OPEC Is an Important Energy Policy Tool to Keep Oil Markets Stable

BY MAMDOUH G SALAMEH

The Founding of OPEC

The Organization of the Petroleum Exporting Countries or OPEC is an intergovernmental organization of 15 nations founded in 1960 in Baghdad by the first five members (Iran, Iraq, Kuwait, Saudi Arabia and Venezuela) and headquartered since 1965 in Vienna, Austria. By the end of 2017, OPEC accounted for an estimated 42.6% of global oil production and 71.8% of the world's proven oil reserves giving it a major influence on the global oil market and prices that were previously controlled by the so-called "Seven Sisters" cartel of the world's largest multinational oil companies.[1]

The stated mission of the organization is to "coordinate and unify the oil policies of its member countries and ensure the stabilization of oil markets in order to secure an efficient, economic and regular supply of oil to consumers, a steady income to producers, and a fair return on capital for those investing in the oil industry.[2] The organization is also a significant provider of information about the international oil market. The current OPEC members are Algeria, Angola, Ecuador, Equatorial Guinea, Gabon, Iran, Iraq, Kuwait, Libya, Nigeria, Qatar, the Republic of Congo, Saudi Arabia (the de facto leader), UAE and Venezuela.

The formation of OPEC marked a turning point toward national sovereignty over natural resources and OPEC decisions have come to play a prominent role in the global oil market and international relations. The effect can be particularly strong when wars or civil disorders lead to extended disruptions of supply. In the 1970s, restrictions in oil production led to a dramatic rise in oil prices and in the revenue and wealth of OPEC with long-lasting and far-reaching consequences for the global economy. In the 1980s, OPEC began setting production quotas for its member nations; generally, when the quotas are reduced, oil prices increase. This has occurred most recently from the organization's 2008 and 2016 decisions to trim oversupply.

The OPEC Reference Basket of Crudes has been an important benchmark for oil prices since 2000

Since the 1980s, representatives from Egypt, Mexico, Norway, Oman and Russia and other oil-exporting nations have attended many OPEC meetings as observers. This arrangement serves as an informal mechanism for coordinating policies.

How Influential Is OPEC?

The influence of OPEC has closely followed the peaks and valleys of the world's demand for oil. September 14, 2018 marked the group's fifty-eight anniversary — more than a half-century of existence characterized by embargo, conflict, and even war.

Today, economists and analysts debate how influential OPEC is. Conventional wisdom holds that OPEC has the world in its grasp. It can manipulate prices by tinkering with supplies. But the conventional wisdom is mostly wrong. For the most part, its actions lagged behind fundamental changes in oil supply and demand rather than led them. OPEC looks like a masterful cartel when, in fact, it is mainly just riding the waves.

Over the last five years, OPEC members have announced ever-higher price goals only after the market has already delivered those high prices. As the market has soared, OPEC has followed.

Today's OPEC, even more than in the past, is really about Saudi Arabia. The Saudis can adjust their output a bit since they are presumed to control nearly all of OPEC's spare capacity. The Saudis claim they have an ambitious plan to increase output by about one third over the coming decade, but they are finding that it will be a stretch. Their fellow OPEC members are in a similar situation, and those hard facts produce high oil prices. In fact, the Middle East members of OPEC are today producing at just the same level as they were three decades ago because none of them invested much in finding and producing new supplies. High prices into the future reflect these fundamental facts rather than the assumption that OPEC is a masterful cartel.

Decision-making inside OPEC is quite complicated most of the time. This is because the policies of its de facto leader Saudi Arabia sometimes differ radically from other OPEC members' in relation to prices and supplies.

When oil prices crashed in July 2014, Saudi Arabia decided to flood the global oil market in defiance of OPEC's time-honoured and agreed policy of cutting production to bolster oil prices. This time at its 166th meeting on the 27th of November 2014 OPEC decided under strong pressure from Saudi Arabia not to cut production.[3]

Saudi Arabia's oil strategy aimed at defending its market share, taking advantage of low oil prices to inflict damage on Iran's economy and weaken its influence in the Middle East in its proxy war with Iran over its nuclear programme and also slowing down the development of U.S. shale oil production.[4]

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See footnoes at end of text.

However, the Saudi strategy failed miserably in harming Iran's economy and disrupting U.S. shale oil production and inflicted huge damage on the Saudi economy, the economies of OPEC members and the global economy at large.

