A Future for OPEC

*By Paul Tempest**

Summary and Contents

Fortified by relief and exuberance at the return of the market to $20-30 oil, there has been much talk within OPEC of further tightening of its member production quotas. How far can OPEC go? How does OPEC view the wider global macro-economic issues and prospects? To what extent do the current condition and prospects of the global oil market present new risks and new opportunities for the member-countries of OPEC and other leading oil producing countries? These questions lead to a much broader issue–whether OPEC can play in future years a much expanded role as a strong stabilising force in the global economy.

This paper looks at OPEC's prospects in the light of its own actions since its foundation in 1960 and in the light of recent developments in the global economy and markets. The events of the last forty years should give some clear pointers for future action. OPEC's standing is again high. The need of the industry–as well as the need of the global markets and the global economy–for OPEC has again been amply demonstrated over the past year.

The Global Need for OPEC

In 1999, the oil and gas industries were unable to resolve on their own the structural damage and policy dilemmas of a steeply falling oil price. Even the largest companies were faced with the possibility of dismemberment or forced acquisition. The oil price collapse threatened not merely the curtailment of new energy investment world-wide but also a disruptive check to global economic growth.

OPEC's price stabilisation actions in both 1986 and 1999 have, therefore, earned the organisation considerable prestige, as well as a right to a significant voice and useful lever in the future conduct of global economic policy. A closer OPEC involvement in natural gas development and trade, and a strengthened role in market management, together with a jettisoning of the sterile and exaggerated consumer-producer confrontations of the past would seem to be sound ways forward. There are other options under discussion.

A Difficult Path Ahead

OPEC's enhanced position comes at the right time. The latest global and regional environmental, commercial and trading proposals emanating from the United States, West Europe and Japan appear to inflict a heavy environmental and payments burden on many countries of the developing world and on the other smaller OECD economies. For the OPEC countries, these latest proposals have even more severe impacts. They seem to imply a damaging distortion of the terms of trade as well as further isolation from the global economic mainstream and, by implication, deteriorating global leverage.

In the face of these developments, there is again a need for a wider understanding of the issues and for broad agreement on how to secure an acceptable and effective compromise. Policy priorities need to be established to prevent, for example, the exclusion of many countries from the World Trade Organisation, severe distortion in tropical agricultural exports, or the prevention of the further transfer of the most polluting heavy industries from the industrialised to the developing world. Strong leadership will be needed. OPEC may once again be called upon to play a valuable macro-economic role in this process.

OPEC Leadership

The OPEC countries are still the key custodians of the global petroleum resource, the key mineral resource of the global economy, at least for the next few decades and probably for much longer. OPEC as an organisation has also had wide experience over the last forty years and is an adept economic and commercial operator with considerable political understanding.

The main lesson of OPEC's early years was that OPEC leadership provided inspiration and support for the entire developing world. Here was a genuinely global institution comprising key country-members from the Middle East, North and West Africa, Latin America and South-East Asia which was capable of standing up to the super-power governments and the formidable weight of the major multinational corporations and financial institutions.

OPEC retains today its wide undiluted geographical distribution and its multi-cultural character. It deserves to command the respect of the very many countries it is supplying with oil and natural gas, and, indeed, the esteem of all the many players in the global energy markets.

Past Successes and Consequences

OPEC shifted rapidly from the strategies of price control (P) to those of Quantity or Volume (Q). At the outset, reliance on direct action on the posted price to increase tax revenue increased expectations of steadily increasing OPEC government revenue which proved difficult to sustain. In addition, OPEC pricing became a target of consumer countries free trade and anti-cartel legislation.

In October 1973, a partial oil delivery embargo on the United States and various European countries, together with further production constraints and widespread consumer panic, helped to drive oil prices up very sharply. In 1979, the impact of the revolution in Iran had a similar effect on consumer confidence, resulting in another sharp price rise.

The ensuing wave of global inflation and recession caused severe debt problems in the developing world. The OPEC producers were also quickly faced with sharp declines in oil and gas revenue while at the same time their enhanced appetite for imports, particularly arms, and for infrastructure development showed little sign of abatement. Accumulating debt became the central economic management problem throughout the developing world. As soon as the cushion of financial reserves had been exhausted in each of the OPEC states, they also found themselves grappling in the eighties with increasingly acute budgetary and debt constraints. The combination of lower market share and lower prices gave little hope of any alleviation.

The Consequences of Further Confrontation

If the OPEC member states were to decide today that the

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only remedy for their current financial problems lies in another bout of extreme outright confrontation on price whether directly or by means of massive cuts in oil production, they would run much greater risks than in the confrontations of the seventies. The market response would again probably be rapid and savage and might prove ungovernable if a domino effect caused the difficulties to spread from state to state.

