

## When Oil Markets Go Viral

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The Covid-19 crisis has led to a huge drop in the demand for, and price of, oil globally. In this article, Adam Hanieh looks at what this might mean for the global economy.

The ecological dimensions of COVID-19 have become increasingly prominent in much recent discussion, with several important contributions exploring the pandemic in relation to capitalist agribusiness, widespread loss of biodiversity, and the destruction of natural ecosystems. There is, however, a further element to COVID-19's 'ecology' that deserves much greater attention: the ways the escalating pandemic intersects with, and is simultaneously acting to accelerate, a profound shock to the fossil fuel industry. Global oil markets are undergoing an unprecedented transformation as a result of this shock, and while longer-term trajectories remain open, this moment will undoubtedly shape the politics of oil – and the prospects of mitigating climate change – for decades to come.

With states representing over 90 percent of global GDP stuck under some form of lockdown, and the simultaneous shuttering of large swathes of global manufacturing, transport, industry, and retail – the demand for oil and oil products has dropped to historic lows. Indeed, it has been estimated that the reduction in US automobile use alone has led to an astonishing 5 percent fall in global oil demand – about the same as if the whole of Europe, Africa and the Middle East had simultaneously stopped driving. The International Energy Association's Executive Director, Fatih Birol, estimated on 25 March that global oil demand could fall by about 20 million barrels per day, a prediction that has now been revised up to 30 million barrels per day. This plunge in world energy use is unparalleled in both speed and depth, exceeding all other major crises of the last century – including the 1929 Depression and the 2008 global financial crash.

And just as energy demand is in free-fall, world oil supplies look set to significantly increase following an announcement in early March that Russia and Saudi Arabia would remove limits on oil production levels. Combined with the effects of the pandemic, this 'Oil War' has pushed global oil prices to multi-decade lows, and left producers rushing to find storage space on land and sea for their oil, rather than sell it at a loss. With global storage fast approaching full capacity, some oil traders are actually now expecting producers to pay them for taking oil off their hands. All of these factors have led analysts to forecast a record number of bankruptcies among oil companies for 2020, an eventuality that could imperil a range of important banks and financial institutions in a manner redolent of 2008.

But what might this extreme shock to energy markets mean for the future of the fossil fuel industry and the possibilities of ending oil-dependency? Some commentators have speculated that this might all be a little bit of good news in the context of the COVID-19 calamity – the pandemic could “kill the oil industry and help save the climate” as a [headline](#) in the Guardian newspaper exclaimed on 1 April, with the demise of many smaller oil producers and the weakening of oil majors such as Exxon Mobil, Royal Dutch Shell, and BP bringing us closer to a transition away from fossil fuel use.

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by [Andreas Malm](#)

#### A History of the World in Seven Cheap Things

by [Jason W. Moore](#) and [Raj Patel](#)

#### The City

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Such rosy scenarios, however, tend to abstract from the realities of a [catastrophe capitalism](#) that is inexorably tied to the extraction and exploitation of fossil fuels, and which has deeply embedded 'Big Oil' in all facets of our lives. Like all moments of sharp change, the eventual path we take out of these multiple, intersecting crises – an oil price crash, severe economic downturn, and virus pandemic – will depend on our capacities to build effective political alternatives to [Fossil Capital](#). We need to pay close attention to the possible winners and losers that might emerge from this current moment, and be wary of equating the temporary (albeit severe) collapse of an oil-based economy with the demise of the system itself.

### **The Middle East, Russia, and US Oil**

There is a long and complex story behind the rise of an oil-centered global capitalism. This story encompasses the displacement of coal by oil and gas in the early 20<sup>th</sup> century, the rise of Middle East oil producers (led by Saudi Arabia) through the post-war period, numerous wars and revolutions, huge fluctuations in global oil prices in the 1970s and 1980s, and major shifts in the structure of the global oil industry. Importantly, this history is also centrally linked to how global finance developed in the postwar period – a fact often omitted in accounts that focus too much on oil as a physical commodity. Flows of so-called ‘petrodollars’ were essential to the emergence of new financial markets (such as the Euromarkets) from the 1960s onwards, the rise of Anglo-American financial dominance, and the patterns of debt dependency that continue to mark the relationships between countries in the North and South. Oil, in short, had come to permeate all aspects of global capitalism by the end of the 20<sup>th</sup> century.

