Oil's decline is proving to be the worst since the collapse of the financial system in 2008 and threatening to have the same global impact of falling prices three decades ago that led to the Mexican debt crisis and the end of the Soviet Union.

Russia, the world's largest producer, can no longer rely on the same oil revenues to rescue an economy suffering from European and U.S. sanctions. Iran, also reeling from similar sanctions, will need to reduce subsidies that have partly insulated its growing population. Nigeria, fighting an Islamic insurgency, and Venezuela, crippled by failing political and economic policies, also rank among the biggest losers from the decision by the Organization of Petroleum Exporting Countries last week to let the force of the market determine what some experts say will be the first free-fall in decades.

“This is a big shock in Caracas, it's a shock in Tehran, it's a shock in Abuja,” Daniel Yergin, vice chairman of Englewood, Colorado-based consultant IHS Inc. and author of a Pulitzer Prize-winning history of oil, told Bloomberg Radio. “There’s a change in psychology. There’s going to be a higher degree of uncertainty.”

A world already unsettled by Russian-inspired insurrection in Ukraine to the onslaught of Islamic State in the Middle East is about be roiled further as crude prices plunge. Global energy markets have been upended by an unprecedented North American oil boom brought on by hydraulic fracturing, the process of blasting shale rocks to release oil and gas.

Cheap Gasoline

Few expected the extent or speed of the U.S. oil resurgence. As wildcatters unlocked new energy supplies, some oil exporters abroad failed to invest in diversifying their economies. Coddled by years of $100 crude, governments instead spent that windfall subsidizing everything from 5 cents-per-gallon gasoline to cheap housing that kept a growing population of underemployed citizens content.

Those handouts are now at risk.

“If the governments aren’t able to spend to keep the kids off the streets they will go back to the
streets, and we could start to see political disruption and upheaval,” said Paul Stevens, distinguished fellow for energy, environment and resources at Chatham House in London, a U.K. policy group. “The majority of members of OPEC need well over $100 a barrel to balance their budgets. If they start cutting expenditure, this is likely to cause problems.”

**Costs as Benchmark**

Oil has dropped 37 percent this year and, in theory, production can continue to flow until prices fall below the day-to-day costs at existing wells. Stevens said some U.S. shale producers may break even at $40 a barrel or less. The International Energy Agency estimates most drilling in the Bakken formation -- the shale producers that OPEC seeks to drive out of business -- return cash at $42 a barrel.

“Right now we’re seeing a price shock coming out of the meeting and it will be a couple of weeks until we see where the price really falls,” said Yergin. Officials “have to figure out where the new price range is, and that’s the drama that’s going to play out in the weeks ahead.”

Brent crude finished last week around $70, and New York oil near $66. Brent is now at its lowest since the financial crisis -- when it bottomed around $36.

**Not All Suffer**

To be sure, not all oil producers are suffering. The International Monetary Fund in October assessed the oil price different governments needed to balance their budgets. At one end were Kuwait, Qatar and the United Arab Emirates, which can break even with oil at about $70 a barrel. At the other extreme: Iran needs $136, and Venezuela and Nigeria $120. Russia can manage at $101 a barrel, the IMF said.

“Saudi Arabia, U.A.E. and Qatar can live with relatively lower oil prices for a while, but this isn’t the case for Iran, Iraq, Nigeria, Venezuela, Algeria and Angola,” said Marie-Claire Aoun, director of the energy center at the French Institute for International Relations in Paris. “Strong demographic pressure is feeding their energy and budgetary requirements. The price of crude is paramount for their economies because they have failed to diversify.”

Brent crude is poised for the biggest annual decline since 2008 after OPEC last week rejected calls for production cuts that would address a global glut.

Like this year’s decline, oil’s crash in the 1980s was brought on by a Saudi-led decision to defend its market share, sending crude to about $12 a barrel.

**Russia Vulnerable**

“Russia in particular seems vulnerable,” said Allan von Mehren, chief analyst at Danske Banke A/S in Copenhagen. “A big decline in the oil price in 1997-98 was one factor causing pressure that
eventually led to Russian default in August 1998.”

VTB Group, Russia’s second-largest bank, OAO Gazprombank, its third-largest lender, and Russian Agricultural Bank are already seeking government aid to replenish capital after sanctions cut them off from international financial markets. Now with sputtering economic growth, they also face a rise in bad loans.

Oil and gas provide 68 percent of Russia’s exports and 50 percent of its federal budget. Russia has already lost almost $90 billion of its currency reserves this year, equal to 4.5 percent of its economy, as it tried to prevent the ruble from tumbling after Western countries imposed sanctions to punish Russian meddling in Ukraine. The ruble is down 31 percent against the dollar since June.

