

ECONOMIC VIEWPOINT

The OPEC Crisis: Is History Repeating Itself?

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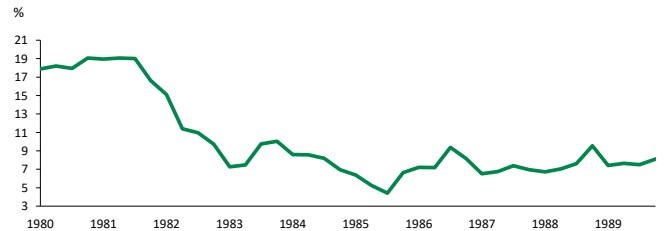
The growing disagreement among OPEC+ members about whether oil production levels should be maintained, reduced or increased has rekindled fears of another crisis within the organization. With Angola’s recent departure from the group and the introduction of a laxer production agreement, OPEC+ seems to be headed down the same path that led to the crises of 1985, 2008, 2015 and 2020. This note explores what would happen if a dispute triggered a sharp drop in oil prices. If this were to happen, all producers would be affected, but Canada and the United States would probably fare better than other countries thanks to short-cycle production, better resilience and the replenishment of the US’s Strategic Petroleum Reserve. A dispute within OPEC+ would therefore pit the group’s members against each other rather than against the US, as was the case during the 2014–2015 crisis.

A Quick History Lesson

There have been four noteworthy incidents during which the Organization of the Petroleum Exporting Countries (OPEC) either suspended production or ignored its own production agreements (graph 1). The first was the oil price collapse of the 1980s, which is still fresh in Saudi Arabia’s mind. The Iranian Revolution (1979) and the subsequent Iran–Iraq war (1980–1988) caused instability in oil prices and supply. This pushed prices up, leading to a decline in global demand. OPEC then gradually reduced its production target to prevent prices from falling too low. But several members cheated by exceeding their production quota, resulting in the price of West Texas Intermediate (WTI) falling more than 25% between 1980 and 1985. This prompted Saudi Arabia, which had sacrificed more market share than its partners in an attempt to stabilize prices (graph 2), to open the spigot in 1985. This decision, along with the challenging economic

Graph 2
Saudi Arabia Was Responsible for the Lion’s Share of Production Cuts during the 1980s Crisis

Saudi Arabia’s market share*



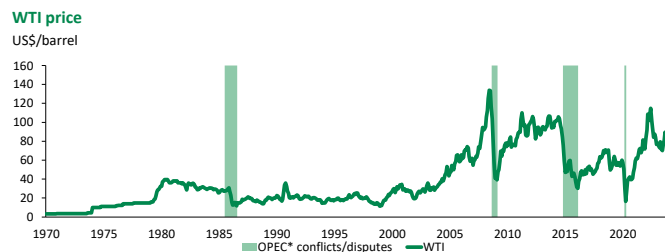
* Market share is domestic oil production divided by total global supply.
U.S. Energy Information Administration, Oxford Economics and Desjardins Economic Studies

conditions that prevailed at the time, resulted in the WTI price tumbling by more than 60% between November 1985 and July 1986.

Another conflict, albeit a more modest one, arose on the eve of the 2008 financial crisis, when OPEC members voted to scale back production in the hopes of keeping the price above US\$100 per barrel. Saudi Arabia, however, refused to comply with the production quota because it felt that oil prices needed to come down in order to bolster economic growth, which was precarious.

But OPEC’s biggest challenge since the 1980s was the 2014–2015 price collapse. Prices had been stable at roughly US\$100 per barrel for several years when a glut in supply, mainly caused by the [US shale revolution](#), drove oil prices down in

Graph 1
Tension between OPEC Members Tends to Rise When Oil Prices Fall



* OPEC became OPEC+ in 2016; OPEC+ Organization of the Petroleum Exporting Countries and its partners; WTI: West Texas Intermediate. Datastream and Desjardins Economic Studies

early 2014. Even though total OPEC production had already started to come down a few years earlier, member countries refused further cuts during their meeting on November 27, 2014, with some citing technical constraints and others simply saying it was bad timing. Once again, Saudi Arabia found itself being asked to sacrifice market share in order to stabilize crude oil prices. Drawing on the lessons learned from the 1980s, the Saudis took a firmer stance and asked the other petroleum producers to make a bigger effort. As a result, for the first time in the group’s history, OPEC members were unable to reach an agreement before their meeting ended. By March 2015, just a few months later, the price of WTI had fallen below US\$50 per barrel.

