010) for President Obama would know better about

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[1] Lawrence H. Summers (2020) - Accepting the Reality of Secular Stagnation : New approaches are needed to deal with sluggish growth, low interest rates, and an absence of inflation - IMF FINANCE & DEVELOPMENT Point of view - March 2020 https://www.imf.org/external/pubs/ft/fandd/2020/03/larry-summers-on-secular-stagnation.htm

[2] Lepetit M. (2019) - 0% interest rates & secular stagnation : What did the great economist P. Samuelson say in 1970 ? his diagnosis and remedies … https://www.linkedin.com/pulse/0-interest-rates-secular-stagnation-what-did-great-p-say-lepetit/

[3] Prof. Summers seems to be found of digital fads. Another fad he is found of, with three other former Federal Reserve Chairs, is carbon tax : "*Some of my friends may not completely agree, but I think the replacement of command and control regulation with a carbon tax is a positive step".*(02/2017)

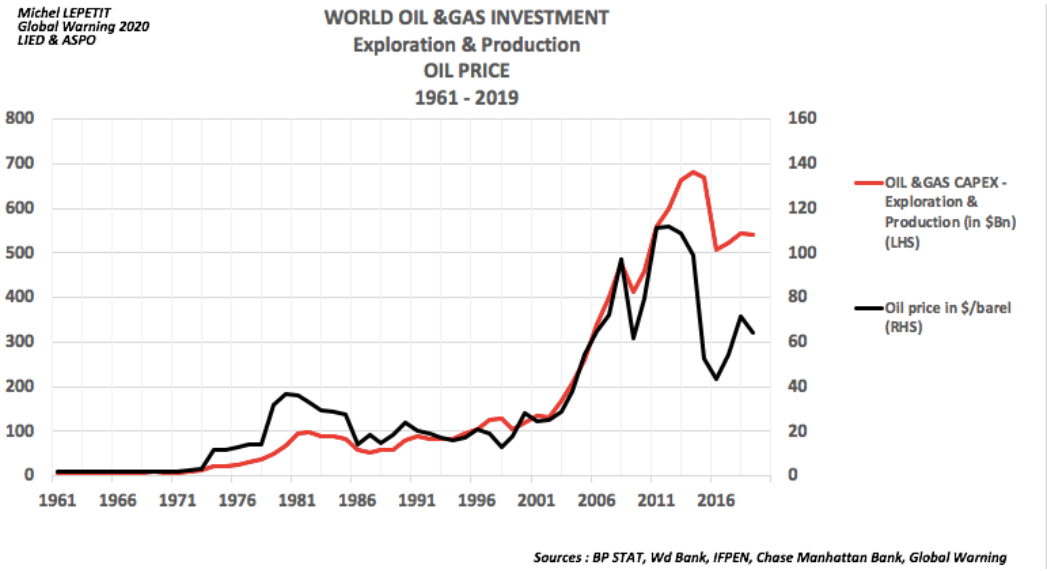
[4] Philippe R. (1980) - L'ENERGIE AU MOYEN AGE - unpublished Sorbonne thesis by F. Braudel's disciple Robert PHILIPPE (1923-1998): INTRODUCTION et Table des matières : https://www.linkedin.com/pulse/lenergie-au-moyen-age-de-robert-philippe-1923-1998-à-michel-lepetit/

[5] Bergeaud & als (2018) - Bergeaud A., Cette G. & Lecat R. – The role of production factor quality and technology diffusion in 20th century productivity growth - Cliometrica - Volume. 12(1), pp 61-97 (2018). https://sites.google.com/site/abergeaudeco/research

energy and the Oil & Gas sector : the US Light Tight Oil (LTO) industry[6] has required huge amounts of CAPEX [7][8] since 2009 ; and the following fact should puzzle the Harvard academic economist : it has never been profitable from its outset [9][10].

Macroeconomic analysis of capital expenditure – as Prof. Summer's analysis - should take into account the weight of energy in general, and the weight of the Oil &Gas subsector in particular, in the global productive investment[11]. Such a global picture is provided by the S&P Global CAPEX 2000[12] survey for 2019. The share of Oil & Gas investment, according to S&P data, is approximately 1/6 of large corporates productive investment, and for the whole of the energy sector, the ratio is close to 1/3.

The affirmation that : "*In addition to capital goods' having lower prices, the downward trend in their prices encourages delaying investment.*" has no meaning in the real world of the Oil &Gas industry. The first trigger to CAPEX in this vital industry is the price of oil, as can be seen in the following graph. Another key trigger is monetary Quantitative easing (2008-?)[13] which is well known by the former director of the National Economic Council.



