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A. Madita Rabe

# Why did OPEC lose its price setting power during the 1980s?

## The need for a political economy perspective

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## The need for a political economy perspective

A. Madita Rabe
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## Abstract

Since the surge in oil prices during the 1970s, there was an increased academic interest in explaining the formation of oil prices and the critical role played by OPEC in this process. A variety of economic models were established to explain the rise of price setting power by OPEC reflected in the massive price increases. During the 1980s, however, against many projections, the surge in oil prices came to a hold and from the 1980s on started to decrease, finally collapsing in 1986 to an unprecedented low. These developments were surprising to many observers and theorists struggled to explain what happened. The paper looks at this phenomenon of the decline of OPEC by posing the question 'why did OPEC lose its price setting power during the 1980s?'. I argue that economic approaches alone are inadequate to explain the collapse of OPEC's price setting power during this phase and demonstrate the need for a broader political economy approach which incorporates historic, political and economic aspects in the analysis. The paper accounts for the historic background of the emergence of OPEC and the political complexity on a global scale. This, I propose, allows for the power relations to enter the analysis, which are inevitably present within the global context of oil markets. This is because, first, due to the high dependence of the world economy on oil, the relations of global supplies are power-laden, and second, because OPEC from the very beginning was a political organization aiming to confront the US domination within a context characterized by colonial legacies. I outline a political economy approach to the phenomenon, which expands the view of the economic approaches by the importance of the political and historic aspects and as such allows for the analysis of global power-relations. I show that via this approach strategies of the Western powers to confront the power challenges of OPEC can be determined, which in turn had a significant impact on the decline of OPEC's price setting power by undermining Western demand for OPEC-oil.

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## 1. Introduction

Since the surge in oil prices during the 1970s there was an increased academic interest in explaining the formation of oil prices and the critical role played by OPEC in this process. A variety of economic models were established to explain the rise of price setting power by OPEC reflected in the massive price increases. During the 1980s, however, against many projections, the surge in oil prices came to a hold and from the 1980s on started to decrease, finally collapsing in 1986 to an unprecedented low. These developments were surprising to many observers and theorists struggled to explain what happened. The present paper looks at this phenomenon of the decline of OPEC by posing the question 'why did OPEC lose its price setting power during the 1980s?'. Price-setting power is here understood not in the narrow sense of OPEC acting like a cartel, unilaterally setting the price of oil, but rather in a broader sense, which – including the cartel view – ascribes OPEC an important influence on the pricing of oil in one way or the other. In this paper I argue that economic approaches alone are inadequate to explain the collapse of OPEC's price setting power during this phase and demonstrate the need for a broader political economy approach which incorporates historic, political and economic aspects in the analysis. In doing so, I account for the historic background of the emergence of OPEC and the political complexity on a global scale. This, I propose, allows for the power relations, which are inevitably present within the global context of oil markets, to enter the analysis. This is because, first, due to the high dependence of the world economy on oil, the relations of global supplies are power-laden, and second, because OPEC from the very beginning was a political organization aiming to confront the US domination within a context characterized by colonial legacies.

To answer the research question, the paper is structured as follows: Chapter 2 provides a brief overview of the historic emergence of OPEC, from the pre-OPEC period, to the founding of the organization in 1960, to its emergence during the preceding decades and its decline during the 1980s. The chapter serves to historically contextualize the period of the 1980s in light of the power struggles related to OPEC from the very beginning. Chapter 3 then looks at theoretical approaches to explain the loss of price setting power. In chapter 3.1. I start with a cursory outline of two dominant economic approaches, namely monopoly models and competitive models. These approaches render insightful explanations of the decline, however, as I argue, they fall short in grasping the complexity of the developments. Thus, in chapter 3.2. I outline a political economy approach to the phenomenon, which expands the view of the economic approaches by the importance of the political and historic aspects and as such allows for the analysis of global power-relations. I show that via this approach strategies of the Western powers to confront the power challenges of OPEC can be determined, which in turn had a significant impact on the decline of OPEC's price setting power by undermining Western demand for OPEC-oil. It should be noted that my aim here is not to provide a specific theoretical framework but highlight that a political economy perspective – in the broader sense – is fruitful to analyse the decline. Finally, Chapter 5 provides concluding remarks.

