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A Historic Agreement to Reduce Oil Production

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The understandings led by the United States, Russia, and Saudi Arabia to cut oil production are the principal multilateral measure aimed at stabilizing the global economy during the coronavirus crisis. It is expected to revive OPEC+ and build the initial infrastructure for strengthening the cartel's influence on the entire energy market. Despite the conflicting interests of the respective parties and the loose nature of the agreement, the common economic distress should help to maintain compliance in the coming months. If the crisis persists, it is possible that the understandings will evolve into an institutionalized mechanism that will contribute to less confrontational political discourse among the superpowers. The United States, Russia, and Saudi Arabia can regard the agreement as an achievement. President Trump demonstrated leadership in the international arena, and alleviated the pressure on the American oil industry. President Putin proved the importance of Russia for the global economy, and utilized the crisis to restore Moscow's dialogue with the United States. Saudi Crown Prince Mohammed bin Salman showed his resolution in the face of a Russian maneuver. A strengthened America-Russian dialogue following the agreement is likely to present Israel with an opportunity to restore Iran to the center of the international agenda. At the same time, it could also create a challenging strategic environment if Russia feels more confident in the Middle East, while the United States concentrates on internal affairs ahead of the presidential elections.

In an effort to stabilize the global oil market, the United States, Russia, and Saudi Arabia held intensive talks in recent weeks, culminating in a historic agreement whereby the expanded oil cartel OPEC+ will cut production by 9.7 million barrels of oil by the end of June. Under the agreement, the production cut is also planned to continue afterwards (7.7 million barrels a day until the end of 2020, and 5.7 million barrels a day until April 2022). Most of the cut in production is to be carried out by Russia and Saudi Arabia; each of them will produce only approximately 8.5 million barrels, compared with approximately 10 million barrels in February 2020.

Russia's refusal on March 5, 2020 to agree to a cut in production surprised the OPEC+ members and dragged Saudi Arabia into a price war. The price of oil then dropped by 50 percent in less than two weeks to its lowest point in 18 years. Low oil prices, combined with global health and economic uncertainty caused by the coronavirus crisis, ignited panic on the financial markets and the steepest fall in prices since the 2008 financial crisis. The Russians explained their refusal by saying that continued production limits by the OPEC+ countries would have enabled the American oil companies to enlarge their market shares, and that the steep cut in prices was aimed at countering this trend. Most production in the United States utilizes innovative shale oil technologies, which cost far more than oil production in Saudi Arabia and Russia, and only a price higher than $50 a barrel can allow them to make a profit. The steep fall in prices indeed dealt the American energy companies a severe blow in both revenue and the value of their shares. These companies therefore exerted pressure on the US administration to demand that Saudi Arabia and Russia halt the price war, and to impose sanctions on them.

President Trump was directly involved in the talks with the Saudi and Russian leaders, and contributed to the resolution of the dispute between Mexico and the other OPEC+ countries about the extent of the production cut underlying the entire agreement. The United States refused to commit itself to a direct cut, claiming that the market forces had already lowered the extent of production by the American oil companies, but it backed the agreement "from outside." The issue was also the focus of discussions on April 10 between the G20 energy ministers, who issued a general commitment to do everything possible to stabilize the energy markets (presumably also natural gas), and established a "voluntary" work group to monitor developments. Additional large oil producers declared their intention of restricting their volume of production, and the expectation was that the overall global cut would amount to 15-20 million barrels a day.

The immediate goal of the agreement was to prevent oil prices from falling to nearly $10 a barrel. It is also likely to prompt a price rise later, when the global economy shows signs of recovery. Since the agreement was signed on April 12, the price of oil has fallen, showing that the market had already taken the agreement into account before it was signed. A tweet by President Trump on March 30 about the emerging agreement sent the price of Brent crude oil soaring by about 50 percent within four days – from $23 to $34. It appears that the drop in the price following the agreement is due to an assessment that the volume of the production cut is significantly less than the drop in demand (a decrease of 29 million barrels a day in comparison with April 2019, according to the International Energy Agency) and the gloomy forecasts by the International Monetary Fund about recovery in the global economy.