2. SLOWING PRODUCTIVITY

In his article, Prof. Summers argue against alternative academic views on the secular stagnation phenomena and its symptoms. He dismisses Prof. Robert Gordon's argument on structurally slowing productivity [14] :

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[6] Read for instance the last International Energy Agency World Energy Outlook 2020 on LTO.
[7] IMF : World Economic Outlook, April 2017 - Chapter 1 : Global Prospects and Policies (source : Rystad) : https://www.imf.org/en/Publications/WEO/Issues/2017/04/04/world-economic-outlook-april-2017
[8] According to International Energy Agency (IEA : The Oil and Gas Industry in Energy Transitions - January 2020) the share of shale oil/gas in global Oil & Gas development and production investment (estimated 500 Bn$ in 2019) was around 25%.
[9] IEA – Oil market report – December 2016 : US shale producers gear up for increased investments
[10] IEEFA 19/11/19 : Fracking sector spills more red ink in Q3 Cash flow from E&P companies disappoints debt, equity investors – again: https://ieefa.org/ieefa-update-fracking-sector-spills-more-red-ink-in-q3/
[11] non residential ; and non public
[12] S&P- Global Corporate Capital expenditure Survey 2019 (Global CAPEX 2000): https://www.spratings.com/documents/20184/1481001/Global+Corporate+Capex+Study+2019+Curbed+Enthusiasm/086812c1-e10f-e2e7-2be0-89c7e34d8bc7
[13] forthcoming paper : LEPETIT M & als (2020) – Unconventional Monetary Policy for Unconventional Oil
[14] Gordon R J (2016), *The Rise and Fall of American Growth - The U.S. Standard of Living Since the Civil War*, Princeton

« (…) *If, as many suggest, the dominant reason for stagnation is disappointing productivity performance, we would expect to see prices rise rather than fall.(…)* » and he adds "(…) *Lack of productivity growth would be expected to lead to increased product price inflation and reduced asset price inflation*.(…)"

Here again Prof. Summers' view on the absence of inflation is somehow biased. Born in 1954, he should know better on the two oil crises and their inflationary impacts.

- In the 1970s, starting in March 1970, the oil price inflation pressure, anticipating the US peak oil (November 1970) [15] intensified up to October 1973[16]. This crisis led to a totally new financial world with the ending of Bretton Woods monetary Agreements in August 1971 by President Nixon. After two and a half millennia, money is no longer pegged to any physical reality.

- At the beginning of this century, the oil price inflation pressure led to summer 2008 Lehman Brothers collapse[17]. Here again, the following crisis led to a totally new financial world with the advent of Unconventional monetary policies ; that are so conventional today. No limit to money creation.

In that sense, Prof. Summers statement on oil investment that "*IT makes targeting of exploration much easier* " is misleading. Quantitative easing made oil investment much easier.

As Prof. Summers stated on his blog in 2015 : "*Seven years ago it was inconceivable that the United States would ever achieve energy independence*". The public policy he co-elaborated in 2008 (monetary policy, QE, TARP program, regulatory reform …) for newly-elected President Obama did just that with oil : in huge quantity, the Quantitative Easing that he monitored as director of the National Economic Council (2009–2010) made US shale oil investment much easier.

3. FUEL FOR THOUGHT : SECULAR STAGNATION OR SECULAR DEGROWTH ?

Prof. Summers writes he is "*not aware of any other theory that can explain sluggish growth in the face of hyperexpansionary policies and rapid acceleration in private sector credit growth.* ». Professor Summers should look at oil more closely[18]. He knows about the role of energy and he has professed very sharps view on the vital importance of energy[19]. Oil is often called "black gold"[20] because it is a reality that matters much more than internet gizmos …

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[15] LEPETIT M. (2019a) - Remarks by W Laird *« Events in the Middle East and North African oil producing nations* - OECD Confidential report DIE/E/PE/70.122 - September 1970

[16] LEPETIT M. (2019b) - draft report on oil supply and demand problems (1973) – OECD Confidential Report DIE/E/PE/73.36 – April 1973