It wasn’t until September 2016 that a deal was struck by OPEC members and partners that included Russia, Mexico, Kazakhstan and 7 other countries. Representing about 50% of global oil supply, the new group adopted the name Organization of the Petroleum Exporting Countries and its partners (OPEC+). The newly established collaboration between Riyadh and Moscow was put to the test in March 2020, when the pandemic caused a historic drop in oil demand. After Russia rejected a Saudi ultimatum to cut production, a price war broke out between the two countries, dragging down oil prices. That same month, OPEC+ finally reached an agreement to cut production by a historic 9.7 million barrels per day.

The Dispute Timeline

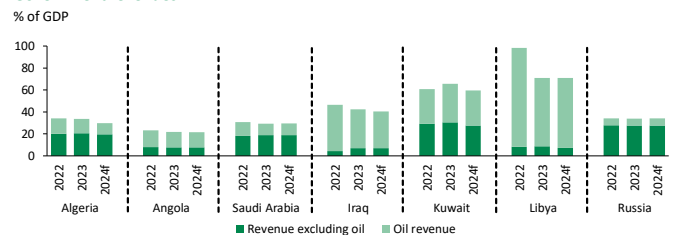
Even though each dispute is unique, there tends to be a pattern in how they unfold. The precursor seems to be falling prices, as was the case in 1980, 2008, 2014 and 2020. Price declines can happen for a number of reasons, but most often excess supply and weak demand are to blame. The cartel usually tries to stabilize prices by reducing production quotas, but this tactic often fails or is only partially successful. There are two reasons for this. The first is that market forces are simply too strong. We saw this happen in the 2010s, when US oil supply grew steadily and OPEC couldn’t do anything about it. The second reason is that members want to protect their market share as much as possible by getting other producers to reduce their output. The crises of 1980 and 2014–15 were both characterized by poor compliance with production quotas. For instance, the cartel had already been exceeding its agreed-upon target for 18 months by the time Saudi Arabia decided to step up production in December 2015.

When member viewpoints start to differ and reaching an agreement becomes harder to achieve, the group generally aims to strike a laxer-than-usual deal. Finally, Saudi Arabia is always the pivotal player in the organization and it sometimes loses patience when it has to unilaterally sacrifice a significant portion of its market share in order to stabilize prices. When that happens, the kingdom opens the taps to bring prices down quickly and force the other members back to the negotiating table.

Similarities with the Current Situation

Crude oil prices started edging downward in July 2022, prompting OPEC+ to begin voluntarily restricting output in September 2022. The cartel reduced its production by 4.5% and was somewhat successful in stabilizing oil prices, which rebounded in the summer of 2023. However, prices started coming down again in September. For several members, the combination of weaker prices and lower production quotas creates a major risk for their public finances. In Angola, Iraq, Kuwait and Libya, most government revenue comes from oil (graph 3). Each of these smaller producers stands to gain from increasing their own production to offset the effects of lower oil prices while allowing the others to scale back production. This explains why rumours about a disagreement regarding production quotas started flying last November, and Angola announced its withdrawal from OPEC+ just a few weeks later. It’s the third country to leave the group in recent years, following Qatar (2019) and Ecuador (2020).