Beginning in the early 2000s, world oil prices rose steadily on the back of the increasing global demand associated with the rise of China. Prices fell back sharply in 2008 with the global economic crisis, but soon resumed their upward trajectory and eventually peaked at around \$114/barrel in mid-2014. This was a financial boon for most Middle East oil exporters (and carried major consequences for the political dynamics of the wider Middle East region), but the extended period of rising prices also benefitted marginal producers elsewhere in the world. Most significantly, investments in the development of so-called ‘non-conventional’ oil and gas supplies – reserves that are difficult and significantly more expensive to extract than conventional fossil fuels – were strongly incentivised during this prolonged period of high oil prices.

Of particular relevance here is US shale, crude oil that is held in shale or sandstone of low permeability and which is typically extracted through fracturing the rock by pressurized liquid (hence the term ‘fracking’). There are a variety of ways of calculating the ‘break even’ cost of shale production and this figure changes depending on the particular oil field and the prevailing costs of technology, labour, taxes and so forth – but a widely quoted figure is that most US shale producers require a price of \$45 or more to turn a profit. By contrast, Saudi oil has a production cost of around US\$4/bbl and Russian oil around US\$10/bbl. These comparisons need to be interpreted with care, as Saudi Arabia and Russia are states not companies, and they depend heavily on oil and gas revenues to meet their budgetary needs – in this sense, the ‘breakeven price’ of oil for these states is much higher and fluctuate according to levels of government spending. Nonetheless, there is no doubt that consistently high oil prices through most of the first two decades of the new millennium helped to attract large investments into shale field development and drove significant improvement in extraction technologies for these non-conventional supplies.

This, of course, was an unmitigated ecological and social disaster, which rested fundamentally on the repeated deployment of state-backed violence against Indigenous populations in the US (and Canada) in order to make way for pipeline routes and other infrastructure. But the result was a spectacular boom in US domestic oil production. Between 2009 and 2014, the production of US shale oil tripled, propelling the United

States into the top rank of oil producers globally. Remarkably, the US became a net exporter of oil in early 2011, and overtook Saudi Arabia to become the world's largest producer in 2013 – a position it has maintained until this day, and a far cry from the panicked predictions of 'energy dependence' that had marked US policy debates in the early years of the new millennium.

### **OPEC+ and 2020 Oil Price War**

However, the huge increase in global oil inventories that resulted from this additional US production – coupled with a moderation of Chinese energy demand, a sputtering global economy, and the move towards greater use of renewable energy sources – brought the period of high global oil prices to an abrupt end in mid-2014. The price of Brent fell by 70 percent through 2015, eventually bottoming out at around \$30/barrel in early 2016. This was the largest drop in oil prices in three decades. With the US experiencing its first decline in annual oil production since 2008, many smaller and highly leveraged companies went under – for 2015, the U.S. Energy Information Administration (EIA) estimated that the combined losses of major publicly traded onshore producers reached a staggering \$67 billion.

US oil producers were not the only ones hit by the price rout of 2014-2016. All major oil exporters confronted mounting budget deficits and haemorrhaging of their reserves – this included Saudi Arabia, which burnt through more than one-third of its foreign reserves between the oil price peak in 2014 and end-2016. In the face of these mounting fiscal pressures, two of the world's leading oil-producers, Russia and Saudi Arabia, took steps to strengthen global oil prices through a series of coordinated cuts to production. This de facto alliance was formalised in a mutual pact, dubbed OPEC+, which was established between the Organization of Petroleum Exporting Countries (OPEC) and 11 non-OPEC countries in December 2016. Until it unravelled in early March this year, OPEC+ proved successful in keeping the price of oil within a narrow band of around \$50-\$80.

