

William D. Nordhaus Paper:

When the United States invaded Iraq in March 2003, many economists feared that the war would lead to a sharp decline in Iraqi oil production, a spike in oil prices, and a recession like those following the oil shocks of 1973, 1978, and 1990. Oil prices have indeed risen sharply, but the behavior of output after the latest shock was completely different from that in earlier episodes. Output continued to grow relative to potential after the shock, and the unemployment rate continued to fall. The paper identifies three reasons for the difference: the shocks were smaller, the transmission mechanism has progressively tended to moderate the macroeconomic impacts of shocks, and other variables moved favorably in the 2000s. The most recent evidence suggests that the economy is more robust in the face of major energy shocks than is generally believed.

JEL classification codes: E32, Q43