

Oil price war during covid-19 and its impact on Pakistan

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Abstract:

This article gives view point on the oil war prices between countries in the time of covid-19. It also provides brief history and the role of OPEC and non OPEC countries to detect the oil prices. The objective of this study to analyze the positions of the countries in this war, impacts on countries economy, as well as on Pakistan's economy. The discourse analysis is used for the data analysis. For the brief understanding of the issue, theoretical work also been done. Furthermore, comprehensive discussion has been extracted after analyzing data at the end of the paper.

Keywords: Oil economy, oil politics, COVID-19, OPEC, discourse analysis

Introduction:

After Spanish flue (1918), the biggest pandemic that humans have been facing for 3 months is called Covid-19. Due to this horrific pandemic: which is spreading through little virus, human race seems powerless with its advanced technology and industrial capability in front of this tiny thing. Governments from all over the world put restrictions on citizens of their respective countries so that humans can be protective from corona virus. Due to this lockdown in all over the world, businesses, industries, and all other important activities are being suspended. Practically, world's economy is in ICU.

In these harsh conditions, besides of the developing countries, rich oil producing countries are also seem stupefy, and in these economic conditions, every oil producing state want to gain maximum profit out of this oil war among the countries. In this oil war, the two big countries confronting each other are Russia and Saudi Arabia (Cook, 2020).

Due to the ***Covid-19 pandemic***, the prices of crude oil has been decreased, besides the pandemic, the main reason behind this decrease in crude oil is the price war that has been initiated between OPEC and Russia, and the price of crude oil has fell down by 30% in the beginning of March (Felicia, 2020).

In this paper, it is addressed that why Russia and KSA are fighting over the oil market? What are the different cause and implications of this war and which country contains upper hand in this war? Furthermore, it will also be analyzed that in this war, where the Americans oil companies stand? Above all this, what are the impacts of this war on Pakistan's economy?

Economics of oil:

Plenty of economists strongly believe that the fluctuation in the oil prices has an impact on countries economy. These kinds of consequences have different degree of impact on oil exporting and oil importing countries: increase in the oil price is happy news for the oil exporting countries, whereas in reverse, decrease in oil prices should be the bad news for oil producing countries (Morris, 2004).

Form last three months, oil prices have been crushing down (Kelly, 2020). Oil prices hit down 3 times in this pandemic period. There are several causes of this oil price down

China oil demand has decreased:

After the corona virus outbreak in China, everything had been locked down including transport, industries and other activities which have directly or indirectly link with petroleum product. Due to this situation, demand of oil has been decreased in China (Cang, 2020). Decreased oil demand in China is the result of decreased oil demand in the world. The reason behind this trajectory is that China is the 2nd largest oil import country, almost 14% of world’s oil demand lies under the demand present in China.

The 10 largest oil¹ consumers and share of total world oil consumption in 2017²

Country	Million barrels per day	Share of world total
United States	19.96	20%
China	13.57	14%
India	4.34	4%
Japan	3.92	4%
Russia	3.69	4%
Saudi Arabia	3.33	3%
Brazil	3.03	3%
South Korea	2.63	3%
Germany	2.45	2%
Canada	2.42	2%
Total top 10	59.33	60%
World total	98.76	

¹ Oil includes crude oil, all other petroleum liquids, and biofuels.

² Most recent year for which data are available when this FAQ was updated.

Source: (U.S energy information administration) (EIA, 2017)

Global pandemic:

In March 2020, this corona virus pandemic had spread all over the globe. According to CNBC (CNBC, 2020), “world health organization warns world as corona outbreak is world pandemic and spreads swiftly”. Like China, other part of the world also put lockdown on transport, industries and other important activities. For this reason, oil demand went low all over the world (Javier, 2020).