The main problem today in the OPEC countries is that most of their governments have been too preoccupied with “protecting the golden goose”–maximising oil and gas revenue in the short-term to resolve their acute budgetary and debt problems. They have lost sight of the broader long-term benefits and political dividends of improved economic and social management. They have also become more isolated from world markets and the free flow of trade and capital. In these circumstances, they need to re-examine the benefits of opening up to much wider co-operation for new investment. They need to be leaders in the rapid expansion in global petroleum production in which, in cost and resource terms, the OPEC states deserve to have by far the largest share.

OPEC is Moving in the Right Direction

What then is the downside risk of an OPEC/Consumer confrontation, of another global economic slowdown, and consequently of another political, economic and social firestorm in the OPEC states ?

I think the risks are small because moderate and sensible policies have already been seen to prevail and to bring more sound solutions of long-standing durability. Moreover, in addition to the self-correcting character of all free, open markets, there are now effective market safety-nets in place. On the producer side, OPEC has demonstrated both its determination to rescue the market from low-prices and its ability to cool steeply rising demand by expanding production. On the consumer side, the United States provides a model of how planned sales from the Strategic Petroleum Reserve or other government or commercial stocks can be used to moderate excessive upward surges in price.

Further Globalisation is Likely to Strengthen OPEC

Over recent years, the OPEC member countries have shown only limited enthusiasm for the rapid globalisation of world markets. The oil market has moved a long way from the secret long-term contracts at fixed prices agreed essentially between each producer government and a very limited number of rich and market dominant multinationals whose credit and financial reserves were beyond all question. Today, there are very many players in the market. Arbitrage works easily and automatically through the market. Margins have been squeezed. Inefficient operators have been eliminated. Supply has become much more regionalised. Even the three new super-majors now tread cautiously.

If the market continues to expand, there will be ample demand for oil and gas from OPEC and that demand will be largely free of the political and strategic intervention which came with it in the past.

Above all, the widening of the oil market makes the market more not less robust and that is likely to work in favour of OPEC, particularly in the long-term as the OPEC economies open up much more widely to international capital and trade.

Keeping up with the New Technology

The globalisation of oil, gas, commodity, capital and other financial markets has brought the disciplines of the global market to bear on even the most isolated of oil and gas producers. Their need to keep up with the ever-advancing new technology of petroleum exploration and production can no longer be pushed to one side by entrenched industry conservatism or by ossified bureaucracy or by misguided ‘command’ direction by the government. Access to international finance is also becoming essential in all high-cost marginal areas. Even the high-reserve producer countries of the Gulf are conscious of the risk of lagging behind in the race for new technology and they are all having difficulty in mobilising adequate marginal finance.

It would be foolish to delay such high-technology investment. While the short-term future of conventional oil and gas production is very bright, the longer-term prospects deserve careful evaluation.

Energy Long-Term Fundamentals

Above all, there is now an increasingly wide consensus that the development of heavy crudes, tar-sands and oil shales will enhance and prolong oil production just at the same time as gas to liquids, coal-bed methane and other new gas technology will give a major stimulus to gas production. If OPEC were to deter inward investment, much of this new petroleum development activity may be diverted outside the current OPEC membership.

OPEC’s former expectations of once again dominating the oil market and again becoming the most significant factor in determining the oil-price may, therefore, be badly flawed in the longer term. OPEC expectations were based on assumptions of depleting and declining global supplies of petroleum and ever-rising demand. These supply assumptions are now very widely challenged. Indeed recent studies of long-term prospects commissioned by the International Agencies point to a peaking of global oil production in about 2060 at about double current levels and a peaking of global natural gas production somewhat later at about five times current levels. Some may argue that this level of increase is exaggerated, but very few now believe that, for a very long time, despite environmental pressures, overall petroleum production is likely to stagnate or decline. Even in the short term, the industry is working on expectations of a 2% p.a. increase in global oil demand and even higher rates for natural gas.

China and the Hydrogen Economy

Over the next twenty to fifty years, we will witness the arrival of much more efficient hydrogen fuels and the mass production of vehicles and power modules based on fuel cells and other chemical engines, requiring much less petroleum and, eventually, none at all. China, given its imminent explosion of demand for private sector vehicles of all kinds and also its pressing need to alleviate urban pollution and rural poverty while minimising rising oil import dependence, is likely to provide the major initial stimulus and may quickly capture the manufacturing leadership role in these new technologies as well as finding a new source of economic and trading strength in the form of vehicle and chemical engines exports world-wide. India may not be far behind.

