OPEC, The Opaque - A Valuable Political Screen

*By Paul Tempest**

"We love to expect and, when expectation is disappointed or gratified, we want to be again expecting"

Dr Samuel Johnson
1709-84

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"To bake today an OPEC pie
Take a barrel of crude. Deep fry
Red herrings. Add soft soap to the quota.
Allocate then the dough pro rata"

From 15 Poems for OPEC, 1985-91

Editor's Note:

Between 1985-91, Paul Tempest went to 15 OPEC Meetings, each lasting 3-15 days, as the on-the-spot representative of the Shell Group. For the Oil Ministers and also the press and others outside the council door in Geneva, Vienna and Brioni, it was not all hard grind. There were official and unofficial OPEC parties, excursions to the surrounding countryside, gastronomic "treats", a box at the Vienna Opera and the activities of the OPEC POETS, who, led by the voluminous Oil Minister of the UAE, strove, in their leisure time together, to reduce the proceedings and almost anything else they could think of, to light verse.

Tempest had had some oblique experience of OPEC more or less from its foundation in 1960/61 when he had been working in the Bank of England on the management of the Kuwait external reserves and later in Doha, Qatar in 1970-71 as General Manager of the currency authority covering seven of the Emirates of the Lower Gulf. In 1973/6 he was Secretary of the Bank of England's Special Oil Committee, which, under the Chairmanship of Sir Kit McMahon, handled several difficult oil-related issues, including the impact of the new oil surpluses on the London euro-dollar market and on the London banks, recycling mechanisms in the industrialised world, debt and trade impacts at home and elsewhere as well as specific infrastructure problems which emerged in Saudi Arabia and among the OPEC producers.

In 1990, OPEC published, in its 30th Anniversary Bulletin, his "OPEC – A View from the Deck" on the past, present and future of OPEC. The theme was continued in articles by him in the Oil and Gas Journal, Energy Policy, the Geopolitics of Energy and the IAEE Newsletter and in "The Politics of Middle East Oil" (Graham and Trotman, London, 1993) which he introduced and edited with chapters by Grigor Bondarevsky, Kunio and Motoko Katakura, Hermann Eilts, Melvin Conant, Sir John Moberly, Malcolm Mackintosh, Jean-Pierre Audoux, Ian Skeet, John Devlin and Murray Gart, all members of the Royaumont Group (1985-93) and including a special contribution from Ahmed Zaki Yamani.

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Introduction

OPEC has recently again come into the focus of public attention. Energy economists world-wide are again modelling its probable and possible responses to a weak market. Can OPEC again save the day?

OPEC has never been a transparent organization, operating always discreetly behind closed doors. In the United States, it is still quite widely and frequently demonized as the disruptive secretive cartel which out-witted the rest of the world in the seventies and twice imposed very high oil prices on the global economy at the cost of major economic slowdown world-wide, a global banking and international debt crisis and levels of inflation which threatened to destroy many economies in the developing world. Yet OPEC changed its stance in the eighties and its opaqueness may now be seen as a virtue.

This paper is intended as a short briefing for the newcomer on the politics of OPEC, an essential prelude to any energy economics prediction exercise. It identifies the key characteristics of OPEC as it has evolved since its foundation. It examines OPEC's current weaknesses and strengths and concludes with ten guidelines and constraints indicating how, over the next few years, within its limited scope, OPEC is likely to try to strengthen its position in the global oil market and how it is likely to respond to imbalances of oil supply and demand whenever they occur.

OPEC - A Political Survivor

My first point about OPEC is that it is essentially driven by political input and often has to struggle hard to reconcile its decisions by the use of economic logic and market common-sense. The fact that it is still with us, forty-one years after its foundation in Baghdad on 10-14 September 1960 demonstrates that OPEC is a determined and skilful survivor. It can only survive by performing a function which serves the needs and demands of its members and it can only achieve their common objectives without radically alienating the major oil consumer countries or without posing any sort of threat to global economic stability. To the surprise of many, OPEC has turned into a significant international organisation acceptable to the West.