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For US oil companies – who were not bound by any of these international agreements– OPEC+ proved extremely fortuitous. In the wake of the 2015 plunge in prices there had been a wave of consolidations and bankruptcies in the US oil industry, and the stabilisation of relatively high oil prices served to reinvigorate domestic oil exploration and production. Indeed, by January 2020, daily US oil production was to reach over 12.7 million barrels, an increase of nearly 45 percent since December 2016 and up from less than 5 million barrels/day in 2008. These figures starkly demonstrate that while most of the world's major oil producing countries sought to limit their production levels in line with OPEC+, US oil companies were essentially left free to increase their levels of production unhindered. As Keith Johnson noted in *Foreign Policy* on 27 March, “No country has added more oil to the global glut in recent years than the United States—and despite the recent plunge in crude prices, U.S. producers are still increasing output.”

However, on 6 March this year, the OPEC+ alliance was to break apart spectacularly after Russia rejected a call by OPEC to cut global oil production by a further 1.5 million barrels/day. Not only did Russia refuse OPEC's request, it also announced that it would no longer abide by the initial December 2016 agreement. This decision was swiftly met by a Saudi counterattack delivered on 8 March – a bombshell announcement that the Kingdom was also no longer committed to the negotiated production limits, and would seek to increase its oil supply to 12.3m barrels/day in April (up from 9.7 million barrels/day in March) and then further boost its production capacity to 13 million barrels/day as soon as possible. With the prospect of an additional several million barrels of daily supply about to hit world oil markets, the price of the key international benchmark for oil, Brent Crude, dropped more than 30 percent in the space of 48 hours. Global stock markets also plunged, with the Dow Jones Industrial Average falling a record 2000 points on 9 March, the largest ever intra-day loss.

The precise trigger for Russia and Saudi Arabia's decision to walk away from OPEC+ remains unclear. Some observers speculate Russia may have been seeking to retaliate for US sanctions that had been placed on the largest Russian oil company, Rosneft, in February. Others claim that Russia's decision needs to be understood in the context of its own internal politics, with Putin seeking to cultivate support among Russian elites closely connected to the oil industry and who have long opposed OPEC+. Other analysts have described the Russian and Saudi actions as a “game theory masterstroke”, which both countries were fully anticipating prior to the March announcements.

Regardless of the immediate conjunctural factors, the longer-term strategic motive behind the Russian and Saudi decision is clear. For several years, both countries had seen US oil producers, unhindered by any production limits, continue to gain market share at their expense. By threatening to flood the world with more oil (and here, Saudi Arabia's actions are particularly decisive, due to its unique ability to quickly ramp up production capacity) the price of oil would fall significantly. Saudi Arabia and Russia would need to endure the pain of low oil prices for several years; in the meantime, high-cost US producers would be driven to the wall.

## An Oil Price War Meets COVID-19

However, in the days following this massive supply shock to global oil markets, it quickly became evident that a much larger blow to oil prices was looming as a result of COVID-19's escalating spread outside of China. For oil producers, the tsunami of demand destruction greatly magnified the effects of the Saudi and Russian announcements, and pushed oil prices towards single digit levels. By 29 March, the price of the US benchmark, West Texas Intermediate (WTI) oil had dropped by more than 60 percent since the beginning of the year, falling below \$20/barrel, its lowest level in 18-years. The international benchmark, Brent, dropped to \$23.03/barrel, the lowest since 2002. Importantly, these benchmark prices often don't reflect the actual real price that a barrel of oil costs in the physical market – with traders reporting some types of oil selling for as low as \$8/barrel. Amidst predictions of \$10/barrel, oil companies began to slash their spending on further exploration, rig construction, and capital expenditure.