## 2. Context: A brief history of OPEC's emergence and the decline in the 1980s

Being fully aware that a comprehensive outline of the historical context of the emergence of OPEC transcends the scope of this paper due to the complexity of the shifts in geopolitics over the period of several decades, I still want to outline, what I consider the most relevant aspects. This is because I argue that an understanding of the decline of OPEC's price setting power during the 1980s can only be comprehended in its complexity when it is analysed within this historic context. The following chapter will briefly outline the genesis of OPEC, starting from the pre-OPEC period characterized by British and later American hegemony in the oil sector. Moving on to the founding of OPEC in 1960 and its emergence during the preceding decades, culminating in the sharp oil price increases of 1973 and 1978 pushed by the organization. Finally, the decade of the 1980s, which saw the decline of OPEC's price setting power, will be briefly outlined.[1]

In the pre-OPEC period, routed in colonialism, the emerging global oil market was dominated by Western imperial powers. The British dominance, especially in the oil-rich countries of the Middle East, was successively diminished by American influence. The period of 1920-1950 saw a struggle for influence in the Middle East over concession rights for oil (Motzkuhn, 2005, 47f.). Further it witnessed the rise of the so called 'Seven Sisters', seven big oil companies – five of them American – which emerged to dominate the international oil market.[2] The immense power of these big oil companies stemmed not only from the control of the production of oil, but also refineries, transport, and marketing and allowed them to set the prices for oil and thus the revenues of the oil producing states (Motzkuhn,

[1] For comprehensive historical accounts of OPEC see for instance Motzkuhn (2005), Skeet (1988), Terzian (1985) or Schneider (1983).

[2] The 'Seven Sisters' comprised five American (Gulf Oil, Standard Oil Co. New Jersey, Standard Oil Co. of California, Socony-Vacuum Oil Co. Ltd. and Texaco Co.), one British (Anglo-Iranian Oil Co. Ltd.) and one British-Dutch oil company (Royal Dutch Shell), see Motzkuhn (2005, p. 178).

2005, 184f.; Skeet, 1988, p. 222). This situation did not remain uncontested, and several attempts were made by the oil exporting countries to increase their share of profits. However, only after the Second World War, with Venezuela taking the lead, could a range of oil exporting countries renegotiate the share of profits to their benefits (Motzkuhn, 2005, p. 122). Nonetheless, leaving untouched the Seven Sisters' price setting power.

It was this price setting power of the big oil companies which eventually triggered the founding of OPEC in 1960. In August of this year the major oil companies unilaterally installed price cuts which led to the price of oil falling to its 1950s level within two weeks, causing a significant decline in the exporting countries' revenues (Terzian, 1985, p. 32). On the initiative of Venezuela and Saudi Arabia, five major oil exporting countries met in Baghdad in September 1960 at the so-called Baghdad conference, at the end of which the creation of OPEC was announced (ibid.). The founding members of OPEC were Iran, Iraq, Kuwait, Saudi Arabia and Venezuela.[3]

> "Opec was established in 1960 as a joint political initiative that responded to nationalist aspirations; these aspirations sought to alter a set of inherited obligations which limited national control over development and pricing of natural resources. The degree of perceived colonialism or independence in this arrangement varied between the states, but the revenue effect was common to them all." (Skeet, 1988, p. 222)

OPEC's aim was to confront the dominance of the Western oil companies and most importantly to put an end to the companies' ability to unilaterally set prices. In the longer term, they aimed at gaining total independence in the oil sector of their economies. The short-term aim of arresting any further erosion of oil prices was immediately successful. Never again did the companies try to change oil prices unilaterally. However, to achieve any progress with regard to the longer term aim of independence, the OPEC members had to wait another decade (ibid. 1988, p. 223). During the 1960s, apart of their success to put an end to any unilateral cut of the oil price, OPEC remained rather weak and ineffective, mainly due to internal conflicts and disparities among the member states (Motzkuhn, 2005, p. 136).

The 1970s, however, saw significant changes in the political and economic conditions. The economic situation of the 1970s was characterized by an increased demand for oil in OECD countries and at the same time pressure on supply in the aftermath of the Arab-Israeli war of June 1967 and the closure of the Suez Canal. The political condition witnessed new political

[3] Up to the 1980s further eight countries joined OPEC. These are Qatar (1961), Indonesia (1962), Libya (1962), the United Arab Emirates (1967), Algeria (1969), Nigeria (1973), Ecuador (1973), Gabon (1975).

ambition particularly among the Arab nations, resulting from their alignment in the Arab-Israeli war, the British pull out of the Gulf in 1968, and the Libyan revolution of 1969 (Skeet, 1988, p. 224). These geopolitical developments put OPEC in a stronger bargaining position, with the West being increasingly dependent on oil exports from OPEC countries, who's oil production almost doubled from 1965 to 1970 (Motzkuhn, 2005, p. 139). These changing conditions lead to a range of nationalizations of the oil companies with Libya taking the lead in the early 1970s. One after the other, the OPEC countries partially or fully nationalized the oil companies, allowing OPEC to play a decisive role in price setting and significantly increasing their share of profits (ibid., p. 138).