Remember that OPEC's origin was essentially diplomatic, a producer government response to short-sighted posturing by the leading companies and to the connivance or hostility of the leading consumer countries. A joint meeting of Arab Governments in Cairo in 1958 had declared that the price of Middle East crude oil, as set by the major companies, should not be reduced without prior consultation with Middle East governments. Ignoring this in 1960, the U.S. companies with the full support of Shell, BP and CFP cut the price. The formation of OPEC was a direct retaliation to this act.

OPEC Objectives

The objectives of OPEC are defined in four fundamental points in its charter documentation:

- to co-ordinate and unify petroleum policies among member countries,
- to secure fair and stable prices for petroleum producers,
- to ensure an efficient, economic and regular supply of petroleum to consuming nations, and

- to ensure a fair return on capital to those investing in the industry.

There have been many quibbles over the years on what is meant by a fair price and a fair return, but by and large the original definition of objectives has served OPEC well. They have not needed amendment and they still look today appropriate to current needs and as good a basis as one could ask for over the next few years.

OPEC Membership and Leadership

The five founding members – Iran, Iraq, Kuwait, Saudi Arabia and Venezuela have today six other full members with them: Qatar (from 1961); Indonesia (1962); Libya (1962); United Arab Emirates (1973, from Abu Dhabi joining in 1967); Algeria (1969) and Nigeria (1971). Ecuador joined in 1973 and left in 1992 and Gabon joined in 1975 and left in 1995.

So the leading members have stuck together firmly even under very difficult circumstances. Take the Iraqi occupation of Kuwait in 1990-91 when over 1,000 young Kuwaitis disappeared into Iraq and where over 600 are still thought to be held prisoner there: almost every family in Kuwait has lost someone. Or the Iran/Iraq War of 1980-88 when - for eight years despite half a generation of young men killed, wounded, or listed as missing - Iran and Iraq sat regularly side-by-side at the OPEC meetings. Over the last forty years, several leading members including Iran, Nigeria and Indonesia have experienced major revolutions or civil war, yet they have still hung on to their OPEC membership.

There is no quibble about OPEC leadership. Originally conceived between Saudi Arabia and Venezuela, and, until 1979, shared fairly evenly between Saudi Arabia and Iran, OPEC is now firmly in the hands of the single giant in terms of global oil-exporting, reserves and production, Saudi Arabia. Moreover today Saudi Arabia can still generally rely on the support of three partners in the Gulf Co-operation Council, namely Kuwait, Qatar and UAE and requires therefore the support of only two other members to achieve a simple majority among the total membership. On some purely Gulf issues, two other Gulf members, Iran and Iraq can be expected to support the Saudis, giving a simple majority without recourse to members outside the Gulf. Decisions are almost never taken simply on a majority vote and every effort is made to achieve unanimity. Nonetheless, this weighting in favour of the Gulf states is central to the process of OPEC decision-making and is reflected in the fact that each member delegation has more or less equal space around the conference table.

The non-Gulf members have most certainly contributed a great deal to OPEC's credibility and influence, extending the membership spread to Latin America, South East Asia, North Africa and West Africa, and giving a non-regional character and non-factional face to OPEC. In this respect the membership of Venezuela most usefully bridges the gap between Islam and Christianity and between the Americas and the rest of the world. The diplomatic route from Washington, DC to Riyadh and on to OPEC's Headquarters in Vienna often still includes a stopover in Caracas while that from Europe has been known to pass from time to time through Algiers and from Japan via Jakarta .

OPEC, in 1986-88 and quite recently, has made strenuous efforts to extend its membership, most notably to Norway, Russia and Mexico as well as to half-a-dozen other smaller oil exporters. So far this has been without success, other than to secure some promises of production cuts to help enhance prices. Most significant of these was the recent (rather rash) Russian promise to cut production by 150,000 bd to match a Saudi commitment to cut Saudi production by 462,000 bd to a new quota of 7,053,000 bd.