In the face of these extremely low prices, oil producers have been scrambling to store their oil in the hope of making a profit when prices rise sometime in the future. The problem, however, is that storage space is highly limited (particularly on land) and there are logistical and technical costs associated with bringing oil to where it can be safely stored away. Analysts have estimated that around three-quarters of the world's storage capacity is already utilised, and that limits will be reached by the end of May. By mid-March, leading pipeline companies in the US were worrying that oil producers might attempt to use their infrastructure to store oil rather than transfer it somewhere else, and thus began insisting on a bill of final receipt before they would accept any new oil. And because it is expensive to shut down or temporary halt oil wells (and land leases sometimes contain clauses that require continuous production), oil companies may prefer to give away their product rather than halt work; indeed, in mid-March, traders were bidding for Wyoming Asphalt Sour (used mostly to produce bitumen) at *negative* 19 cents per barrel, effectively asking producers to pay them in return for taking the oil off their hands.

All of this presents enormous pressures across the entire oil value chain, from crude oil producers (companies and countries) through to refining and the petrochemical industry. Firm bankruptcies and the shutting down of oil wells are almost certain in the immediate weeks, and will likely be concentrated among those producers who rely upon relatively high oil prices, e.g. US and Canadian companies active in oil sands and shale production. Indeed, this prognosis was confirmed in the Dallas Federal Reserve March Monthly Survey on Oil and Gas, where industry respondents commented that the prospect of “the domestic oil and gas industry has never been bleaker” – this was “a perfect storm of disaster” and “the single worst reset in energy prices in [a] lifetime”.

## Oil and Finance

But mapping the potential trajectories of this pandemic-led crash requires a closer examination of the linkages between the oil industry and the wider economy. Crucial here is the deep interconnection between energy-related companies and financial

markets, most evident in the US, where energy companies have become extremely leveraged over recent years. Much of the debt issuance by these companies – not only producers of crude oil, but also oil field service companies, refiners, and other ‘mid-stream’ firms such as pipeline companies – has been rated below investment grade. Quite strikingly, energy companies have been the biggest issuers of ‘junk bonds’ in the US for 10 out of the last 11 years, and now make up more than 11 percent of the entire US junk bond market. The problem is compounded by the very significant amount of unsecured debt (debt that is not backed by any collateral) of US energy companies; this figure surpassed the levels of secured debt for the first time in 2016, reaching \$70 billion in December 2019, up from only \$1 billion in 2015.

With the cratering of demand in the wake of COVID-19 – amplified by the Russia/Saudi decision to increase production levels – many energy-related companies face an imminent downgrade to their financial ratings. UBS Group estimated on 16 March that up to \$140 billion of bonds issued by US energy companies are at risk of becoming ‘fallen angels’ – i.e. losing their investment-grade status. As this debt is downgraded to junk-bond territory, the increased supply will act to lower bond prices while increasing their yields (the interest paid on the bond, which moves inversely to price in the case of bonds). One possible consequence is a liquidity crisis where energy companies not only find it very difficult to find buyers for their debt – a critical issue as many are due to renegotiate their debt throughout 2020 - but are also forced to pay much higher interest rates on their bonds.

The net result will undoubtedly be a sharp increase in bankruptcies among such US energy companies over 2020 and 2021. Indeed, the first of these casualties occurred on 1 April with the filing for Chapter 11 by Whiting Petroleum, the largest independent oil company in North Dakota (the second-biggest US oil producing state). Whiting carried carried more than \$2.8 billion of debt on its books, but just days before the Chapter 11 filing, its senior executives awarded themselves \$14.6 million in bonuses, with the company’s CEO walking away with an immediate payment of \$6.4 million – much more fortunate than the one-third of the company’s workforce that had been fired last July. Whiting is almost certainly the first in a coming wave of energy company bankruptcies; indeed, Rystad Energy estimated on 3 April that if oil continues to sit around \$20/barrel then more than 500 firms would be pushed into Chapter 11 over 2020-21, the largest number of such filings in modern history.