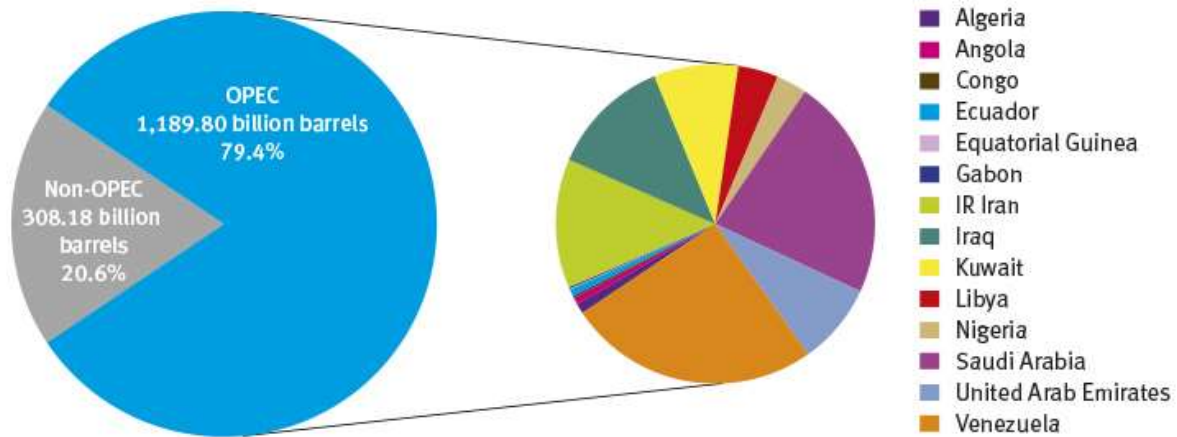
As mention earlier, when oil demand goes down, it effects the economy of oil producing countries: less business causes less profit and oil producing countries face difficulty in making national budget. For the best benefit of the oil producing countries, they established an organization called OPEC.

Organization of petroleum exporting countries (OPEC):

The 20th century was the era when crude oil became the most important indicator of world economy, it had become the main source of energy (and somehow it is), when new sources of energy (wind, water, solar energy) had appeared, oil as the main source of energy has waned somewhat. However, the standing of oil as a main indicator of energy increased in the context of economic aspects and impacts of social life in general. Eventually, the existing view point of economists is that there is strong relationship between the country’s economic growth and oil-price changes (Ghalayini, 2011).

Historically, Organization of petroleum exporting countries (OPEC) has been controlling the price of crude oil since 1960s onwards. OPEC contains almost 80% of world crude oil. According to the OPEC, its mission to ensure the price of petroleum product with efficient economic and regular supplies of crude oil to the consumers under the policies of member countries (OPEC, 2000).

OPEC share of world crude oil reserves, 2018



OPEC proven crude oil reserves, at end 2018 (billion barrels, OPEC share)

Venezuela	302.81	25.5%	Kuwait	101.50	8.5%	Algeria	12.20	1.0%	Gabon	2.00	0.2%
Saudi Arabia	267.03	22.4%	UAE	97.80	8.2%	Ecuador	8.27	0.7%	Equatorial Guinea	1.10	0.1%
IR Iran	155.60	13.1%	Libya	48.36	4.1%	Angola	8.16	0.7%			
Iraq	145.02	12.2%	Nigeria	36.97	3.1%	Congo	2.98	0.3%			

Source: OPEC Annual Statistical Bulletin 2019.

(Source: OPEC)

14 September 1960, organization of petroleum exporting countries (OPEC) has been founded by the five founding members included Saudi Arabia, Iran, Iraq, Kuwait and Venezuela. Later in 1961, Qatar also joined OPEC, but in 2019, its membership has been terminated. Indonesia joined in 1962 and suspended its membership in 2016. Libya, UAE, Algeria and Nigeria joined OPEC in 1962, 1967, 1969, and 1971 respectively. Currently organization has 13 country members. OPEC operated from Geneva (as its headquarter) for first five years then its headquarter moved from Geneva to Vienna, Austria in 1965 (OPEC, 2000).

1960s was the decade when the transition in the international economy and politics has occurred with the independence of many new nations in the third world countries. At that time, the global oil market influenced and dominated by the “seven sisters” multinational companies. OPEC had developed its collective vision and objectives. In 1968, OPEC adopted policy in its member countries in which it was emphasized on the right of a sovereign country to protect its natural resources for the betterment of its nation and development (Rilwanu, 2005).

In the decade of 70s, OPEC grew exponentially, the member of the organizations took over their local oil industries and created their position to control oil price in the global market. In 1973, during the Arab-Israel war, the price of oil went high in the market. The term used for this crisis in called oil embargo. USA claimed that “ the members of the OPEC imposed an embargo against US alleged to help Israel during the war, this decision of OPEC caused the hike in oil prices (Historian, 2002).

