RSTV Special: Oil Price War & Implications

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

The oil prices have reached their lowest levels in years, leading to the deepest oil crisis in decades. Organization of the Petroleum Exporting Countries (OPEC) and its allies led by Russia under the OPEC+ framework have agreed to cut their oil output by 10m barrels per day, or 10% of global supplies. This move is aimed at propping up the falling crude oil prices. They expect the United States and other producers to join in their effort by reducing up to 5m barrels per day.

Impact of COVID-19 on Oil Sector:

Reduced demand:

- Restrictions on movement have reduced travel needs and industries have been closed down. Major demand for crude oil comes from transportation and industries along with electricity sector which are under shut down mode.
- China, a major demand market for crude oil was impacted the most in the initial phase of the Pandemic. The western nations including the U.S. are currently under lockdown. The pandemic has spread worldwide.
- The prevailing market conditions have led to a drastic fall in global demand for crude oil and led to steep drop in the oil prices.
- Current estimates place a 20-30% fall in demand due to the lockdown worldwide.

Disrupted supply chains:

- The restriction on movement has made the movement of oil from the producer countries to the demand economies difficult, making it expensive.
- Disruptions in the oil supply chains have also been reported.

Business sentiment:

- Given the fact that economic recovery would need a long period of time, the disruptions would last for an extended time frame.
- This would lead to the reassessment of planned projects in the major oil economies. This would render investment at least in the short term, doubtful.

Miscellaneous factors at play:

- Corona virus pandemic has just increased the rate of fall in crude oil prices. There have been other factors at play too.

Political agenda:

OPEC+:

- Saudi Arabia and Russia have been previously engaged in a price war over the crude oil. They have previously resorted to increasing their production to retain their market shares.
- Though Saudi Arabia and Russia both are reliant on oil revenues to support their
economies, both nations had stayed away from cutting productions to prop up prices due to their political agendas.

- **Saudi has been trying to target its regional rival Iran**, also an oil producer. The decreasing oil prices would have had a higher adverse impact on Iran (currently under an economic turmoil) than on Saudi Arabia.
- **Russia has been looking to target U.S. interests in the Shale gas sector** and is also looking to find a way out of the economic sanctions imposed by the west.
- Each of the member nations of the OPEC+ have their own agenda and interests which had made the conclusion of an agreement to cap oil production difficult. However the continued inability of the OPEC+ to agree on production cuts led to historic falls in oil prices.

**The U.S.:**

- The S. interests were also hurt because its shale gas sector was finding it difficult to compete against the low priced oil. **Crude oil prices of less than 40 dollar per barrel will pressurize shale gas producers and make it economically unviable.** The shale gas sector supports a large proportion of the employment in the U.S. hence any disruption in this sector would lead to large scale unemployment and loan defaults by the sector.
- Hence with an agenda to support its shale producers in the election year, the U.S. decided to intervene to help conclude an agreement on production cuts of crude oil. Given its low leverage over Russia it has been pressurizing Saudi Arabia through the threat of sanctions to restart its negotiations with Russia.
- A G-20 meeting under the chairmanship of Saudi Arabia has been called to stabilize the oil market.

**Global recession:**

- Even before the COVID-19 pandemic, the world economy was going through a prolonged phase of low growth. There had been reduction in growth rates of oil demands.

**Move towards Renewable energy:**

- Despite a predominantly Oil based global economy, there have been attempts being made towards more electrification and shift to renewable energy sources. Continued global investments in renewable energy sources had posed a challenge to the oil sector.

**Concerns:**

**Governance structure for energy sector:**

- There is no one global governance structure for the energy sector involving all the major stakeholders. There are multiple international forums with limited leverage over all.
- The global governance for energy sector has collapsed.

**Too low oil price level:**

- The current level of oil prices is too low to economically sustain the oil production. This would make the oil sector economically unviable.

**Interdependency of the world economy:**
Given the high interdependence of the world economy, the oil crisis is not limited to just the oil producing countries. For example, though India, a major demand market for energy resources might benefit from the low oil prices in the short term, the long term impact might not be good for India. A large portion of Indian Diaspora is resident in the oil dependant economies of the Middle East. A major disruption of these economies might apart from reducing India’s inward remittances also lead to reverse migration to India.

The impact on the oil producing economies would also impact the growth prospects of global economy, due to disruptions in trade and investments.

**India’s case:**

- The Low oil prices has both advantages as well as challenges for India, as very low prices are equally bad as very high prices.

**Positives:**

- India is predominantly dependant on import of its energy sources. It imports around 80% of its energy requirements. The steep drop in prices is beneficial given that it would help contain its Current Account Deficit.
- India should take advantage of the low prices to stock up on crude oil in its strategic oil reserves and refineries.
- The oil savings made by the government could help it finance the economic package announced by the government during the pandemic, without affecting its fiscal position.

**Challenges:**

- The fall in oil prices could have an adverse impact on India’s large diaspora settled in the Middle East. Apart from threatening the economic security of the Diaspora it would also lead to a subsequent reduction in inward remittances to India.
- The Domestic oil producers in India are also suffering due to the unviable low prices in the market and may need some relief from the government.

**Way forward:**

**Finalize an agreement:**

- The G-20 conference should help the oil sector finalize an agreement which could help bring the oil prices to a healthy range of around 40 dollars per barrel which could be beneficial for the producers and economically viable, even for the producers.

**Global governance structure:**

- Given the criticality of the energy sector in the world economy, the lack of an effective global governance structure in this domain is a cause of concern. There is the need for an international intergovernmental framework for energy governance.

**Reforming the sector:**

- There is the need for a relook at the energy sector as a whole.
Reforming and streamlining the gas and oil sector must be considered.

**Conclusion:**

- Given the **heavy reliance of economies on oil**, there is likely to be a recovery of the oil sector in the post pandemic phase. However, there is an urgent need to protect the interests of the sector in the immediate future.