Such defaults could seriously destabilise other parts of the financial system. Pension funds, insurance companies, banks and other financial institutions hold large quantities of energy debt and may be placed at risk in the event of a large wave of corporate defaults – smaller US regional banks, in particular, are heavily exposed to the oil and gas sector. Recent years have also seen the widespread practice of securitising highly leveraged corporate loans – i.e. the bundling together of a large number of risky corporate loans that are then sold as securities known as Collateralized Loan Obligations (CLOs). Although it is difficult to disaggregate CLOs by sector or to determine with any precision who holds them, a wave of defaults among oil and gas companies could

cascade through financial markets in much the same way that occurred with mortgage backed securities in 2008. Such interdependencies with financial markets are of course not unique to the fossil fuel industry. However, this sector stands out particularly sharply among the potential landmines that lay littered across financial markets today. Very high levels of unsecured debt, a predominance across junk bond and distressed debt categories, and the extreme shock presented by the oil price crash – all combine to make this sector a likely candidate for the propagation of severe financial stress throughout other parts of the global economy (much like the real estate sector in 2008-2009).

### **Winners, Losers ... and the Climate**

It is certain that all parts of the fossil fuel industry will face a severe crisis over the remainder of this year and into 2021 – but what might this mean for our ecological future? Unfortunately – unless fossil capital can be effectively challenged now – a likely scenario is that a significant wave of bankruptcies in the energy sector will actually accelerate the further centralisation of control by the largest oil majors. ‘Big Oil’ – Exxon, Shell, BP and a handful of others – are much better positioned to survive this crisis than other smaller producers. They tend to be vertically integrated firms, i.e. they are active across the entire energy value chain, including refining, and thus will have some of their losses in crude production offset by the lower cost of fuel inputs for their downstream operations. As truly global firms, they have reserves and assets distributed across the world, not solely in the higher cost shale fields of the US. Financially these firms also tend to have much deeper pockets, and their prospects are deeply entwined with broader financial markets (including pension funds) – in the UK, for example, BP and Shell account for a remarkable one-fifth of all FTSE dividends.

This scenario is precisely the one that leading financial firms are expecting to see unfold over the next 12-18 months. Goldman Sachs, for example, noted recently that while the current crisis will undoubtedly “be a game changer for the industry,” the probable outcome is that “Big Oils will consolidate the best assets in the industry and will shed the worst ... when the industry emerges from this downturn, there will be fewer companies of higher asset quality”. Inter-industry disputes over state support to the ailing shale industry in the US also reflect this possible outcome. Here, as Justin Mikulka meticulously documents, large oil majors such as Exxon have sought to hasten the collapse of smaller producers and have vigorously *opposed* any state support to the shale industry. Mikulka cites the CEO of one shale firm, Pioneer Natural Resources, who told CNBC that efforts to engage the Trump administration in support of shale producers were not going well, because “We’ve had opposition from Exxon who controls API [American Petroleum Institute] and the TXOGA [Texas Oil and Gas Association] ... they prefer all the independents to go bankrupt and pick up the scraps.”

For this reason, the current moment presents a real danger for climate justice campaigns. In the US, for example, the Trump administration has agreed to loosen environmental regulations for power plants, factories and other industrial facilities – essentially allowing these polluters to ‘self-monitor’ their own pollution levels, according



to a recent report in the New York Times. This new policy has been rolled out by the Environmental Protection Agency as part of addressing the COVID-19 crisis, but tellingly, it was also one of the key demands raised by the American Petroleum Institute in a letter sent by these Big Oil lobbyists to the Trump administration on 20 March. It is not just the fossil fuel industry that is attempting to use this crisis to roll-back environmental regulations, large banks and financial firms are similarly pushing for a relaxation on climate change reporting requirements and a delay to climate change 'stress tests'.