In 1973, events came to a head. In September OPEC demanded renegotiations of the Tripoli and Teheran agreements.[4] After the negotiations failed, OPEC unilaterally increased the prices by 70% from 3$ to around 5$ per barrel (Motzkuhn, 2005, p. 140). In December of the same year, as a response to Western support of Israel in the Yom-Kippur-war, OPEC decided on another price increase of 130% and an oil embargo targeting the respective Western countries (see Table 1).

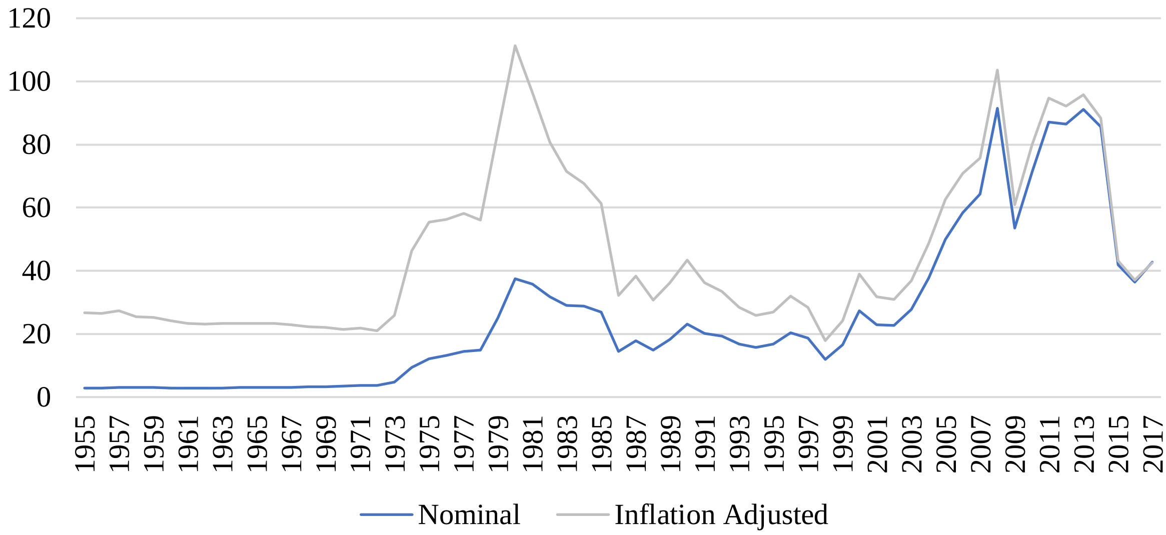


Table 1. Crude Oil Price Annual Average in US $ per barrel 1955-2017
Source: Data retrieved from US Energy Information Administration.

These events, later known as the first oil price shock, not only catapulted OPEC into the spotlight of the world public, they also marked a dramatic shift of power from Manhattan to Vienna, the seat of OPEC headquarters (Sampson, 1975, p. 15). From 1973 onwards OPEC's role changed significantly. From its founding onwards through the 1960s its role within the

[4] The Tripoli and Teheran agreements between OPEC and the major oil companies in 1971 reached higher profit shares for OPEC countries and were important steps towards the nationalization of the oil companies by raising the government share to 55%, see for instance Zündorf (2008, p. 154).

oil market was limited to negotiating prices with the still dominant oil companies. From 1973 on, it took the role of managing prices, making independent decisions (Skeet, 1988, p. 226).

The late 1970s saw further dramatic increases of the oil price following the geopolitical instability triggered by the Iranian revolution of 1979 and the Iran-Iraq war erupting in 1980. These developments resulted in disruptions of supplies in the region and an oil price panic. This would come to be known as the second oil price shock, which saw the increase of oil prices to an unknown high of 25$ per barrel in 1979 and rising even higher in 1980 to its peak of 37$ per barrel (see Table 1). The attempts of other OPEC members – mainly Saudi Arabia – to compensate for the loss of supply form Iran and Iraq did not succeed to stabilize the oil price.

From 1981 onwards, however, the oil price saw a dramatic decline from its peak within a couple of years. The decade of the 1980s was further characterized by a decrease in demand for OPEC-oil, a continuous decline of Saudi Arabia's market share and the introduction of output quotas by OPEC. Despite the attempts to restore prices, they eventually collapsed to 14$ per barrel in 1986 (see Table 1).

# 3. Explaining the loss of OPEC's price setting power through different theoretical lenses

The following chapter will look at different theoretical approaches to explain this dramatic decline of OPEC's price setting power. Since economic models are very present in the literature on the oil market, the first part of this chapter will give an overview of the dominant economic models, which offer explanations for this period. However, I argue that these approaches are too narrow to put forth an adequate explanation of the phenomenon. Therefore, in the second part of the chapter, I propose a political economy approach and highlight how it can overcome the explanatory weaknesses of the economic approaches.