(Oil embargo started in 1973 and ended in 1974. During this crisis, the price went high from \$25.97 to \$46 in the span of one year.)

(Blue line for nominal line and orange for inflation adjusted price)

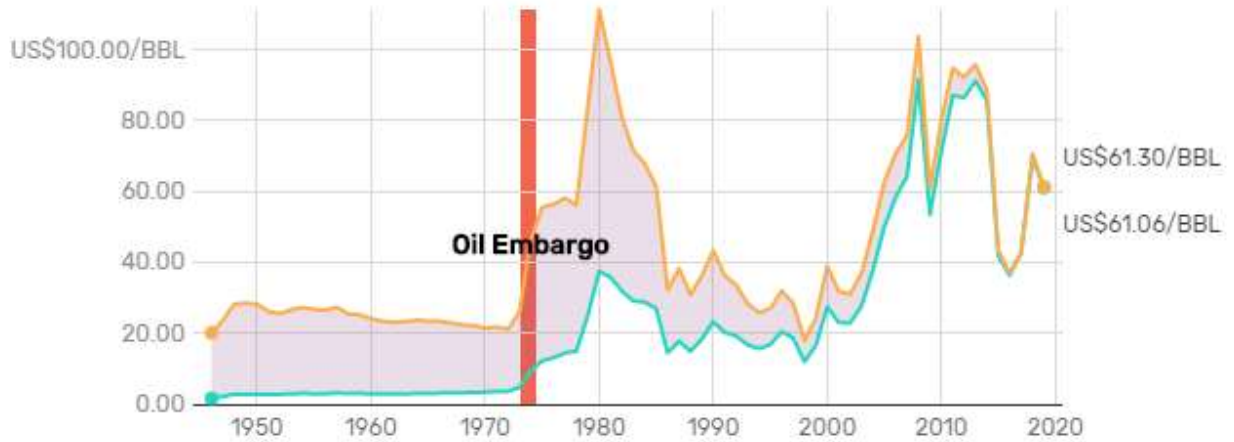
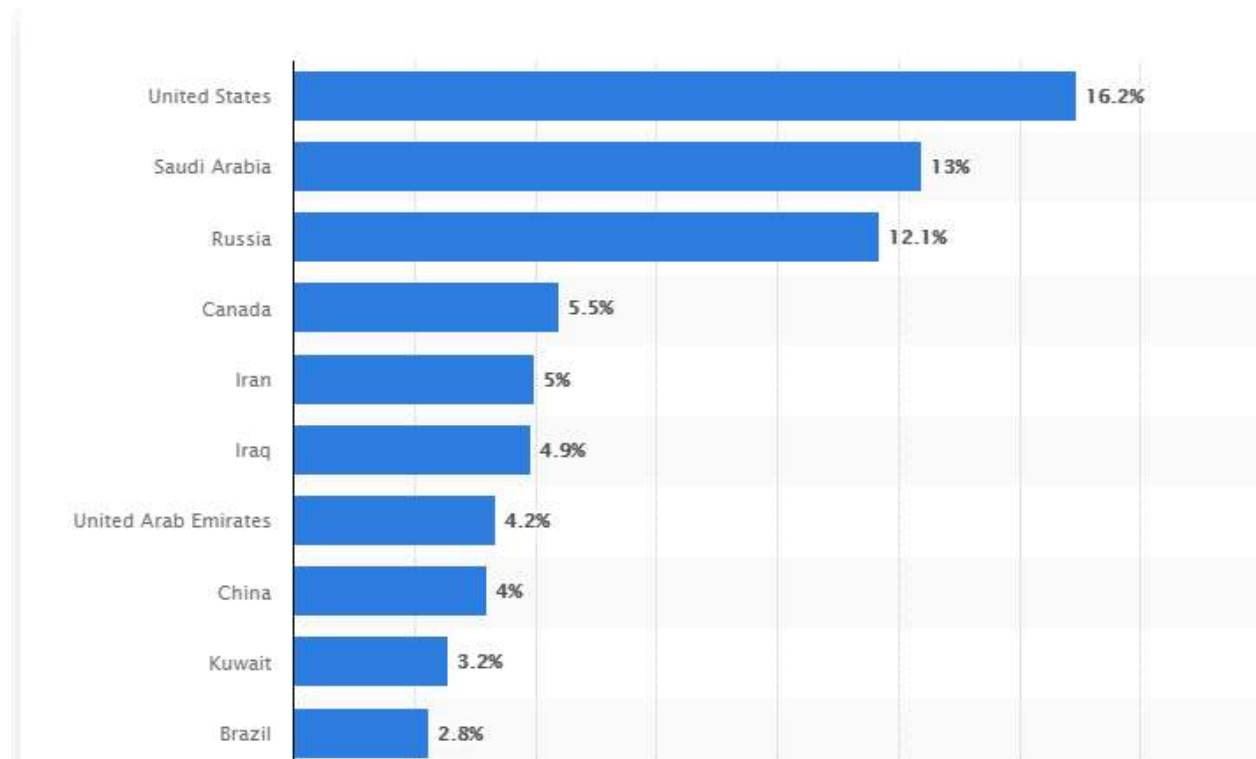