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So, however the oil supply balance might now be swinging markedly in favour of OPEC in the short-term, this does not mean that OPEC can expect to distort the balance to its own long-term economic advantage. If OPEC were simply to pursue its traditional confrontational role in the global energy markets, its prospects would appear to be very bleak indeed.

This probable long-term weakening of OPEC leverage and its inability to influence all or particular sectors of the petroleum market may prompt the organisation to review what it has learnt from its operations and experience over the first four decades of its existence and to identify its unique strengths.

U.S.–Saudi Symbiosis of Long-Term Interest

It is very difficult to envisage any change to the overall direction of the oil market. On the producer side, Saudi Arabia, holding one quarter of global proven oil reserves is the obvious counterpart to the United States, which accounts for one quarter of global oil consumption. A symbiosis of interest between Saudi Arabia and the United States–both principally motivated by a common concern for economic and political stability–is likely to prevail.

Setting the Market Parameters

These factors seem to translate into a signal that anything below $15 today spells danger, and that any price approaching the $10 level requires action.

A similar parameter can be constructed if prices shoot up much beyond $30. Here, the interest of the United States is in avoiding major global inflation and, as in the 1980s, a slowdown in global economic activity. Any serious disruption in the supply of internationally traded oil in the Gulf, as in 1986-88 and 1990-91 is enough to trigger well co-ordinated consumer responses, both military and political.

The Main Lesson of 1986 and 1999

The main lesson of 1986 and 1999 is, in my view, rather different. It is that OPEC not only learnt to survive in a flood of non-OPEC oil and gas and through tough political and military conflict between members, but that it has gradually won the fundamental argument with the consumers that it is much better for the world economy to have a stable oil price and smooth flow of development than to allow the free market to produce very sharp imbalances and fluctuations in price, particularly if these fluctuations are exaggerated by speculation and consumer panic resulting in long-term damage to the industry and making new long-term investment much more difficult and much more costly. Indeed, OPEC has won world-wide a grudging admiration for its actions in 1986 and 1999, when the international oil industry was brought to its knees by low oil prices and when even the very largest companies found themselves facing up to the prospect of collapse or dismemberment.

OPEC, therefore, has a firm foundation on which it could build a new and highly legitimate role in the global community.

Let us, therefore, look at the key strengths of OPEC and how they might be developed.

Resilient Market Strength

OPEC's market share peaked in the early seventies (see Table 1) at over half global oil production. Thanks to the stimuli given to non-OPEC production by the steep price rises of the seventies, OPEC market share fell back to below one third by the mid-eighties. It is now likely to rise to 37.6% in the year 2000.

The above figures include all oil produced and consumed at home as well as for export. If we look solely at the export figures, we immediately see a very different picture : OPEC still accounts for some two-thirds of global exports of crude and about one-third of global exports of product. In the international oil trade, OPEC, as an aggregate of its members and provided it can achieve unity in its purpose and co-ordinated action, is still very powerful indeed.

Table 1
Global Oil Market Share

		OPEC*	NON-OPEC
At Ten Year Intervals			
	1960*	39.4%	60.6%
	1970	49.3%	50.7%
	1980	43.7%	56.3%
	1990	37.8%	62.2%
	2000**	37.6%	62.4%
The Oil Price Discontinuity Years			
UP	1973	53.1%	46.9%
UP	1979	47.9%	52.1%
DOWN	1986	32.4%	67.6%
DOWN	1999**	37.2%	62.8%

*OPEC members as at 1.1.2000

** Estimate

OPEC Cohesion and Leadership

Throughout the last forty years, OPEC has developed quite remarkable cohesion and its survival has often demonstrated mature and intelligent leadership.

It has survived two major price collapses and a persistent decline in its market share. Even during the eight years of the Iran-Iraq war (1980-1988), Iranian and Iraqi delegates sat shoulder-to-shoulder in OPEC meetings. During the period of the Iraqi occupation of Kuwait (1990-91), both countries continued to be represented at OPEC. In both periods, cohesion was maintained by sensible compromise to the lasting credit of OPEC diplomacy and astute strategic planning.

Effective Decision-making

OPEC decision-making is more straightforward than it might appear. The organisation was founded in Iraq, thanks mainly to the co-operation and inspiration of two individuals, Perez Alfonso of Venezuela and Abdulla Tariki of Saudi Arabia. The other two founding member-countries were Iran and Kuwait. To this day, although OPEC is scrupulous in allowing all members to have their say and, wherever possible, to proceed by unanimous consensus, any controversial OPEC decision begins–in effect–with the views of these five founding members. The leadership of the organisation still turns on Saudi Arabia's ability to secure the support of, first and foremost, Iran. Venezuela has also repeatedly made a major and mature contribution to OPEC thinking.