## *3.1. Economic Approaches*

The economic literature on the oil market, oil prices and OPEC is broad and comprises various approaches. Many reviews of the literature have been written and most authors divide the literature into three strands.[5] These are informal models – which use no or only little mathematical specifications –, simulation models, and theoretical models. Here I will focus on the first strand because, first, the other models tend to a high degree of mathematical abstraction and aim at generating universalizable general conclusions, thus are not very suitable for an analysis of a specific historic period. And second, because the informal models lend themselves more easily to be incorporated in a political economy approach. Crèmer and Salehi-Isfahani (1989) in their comprehensive review subdivide informal models into two subareas. First, models emphasizing monopoly behaviour and, second, models emphasising competitive behaviour. In the following chapter I will outline the theoretical underpinnings and assumptions of these models and analyse the decline of the oil price in the 1980s from the respective perspective. As we will see, these models do have some explanatory power and help understand the decline of OPEC price setting power. However, I argue that they do have some significant limitations which makes it necessary to broaden the theoretical perspective.

#### *3.1.1. Monopoly models*

Models emphasising monopoly behaviour comprise the cartel model and the dominant firm model. Both strands assume that OPEC – as a whole, some group of members, or a single member – hold market power and, thus, have significant influence on setting the oil price. These approaches emerged in response to the first oil price shock in 1973, with the cartel model being particularly prominent in the immediate aftermath of the crises and the dominant firm model emerging during the phase of relative stability towards the 1980s.[6] There has been great discussion in the literature on which model, or which specification of these models, suits OPEC behaviour best (e.g. Böckem, 2004, p. 1355). Nonetheless, the cartel model remains the more prominent one, therefore, due to limited space, the following section will focus on the cartel model.

In the textbook version of cartel theory, a cartel is comprised of a group of producers which reduce supply cooperatively with the aim of raising the prices and, thus, their profits.

[5] See for instance Crèmer and Salehi-Isfahani (1989), Mabro (1998), Gately (1984), Griffin (1985) and Griffin and Teece (2016).

[6] For one part cartel models see for instance Böckem (2004), Loderer (1985), Griffin (1985), Jones (1990), Youhanna (1994) and Gulen (1996). For two or three part cartel models see for instance Tourk (1977), Hnyilicza and Pindyck (1976) and Griffin and Steele (2014). For dominant firm models see for instance Adelman (1993), Griffin and Neilson (1994), Alhajji and Huettner (2000) and Dahl and Yucel (1991).

Figure 1 depicts a simplified version of the theoretical assumptions of the cartel theory. By way of cooperatively reducing demand to point $Q_2$ the cartel moves the supply curve away from the market condition, depicted as $S_m$, towards $S_c$ and thereby achieves the higher price $P_2$. For a cartel to function, it is necessary that it agrees on a desired price path and the respective output must be distributed among the members in a binding manner. One of the greatest challenges, which leads to an instability of cartels, is the incentive to cheat. According to the prisoner's dilemma prominent in game theory, each member faces an incentive to raise their own profits by unilaterally lowering the prices or increasing output (Griffin & Neilson, 1994). Hence, for a cartel to function it is necessary that an effective monitoring is in place and that defectors can be adequately punished to enforce discipline.

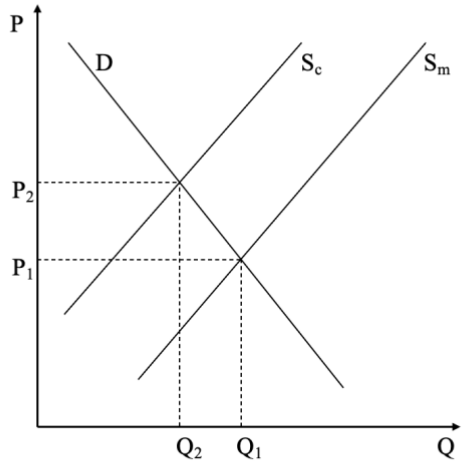


Figure 1. Quantity and Price under market and cartel condition.
Source: Authors own illustration.

