Covid-19 and Economic shocks

Part of: GS-III- Economy (PT-MAINS-PERSONALITY TEST)

Steep fall in crude oil prices. Recently, May futures for the West Texas Intermediate (WTI) U.S. crude has plunged below zero and Brent crude futures has also witnessed a steep decline. A negative price implies that a seller would have to pay the buyer to hold the oil to be supplied.

Causes:

- The unprecedented plunge in the particular futures contract could be partly as a technical anomaly given the way future contracts work.
- However, there has also been a constant and steep fall in the oil prices.
  - The price war between the key producers Saudi Arabia and Russia saw them ramp up output which has caused a supply glut.
  - The demand has continued to contract on account of the COVID-19 outbreak. The lockdown has destroyed demand on an unprecedented scale. The international energy agency has observed that the confinement measures instituted worldwide have resulted in a dramatic decline in transportation activity which is a major demand sector for oil.
- The storage facility for crude on land or offshore in super tankers are nearing capacity or becoming prohibitively expensive.

Indian scenario:

Positives:

- India has been using the sharp fall in both crude prices to accelerate the build-up of its strategic reserve.
- The sliding oil prices would help significantly reduce India’s energy import bill and hence contain current account deficit.

Challenges:

- The protracted demand drought for oil would end up hurting the government’s tax revenues severely, especially at a time when it badly needs financial resources in its fight against COVID-19.
- The low oil prices would damage the economies of producer countries including those in West Asia. This, apart from hurting inward remittances for India, could also lead to a reverse migration to India.

Way forward:

- Oil producers will have to consider considerably curtailing output.
- After the lockdown, the Central Government of India ought to consider using the low prices opportunity to cut retail fuel prices sharply by foregoing some excise revenue for a while in order to incentivize momentum into the wider economy.

IEA
The International Energy Agency (IEA) is a grouping of major oil-importing countries which was created in 1974 by the members of the Organization for Economic Cooperation and Development (OECD) at Paris, France, following the Arab oil embargo of 1973 which had resulted in a dramatic rise in oil prices. It was established with a broad mandate on energy security and other issues about energy policy cooperation among the member countries. Long term supply, transparency, security of supply, international energy relations, research and development were its focal points. However, today IEA has expanded and evolved to be at the heart of global dialogue on energy, examining the spectrum of energy issues to advocate policies and ensure affordability, reliability & sustainability of energy among its members. It has 30 member nations and only OECD nations are given membership to the IEA. All the OECD members except for Chile, Iceland, Israel, Mexico and Slovenia are members of IEA. India became an Associate Member in 2017 while Mexico became the 30th member of IEA in 2018. The other Associate members, apart from India, are China, Brazil, Morocco, Indonesia, Thailand and Singapore.

Objectives of IEA

The International Energy Agency was established with an objective to coordinate the response of the participating states to the world energy crisis along with developing a mechanism for oil-sharing for use during supply difficulties. IEA mainly focuses on its energy policies which include economic development, energy security and environmental protection. These policies are also known as the 3 E’S of IEA.

Structure of Indian Energy Agency (IEA)

The IEA consists of three main controlling bodies:

1. Governing Board
2. Management Committee
3. The Secretariat

The Governing Board is composed of ministers of all the member-governments who are responsible for decision making. The Board is assisted by three standing groups dealing with emergency questions, long-term cooperation and the oil market.

The Management Committee deals with energy, research and development and the non-member countries.

The Secretariat is headed by the Executive Director. Apart from these, the IEA also maintains an import-monitoring system and a quick response mechanism.

India and IEA

India became an associate member of IEA in March 2017 but it was in engagement with IEA long before its association with the organization. India was a party to the Declaration of Cooperation, signed in 1998 which covered matters relating to energy security and statistics. India had also signed three joint statements with IEA that covered areas of mutual interest in the energy arena with major focus to gas and oil security.

Some of the benefits provided to India for being an associate member of the IEA are:

1. Providing access to India to participate in meetings of working groups, standing groups and committees that constitute the governance structure of IEA.
2. Allowing India to take lead in the geopolitical platform on climate and energy issues due to IEA’s increasing role in combating climate change.
3. Helping India to take forward the International Solar Alliance framework to other countries through a greater
partnership with IEA.
4. To help India in achieving its vision of ensuring 24×7 affordable and environment-friendly ‘Power for All’ with increased engagement with IEA.
5. To enable India in setting up its own robust integrated database on energy. With India as an associate member, IEA now formally covers 70% of the world’s energy consumption.