Continuity of Membership and Direction

There have not been many changes in OPEC membership.

While a total of eight other petroleum exporting countries later joined the organisation, Ecuador and Gabon dropped out, leaving a total of eleven countries at present–Algeria, Indonesia, Libya, Nigeria, Qatar, and UAE plus the five founding members. If Oman can be persuaded to join, the Arab Gulf states will move from a five-country, 45 percent share of the membership to a six-country and 50 percent of the membership. This share would, of course, be diluted if OPEC ever persuaded other major oil exporters such as Colombia, Mexico, Norway or Russia to join. However, this does not seem to be very likely at present.

In terms of the structure of the present organisation, Mexico, Norway, Russia and Colombia are likely to continue as sympathetic onlookers. Further defections appear unlikely.

A Valuable Bridge

Another remarkable success of OPEC has been to weld political extremes–extreme right and extreme left–into effective co-operation.

OPEC has also always provided a useful channel of communication to some of the most inaccessible and difficult regimes in the world: Algeria, Nigeria, Venezuela and Indonesia when they were in the midst of acute turmoil at home; Iran, Iraq and Libya grappling with United States and UN sanctions, Kuwait under occupation. For most of the teams of oilmen, dealers, diplomats, arms salesmen and others in the lobbies of the hotels around an OPEC meeting, what OPEC decides or does not decide is of relatively little importance. These hangers-on are there to have discreet and easy access to Ministers and senior officials, whose accessibility at home is severely constrained. Similarly, the company traders are there in strength as this is where many of the deals with the national oil companies are done and the contractual arrangements agreed.

The Public Face of OPEC has Changed

As outlined above, throughout the last forty years OPEC has been widely regarded as an umbrella or screen to give added legitimacy to the market intervention of its two leaders, Saudi Arabia and Iran. The other members were happy to go along with this, so long as each could see the demonstrable benefits of concerted action, and while the real economic pain of limiting output and thereby foregoing immediate revenue fell principally on the two leading countries. Some of the internal squabbles of the smaller members faced with mainly hostile consumer response were re-ignited in1999 with the new OPEC calls for cuts in quotas and overall production constraint.

Thanks mainly to the inspiration and leadership of former Secretary-General Dr. Subroto of Indonesia, OPEC through the 1980s and 1990s largely succeeded in shedding its confrontational image. It now presents itself as an oil producer and trade association willing always to engage in constructive dialogue with the consumer and as fully aware of the need to preserve the integrity of global markets and the free flow of goods and services across international boundaries. It reminds the press and others that its original Constitution and mandate emphasise the need for the international companies to achieve an adequate rate of return on capital employed, and for consumer governments to enjoy stable prices and security of supply.

Currently, OPEC is hunting desperately for the right arguments to accommodate well-orchestrated challenges from the World Trade Organisation and others regarding its market intervention intentions.

OPEC should be able to come up with some sound responses. But it could go much further in this direction if the key member-countries could see the long-term benefit of more co-operative policies. Among such options, natural gas may provide a route to a wider global role for OPEC.

Natural Gas Exports - A New Role for OPEC

OPEC is the Organisation of Petroleum Exporting Countries; petroleum embraces crude oil and condensates and also natural gas and natural gas liquids. So far, OPEC has focussed on the co-ordination of oil exports. It has devoted few resources or initiatives towards the natural gas sector and its leading exporters.

The rapid evolution of major trans-continental gas pipelines poses a question as to how the major gas exporters might wish to strengthen their negotiating positions. This presents some difficulties for OPEC. It is hard to see how Canada and the gas exporters of Latin America could be persuaded at present to join a global organisation located in Vienna and directed mainly from Riyadh and Tehran. Equally, the issues of liquefied natural gas supply to Japan, Korea and other markets in Southeast Asia would suggest some form of regional leadership by Australia.

This leaves the Europe-Asia-North Africa gas supply system of the future. This will turn on an inter-linked longitudinal production hub of Siberia, Caspian/Central Asia and the Gulf states, and a latitudinal production axis stretching along North Africa, from Algeria through Libya and Egypt and on through Saudi Arabia to the Gulf states and Iran.