Although OPEC was frequently referred to as a cartel from the 1973 price hike onwards, it did not start acting as a 'textbook' cartel before 1982 when it introduced output quotas for the first time, due to the pressure of declining demand and excess supply. However, the allocation system failed to restrict collective output and cheating in the form of price cutting and overproduction was a widespread phenomenon (Skeet, 1988, p. 202). Two major problems of cartels arose in this context: the inability to detect defectors, and the inability to punish the respective members. There were attempts to allow for a functioning monitoring by the establishment of a Ministerial Executive council to supervise compliance with price and output quotas. However, due to a lack of disciplinary powers and cooperation from OPEC members, the initiative failed (Crèmer & Salehi-Isfahani, 2013, p. 41). The problem to confront cheating by the establishment of a punitive system was never even addressed. Hence, OPEC had to rely on indirect punishment, i.e. the threat of overproduction. The problem of cheating became so severe that Saudi Arabia, which absorbed other members' overproduction to ensure stable prices, saw its market share decrease significantly, as to a point that its output declined from 10mbd in 1981 to only 2.7mbd in 1985 (ibid., p. 40). In late 1985 Saudi Arabia decided to adopt netback pricing and flooded the market with cheap oil in order to regain its market share. This led to the final collapse of the oil price in 1986. From the perspective of cartel theory this decision can be interpreted as Saudi Arabia punishing other members for defecting, in order to enforce discipline among OPEC members (Griffin & Neilson, 1994).

To conclude, from the perspective of cartel theory the decline of OPEC's price setting power can be explained as a failure of the cartel to function due to the high incentive of cheating, which, in general, is seen as causing the instability of cartels. This is, first, because OPEC failed to successfully establish a monitoring system, and second, a punitive system to guarantee for discipline among the members. This situation led to a successive decrease of prices which culminated in Saudi Arabia's decision to flood the market with cheap oil. This decision, from the perspective of cartel theory can be explained as a punitive measure to enforce discipline among the OPEC members.

As seen, the cartel theory offers a rather plausible explanation for the loss of price setting power during the 1980s. However, the view of OPEC as a cartel was heavily contested in the economic literature, most importantly because OPEC only started acting as a cartel during the early 1980s and failed significantly. Before, no quotas or coordinated agreements were in place. Further, in retrospect it can be stated that the harsh decline of the prices of oil did not lead to the dissolution of OPEC as proclaimed by cartel theory (see Table 1). Nonetheless, cartel theory points to an important aspect of the analysis, i.e. the internal conflicts among member countries, which are all but homogeneous in their characteristics and interests. However, it explains these in merely economic terms, relying on the simplistic assumption of rational agents who maximize their profits. Further, by focusing on the internal organization of OPEC, the theory contains an important blind spot, that is the international context in which OPEC operates.

### *3.1.2. Competitive models*

Another strand of models are the so-called 'competitive' models. Other than the models presented in the previous section, they emphasize competitive rather than a monopoly behaviour. Most of these models were developed as a response to the lack of output restrictions by OPEC before 1982, which does not conform to the cartel assumption and was represented in the cartel model's poor performance in predicting oil price paths. Crémer and Salehi-Isfahani (2013) comprise three strands under these models: First, the backward bending supply curve model, second, the property rights model and third, the supply shock model. The focus here will lie on the backward bending supply curve model, since it is regarded as the most suitable for the purpose of this paper.[7]

Based on the assumption of limited absorptive capacity, several scholars argued that OPEC had no incentive to increase production at high prices and thus, cannot easily be regarded as a cartel during the 1970s and 80s. Crèmer and Salehi-Isfahani (1989) proposed a formalization of this argument with the backward bending supply curve model. They argue that the price increase of the 1970s did not lead to excess supply which had to be 'absorbed' by OPEC members in order to keep prices high. On the contrary, they propose that OPEC countries face a backward bending supply curve which lead to multiple equilibria on the oil market (see Figure 2). Thus, explaining the stability of OPEC during the 1970s, which was contrary to the cartel approach's predictions of a rapid decline due to the instability of cartels. The shape of the supply curve is based on constraints on the use of oil revenues for investment, consumption, and external lending. That means, that at a certain level the oil price leads to an excess of revenues which cannot be profitably used by the respective countries, thus, triggering a 'perverse' effect on supply. Within this framework the ascribed role of OPEC shifts from output coordination to the formation of expectations as it provides a forum where leaders can regularly discuss their plans. Expectations on price paths are important here, as producers will only limit production if they expect an increase of prices to be permanent rather than temporary.[8]

[7] The property rights model explicitly seeks to explain the price rises of the early 1970s by the shift of property rights from the Western oil companies to OPEC governments, see for instance Johany (1979), Mead (1979) and Odell and Rosing (1983). Hence, it does not lend itself for an explanation of the decline of OPEC's price setting power during the 1980s and is, thus, not included in this paper. Supply shock models explain the fluctuations in oil prices by historic or political events, see for instance Weiner and MacAvoy (1983), Verleger (1982) and Moran (2015). However, they do not attempt to explain these events, rather they are regarded as exogeneous to the economic model.

[8] In the case of temporary price increases producers would rather increase production in order to profit from the temporary high prices, which in turn leads to a rise in supply and thus a decrease in prices.