A scenario that sees the undermining of (already inadequate) environmental regulations and a wave of industry consolidation ultimately places Big Oil in a stronger position to capitalise from a post-viral world. While oil prices are today at historically low levels, they will not remain there over the longer term. One of the critical consequences of today's vast destruction in the demand for oil is that most leading oil companies are announcing savage cuts to their capital expenditure (CAPEX) on oil exploration and project development. For the oil majors these initial cuts have averaged around 20 percent over the last few weeks; they are even higher in the shale industry, where one energy consultant expects a 40 percent drop in spending over 2020. It takes considerable time and expense to restart or bring new oil production online after projects have been halted or oil-wells shut-in, and for this reason, the effects of today's cutbacks to CAPEX will be felt in supply constraints for some time in the future. This creates a strong possibility of a sharp rebound in prices as we emerge from this crisis – an outcome that will incentivise a renewed wave of investment and expansion in fossil fuels globally (much as happened through the recent history of US shale production).

How might this be reflected beyond the US and the fortunes of the large, globally-diversified oil majors? Here we also need to differentiate between the more powerful oil producing states and other poorer oil exporters. There is no doubt that countries like Saudi Arabia, the United Arab Emirates, and other Gulf states will certainly experience rising deficits and greater pressure on government spending in a prolonged period of low oil prices. These states, however, have relatively low levels of existing debt and can borrow fairly cheaply on international markets. The Gulf's particular class structure – an overwhelming reliance on temporary migrant workers that make up more than 50% of the Gulf's labour force – also means that any sharp economic contraction can be partially displaced through simply sending migrant workers home (as happened in Dubai in the aftermath of the 2008 crisis). Indeed, much like the possible strengthening of 'Big Oil' through this crisis, the Gulf states could see their position further consolidated if assets in neighbouring countries become more cheaply available in a post-viral world. One important market here is India, where companies headquartered in the Gulf are continuing to make significant inroads in expectation of a boom in future energy demand. The Gulf's strategic insertion within trade and financial networks connected to China is also important to highlight. Crude oil and petrochemicals remain central to these connections, and work on key projects in these sectors is continuing throughout the current crisis (such as Abu Dhabi's Ruwais refinery, which will be the largest integrated refinery and petrochemical plant in the world on completion).

Other poorer oil exporters will face much more serious problems as a result of the current plunge in oil prices. These include Ecuador, Venezuela, and Iran – the latter two contending also with savage US-imposed sanctions. States such as Nigeria – which depends upon oil for 57 percent of government revenue and over 90 percent of foreign exchange earnings – will find it exceedingly difficult to meet budgetary demands, a problem that will have deadly consequences in the midst of the current pandemic. Similarly, for Iraq, where oil exports make up 90 percent of government revenues and a large proportion of the population depends upon the public sector for wages or pensions, it is difficult to see how the expected shortfall in funding will be addressed. The problems these countries face, however, should not be blamed on low oil prices; instead, longstanding legacies of colonialism, the destruction wrought by Western-led wars and occupation, and the relations of debt and dependency that bind these countries to the centres of the global economy need to be placed upfront in tackling this pandemic. Nigeria, for example, may depend on oil for a large proportion of government revenues – but more than half of these revenues are spent simply on servicing existing foreign debt. Any attempt to move beyond fossil fuel dependency at the global level must challenge this combustible mix of oil, debt, and finance.

At the time of writing, there is talk of a possible deal between the US, Saudi Arabia, and Russia around oil production levels. It is unlikely that such a deal would have any sustained effect on the price of oil given the vast destruction of demand that has occurred in recent weeks. Some observers have noted the irony of seeing leading Republicans who had previously called for the dismantling of OPEC because of its 'cartel'-like behaviour now demanding greater market collusion with Saudi Arabia and Russia over prices. There is certainly no doubt that the mutually-reinforcing crises of the COVID-19 pandemic and the global economic downturn are indeed provoking a whole range of unexpected political realignments, strange bedfellows, and new openings for political change. But this moment is also one where previously existing arrangements may be re-worked and consolidated in the interests of the most powerful – we face the very real danger of an emboldened and resurgent oil industry, positioned ever more centrally within our political and economic systems. Such an eventuality would be a disastrous outcome to this current pandemic.

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