Figure 1 source: the balance

Other oil producing countries:

Historically, OPEC has been controlling the oil prices due its larger share of crude oil in the market, but from the last decades, there are other countries too which have been start to producing oil.

Leading oil producing countries in 2018 (Statista, 2018)



Source: Statista

According to the report, United States of America is producing 106.2% of the world oil. With the help of Fracking technology, America is able to achieve this status: this technology has made Americans very much independent and they are reducing their import of oil day by day. Almost, 30 years of increasing oil import is now decreasing and behind this success, there is a major part of Fracking technology (J.B, 2020).

On the other hand, Russia had also become the 3rd largest oil producing country with 12.1% share.

These non-OPEC countries producing large share of oil and this resulted the reduction of oil in the OPEC countries. According to the outstanding figures, OPEC oil supply will fall in the next five years as USA is expanding its shale oil reserves, OPEC petroleum products will be declined from 32.8 million barrels per day by 2024 with the comparison of 35million bpd in 2019 (Alex, 2019).

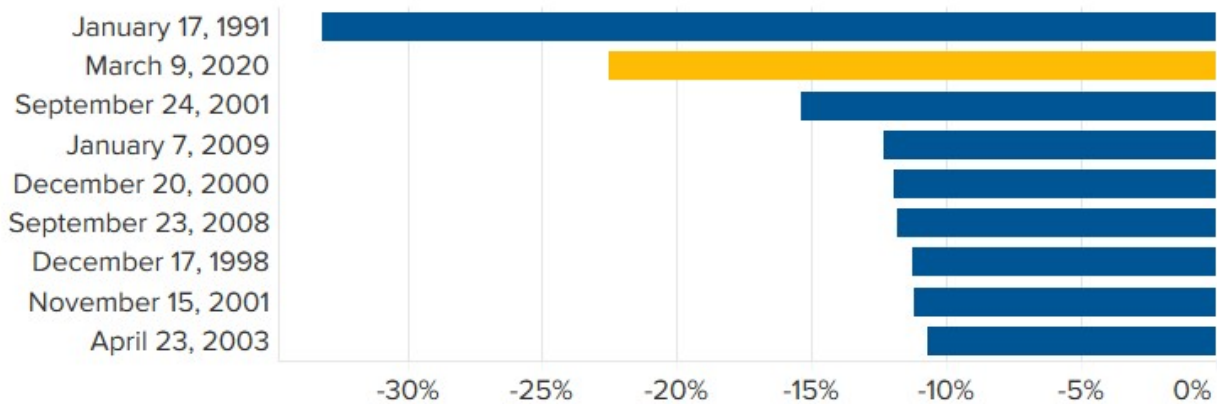
Due to increase in the production of oil in the non-OPEC countries, the power to hold the oil price in the market for the OPEC has reduced. For instance, OPEC countries reduce its oil supply, and non-OPEC countries deny to reduce supply, there will be no much change in oil prices. Tim Treadgold writes that when Iranian oil minister Bijan Zanganeh showed his concerns by saying that private Saudi- Russia deal will be the thereat for OPEC, he was not wrong at all (Tim, 2019).

Now (due to covid-19) pandemic, oil prices have been free-fall in China and other part of the world. Due to this situation in the market, oil producing countries are much deep in trouble; they are struggling to meet the cost of petroleum product.