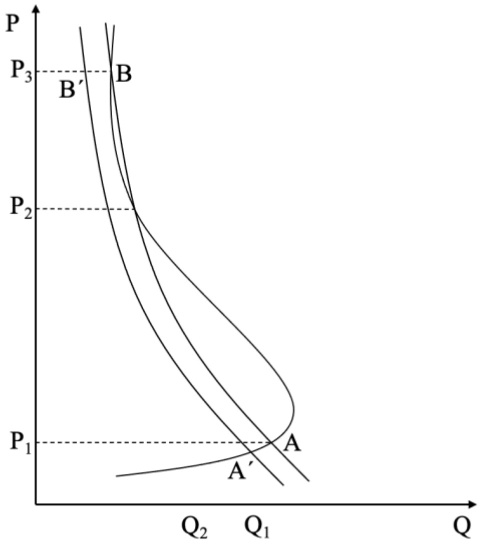


Figure 2. Backward bending supply curve
Source: Authors own illustration based on Cremer 2013 p.46; 1989 p.432.

This model explains the decline in oil prices during the 1980s by the emergence of excess supply caused by a shift of the supply and demand curve (see Figure 2). This shift implies that only one equilibrium (the low price) remains, hence forcing OPEC members to start coordinating their action. This is precisely what they started doing *only* in 1982, without much success. Hence, in this interpretation the reason for the decline of oil prices is not that the cartel ceased to function, as the authors argue that OPEC never actually acted as a cartel. However, that OPEC did not get hold of the severe price drop was due to its inability to act like a cartel in circumstances that required coordinated action. [9]

This model highlights structural elements of the oil market, rather that internal organizational structures within OPEC as the cause of the price drops. Crémer and Salehi-Isfahani propose that these shifts of the supply and demand curve were the result of conservation measures in oil importing countries and an increase in the absorptive capacities of exporting countries. However, they fall short on analysing the causes of these shifts of supply and demand, thus the explanation remains rather vague. Nonetheless, the emphasis on the structural elements of the oil market point to an important level of analysis.

[9] One could argue that this implies that OPEC never had any price setting power. However, using a wider notion of price-setting power, also in this model OPEC is ascribed a price setting power before the 1980s as it managed to move prices towards the high price equilibrium, despite not acting as a cartel.

### 3.2. Political Economy Approach

As seen, economic models help to understand some aspects of the decline of OPEC's price setting power during the 1980s. The internal conflicts among OPEC members certainly played a key role in this phase, as well as the changes in the structural elements of the oil market, most importantly a significant decline in the demand for OPEC-oil. However, through the exclusive focus on economic aspects, these approaches fail to put forth a sound explanation taking into account the complexity of the causes of the decline of OPEC's price setting power during the 1980s. I propose that a political economy perspective is more suitable for this inquiry, as it emphasises an interdisciplinary approach comprising economic *and* political perspectives while situating it within the respective historical context. Crucially, a political economy approach highlights the importance of global power relations, which undeniably play a key role when looking at a resource that forms the basis of the current economic system and, thus, of Western economic development and dominance. My aim here is not to propose a specific theoretical framework to analyse the phase in all its details, as this would extend the scope of this paper. What I propose is, however, that a political economy approach – more broadly – can be fruitfully applied to explain, in a more comprehensive manner than purely economic approaches, why OPEC lost its price setting power during the 1980s.

"Opec as an institution obtained independence in as real a sense as by now all its individual members had detached themselves from colonial ties." (Skeet, 1988, p. 226)

In this quote Skeet points to an important aspect, i.e. that situating the emergence of OPEC within its historic context and the prevailing power-relations means to link it to colonialism. During the 1960s decolonization was still an ongoing process and the dominance of Western Powers on the world stage was not limited to the oil market alone. Colonialism divided the world along colonial power-relations which after decolonization live on in the colonial legacies, leading to a North-South divide of "developed" and "developing" nations. OPEC was precisely an attempt of some part of the so-called Third World to gain power over their natural resources, in the narrow sense, and political and economic independence in the broader sense. At the latest with the unilateral massive price increase, OPEC emerged as a serious threat to Western hegemony. With increased Western dependence on oil in general and on OPEC-oil in particular, the price shock hit the Western world sensitively and caused a severe recession of the world economy. Further, it was OPEC that was leading the push for a dialogue between the industrialized world and a then unified 'Third World front' on problems of raw materials and development. This eventually initiated the call for the establishment of a ‘New International Economic Order’ at the UN General Assembly in 1974 (Seymour, 1980, 257f.). Hence, OPEC, with its emerging power over oil, had a sensitive tool at hand and used it to lead Third World countries to confront the dominance of the Western Powers.[10] This emergence of the countries of the Global South was not left unchallenged by the Western Powers and I argue that it was precisely this struggle for power that had important implications for the decline of OPEC’s price setting power during the 1980s. These power relations only enter the analysis once one broadens the perspective, away from an exclusively economic approach towards a political economy approach.