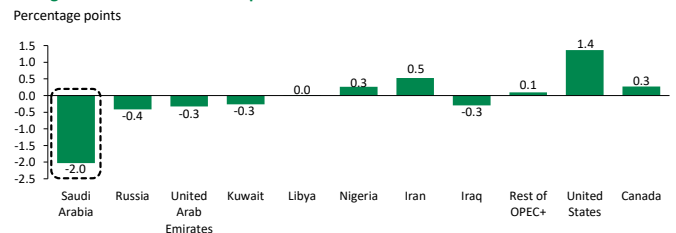
Graph 3
Revenues Are Down for Oil-Producing Countries Due to Falling Prices and the Global Economic Slowdown
Government revenues



f: forecast
 International Monetary Fund, Bloomberg and Desjardins Economic Studies

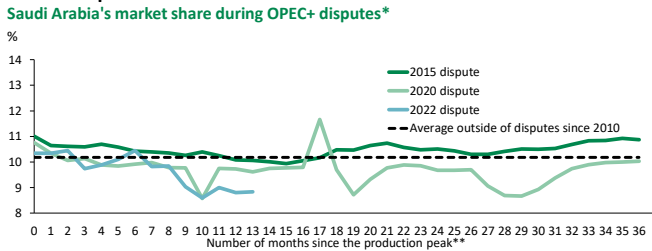
We’re now seeing the same old dilemma surface for OPEC+ and more specifically for Saudi Arabia, which has already given up more market share than all other group members combined (graph 4). Despite an agreement in early 2024 to cut production another 2.2 MMB/d, the International Energy Agency estimates that OPEC+ will actually cut less than a quarter of that amount.

Graph 4
Saudi Arabia Gave Up More Market Share than All Other OPEC+ Countries in Order to Stabilize Oil Prices
Change in market share since September 2022*



* Market share is domestic oil production divided by total global supply; OPEC+; Organization of the Petroleum Exporting Countries and its partners. U.S. Energy Information Administration and Desjardins Economic Studies

Graph 5
Saudi Arabia's Market Share Is Now below the Levels Seen during Recent OPEC+ Disputes



* Market share is domestic oil production divided by total global supply. ** Peak production dates in order: August 2018, October 2018 and September 2022; OPEC+: Organization of the Petroleum Exporting Countries and its partners. U.S. Energy Information Administration and Desjardins Economic Studies

As in the past, this flexible arrangement puts the production cut burden on the Saudis, whose market share has already dipped below the levels seen during recent disputes (graph 5).

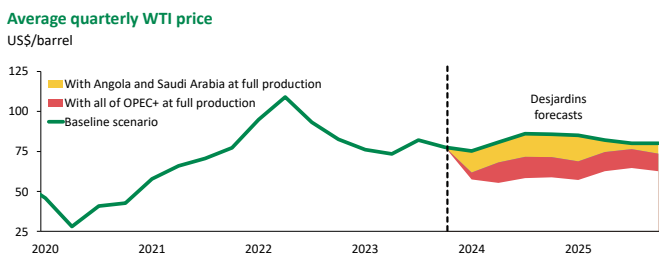
Are We Headed toward Another Dispute?

The new production cut announcement had an unexpected effect on oil prices, pushing them down instead of up. This signals the market's lack of confidence in the agreement. In other words, there are fears that some countries might keep their output too high. If this happens, there's a risk that Saudi Arabia could once again lose patience and decide to flood the market to force the other producers back to the negotiating table—a move that would put additional downward pressure on oil prices.

To assess how this might affect WTI prices, let's first consider a first scenario in which only Saudi Arabia and Angola, which no longer has a production cap to comply with, were to produce at full capacity for a three-month period. Global oil supply would surge by 3.3 million barrels per day (of which 3.2 million would come from Saudi Arabia), and the price of WTI would plunge to an average of US\$60 per barrel (graph 6). Prices would then remain approximately US\$10 per barrel below the baseline scenario until the second half of 2025.