Already, there are the two trans-Mediterranean gas pipeline routes, extensive linkages from Siberia through Eastern Europe to the Western Europe industrial heartland, links across Saudi Arabia, and from Iran to Russia. As these gradually develop into a comprehensive network extending most certainly into China and possibly to the sub-continent, there will be demands for co-ordination from the various gas suppliers. Among OPEC members, Algeria already stands out as a major gas exporter. Nor can the gas export potential of Iran be ignored, given its abundant resources and ability to provide transit facilities for other Gulf gas. Outside OPEC, despite all its current difficulties, Russia is, and will remain, the obvious leader. Norway also is likely to be very interested in keeping abreast of these developments. Iraq, as in its potential to swamp the oil market, is a wild card in Euro-Asian gas supply.

If indeed Kazakhstan, Uzbekistan, Azerbaijan, and other central Asian states follow up on their first tentative overtures to OPEC, we may well see OPEC evolving into a completely new direction and with a significant natural gas component. The consequent strengthening of Iran's position within the organisation might, in the long run and despite a distinct shift in the regional geopolitics of the Gulf, provide a welcome relief to Saudi Arabia. Any such development would likely enhance the durability of OPEC.

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Much Wider Global Producer Cooperation

Oil has been the prime fuel of global economic growth through the 20th Century. Both oil and natural gas are likely to be even more significant in terms of volume and will be slow to cede market share of the total global energy mix at least for the first half of the 21st century. As international trade in both oil and gas continues to expand vigorously, there will be a need for much closer co-operation and co-ordination at the technical and market regulatory level.

Sooner or later questions of reserve quality, volume, technical specification, storage and transportation criteria, refinery and product specifications, etc. will call for something more than informal inter-company exchanges. The global energy markets will expand strongly and need firm infrastructure. There will be new international agencies. OPEC is now well-placed to widen its activities and to develop its current technological expertise. One option might be to launch a global Petroleum Institution or Agency with United Nations recognition, serving all OPEC and non-OPEC producers. Another might be to play a much stronger role as an accredited agency of the World Petroleum Permanent Council (59 national committees, including virtually all major producers and all major consumers) or to use the expertise of the International Energy Agency based in Paris in building a stronger economic and technological OPEC expertise and management capability. Another option is a redefinition of the objectives of the OPEC Fund.

Yet another option which is in line with the world-wide trend to privatise state industries would be to align OPEC with private sector commercial practice. There may be other mechanisms to draw the leading multinationals into a much closer relationship with OPEC. An OPEC/ Petroleum Industry Council might be used very usefully in market management and in establishing new technical procedures and standards.

Conclusions

OPEC today still runs the risk of being trapped in the seventies-style Price (P) and Quantity (Q) confrontational politics which proved so sterile and, in the long-run, ineffective. On the other hand, the friendly and helpful face of OPEC as developed in the eighties and nineties and the support of the bulk of the global oil industry could lead to a broadening of OPEC coverage for both oil and natural gas producers within and outside current OPEC membership and for a widening role of technological co-operation and co-ordination of the global energy markets.

IAEE Awards Four Scholarships

The IAEE Scholarship Committee has awarded four $2500 scholarships for the year 2000. Earning these awards were Fabian Bachtiar, Alberto Elizade Baltierra, Ausra Pazeraite, and Wei-Hun Siew.

Fabian Bachtiar, who comes from Indonesia, is a senior at the University of Oklahoma, majoring in Energy Management. He has worked as an intern from both ARCO and Devon Energy and is currently producing a major paper on Phillips Petroleum for his class project.

Alberto Baltierra is a second year doctoral student at the University of Paris IX-Dauphine and IFP School. His work there concerns the articulation of Mexico into the competitive dynamics of the North American natural gas market. His earlier studies were at the National Autonomous University of Mexico (UNAM).

Ausra Pazeraite is pursuing a Ph.D. in Business and Management at Vytautas Magnus University in Lithuania while at the same time working for the Lithuanian Energy Institute. As part of her work she has participated in the development of a National Energy Action Plan and Strategy for Lithuania. Though in her early twenties, she has written solely or with colleagues nine papers and made presentations to the World Energy Council Regional Forum.

Wei-Hun Siew is a Ph.D. student at the Centre for Energy, Petroleum & Mineral Law & Policy in Dundee, Scotland. His thesis will investigate the use of modern finance and economic theory in assessing risk in an oil company's investment decision-making process. He graduated from the University of Manchester with first class honours in Finance.

The Scholarship Committee was composed of Jean-Philippe Ceuille, Michelle Foss and Peter Davies with the latter as chair. This is the second year the IAEE has awarded scholarships. In both years, $10,000 was awarded.