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At a time when the service industry is making the great shift to work-from-home due to the COVID-19 pandemic, the industrial and extractive sectors across the globe are struggling with the new normal.

Anticipating tougher quarters ahead for revenue amid the economic shock of COVID-19, oil and gas giants recently made salary and job cuts, while suspending new exploration and expansion projects. Oil-dependent Kazakhstan was no exception to this global trend. This article outlines the causes and consequences of the current oil slump and potential ways out of this crisis.

Price Wars, Not Crises

Looking beyond the buzzword, what the media calls "oil crises" are often supply shortages caused by either transport bottlenecks or trade spats rather than production problems. We see this in other types of crises too, as symptoms of larger problems. A humanitarian crisis is often the result of a conflict or natural disaster, a financial crisis may be triggered by imbalances between the real sector and investment and a migrant crisis likely has its roots in armed conflict, deepening global inequality and exclusionary border management. So until the world runs out of extractable oil within a few generations, producers will continue to find a way to drill and sell crude oil worldwide, "crises" notwithstanding.

The "oil crisis" of March 2020 started with a different crisis four years before. Oil prices dipped below US$30 per barrel in early 2016, and oil-exporting countries devised strategies to gradually cut production in an effort to squeeze the market and cause a price surge. For years, this strategy was unevenly followed by the OPEC+ group, which includes the 14 members of the Organisation of Petroleum Exporting Countries (OPEC) and non-OPEC members, among which Russia and Kazakhstan, and sets monthly and quarterly production and export goals. In the past few years, Kazakhstan was regarded as one of the least compliant countries in this respect. A steady flow of crude launched the new Kashagan Field and several other fields were expanded, causing an increase, rather than a cut in production as predicated by OPEC+ quotas.

The world's two main oil producers and exporters, Russia and Saudi Arabia, met in March at an OPEC+ convention to negotiate this year's production cuts. Russia rejected the Saudi plan for deeper production cuts, to which Saudi Arabia countered with a plan to increase production, which would have flooded the global market with oil and driven its price even lower. Russia responded by increasing production as well, with both countries engaging in a political game of economic self-sabotage. Oil prices spiralled down to a historic low, forcing producers to halt extraction at unprofitable fields and traders to keep their tankers at sea instead of docking and selling oil for cheap.

Russia and Kazakhstan were hit by this crisis to a greater extent than Saudi Arabia or other oil exporters due to the nature of their oil reserves. At some of their older or technically challenging fields, oil can be relatively more expensive to extract and production more costly to halt because machinery wears out from inactivity, increasing extraction temperatures is expensive and seasonal production cycles are thrown off schedule.

The "crisis" thus emerged before the pandemic and was only worsened by it. As demand from China decreased because of COVID-19 and storage facilities filled up with oil that was too cheap to sell, U.S. President Donald Trump intervened and negotiated a settlement between Russia and Saudi Arabia. But the pandemic had already taken its toll on industrial activity and human mobility, with road and air traffic dramatically reduced. The demand for oil fell sharply and prices remained low. Overall, the crisis-pandemic mix hurt the sustainability of economies dependent on oil exports. The Kazakh tenge, for example, depreciated sharply against the U.S. dollar and the euro, burdening the banking system and people's livelihoods. In a country so dependent on imported goods and commodity exports, a weak currency translates into economic trouble.

Big Oil, Small Profits

Triggered by a combination of political and public health emergencies, the oil price slump affected private oil companies across the globe. Big Oil, or the five largest oil and gas companies, posted quarterly losses and a historical dividend cut for April, May and June and is reconsidering the viability of its low-margin oilfields. For example, BP halved its shareholder dividend and posted a US$6.7-billion quarterly loss in August, a far cry from its US$2.8-billion profit in the same period last year. It slashed up to US$17.5 billion from the value of its assets in June and plans to cut 10,000 jobs by the end of the year.

Some of the world's most expensive drilling operations were halted to cut costs. Analysts say that these oil wells may never be exploited again because resuming operations would be too costly. In fact, many oil basins require constant extraction and cannot be switched on and off at the push of a button. Around 7 per cent of Russia's production could be affected by these problematic wells. In Kazakhstan, state-owned Kazmunaigas said it could halt several of its mature projects as costs offset revenues in the current economic climate.

When oil prices fall, the effect on the downstream sector is generally positive because it is cheaper for refineries to buy crude oil. In the current market of low prices and low demand for gasoline and air fuel, however, refineries have slowed down their purchases. Traders, too, have been reluctant to sell crude oil at prices too low for profitability. Importantly, this has created a series of "traffic jams" at sea as traders booked an increasing amount of tanker storage for their unsold oil, keeping vessels near the major trading ports. Tanker traffic has become an environmental risk, also causing enormous stress for the staff on board, unable to predict the date of docking.

Production and Job Cuts

In Kazakhstan, the oil sector has suffered from worsening market conditions. In March, Tengizchevroil General Director Eimear Bonner said that the company was "ready to survive the tough situation in relation to the pandemic and the oil price… [and] did not foresee job cuts." COVID-19 spread in the rotation camps near Tengiz in April, triggering several protests by workers who had asked to be sent home to keep away from the infection hotspot. In May, two workers at the Tengiz Field died after testing positive for COVID-19 in May and June, which triggered a swift evacuation of non-essential workers from the rotation camps.