In the following I will look at strategies used by Western Powers to undermine the newly achieved power by OPEC. Since, due to the loss of direct control over the oil resources in OPEC countries and, thus, the loss of price setting power, they had to find other means to diminish their dependence on OPEC. For it was precisely this dependence of Western countries on OPEC-oil what formed the basis of OPEC’s power in the broader sense and its price-setting power in the narrow sense.

One of the first responses of Western countries to the unilateral sharp price increase of the 1970s was the establishment of the International Energy Agency (IEA) in 1974 mainly driven by US president Nixon. The IEA’s explicit aim was to decrease the dependence of OECD countries from OPEC-oil by establishing strategic reserves in the member countries (Motzkuhn, 2005, 147f.). Further, OECD countries adopted energy conservation policies in order to decrease their demand of oil and, thus, to restore some kind of control over the oil market (ibid., 398f.; van Vactor, 1978). Another strategy was to push for alternative oil production sites (Bromley, 2005, p. 235), which lead to an increase of non-OPEC oil production as illustrated in Table 2. When looking at the market shares, the magnitude of this shift becomes even more apparent: between 1975 and 1985 the share of non-OPEC production increased from 48% to 71% most importantly due to new reserve discoveries in Mexico, the North Sea and the Soviet Union (Fattouh, 2007, p. 7).

[10] It is important to note that the NIEO in the long run did not achieve its promises and that the initial unison among OPEC members and other countries from the Global South was not to last very long, see for instance Hunter (2020, p. 266). However, for the points made here this is not of greater importance, since during the 1980s this was still mainly the case.

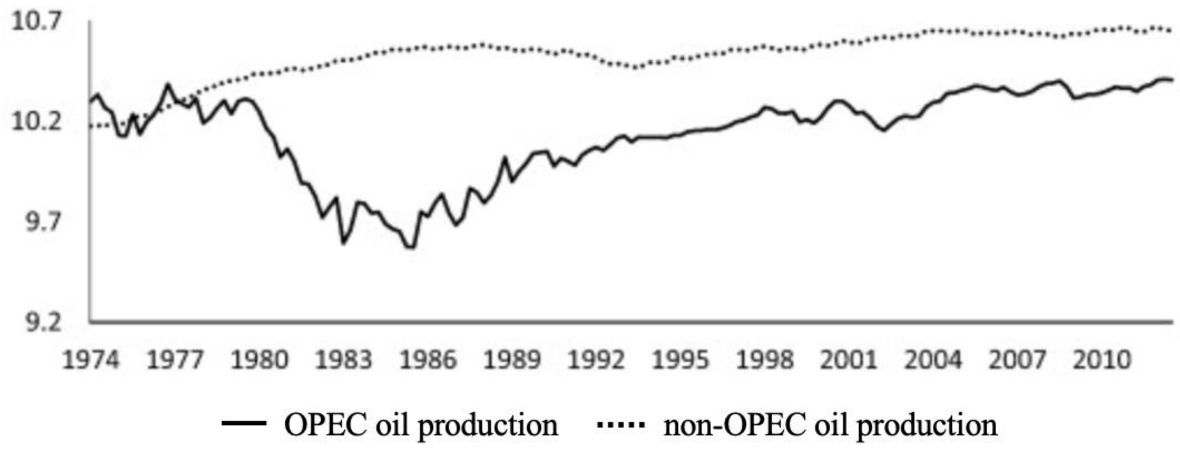


Table 2. OPEC and non-OPEC oil production (in logs of million barrels per day) 1974-2014
Source: Adjusted on the basis of Ratti and Vespignani (2015, p. 365)

Further, Western countries pushed for substitutes for oil to decrease their dependence on OPEC-oil (Bromley, 2005, p. 235). As Table 3 shows the 1980s witnessed a sharp decline of oil consumption while other sources experienced a steady increase.