As a second scenario, let's suppose that all OPEC+ countries go into full production capacity for three months. This would constitute a major dispute, one that we believe is very unlikely

Graph 6
Oil Prices Could Plunge If Tensions Escalate between OPEC+ Countries



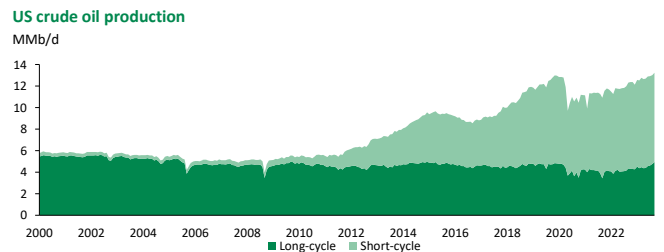
Note: Full production means that the countries operate at their maximum sustainable capacity, which is 12.2 MMB/d for Saudi Arabia, 1.1 MMB/d for Angola and 41.9 MMB/d for OPEC+ as a whole; OPEC+: Organization of the Petroleum Exporting Countries and its partners; WTI: West Texas Intermediate. Datastream and Desjardins Economic Studies

to happen. In this situation, the WTI price could come in at least US\$25 per barrel lower than in the baseline scenario, with the quarterly average falling to US\$50. However, neither of these scenarios captures the fluctuations that could arise from one day to the next, especially in a situation as unpredictable as a major dispute within OPEC+. It's also hard to predict what kinds of production agreements might be struck in the wake of these crises or how low oil prices might affect demand.

All Producers Stand to Lose, but Some More than Others

Broadly speaking, oil production can be divided into two main categories: short-cycle and long-cycle. The first allows wells to be drilled and brought on stream quickly and at a low cost, but this method requires frequent reinvestment for new well drilling. The advantage of short-cycle production is that operations can be halted quickly and easily when prices fall, then quickly restarted when market conditions are favourable again. In the United States, more than 60% of oil output comes from short-cycle production facilities (graph 7). So if prices were to suddenly drop, the US would probably slash production until things stabilized. This could, however, force some companies to close, cut jobs or scale back investment, as was the case in the 2014–2015 crisis.

Graph 7
Short-Cycle Oil Production Represents More than 60% of US Supply



U.S. Energy Information Administration and Desjardins Economic Studies

Long-cycle production has very high up-front costs, but this method requires less subsequent reinvestment. The oil sands fall into this category. Long-cycle projects take several years to develop, which leaves them vulnerable if oil prices fall below the breakeven threshold established during the design phase. In most cases, it's harder and more costly to stop production at long-cycle facilities. In Canada, roughly 70% of production comes from the oil sands. This means that a price decline could force producers to temporarily operate at a loss, as was the case during the 2014–2015 crisis. In addition, oil-producing provinces—like Alberta, which based its 2024 revenue forecast on an average WTI price of US\$78.50 per barrel—could experience a revenue shortfall if oil prices were to fall steeply. That said, Canadian producers have significantly reduced their production costs and debt levels over the past decade, which has improved their resilience.

The Ace up the US's Sleeve

In addition to relying on an advantageous production method, the United States has another major advantage: the Strategic Petroleum Reserve (SPR), which the government keeps for emergencies. After the war broke out in Ukraine and crude oil prices skyrocketed, the US government sold 45% of its SPR to stabilize prices and supply (graph 8). A few months ago, it started buying back barrels, which could ensure stability for North American producers by preventing prices from falling too far and guaranteeing a certain level of demand. Since the Canadian and US industries are highly integrated, producers on our side of the border would also benefit from this. However, the US government may take a cautious approach to the replenishment process since it doesn't want to drive up energy prices in a fragile economic environment and during an election year.

Graph 8
Replenishing the SPR Could Protect the US Oil Industry from Falling Prices



SPR: Strategic Petroleum Reserve.
 U.S. Energy Information Administration and Desjardins Economic Studies

Conclusion

OPEC+ relations seem to be following the same path that led to the crises of the recent past. If history repeats itself and Saudi Arabia moves into full production, oil prices could fall precipitously. This would have an impact on all producers, but Canada and the US would probably fare better than other countries thanks to their shorter production cycles, better resilience and the replenishment of the US's Strategic Petroleum Reserve. This means a disagreement within OPEC+ would pit the group's members against each other rather than against the US, as was the case during the 2014–2015 crisis. Lower oil prices could help trim inflation even more than expected, which in turn could prompt the Bank of Canada to lower its policy rate more quickly. That said, this isn't the first time there's been disagreement within OPEC+, and it's still possible for the situation to be resolved without resorting to flooding the market. In our view, this remains the most likely scenario.