The Management of OPEC

There are only two outstanding names in the history of OPEC:

- Sheikh Ahmed Zaki Yamani, Saudi Oil Minister (1962-86) who master-minded the oil-price confrontations of 1973/4 and 1979/80 and who, after 1979, ensured that OPEC provided a convenient political screen and endorsement for policies dictated essentially by the wishes of Saudi Arabia;
- Dr Subroto, Indonesian Oil Minister and through the late 80's Secretary-General of OPEC who is credited with securing the transformation of OPEC into an institution in lively contact with the consuming and importing countries and no longer in apparent conflict with the generally agreed global economic objectives of securing high economic growth, low inflation and, particularly, stable energy prices.

'The OPEC Camel'

Since then, OPEC has continued to function with all the characteristics of a rather disparate committee charged with preserving the status quo - a discreet defensive screen to protect the interests of its lead-member. Much smoke and chat, but not a lot of effective action. Saudi Arabia, in turn has proved responsive to prompting by the United States and other leading industrial countries both to increase production to moderate oil prices and, within a few months, to cut production to underpin them. Meanwhile, therefore, the 'OPEC Camel' has been encouraged to plod on stolidly up-hill and down through mainly waterless desert and occasional sandstorms.

Through the nineties to the present, OPEC has indeed performed a delicate and painful balancing act to try to stabilise the oil market. It has been a delicate task, in that world events and politics delivered forces and pressures far beyond OPEC's experience and competence hitherto. The process was also extremely painful in the periods when OPEC market share declined sharply and whenever, over long periods, oil prices registered a decline in real terms resulting in much reduced oil income and purchasing power for all members and a savage curtailment of investment and government spending.

Nonetheless, since April 1999, OPEC Ministers have met frequently to tweak the system by repeated adjustments to production ceilings and, as much by luck and external circumstance as by good management, they have taken most of the credit of keeping prices close to the lower target of their range. By focussing on an aggregate number with quotas adjusted in strict pro rata proportions, they have side-stepped the damaging in-fighting among members which characterised some of the earlier debates within OPEC. Old grudges, however, remain below the surface and are bound, sooner or later, to reappear. This is one aspect of OPEC's underlying preference to avoid outright confrontation between members.

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OPEC's treatment of Iraq, for example, can only be described as 'a benign tolerance' of the black sheep in the OPEC family.

Outside observers are quick to point out that agreed quotas are rarely adhered to, the degree of 'cheating' rising sharply, whenever the market comes under pressure. Nonetheless, the semblance of concerted action is often enough to steady a runaway market and that, supported by a strong lead from Saudi Arabia, has proved a most valuable regulatory mechanism in an otherwise volatile global market.

'A Thorn in the Eye'

As I have emphasised, there is nearly always a strong political dimension in the deliberations and decisions of OPEC.

OPEC will be "a thorn in the eyes of those who deviate from the right path" declared General Kassim, President of Iraq on the foundation of OPEC. Mercifully, the outright political struggles of the Middle East leading to the oil-price discontinuities of 1973/4, did not result in the "OPEC oil-weapon" being developed to serve only Middle East political interests. Indeed OPEC set a model for many other international organisations, demonstrating reasoned and informed judgment and sensitivity to the needs of the global community.

Leverage in the World Oil Market

Despite the lead-position of Saudi Arabia, OPEC does still derive great strength from an internal balance of interest, most notably between Saudi Arabia and the other Gulf states. Note, for example, that Saudi Arabia's lead-share of proven global oil reserves (25%) is more than matched by the combined share of the other Gulf states together (39.2%). Similarly, while Saudi Arabia heads the list in its 12.3% share of global oil production, the other Gulf states together count for more (15.9%). Outside the Gulf the only OPEC member with weight is Venezuela with 7.3% of reserves and 4.6% of global oil production.