Significance

The agreement constitutes a compromise by all of the parties, and strengthens an assessment that Russia and Saudi Arabia realized that their belligerent undermining of the price of oil in March was a strategic mistake that hurt them no less than the American oil industry. Washington, Moscow, and Riyadh, each for its own reasons, regards the agreement as a substantial political achievement that extends beyond its economic aspect.

President Trump's actions highlight the extent to which he regards preventing extreme volatility in the economic situation, especially in view of the coronavirus crisis, as critical to his success in the November 2020 presidential elections. His measures are aimed at showing the American voter that he was the patron of the deal that saved tens of thousands of jobs in the United States, without making any commitment to production cut. The American oil industry, on the other hand, may find it difficult to recover from the blow, although it is likely that the importance of the American energy independence project will require an investment by the administration in order to help rebuild the sector. At the same time, the importance attributed by the administration to saving this industry may have dragged it, contrary to its basic interests, into promoting higher prices through the cartel, after having strived to lower prices in recent years.

The Russians refuse to admit that they erred in early March by ending their previous cooperation agreement with OPEC. Yet while they are now required to make a far larger cut in production than was required from them in March, it is possible that they would have had to make a bigger cut in production in any case because of the decline in demand. As the Kremlin sees it, Russia has confirmed its importance in the global economy, and may also have laid the foundation for its long-term goal of greater cartelization of the oil and gas market. The agreement marks a new height in the reciprocal gestures between Moscow and Washington – and Putin will try to utilize it to ease the isolation and sanctions imposed on Russia by the West. The hazy reports about the dialogue between Trump and Putin suggest that they may have achieved additional undisclosed understandings. The image of Putin and Trump acting jointly to stabilize the global economy against the common enemy – the coronavirus – strengthens Russia's image as a leading global power. Finally, the revival of OPEC+ and the stabilization of oil prices have (as of now) ended the Russian-Saudi rift, and have reminded Middle East leaders that Russia wields influence on their economic stability.

Riyadh did not balk at the Russian plot, and showed the world its power and its damage potential. The kingdom, which heads the G20 this year, is portraying itself as having prevented further collapse in the global capital markets, which might have happened unless the production cut deal was reached, alongside G20 support for it. On the other hand, despite President Trump's praise of Saudi Arabia, the crisis underscored, at least among parts of the administration and Congress, questions regarding the judgment capacity of the Saudi Crown Prince.

China, the world's largest oil importer, profited from both the price war and the agreement. The fall in oil prices before the agreement helped Beijing fill its strategic reserves, thereby aiding the recovery of the Chinese economy, which is already feeling its way toward the coronavirus “exit strategy.” Even after the agreement, the price of oil is still comfortable for the Chinese, and Saudi Arabia also gave them major discounts in an attempt to exploit the crisis to increase its market share.

Many factors are still likely to jeopardize implementation of the agreement. There is little trust between the parties, the agreements are not ironclad, there is a significant temptation for breaches, and the production cut is not large enough, especially if demand continues to diminish. Nevertheless, at a time when countries around the world are turning inward and are concerned primarily with themselves, this is one of the most significant multilateral measures aimed at stabilizing the global economy since the crisis began. It is also a watershed in the history of the oil industry, with potential for the formation of a more institutionalized coordination mechanism – especially if the crisis persists and continues to hurt the world's economies.

The developments in the oil market since early March show that the crisis pushes countries into changing their previous strategic policies. The rapprochement between Moscow and Washington, especially if it expands, will pose both challenges new opportunities for Israel. Even if the American-Russian détente materializes only in part, Israel can attempt to return the multi-faceted Iranian problem to the center of the international agenda and influence it with political and military measures, especially in the northern theater. On the other hand, the concentration by the Trump administration on internal affairs as the presidential election campaign proceeds is likely to afford Russia greater confidence in the Middle East, which in turn could challenge Israel's operational freedom of action in the northern theater.