Rotation camps at the Tengiz Field quickly became COVID-19 hotspots. Production and sales levels fell after around 3,000 workers tested positive to the virus and the company reduced its personnel at the industrial areas. By June, hundreds of workers had their salaries slashed and many lost their jobs, with service companies in the Tengiz Field also laying off their staff. In an effort to contain the spread of the virus, Tengizchevroil doubled its rotation schedule for workers from 28 to 56 consecutive days. When this measure was also implemented by the company Karazhanbasmunai in Mangistau, workers went on strike.

In July, Kazakhstan's oil and gas industry appealed to the government for anti-crisis measures, hoping to receive vital tax breaks and concessions. Several companies opted to cut administrative costs at first but soon resolved to also cut operations, therefore terminating contracts and jobs.

As workers face layoffs and salary cuts in oil fields across the country, service and seasonal workers indirectly involved in the oil industry have also found themselves unemployed, since commissioned projects were downgraded as company priorities. The US$37-billion expansion of the Tengiz Field was postponed, a move that government officials say could leave around 30,000 service workers at home without pay. In July, rating agency Standard & Poor's maintained its BBB grade for the planned bonds to be issued by Tengizchevroil but also warned of a negative outlook.

China also lowered its demand for oil and gas from Kazakhstan. Corrosive chemicals found in oil pipelines caused a temporary halt in sales from Aktobe in January. The pandemic further reduced demand, slashing eastward pipeline supplies. The state-owned pipeline company KazTransOil reduced transport by 3 per cent in the first half of 2020 compared to the same period last year, decreasing deliveries to refineries by 10 per cent. Lower production at the major oil fields also caused other export pipelines, such as the Caspian Pipeline Consortium, to reduce throughput.

Between a Rock and a Hard Place

There have been several oil price crises in the past few decades. The ripple effects of price shocks on Kazakhstan's national economy and the local economies of its oil-producing regions were pervasive, with the source of income of many revolving around oil. These most recent effects are negatively impacting the value of the tenge, already affected by the OPEC+ row earlier this year. It is thus inevitable that people's livelihoods will take a further hit from the current economic slump. One way of dealing with the sharp fall in state income is by cutting costs, so the government may opt to privatize its assets at a faster pace. Privatization plans have been announced, but so far nothing concrete has emerged.

Economic and energy diversification would have been easier to accomplish at times of high oil prices and sizable revenues. Although a major part of Kazakhstan's political strategy, diversification has remained an unfulfilled promise. Fossil fuels still account for most of the country's revenue and energy consumption. The "war economy" of the Brent oil price dip and pandemic is likely to continue in the mid-term and have long-lasting consequences for the country's economy and elite, which are highly dependent on oil extraction and revenue, respectively.

Importantly, lower prices and demand are a double whammy for both oil-exporting countries and Big Oil alike. As oil prices decrease, even a marginal reduction in demand translates into a sharp revenue fall. In such a negative business environment, investment banks have exercised more wariness on betting on oil ventures. Some of the largest U.S. investment banks have reduced the oil business component of their portfolio and are reluctant to invest in what now appears to be a loss-making industry.

What to Expect

At the current global conjuncture of low oil prices and a pandemic, Kazakhstan's oil production will shrink this year, and so will profits. Companies such as Tengizchevroil and the North Caspian Operating Company (NCOC, the consortium of Big Oil companies developing the Kashagan Field in the Caspian Sea) announced that they will decrease production. Companies' profits will fall from the export of cheaper oil, along with their tax contributions. The oil crisis will also curtail investment. Some fields and projects may be too costly to develop, and contracts, especially with service companies, may be delayed or scrapped altogether. This will impact the country's budget in terms of tax and tariff revenues from its most important economic sector. Companies, both local and international, will look for cost-cutting measures, which will affect infrastructure development and, more importantly, the workforce. Many have had their contracts terminated or stopped receiving their salaries.

Oil-exporting countries like Kazakhstan must now reach into the coffers of their oil funds. Samruk-Kazyna Sovereign Wealth Fund promised to transfer money to the state budget but also warned that this year's losses could dent its sustainability. Analysts expect Brent oil prices to stabilize at around US$30-40 per barrel by the end of the year. While Kazakhstan's government has recalculated state revenue for 2020 with an average forecast of US$20 per barrel, an imbalance remains, as most oil fields in Kazakhstan are profitable only above around US$40 per barrel. Therefore, profits will inevitably fall, with consequences for investments and jobs.

The pandemic was a major opportunity for transnational corporations to engage in social responsibility. Companies in the Atyrau and Mangistau regions bought medical equipment, built hospital facilities and delivered food supplies in villages and settlements near oil fields. NCOC plans to fund the construction of an infectious disease clinic outside Atyrau. Charitable actions are also instrumental for these companies, which can improve workers' conditions and ensure their healthy return to work once the pandemic subsides.

The pandemic had a direct effect on Kazakhstan's non-oil economy as well. According to official statistics, around 4 million people in Kazakhstan face COVID-19-related unemployment or underemployment. The government's US$100 monthly payment for people put out of work by COVID-19 is only a small patch on the gaping hole that could sink the economy if the crisis continues. In addition to the losses in the extractive sector, the pandemic will have long-lasting effects on the country's ability to return to economic growth. Banking, construction and many other industries are closely connected to the oil business, and countless villages across the country depend on the oil sector to survive. As long as oil dependency persists, Kazakhstan will continue to be one oil price slump or demand shock away from another crippling economic downturn.

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