Table 1
Global Oil Market Share of OPEC

	Proven Reserves End-2000 %	Production Year-2000 %	P/R Ratio Years
OPEC Gulf			
Saudi Arabia	25.0	12.3	81.1
Iran	8.6	5.2	65.7
Iraq	10.8	3.6	>100
Kuwait	9.2	2.9	>100
UAE	9.3	3.2	>100
Qatar	1.3	1.0	47.1
Total OPEC Gulf	64.2%	28.2%	-
OPEC North Africa			
Libya	2.8	2.0	55.3
Algeria	0.9	1.9	17.4
Other OPEC			
Venezuela	7.3	4.6	66.4
Nigeria	2.2	2.9	29.4
Indonesia	0.5	1.9	17.4
Total OPEC	77.8%	41.5%	74.3yrs

The five largest of the Gulf producers have very substantial reserve/production ratios – Iraq, Kuwait and UAE have over 100 years. Saudi Arabia's official ratio of over 80 could probably be doubled and Iran's reserves will last at least 65 years. Compare these ratios with those for the United States (10 years), Russia (20 years) and China (20 years).

Table 2
Global Oil Market Share of Non-OPEC

	Proven Reserves End-2000 %	Production Year-2000 %	P/R Ratio Years
Russia	4.6	9.0	20.6
USA	2.8	9.8	10.4
China	2.3	4.5	20.2
Other	12.5	35.2	-
Total Non-OPEC	22.2%	58.5%	13.4years

The P/R Ratio is the Total Proved Reserves of a state or grouping of states at the end of a year divided by the Total Production in the preceding twelve months.
Source: BP Annual Statistical Review of World Energy, June 2001.

Why The Middle East Dominates the Oil Market

If we ignore the volumes of oil production which are consumed in the country of origin and not exported, we can begin to see how dominant the Middle East is in the world oil market with over 50% of world oil exports of crude and almost 25% of global product exports.

Table 3
Global Oil Exports in 2000

	Crude Exports	Product Exports	Mbd Total
From Middle East	16.7	2.2	18.9
Global Total	33.3	9.1	42.7

The term Middle East covers the states of the Arabian Peninsula, plus Iran, Iraq, Israel, Jordan, Lebanon and Syria
Source: Oil and Gas Journal.

Idle Capacity

Non-OPEC oil producing countries maintain almost no idle oil production capacity and, given the profit and revenue pressures of the market, are unlikely ever to do so. Even within OPEC, idle production capacity is not evenly shared, with Saudi Arabia accounting for well over 50% of the total spare capacity of OPEC. The majority of OPEC states most of the time produce flat out at full capacity, whatever their quota commitments to OPEC. Compliance with OPEC is therefore rarely 100% and then often the result of external circumstance rather than specific action by government.

Day-to-day oil production and capacity data of most OPEC members are considered by their governments as 'political' and are shrouded in secrecy: the industry have to rely mainly on their own sources and are often reluctant to disclose market-sensitive information from which they derive commercial benefit.

Reliable estimates put OPEC total spare capacity at 4.1 – 7.1 mbd in mid 2001 and the number took an upward jump in September 2001 as OPEC was obliged to absorb the downswing in global oil demand, following the atrocities in New York. This surplus OPEC capacity is widely expected to reach at least 10 mbd by 2010 unless the global economy can shake itself back into a high-growth trajectory. In this, together with a probable decline in global market share, lies OPEC's greatest weakness over the next few years ahead. Nonetheless, there are also some new strengths.

Current Strengths

OPEC perceives today that it has a window of diplomatic and economic opportunity. Overall surplus capacity is small relative to the eighties and to the apparent prospects for the coming decade. It is now in a pro-active stance in the market, compared to its re-active stance in the past. It carries a new weight in the tacit acknowledgement of the United States that its actions are likely to be stabilising and not destabilising factors in the world economy. Its $22-28 oil-price target has been widely recognised as a helpful and reasonable range within the market capacity of consumers to pay and adequate for the oil industry to secure the financing of perceived levels of investment needed in the industry over the next decade. At a political level, the increased vulnerability of Saudi Arabia to terrorism from within or without the Kingdom enhances the role of OPEC as a screen and channel.