To tackle this situation, the only solution was that to reduce oil supply in the market, but OPEC and non OPEC countries couldn't agree to reduce their supplies in the market. In the reaction, Saudi and Russia increased their production resulted oil prices fell down up-to \$21 per barrel this was the biggest down fall of oil prices after 1991 (Pippa, 2020).

Biggest one-day percent drops in oil prices

West Texas Intermediate (WTI) is on pace for its worst day since the Gulf War and second-worst day since it began trading on the NYMEX in 1983



SOURCE: FactSet. Data as of 8 a.m. ET on 3/9/20.



Source: factset, CNBC

Impact on Pakistan's economy:

As Pakistan is an oil importing country, according to the data, Pakistan is importing oil products at \$7.6 billion, out of which crude oil is \$4.19 billion and gas is at \$3.05 billion (kundi, 2019).

However due to sudden decline in oil prices, it will be helpful for Pakistan's economy. According to the report, if prices are dropped by \$20 per barrel, it will be decrease in import charges by \$3.8 to \$4.2 billion. IN a net shell, the improvement can be seen in country's external account by \$2.2-2.8 billion due to decreased oil prices in the market (News, 2020).

Literature Review:

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Methodology:

For this research paper, many articles, reports and newspapers have been used. The purpose to use these primary resources is the nature of the topic and exceptional situation.

For the better results and better, I have used qualitative set of data. It helped to examine this issue very comprehensively. For analyze the data, I have used “discourse analysis”: this technique can be used for analyzing knowledge produced at different social context. Newspaper, articles, books are those materials which can be examined under this technique. Eventually, it helped to examine the facts and provided critical analysis at the end with the help of gathered factual details and knowledge.

Theoretical framework:

Realism mainly emphasis on national interest and gain more power, this theory argues there is no power above the state as world system is anarchic.so, in the anarchic world system , because of the security dilemma, each state tries to concentrate on relative gains which led states towards zero-sum game: in which one gain and other loss. If we analyze this crisis, Russia and Saudis are perfectly applying zero-sum game and trying to take control over oil market at the cost of other losses.

Analysis:

Factually, Saudi Arabia is far ahead in the oil price war as compare to Russia and America, the reason behind this advantage is that Saudi’s production cost and transportation cost are much less than remaining countries. Now if oil price remains less, it doesn’t cost much Saudis, however profit will be decreased. Saudi economy largely depends on oil, if oil prices remain on 82 dollar per barrel, then Saudi will be able to minimize current account deficit which seems difficult in this situation, however Saudi has enough reserves to back its economy, therefore, Saudi adopted this aggressive policy to knock out its competitors, as Saudis know its competitors cannot sell oil on current oil price (\$21 dollar pbd) because of high production cost, ultimately they have to shut down their supplies and Saudi will capture market and increased its share.

As compare to Saudi, Russia bears high production cost and it was difficult for Russia to cut its supply due to some technical flaws in its production, that is why, Russians also initiate aggressive policy like Saudis, it shall not harm Saudis but some Americans companies surely get affected by this aggressive policy of Russians.

Due to this Saudi-Russia aggressive policy, American shale companies are very much in danger, due to less oil prices, it seems difficult for shale companies to survive in the market, the reason behind this uncertainty is that America wanted to get rid out of dependency from oil import and many American companies invested in shall technology, after the Corona outbreak, these companies are on the corner of bankruptcy.

As far as Pakistan’s economy is concern, it will be a good scenario, as country is a big oil importer. Besides of the pandemic, lower oil prices have positive impact on auto, steel, glass and cement industries. Furthermore, lower oil prices will also lead to a natural decrease in inflation.

Conclusion:

The Covid-19 pandemic situation is getting worse for the oil producing countries, in the near future, oil prices would not have chance to climb swiftly. Dead lock over this situation would have resulted lower oil prices.

Now, shall Americans exert pressure on Saudis and Russians for the sake of their shale companies? Or Saudis and Russians shall lower their oil demand? Or they demand Americans shale companies to reduce their supply too?

For instance, these all demands are met, there will be one question remained? By what mechanism this formula can be implemented so that no one gain more or on one face maximum loss. Or if this pandemic would get long, shall countries lower their oil demands? These questions are hard to address right now, hopefully could be addressed after this pandemic.

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