Oil crisis during 1973-74:

- Oil crisis, a sudden rise in the price of oil that is often accompanied by decreased supply. Since oil provides the main source of energy for advanced industrial economies, an oil crisis can endanger economic and political stability throughout the global economy.
- In the post-World War II period there have been two major oil crises. The first occurred in 1973, when Arab members of OPEC (Organization of the Petroleum Exporting Countries) decided to quadruple the price of oil to almost $12 a barrel (see Arab oil embargo). Oil exports to the United States, Japan, and western Europe, which together consumed more than half the world’s energy, were also prohibited. OPEC’s decision was made in retaliation for Western support of Israel against Egypt and Syria during the Yom Kippur War (1973) and in response to a persistent decline in the value of the U.S. dollar (the denominated currency for oil sales), which had eroded the export earnings of OPEC states.
- With the global capitalist economy already experiencing difficulties, these actions precipitated a steep recession accompanied by rising inflation. This forced capitalist countries to embark on a process of economic restructuring in order to reduce their dependency on oil and prompted fears that the United States might take military action in order to secure free access to its energy supplies. Although the oil embargo was lifted in 1974, oil prices remained high, and the capitalist world economy continued to stagnate throughout the 1970s.

Oil Crisis 1978-79:

- Another major oil crisis occurred in 1979, a result of the Iranian Revolution (1978–79). High levels of social unrest severely damaged the Iranian oil industry, leading to a large loss of output and a corresponding rise in prices.
- The situation worsened following the outbreak of the Iran-Iraq War (1980–88), which further added to the level of instability throughout the region. In 1981 the price of oil was stabilized at $32 per barrel.
- By 1983, however, major capitalist economies had adopted more-efficient methods of production, and the problems of the 1970s had been transformed into a relative oversupply of oil rather than a shortage.

Reason for drop in oil prices by 2014

- Oil prices have been one of the most watched trends in economics during the 21st century. From 1999 to 2008, the price of crude oil saw an unprecedented spike, going from under $25 per barrel to more than $160 per barrel.
- Rapidly increasing demand in emerging economies such as China and India and
production cuts by the Organization of Petroleum Exporting Countries (OPEC) in the Middle East drove the price of oil to its record heights.

- Shortly thereafter, a deep global recession throttled demand for energy and sent oil and gas prices into a precipitous free fall. By the end of 2008, the price of oil had bottomed out at $53. The economic recovery that began the following year sent the price of oil back over $100; it hovered between $100 and $125 until 2014, when it experienced another steep drop.

- Numerous factors contributed to the 2014 drop in oil prices. Economies such as China, whose rapid growth and expansion created an unquenchable thirst for oil in the first decade of the new millennium, began to slow after 2010. China is the world’s largest country by population, so its lower oil demand had significant price ramifications.

- Other large emerging economies such as Russia, India and Brazil experienced similar economic trajectories in the early 21st century – rapid growth during the first decade, followed by much slower growth after 2010.

- The same countries that pushed up the price of oil in 2008 with their ravenous demand helped bring oil prices down in 2014 by demanding much less of it.

- Spurred by the negative effect of high oil prices on their economies, countries such as the U.S. and Canada increased their efforts to produce oil. In the U.S., private companies began extracting oil from shale formations in North Dakota using a process known as fracking.

- Saudi Arabia’s decision between letting prices continue to drop or ceding market share by cutting production in an effort to send prices upward again, the Middle Eastern country kept its production stable, deciding that low oil prices offered more of a long-term benefit than giving up market share.

Why oil prices have come down to Rs.1/barell during COVID-19?

- Pulling off all onerous feats since its inception, the Covid-19 crisis just added another victim to its list - oil.

- In an unprecedented event, oil for the first time in history breached the $0 mark, forcing the mankind to readjust the axes – another impossibility coming true! The WTI (West Texas Intermediate) futures contract of May expiry fell by over 300% to trade at below ‘minus US$39 per barrel’ on the NYMEX on Monday, April 20th.

- The Indian counterpart, MCX, accordingly had to settle the price at just INR 1 per barrel showing that it was unprepared for such an unusual volatility in the international markets.

What is Super Contango?

- A condition called ‘Super Contango’ has sent the oil markets into frenzy. A Contango market implies that oil traders believe crude prices will rally in the future. Thus, spot prices are being offered at super discounts to futures prices.
The primary reason behind this freefall is the lack of fuel demand across the world followed by a glut in global oil markets leading to an acute dearth of available storage capacities.

Thus, increasing the number of market participants who are unwilling to risk doing physical deliveries anymore.

Instead of obeying the future contracts at expiry, the idea of relentlessly selling the front month’s contract at the open market and rolling it over to the next month, appears more feasible.

Unlike Brent crude that is produced near the North Sea and settled in cash at expiry, West Texas Intermediate is produced in landlocked areas and has to be delivered physically, thus, making costs a burden for the latter from a transportation standpoint.

This leads to greater uncertainties revolving around WTI prices than Brent crude as can be seen from the fact that Brent crude prices declined less dramatically on Monday and were still trading at levels close to US$25/barrel.

What this means for the global economies?

- With no recovery in sight in the foreseeable future, the key issue of oil storage is likely to stay. If the oil stays at pennies, the US shale companies would have to pay to dispose the excess stock off! As a result, they may have to further reduce the production by shutting down their rigs and oil wells to avoid plunging into deeper financial troubles.
- Keeping aside the theoretical aspects, there are additional operational and strategic challenges in cutting production. Operationally, there is only up to an extent that a company can do so. To cut production further, they may have to seal their oil wells and thus, risk losing the asset permanently. Strategically, this would mean recurring capital and abandonment expenditures when the market revives and losing its market share to its competitors in the longer run.
- If major oil producing nations like the OPEC countries choose to do this, their currency might devalue significantly.
- However, cheaper fuel may appeal to consumers in the shorter run, but this would also mean lower or no dividend payments by the financially burdened oil companies to the pension funds in the longer run; indirectly affecting millions who are reliant solely on their pension incomes.

What does this mean for India?

- The government earns a large chunk of its income from excise duties with roughly 90% of it coming from oil imports.
- It is interesting to note that the prices for retailers have not been reduced since the government is using the buffer to fund its expenses. However, once the lockdown ends, the government can face increased pressure to reduce the fuel prices for consumers.
- Indian oil companies, especially the E&P space (upstream) like ONGC and Oil India, may face tough times ahead because of increased pressure to sell their products at lower prices ahead.
- The refiners and distributors (downstream) like HPCL, Reliance and IOCL are likely to see improved margins in the coming quarters, once the demand picks up again. As for the storage, if the Indian companies can manage their stockpile well, this is a good time to buy and reserve oil for future use.
- As per the Reserve Bank of India, India’s current account deficit (CAD) stands at 0.2% of
GDP, as of December quarter in FY20 as compared to 2.7% in same quarter in FY19. Since, India imports more than 80% of its oil consumption, lower oil prices are likely to reduce the CAD for the economy.

- The current savings in CAD can, then, be used to continue financing the urgent relief measures against the domestic Covid-19 outbreak.