
Is [only] oil price increasing ?

20-03-2022

Authors

Mahmood Baban

Summary : On March 7, 2022, the price of one barrel of oil has raised to 140\$, which is the highest price record for the past 12 years. The increase was in ways that in less than 24 hours, the price raised 30% percent, following the announcement from Biden administration and U.S. Congress that they are preparing a ruling to ban oil importation from Russia

Introduction

On March 7, 2022, the price of one barrel of oil has raised to 140\$, which is the highest price record for the past 12 years. The increase was in ways that in less than 24 hours, the price raised 30% percent, following the announcement from Biden administration and U.S. Congress that they are preparing a ruling to ban oil importation from Russia. If this blockade is put on the 3rd greatest oil producers in the world, which is exporting about 75% percent of its crude oil and other oil products into the global market, there will be great consequences. However, in this article, the consequences like a food price increase, deceleration of world economic growth, creation of instability in demand and supply market, reforming of alliances and cooperation agreements between countries and the increase of smuggler's role in the energy market will be discussed.

When Oil Price Increases, the Food Price also Increases and the vice versa

Generally, the energy price, especially oil price, is directly proportional to the food price. Therefore, in the past, the food price was low whenever the oil price was low. The food price (agriculture) has always had a proportional mirroring to the oil price. According to research about energy policy, the outcomes show that 64.17% of any change in the food market was directly related to the changes in the oil price¹, which was because of the diverse need for oil for agricultural production, therefore, any inflation in the oil price damages the energy security and is a great threat on food security in the world.

Moreover, according to the U.S. Energy Administration (EIA) and Food and Agricultural Organization (FAO) data, from 1988 to 2022, the food price has increased whenever the oil price did and vice versa, as it has shown in the graphic 1. The price of food and crude oil has increased at a proportional rate from 2000 until today. This is because of the great amount of energy that is consumed in diverse food production, especially because of industrializing the food products that widely relies on crude oil, for the factory running machines and productions in the agricultural fields.

Graphic 1: the price of oil and food baskets from 1988 to 2020

Source: eia² and FAO²

Note: The change in oil price is in U.S. dollar and the change in food price is according to the monthly price change of the food basket.



مركز البحوث الإسلامية
Islamic Research Center
of the Islamic Consultative Assembly



The instability of food security now is worse than 10 years ago, which is because of the pandemic of 2020, the increase of unemployment in 2021 and the current supply chain disruption and disruption of the past few years. This means that even before the conflict between Ukraine and Russia, food security was already in more danger than a decade before, and this conflict will cause form even more instability in the food sector and put global food security in more danger, which is because of the role of Ukraine and Russia in supplying crop to the world and because of putting the Europe countries in an unstable situation because of the war. Albeit there has not been any disrupted in supply chain, the price of crops and their products have increased with an amount of 55% percent in the world⁵, which this affects increasing poverty and starving around the world, but the efforts of the UN for lowering starve and poverty is slowing it down⁶.

Deceleration of Economy Growth and High Oil Price

At the end of last year, the world markets were gradually getting reopened and the economic activities were being normalized, but the Russia-Ukraine war put a great effect on the products' value and raised their prices, in ways that according to an announcement by International Monetary Fund (IMF),

"the sanctions on Russia will have a great effect on global economy and finance markets and also a more significant effect on other countries in the world".

International Monetary Fund

The current high price of oil rides America to crisis and financial recession. The highest level of inflation throughout the last four decades has been recorded in America, which is currently 7.5%. Therefore, some experts expect the economic situation of America to get worse because of the sanctions of Russia. On another side, consumer confidence in America slips in the last month, so plans to buy houses, cars and devices have lowered⁸.

After the oil price was raised to more than 130\$ for each barrel, most of the European stock markets fluctuation were heading down, according to Micheal Hudson an American economist and a senior analyst of CNC markets say, "increasing the price of oil is creating the fear of destroying demand rate and global economic recession which is very dangerous"⁹.

Instability in Demand and Supply of Energy Market and Reformation of Energy Sector Agreements

Imposing sanctions against Russia by America is creating great instability in the energy market, which is why European countries such as Germany are against imposing sanctions on the Russian oil and gas sector, because Russia in January 2022 have produced 11.3 million barrels of oil each day, and, out of that production amount, the country has exported 10 million crude oil barrels, 960 thousand barrels of condensate gas and 340 thousand barrels liquefied gas to the global market, this is aside from the other refined products such as (liquefied oil, petroleum, gas, etc.)¹⁰

Russia is the 2nd exporter of crude oil after Saudi to the world, especially to the countries of European Union. Therefore, the economic minister of Germany has announced in a press conference, "I don't support blockade on Russian oil and on oil importation from that country; I stand against it. Germany regrets still relying on importing energy from Moscow. This is all at a time where the greatest economy of all Europe, Germany, is now noticing the effects of the sanctions imposed on Russia for conquering Europe".

The share of Russia in production and supplying of energy (oil and gas) in the world is in a way that if exportation of Russian oil is decreased by 3.2 million barrels a day, which is 70% of the whole oil exportation of Russia for this month and the coming month, then based on previsions, the price of each barrel of oil will rise by 25\$¹², which is because of the shock of not being able to fill that big gap. However, months later, big changes might happen, especially after the ending of the OPEC and OPEC+ agreement, in April 2022, on the obligation of the agreed amount of oil production after the COVID 19 outbreak.