Saudi Arabia was forced to eventually discard its strategy and engineer with Russia an OPEC/non-OPEC production cut agreement whereby OPEC & Russia cut production by 1.8 million barrels a day (mbd) in support of oil prices effective the 1st of January 2017. As a result, prices have recovered from $40 a barrel to almost $80. The agreement has since been extended to the end of 2018 with talks going on about converting it into a permanent mechanism for cooperation between OPEC and Russia in what has been dubbed as OPEC+.

Anti-OPEC Bill Could Be a Game-Changer for Oil Markets

In its effort to wrest more control over global oil markets away from foreign producers, the U.S. Congress has been pushing a bill that would let the U.S. sue OPEC for an alleged oil price fixing. The bill called "No Oil Producing and Exporting Cartels Act," or NOPEC, was first introduced in May this year.[5]

Now, two Republican Senators and two Democrats introduced legislation on the 16th of July 2018 that's aimed at allowing the U.S. government to bring lawsuits against OPEC members for antitrust violations, which would be an amendment to the Sherman Anti-trust act of 1890.[6]

The Sherman Anti-trust act changed American business culture. It was the first legislation enacted by Congress to curb concentrations of power that interfere with trade and reduce economic competition. One of the act's main provisions outlaws all combinations that restrain trade between states or with foreign nations.

However, the NOPEC idea is nothing new and dates back to 2000. Both former presidents George W. Bush and Barack Obama threatened to use their veto power to halt it from becoming law. This time around, however, there is a good chance that President Trump would sign such a bill into law.[7] Trump has been critical of OPEC for years and during the 2016 presidential election that war of words escalated to the front pages of international newspapers.

While the Congress has every right to prevent concentrations of power that interfere with trade and reduce economic competition within the United States, it has no extra-territorial jurisdiction whatsoever on other countries' commercial practices. What commercial practices OPEC members agree to follow vis-à-vis their oil trade are their own affair and nobody else's. If the United States doesn't like OPEC commercial practices, then it should stop buying oil from OPEC members.

The United States has so far broken the rules of the World Trade Organization (WTO) by imposing sanctions on virtually everybody, walked away from United Nations-recognized Iran nuclear deal and also the UN-supported Climate Treaty without batting an eye lid. Moreover, the United States has been manipulating oil prices through the petrodollar and also through exaggerated claims about rises in U.S. oil production and huge build-up in its oil and refined products inventories in order to depress oil prices and achieve geopolitical and economic aims. One who lives in a glass house shouldn't throw stones.

If NOPEC ever becomes a law and the United States tries to sue any OPEC member under the NOPEC Act, OPEC members collectively could retaliate by withdrawing every single penny they keep in the United States and stop investing in the U.S. altogether. They could also nationalize American interests in their oil industries and discard the petrodollar and adopt the petro-yuan instead.

Political anger at OPEC tends to rise alongside oil prices; the first effort to use antitrust law against the oil cartel came in the late 1970s after a pair of nasty oil shocks. But subjecting foreign states to U.S. legal action is always a sensitive subject. At the time, lower courts avoided the political hot potato by ruling, among other things, that other governments have sovereign immunity from the long arm of U.S. law.[8]

Now, rising oil prices are again stoking predictable anger in Washington — prompting the same legislative exercise. "Every time gasoline prices go up, politicians scramble to see what actions they can take to provide relief for consumers," said Jason Bordoff, the director of Columbia University's Centre on Global Energy Policy. But the NOPEC bill, even if passed, would take a long time to play out in court.

Past administrations have generally been loath to turn over to the courts functions that have traditionally belonged in the diplomatic arena — including persuading Saudi Arabia and other big producers to pump enough oil for the global economy to keep humming. That's especially true because America's oil relations with countries such as Saudi Arabia must be balanced against other key interests from counterterrorism to efforts to rein in regional rivals such as Iran.

The whole debate might again be academic as it was nearly every year in the early 2000s, except for one thing: Donald Trump is now president. He supported prior Congressional efforts to revamp U.S. law to put OPEC in the antitrust crosshairs. And in recent months he has railed against the oil-exporting group on Twitter for allegedly driving up the price of gasoline.

Is OPEC Really a Cartel?

A cartel is defined as an association of manufacturers and suppliers whose goal is to increase their collective profits by means of price fixing, limiting supply, preventing competition or other restrictive practices. Antitrust laws attempt to deter or forbid cartels.[9]

While OPEC may resemble a cartel in some aspects, it is not a cartel. How could it be a cartel when it was founded as a counterweight against the previous "Seven Sisters" cartel of multinational oil companies which dominated every aspect of global oil through price fixing, limiting supplies and suppressing competition for the sole purpose of maximizing its profits.The main purpose behind the founding of OPEC was to give producers more control over their own oil.