OPEC And Global Terrorism

As we have outlined in this paper, OPEC's fundamental interest is inextricably linked to a secure and stable pattern of demand and price for the oil exports of its members, This offers the best option in terms of continuing regularity in the flow of hard-currency oil revenue for each of its members. Disruption of supply as envisaged in the political embargos on the ultimate destination of OPEC oil in the Middle East crisis of 1973/4, which at that time was very widely interpreted as a form of global economic terrorism, is almost inconceivable today. OPEC's part in any renewed holding of the global economy to ransom would today impose immense strain on the cohesion of OPEC and would invite massive and crippling retaliation.

It is worth remembering that, at a personal level, not very long after the oil-price discontinuities of 1973/4, the OPEC Ministers came face-to-face in the following year with the realities of global terrorism. The seizing and kidnap of the leading OPEC Ministers by the Carlos Gang in Vienna in December 1975 had an essentially political motive, not merely one driven by the attempts of a few individuals to extract a huge ransom. It brought home to Yamani and Amuzegar, the Saudi and Iranian Oil Ministers who, at that time over several days, were repeatedly threatened with immediate execution, how extremely dangerous was the game they were playing. Today, there is absolutely no doubt that none of the current oil ministers or their political masters would wish to see similar forces marshalled against them again.

As currents of political unrest begin again to unsettle the Middle East states and are increasingly fed by new internal and external questioning of the legitimacy of the OPEC regimes, OPEC governments can be expected to proceed with caution. High unemployment, under-employment and mis-employment of a large restless new generation with high expectations focuses public attention on the current allocation pattern of oil and gas revenues, OPEC's future will, therefore, be closely linked to the fundamental if muted desire of OPEC governments to ensure the maintenance of law and order, the preservation of a stable economic and political infrastructure and the suppression of global and any other brand of terrorism.

Ten Guidelines for Current OPEC Strategy

In the light of the above analysis, what assumptions can we make to outline OPEC's likely strategy and market intervention over the next few years?

1. OPEC membership is likely to hold together with few defections or newcomers.
2. OPEC leadership will remain with Saudi Arabia. This may in fact be enhanced by the current Saudi rapprochement with Iran or tend to be eroded by further evidence of private Saudi financing of global terrorism or renewed internal feuding within the Saudi royal family.
3. Iraq's membership will continue to be held "at arm's length".
4. Saudi Arabia will continue to enjoy close and loyal support within OPEC from Kuwait, Qatar and the UAE.
5. Iran and Iraq will continue to pose problems in political terms, particularly if the United States persists with its overt policy of branding and linking Iran and Iraq (an "axis of evil") as possible targets for intervention .
6. OPEC will continue to try to stabilise the oil price by cutting or expanding agreed production quotas on a pro rata basis whenever prompted by Saudi Arabia, which in turn will continue to rely on the advice given to it by the United States.
7. Pandora's Box - while promising to do so, OPEC will refrain from any general renegotiation of country quotas, however out of line some of them become. It may attempt, half-heartedly,negotiations with one or two members on a bilateral basis.
8. OPEC is unlikely on its own to generate any extreme direct price confrontation with the consumers.
9. OPEC and its Ministers will continue for the time being to enjoythe tacit support of the EU, United States and Japan.
10. This cosy, tacit relationship could be rapidly overturned if there were any major upheavals in Saudi Arabia, if Iraq-Israel-Palestine relations deteriorated into outright war or if Iran changed track and sought to divert increasing unrest at home into confrontation with Saudi Arabia and the Gulf Emirates.

In summary, the future survival of OPEC is directly related to the need to resolve or neutralise current and future major conflicts in the Middle East. Meanwhile OPEC performs a valuable role in the global economy both as an economic regulator and as a discreet intermediary and channel of communication.

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