There has been a global divide between the two poles of sellers and buyers of energy in the energy market among the powerful, regional, and even very small but rich with natural resources countries. The current increase of oil price and the possibility of sanctions to be imposed on Russian oil importation by America will create big changes on both sides of energy market, especially changes in the connections of Iran and Saudi with a global market and Asian countries, and also the change of the connection of Europe with energy supplying countries. What is clear and expected to happen as soon as possible is an agreement between Iran and (P5+1) countries. Even if the agreement does not satisfy all the objectives, it will probably open a door for Iran's oil exportation to the global market, because Iran will increase the oil production level to 2.5 to 3.5 million barrels daily which is almost equal to the amount that the energy market will lack if sanctions are imposed on Russian oil.

Another aspect of reformations of agreements is a closer relationship of China and Russia that in 2020 out of \$71 billion Russian sold oil income, \$23,769,000,208 was from China, meaning that a third of exported Russian oil income was from China¹³. This quantity might increase and their relationships might get to another level after the sanctions on Russian oil are imposed.

Another country that has a great role in directing the energy market and oil price stability is Saudi which can make great changes in oil prices, and the kingdom also can have an effect on OPEC obligations on its rulings. Up until now, Saudi has not shown any sign of obligation to the Washington rulings which were explicitly shown in the gathering on the 2nd of March. In the last few days, the kingdom has raised the price of light oil in the Asian markets with an amount of 4.95% percent for each barrel.

All of these events tell us that great changes in relations between oil production and oil consumer countries are ahead, therefore the European Union is looking for reformation of its energy system. The Union is looking for transmitting the whole energy system, not only for oil and gas but for all the EU's energy needs, which will have its effect on reformation of relations and will offer great opportunities for other countries in reforming their relations with America and the European Union in the energy sector.

Blockade of Countries and Role of Smuggling

Another outcome of the blockades on Russian oil is an increase in smuggling and of methods to sell oil different from the common methods that are used in the market. Therefore, according to a report from Oxford Energy¹⁴ (Page 8), during the sanctions of America on Iran, the quantity of Iran oil exportation in 2021 has reached 1.2 million barrels a day. This means that there was an additional 250 thousand barrels per day compared to 2019 and 2020, where this has not been mentioned in any international demand and supply system. Now, if sanctions are imposed on the oil sector of Russia, then from different methods and gates the Russian oil will still head up in the energy supply market. Albeit Russia is not like other countries, because, before the start date of the Russian-Ukraine war, it has secured the Chinese market, for both oil and gas, and the 30 years agreement between Gazprom and China was signed some days before the war!

Conclusion

Eventually, the effects of war have explicitly shown up, not only on Russian oil blockade but also on the price of supplements and food, relations between oil exporter and oil buyer countries, assurance of countries' energy security and on decelerating global economy. The exact consequences of the blockade on Russian oil may not be crystal clear, but the immediate effects of such practice can be as follows:

- It will bring a great change to commercial exchanges between countries, which will have a great effect on the instability of oil prices.
- Russia will look for new buyers, especially in Asia that has an interest in light oil. Saudi increased the price of light oil, therefore the Russian oil companies are pressured to start investment in the light oil market.
- There will be great pressure on OPEC countries to pump more oil in the coming months.
- There will be a great possibility to open doors to Iran to supply its oil to the markets, even if the agreement of (P5+1) doesn't happen.
- Europe might rely on the Middle East in a reformation of the energy system and Russia might rely on the Asian and Chinese markets for energy exportations.
- The United Nations might put less focus on Sustainable Development Goals (SDGs) [from now on], such as poverty, environmental changes and encouraging countries to produce renewable power plants in particular, especially when Elon Musk requested an increase in oil production (where he is the head of inventions and owner of electric car idea)!
- A new entrance for new oil-producing countries to fit themselves in the global energy market will form.

Footnotes:

1. <https://pdf.sciencedirectassets.com/271097/1-s2.0-S0301421518X00159/1->
2. <https://www.eia.gov/dnav/pet/hist/LeafHandler.ashx?n=PET&s=RB RTE&f=M>
3. <https://www.fao.org/worldfoodsituation/foodpricesindex/en/>
4. <https://www.ft.com/content/02095093-329b-4b66-9f80-13d07350014c>
5. <https://globalnews.ca/news/8662158/russia-ukraine-war-global-food-supply/>

6. <https://www.fao.org/publications/sofi/2021/en/>
7. <https://www.forbes.com/uk/advisor/personal-finance/2022/02/16/us-inflation-hits-40-year-high-of-7-5/#:~:text=The%20US%20consumer%20price%20index,its%20highest%20level%20since%201982.>
8. <https://www.reuters.com/business/us-consumer-confidence-slips-february-2022-02-22/>
9. <https://www.wsj.com/articles/global-stocks-markets-dow-update-03-07-2022-11646622021?tesla=y>
10. <https://www.iea.org/reports/russian-supplies-to-global-energy-markets/oil-market-and-russian-supply-2>
11. <https://www.dw.com/en/germany-warns-against-ban-on-energy-imports-from-russia/a-61002737>
12. <https://a9w7k6q9.stackpathcdn.com/wpcms/wp-content/uploads/2022/03/Russia-Ukraine-crisis-Implications-for-global-oil-markets.pdf>
13. <https://www.reuters.com/business/energy/ukraine-crisis-will-disrupt-crude-coal-Ing-flows-even-without-sanctions-russell-2022-02-25/>
14. <https://a9w7k6q9.stackpathcdn.com/wpcms/wp-content/uploads/2022/03/Russia-Ukraine-crisis-Implications-for-global-oil-markets.pdf>