When OPEC was founded in Baghdad in 1960, its constitution stipulated that its raison d'etre is to defend the rights of its members by ensuring a stable global oil market and stable prices. That is exactly what OPEC has been doing for the last 58 years and will continue to do so as long as it remains an organization of Petroleum Exporting Countries.

OPEC with its huge proven reserves and production capacity has every right to ensure oil prices are fair enough to provide its members with a reasonable return on their finite assets thus enabling them to explore for new oil and expand production capacity to meet global oil demand. In so doing, they are rendering a great service to the global economy from which the United States benefits. Furthermore, OPEC has never excluded competition. And the proof is that U.S. shale oil is being exported around the world.

One would expect a cartel to curb production in order to raise the price of its product as well as to share market among its members. However, OPEC has never once tried to fix a specific price nor has ever been able to achieve this goal. Wishing a certain price is totally different from fixing it. The fundamentals of the global oil market are the ones that have always determined the oil price helped occasionally by geopolitics. OPEC has no control on these fundamentals and therefore has no control on the movements of prices. It merely takes advantage of market conditions and follows the dictates of the market. For instance, OPEC was not able to prevent prices from falling in the 1980s even after it adopted the production quota system in 1982. Moreover, OPEC was neither able to temper oil prices in 2008 when prices rocketed to $147 a barrel nor was it able to stop the 2014 oil price crash. This raises the question of whether OPEC was ever able to increase the price of oil by curbing its production or whether OPEC simply took advantage of high prices caused by political problems and conflicts between some members.

However, since the economies of the OPEC members are heavily dependent on the oil revenue, they know what price they need to balance their budgets. The overwhelming majority of OPEC members need oil prices above $100 a barrel to "break even" in their budgets (see Figure 1).

When it comes to limiting oil supply, a true cartel like the "Seven Sisters" was able to do exactly that because it was virtually in control of global oil resources. OPEC has never been in such a situation. It only accounts for 42.6% of the global oil market with the rest of the oil-producing nations of the world accounting for 57.4%.

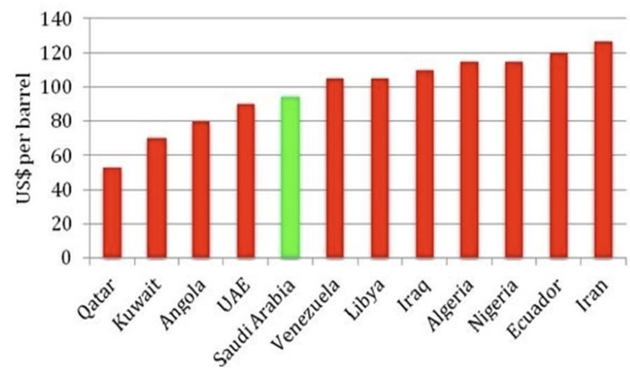

Figure 1. OPEC Median Budgetary Breakeven Price
Source: OPEC "Break-even" Prices (Matthew Hulbert/European Energy Review).

The United States and Russia both account for 12% each.

Furthermore, it was never ever the intention of OPEC to harm customers or the global economy knowingly. Any adverse impact on the global economy or on customers was merely a collateral damage resulting from international policies aimed at either undermining the economies of the OPEC members as a geopolitical tool or enabling their own economies to benefit from low oil prices at the expense of the OPEC members.

OPEC has not been involved in any disputes related to the competition rules of the WTO, even though the objectives, actions, and principles of the two organizations diverge considerably. A key U.S. District Court decision held that OPEC consultations are protected as "governmental" acts of state by the Foreign Sovereign Immunities Act, and are therefore beyond the legal reach of U.S. competition law governing "commercial" acts[10].

Still, OPEC shouldn't be unduly worried about the NOPEC Act. It has enough muscle to retaliate against the U.S. Were the United States to mount a lawsuit against OPEC or any of its members, the organization could stop all its oil exports to the U.S. and even cut its oil production to force prices up. This will harm the U.S. economy most being the world's largest consumer of oil. A case in point is Saudi Arabia's threat to retaliate against any U.S. punishment regarding the Saudi journalist's murder in the Saudi consulate in Istanbul. President Trump took the Saudi threat seriously enough to start back tracking on his threat of severe punishment on Saudi Arabia by floating the idea that "rogue killers" might have been behind the murder of the Saudi journalist.

Another measure OPEC and Saudi Arabia could take against the United States is to replace the petrodollar with the petro-yuan in their oil transactions. That would be the biggest ever retaliation against the U.S.

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