This Will Pass

While the country’s economy minister and some oil executives have warned of tough times ahead, President Vladimir Putin is sanguine, suggesting falling oil won’t force him to meet Western demands that he curb his country’s interference in Ukraine.

“Winter is coming and I am sure the market will come into balance again in the first quarter or toward the middle of next year,” he said Nov. 28 in Sochi.

Even before the price tumble, Iran’s oil exports were already crumbling because of sanctions imposed over its nuclear program. Production is at a 20-year low, exports have fallen by half since early 2012 to 1 million barrels a day, and the rial has plummeted 80 percent on the black market, says the IMF.

Lower oil may increase the pain on Iran’s population, though it may be insufficient to push its leaders to accept an end to the nuclear program, which they insist is peaceful.

‘Already Losing’

“The oil price decline is not a game changer for Iran,” said Suzanne Maloney, senior fellow at the Brookings Institution, a Washington-based research organization, who specializes on Iran. “The Iranians were already losing so many billions of dollars because of the sanctions that the oil price decline is just icing on the cake.”

While oil’s decline wrenches oil-rich nations that squandered the profits from recent high prices, the world economy overall may benefit. The Organization for Economic Cooperation and Development estimates a $20 drop in price adds 0.4 percentage point to growth of its members after two years. By knocking down inflation by 0.5 point over the same period, cheaper oil could also persuade central banks to either keep interest rates low or even add stimulus.

Energy accounts for 10 percent to 12 percent of consumer spending in European countries such as France and Germany, HSBC Holdings Plc said.
**Nigerian Woes**

As developed oil-importing nations benefit, some of the world’s poorest suffer. Nigeria’s authorities, which rely on oil for 75 percent of government revenue, have tightened monetary policy, devalued the naira and plan to cut public spending by 6 percent next year. Oil and gas account for 35 percent of Nigeria’s economic output and 90 percent of its exports, according to OPEC.

“The current drop in oil prices poses stark challenges for Nigeria’s external and fiscal accounts and puts heavy pressure on the exchange rate,” Oliver Masetti, an economist at Deutsche Bank AG, said in a report this month. “If oil prices remain at their current lows, Nigeria will face tough choices.”


The nation is running a budget deficit of 16 percent of gross domestic product, partly because much of its declining oil production is sold domestically at subsidized prices. Oil is 95 percent of exports and 25 percent of GDP, OPEC says.

“Venezuela already qualifies for fiscal chaos,” Yergin said.

**Venezuelan Rioting**

The country was paralyzed by deadly riots earlier this year after police repressed protests about spiraling inflation, shortages of consumer goods and worsening crime.

“The dire state of the economy is likely to trigger renewed social unrest, while it seems that the government is running out of hard currency,” Capital Economics, a London research firm, wrote in a Nov. 28 report.

Declining oil may force the government to take steps to avoid a default including devaluing the currency, cutting imports, raising domestic energy prices and cutting subsidies shipments to poorer countries in the region, according to Francisco Rodriguez, an economist at Bank of America Merrill Lynch.

“Though all these entail difficult choices, default is not an appealing alternative,” he said. “Were Venezuela to default, bondholders would almost surely move to attach the country’s refineries and oil shipments abroad.”


In an address on state television Nov. 28, President Nicolas Maduro said Venezuela would maintain social spending while pledging to form a commission to identify unnecessary spending to cut. He also said he was sending the economy minister to China to discuss development projects.

Falling crude demand and prices in the early 1980s helped send the nation into a debt crisis.

Oil's share of Mexico's exports fell to 13 percent in 2013 from 38 percent in 1990, even as total exports more than quadrupled. Electronics and cars now account for a greater share of the country's shipments. Though oil still accounts for 32 percent of government revenue, the Mexican government has based its 2015 budget on an average price of $79 a barrel.

Related reading:

Oil Seen in New Era as OPEC Won't Yield to U.S. Shale Oil Bust of 1986 Reminds U.S. Drillers of Price War Risk OPEC Refusal Means Oil Industry's Weakest Producers Left Behind

To contact the reporters on this story: Gregory Viscusi in Paris at gviscusi@bloomberg.net; Tara Patel in Paris at tpatel2@bloomberg.net; Simon Kennedy in London at skennedy4@bloomberg.net

To contact the editors responsible for this story: Alan Crawford at acrawford6@bloomberg.net

Timothy Coulter, Ken Fireman

©2014 BLOOMBERG L.P. ALL RIGHTS RESERVED.