Growing bankruptcy crisis in global oil and gas industry

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Lower oil prices have bankrupted dozens of major oil and gas companies since 2015. Moreover, a sharp increase in bankruptcies in the month of April suggests that the worst is yet to come.

A total of 69 major oil and gas companies, with $34.3 billion in debts, have gone bankrupt since 2015, according to a report released earlier this month by Haynes and Boone law firm. In April 2016 alone, 11 significant companies went under. These companies cumulatively held $14.9 billion worth of debt, making April 2016 account for 43 percent of the total bankruptcy debt since the beginning of 2015.

Charles Gibbs, a company-restructuring lawyer, told Reuters that the second quarter of 2016 would have even more bankruptcies than the first. The global consulting and professional service firm Deloitte, meanwhile, predicts that a third of global oil and gas companies, 175 corporations, are at risk of bankruptcy.

Forbes cites a Bernstein Research prediction that before 2019 there will be $70 billion in defaults in the global gas and oil industry and $400 billion worth of risky debt. So far, there has been $34.3 billion in defaults, much of that centered in “unconventional” oil and gas producers. For example, the largest failure so far has been the Canadian-listed company Pacific Exploration and Production, which mines Venezuela’s Orinoco bitumen, also known as tar or oil sands. The company had $5.3 billion in debt.

“Unconventional” fields, such as shale formations, which require hydraulic fracturing, tar sands, and deep-sea offshore reserves, have costs of production far higher than “conventional” oil. While Ghawar, the largest Saudi Arabian field, has a cost of production close to $1 a barrel, an average shale well in the Bakken field in North Dakota only begins to break even at $69 a barrel, according to a recent Scotia Bank estimate.

In 2014, Brent Crude Oil (the international standard for oil price), was a little over $110 per barrel. Since then its price has declined rapidly, descending to nearly $35 per barrel at the start of this year. The rout has devalued US energy company stocks by more than $1 trillion . The spot price, which has risen to about $47.50 at the time of writing, remains highly volatile.

At the beginning of December 2015, the downturn had already led to 250,000 workers being laid off around the world. Tens of thousands more workers have been laid off this year, with more to come.

The crisis in the oil industry is of immense significance and could spark a broader meltdown of the fragile global financial system.

Reuters writes, “U.S. oil and gas companies sold about $350.7 billion in debt between 2010 and 2014, the peak years of the oil-and-gas boom, with junk bonds making up more than 50 percent of all issuance.” By comparison, $177.1 billion in US telecommunication bonds were sold between 1998 and 2002 before the implosion of that industry. However, only 10 percent of those were junk bonds.

A larger sell-off of these bonds could cause a larger panic in US financial markets, where many institutions rely on unprecedented low interest rates to remain afloat.

The downturn in oil prices has also been accompanied by a general downturn in commodity prices, particularly for iron ore. This downturn has hurt many resource-extracting or primary manufacturing countries, such as Brazil, Australia and China, which rely on exporting natural resources and producing steel and other foundational industrial goods. This has exacerbated concerns that there could be an exodus of investment from developing countries, ultimately causing an economic crisis. In China alone, there are expected to be more than 1 million layoffs of steel and coal workers in the next two years.

The past nine years have been a state of near-permanent volatility in the oil market. Between 2004 and 2007, Brent Crude went from $20 a barrel to $147 a barrel. With the financial crisis, it then dropped to around $30 in 2009 before going back up again to about $114 in the summer of 2014 and then plummeting again to $30 in less than a year. This year, the International Energy Association is predicting the price will rise again.

The massive and historically unprecedented volatility in the oil market is an expression of the irrationality of the capitalist economic system. During times of rising oil prices, hundreds of billions of dollars are invested into new, expensive, unconventional oil techniques, such as fracking. But whenever there is a downturn in the price, this unconventional section of the oil market becomes unprofitable and investment leaves.

Rather than create a supply-demand equilibrium as neoclassical economics would predict, there is in fact a chronic imbalance between the two. One day, producers struggle to come up with new oil for an ever-expanding market, and the next day, there is too much of it and pressure is exerted to rein in production. This boom-bust cycle makes any rational planning for a sustainable energy future impossible, so long as the oil industry and the world economy as a whole run on a capitalist basis.

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