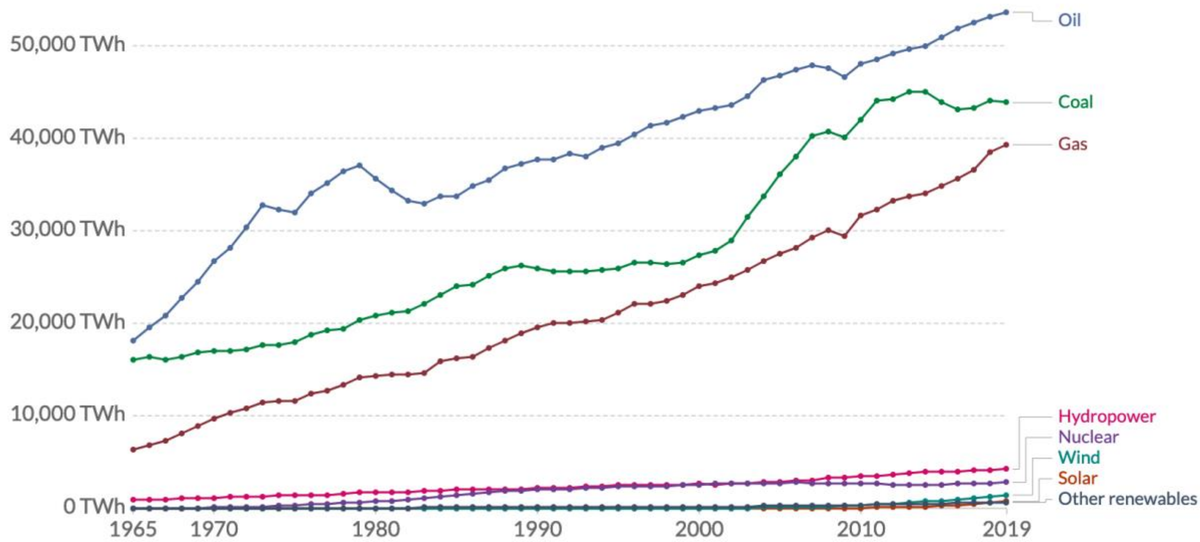


Table 3. Primary direct energy consumption by source, World, 1965-2019
Source: BP Statistical Review of World Energy, see Oxford University (2021)

These strategies by Western countries to reduce their dependence on OPEC worked effectively to limit the demand for OPEC-oil during the 1980s and weakening OPEC's market share decisively (Table 2 and 3). Hence, the economic conditions of supply and demand changed significantly for OPEC during the 1980s. This made coordinated action necessary in order to keep the oil price at a high level. However, internal conflicts and divergent interests of the very heterogeneous members of OPEC inhibited the agreement on and the discipline to abide to a successful strategy to preserve the oil price. Further, Western countries accelerated the internal conflicts among OPEC members, weakening their unity and trying to prevent the formation of a solid Third World front (Hunter, 2020, p. 266).

## 4. Conclusion

OPEC’s emergence during the 1960s and particularly the massive oil price increases of the 1970s which resulted from its newly gained price setting power were surprising for many observers. Even more so was the sharp decline of oil prices during the 1980s and OPEC’s inability to get hold of them. A wide range of scholars tried to find answers to this puzzle, most prominently economists who, if we simplify it, either explained the loss of OPEC’s price setting power as an unravelling of the cartel, or with external shifts in the oil market resulting from a significant drop in demand for OPEC-oil. In this paper I have taken a look at the major economic theories and their explanation of the decline of OPEC’s price setting power and argued that purely economic theories are too narrow to put forth an adequate explanation for the complexity of the processes during the 1980s. Undeniably, the recessions of the years following the oil price shocks played an important role in the decline of demand for OPEC-oil. Further, there is no doubt that the inability of OPEC to coordinate their action in the context of changing oil markets played another crucial role in the decline of OPEC’s price setting power – whether or not it can be understood as a cartel in the preceding years. But this alone does not give a satisfactory explanation, especially not if one only looks at the economic aspects of rational profit maximization as put forth by cartel theory.

I proposed that a political economy approach, which combines political *and* economic perspectives and embeds them in the historic context, are fruitful to overcome these shortcomings. I have shown that this approach allows global power relations to enter the analysis, which are of importance when analysing a commodity as important for the current system of production and consumption. While incorporating the vital aspects highlighted by the economic approaches (internal conflicts and systemic aspects of the market), it allows us to understand the global struggle for power as an important context of OPEC’s loss of price setting power. It helps us understand OPEC in the context of colonialism and colonial legacies and herewith as a rising threat for Western dominance in the global system. The emergence of OPEC and its attempts to unite the Third World, with oil as a crucial tool to confront the Western Powers, was not left unanswered. As shown, a range of strategies were put in place by Western powers to reduce their dependence on OPEC-oil, which formed the basis of OPEC's price setting power in the first place.

To conclude, the decline of OPEC's price setting power was the result of the complex interaction of economic, political, and historic developments. Economic theory is useful to understand important aspects of this decline, however, due to its exclusive focus on economic aspects and the narrow economic methodologies, it cannot fully grasp this complexity. A political economy perspective provides a framework to analyse these complex interactions and, importantly, allows global power relations to enter the analysis. While this paper has shown that such an approach is fruitful, it remains rather illustrative. As it would have exceeded the scope of this paper, it must be left to future research to use and adapt specific theoretical frameworks which allow for more scientific rigour and a more detailed analysis, not only of the decline of OPEC's price setting power during the 1980s, but also the oil market and its inherent power relations more broadly.

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