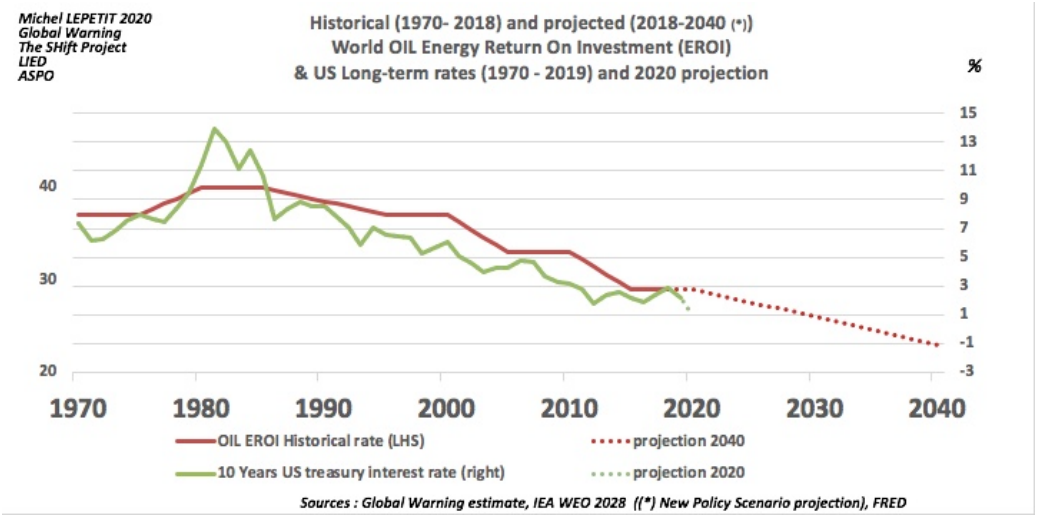
[17] Hamilton J. (2009) : Oil prices and the economic recession of 2007-08 - CEPR - 16 June 2009 https://voxeu.org/article/did-rising-oil-prices-trigger-current-recession

[18] See for instance : Dietrich Domanski, Jonathan Kearns, Marco Jacopo Lombardi & Hyun Song Shin (2015) – Oil and debt – BIS Quarterly Review 18/03/2015 https://www.bis.org/publ/qtrpdf/r_qt1503f.htm
This excellent research paper would need an update.

[19] Summers, L. (2013), "Larry Summers Remarks at IMF Annual Research Conference," https://www.facebook.com/notes/randy-fellmy/transcript-of-larry-summers-speech-at-the-imf-economic-forum-nov-8-2013/585630634864563.
"(…) Now think about the period after the financial crisis. You know, I always like to think of these crises as analogous to a power failure, or analogous to what would happen if all the telephones were shut off for a time. The network would collapse, the connections would go away, and output would of course drop very rapidly. There'd be a set of economists who'd sit around explaining that electricity was only four percent of the economy, and so if you lost eighty percent of electricity you couldn't possibly have lost more than three percent of the economy, and there'd be people in Minnesota and Chicago and stuff who'd be writing that paper… but it would be stupid. It would be stupid. And we'd understand that somehow, even if we didn't exactly understand in the model, that when there wasn't any electricity there wasn't really going to be much economy; and something similar was true with respect to financial flows and financial interconnection, and that's why it's so important to get the lights back on, and that's why it's so important to contain the financials.(…)"

[20] Auzanneau M. (2019) – Oil, Power and War – Chelsea Green

In the following graph, one can see the correlation between the Energy Return On (Energy) Investment (EROI) on oil, as estimated (1970-2018) and forecasted (2019-2040) by the International Energy Agency[21] ; and the US long term interest rates. Of course, correlation is no causation … The 10 Year treasury rate is indicated at 1% for 2020, following the COVID-19 crisis.



CONCLUSION
EROI : What about the "E(nergy)**" if there is no longer any "I**(nvestment)**" ?**

Prof. Summers should give a look at oil because the OPEC+ 2020 March crisis triggered by the coronavirus COVID-19 pandemic has probably unleashed a "dearth of oil investments".[22][23][24]

Maybe, there will be no stagnation, after all.

Michel LEPETIT
Paris, le 18 mars 2020

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[21] IEA World Energy Outlook 2018
[22] IEEFA - Oil price crash pushing independent U.S. producers to the brink of bankruptcy - March 16, 2020
[23] Financial Times - Saudi Aramco slashes spending as oil price war rages – 15/03/2020
https://www.ft.com/content/2db0b152-6694-11ea-a3c9-1fe6fedcca75
[24] Rystad - Get ready for deep cuts in the oilfield service market - March 2020
http://communications.rystadenergy.com/acton/rif/12327/s-0c85-2003/-/l-0044:6ab4/q-0647/showPreparedMessage?sid=TV2:Ew6qwfWoQ
" In total as much as $100 billion could be cut away from the E&P companies' budgets in 2020, and the reduction could grow further to $150 billion in 2021 in a $30 scenario as oil and gas companies scramble to save costs and salvage some profits. Now they will turn every stone and cancel every single non-revenue-generating activity. In the US shale industry as many as 5,800 horizontal wells could be cut in 2020, which would more than halve the number of wells from the 10,900 planned for 2020. As a result, the shale industry would carry the biggest burden of this supply shock by taking as much as $65 billion of the $100 billion spending reduction expected globally."