

Who Benefits From OPEC's Expansion?

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In its 143rd extraordinary meeting held in Abuja, Nigeria, on 14 December 2006, OPEC agreed to admit Angola as its 12th member, effective from January 2007. At the same time, the issue of Ecuador joining OPEC was also under consideration. This country had previously become an OPEC member back in 1973 but left the organization in 1992. The country's new president, Rafael Correa, after his election in November 2006, announced that he would make efforts to join OPEC once again. OPEC in its 147th extraordinary meeting in Abu Dhabi, UAE, announced the resumption of Ecuador's full membership of the organization. And now occasionally it is heard that some other countries are expected to join the organization.

Now, on the verge of 50th anniversary of OPEC, the question is who will benefit from OPEC's expansion? Is this expansion to the benefit of the crude oil exporters or the oil consumers? And to what extent can the advantages gained from joining OPEC encourage other exporting countries to become members of the organization? To answer these questions necessitates paying attention to a number of points as follows.

Oil consumers are usually afraid of the formation of cartels, which eliminate competition and cause maximization of producers' gain. However, contrary to mass media claims, OPEC is not a cartel. Thus, the expansion of OPEC should not cause any anxiety for the consumers. There are various factors to prove that OPEC is not a cartel. These are:

o Decision-making process in OPEC is completely transparent. Decisions are taken in the organization's official conferences and the mass media have a full role in covering these meetings. The media affiliated to the organization as well as other sources quickly inform the market and consumers about OPEC's decisions.

o In their crude oil pricing, none of OPEC members use the fixed pricing system. At present, OPEC member countries take advantage of a market-oriented pricing system. In this method, the market determines the price of the marker crude oil. OPEC member countries sell their crude oil with pre-determined differentials with respect to the price of the marker crude oil. Therefore, the final price is set by the market. Meanwhile, OPEC makes an effort to avoid a shortage or excess of supply by regulating output, in order to maintain market stability through a just price that is determined by oil market and is suitable for both producers and consumers.

o OPEC's policy with respect to prices has also officially been announced. The principle that excessively high or low prices harm both group of producers and consumers is always observed in the organization's strategy. The dynamism and complexity of oil market behavior necessitates continuous support of stable and just prices, supply stability as well as the security of supply and demand. In this regard OPEC has done its best to play its role. In reaction to the 2008 spike in crude oil prices the organization announced that factors other than the fundamental factors of supply and demand have caused such fluctuations.

o Without taking into consideration their production share, each OPEC member has an equal vote. Production quotas determined in OPEC meetings for the organization's members are based on collective agreements. Therefore, there is not any dominant member to force others to accept a certain level of crude prices or production quotas. Each member's decision is based on its sovereign right and is made in the framework of market stability.

o If the quotas are not observed by member countries, the organization does not consider penalizing the violating countries. Capacity building and production planning in OPEC member countries are sovereign decisions and are not controlled by the OPEC organization. The market is fully informed about the volume of production, including violations, through secondary sources and even OPEC members themselves.

o Since the formation of OPEC in 1960, the organization's survival and cooperation between its members have remained more and less intact. The market has also seen conditions change at various points during this period to a buyer's market or a seller's market. Even at the times of a seller's market, when producers could deal individually with the oil buyers, such cooperation between OPEC members has not come to a halt and OPEC has continued collectively to stabilize the market. This behavior shows that OPEC members believe that stabilizing the market is more important than seeking individual profit.

o OPEC and its member countries have been a pioneer of dialogue between producers and consumers. Currently, the Secretariat of the International Energy Forum (IEF) organizing such dialogues is based in one of the big OPEC crude oil producers, i.e. Saudi Arabia. In its long term strategy, OPEC has even stipulated that dialogue between producers and consumers should be more widespread with more depth in order to cover more issues of interest to both parties. Dialogues should be conducted with all producing and consuming countries, regional groups, UN institutions, the IEF, the International Energy Agency (IEA) and so on.

o In addition to its ordinary meetings, OPEC also convenes extraordinary conferences during the year. The extraordinary meetings take the necessary decisions in reaction to the market requirement. In some cases, OPEC oil ministers even take a necessary decision through telephone conversations. The extraordinary meetings are convened with the aim of informing the market that OPEC will guarantee market stability through its decisions and resolutions.

o Putting enough crude oil supply at the market's disposal is a pivotal point in OPEC's official statements. This organization has tried to avoid excess supply of crude oil to the market just as it is also avoiding creation of an artificial crude oil shortage in the market. In its long term strategy, OPEC has also declared that a market suffering from excess supply or supply shortage should be avoided.

o It is evident that OPEC's measures fail to have an impact on oil prices when crude oil prices are under the influence of non-fundamental factors. OPEC can manage to stabilize the market only through an increase or decrease in its output. In addition, under conditions when crude oil prices increase to very high levels under the said influences, OPEC will practically be unable to change the trend of the prices if its



members lack sufficient excess capacities, as was the case in the first half of 2008 when OPEC excess capacity was reduced to 1mn b/d (Table 1).

Table 1: Excess Crude Oil Production Capacity In OPEC Member Countries, 2008 (Mn B/D)

	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec
Algeria	0	0	0	0	0	0	0	0	0	0	0	0
Angola	0	0	0	0	0	0	0	0	0	0	0	0.1
Ecuador	0	0	0	0	0	0	0	0	0	0	0	0
Iran	0	0	0	0	0	0	0	0	0	0	0	0
Iraq	0	0	0	0	0	0	0	0	0	0	0	0
Kuwait	0.05	0	0	0	0	0	0	0	0	0	0.15	0.2
Libya	0	0	0	0	0	0	0	0	0	0	0.05	0.1
Nigeria	0	0	0	0	0	0	0	0	0	0	0	0
Qatar	0.03	0.02	0.04	0.05	0.06	0.08	0.1	0.11	0.13	0.18	0.23	0.3
Saudi Arabia	1.3	1.4	1.4	1.5	1.2	1.15	0.9	1	1.2	1.2	1.65	2.1
UAE	0	0	0	0	0	0	0	0	0	0.05	0	0.2
Venezuela	0	0	0	0	0	0	0	0	0	0	0	0
OPEC Total	1.38	1.42	1.44	1.55	1.26	1.23	1	1.11	1.33	1.43	2.08	2.9

Source: <http://www.eia.doe.gov>

Under such conditions, some analysts may believe that adding new members lacking excess capacity is irrational. But another point should be considered here: under such conditions, the presence of the organization of OPEC can give assurance to the market that market stability will be preserved because the floor for prices will be maintained by OPEC members in the long term. The more the number of OPEC members, the more confidence will be built. The appearance of a lot of small producers with significant combined production outside OPEC was one of a number of reasons behind the crash of prices in the second half of the 1980s. The crash of crude oil prices in the late 1980s and the weakness of prices in the 1990s brought about an unpleasant consequence for the energy industry in general and the oil industry in particular. Investments to create new capacity were surrounded by doubt because of uncertainty in those years with respect to prices and profits. The shortage of investment cast a shadow on the upstream and downstream sectors. Consequently, the oil market faced with the shortage of production capacity in both sectors. This capacity shortage was one of the fundamental reasons for prices hike in first half of 2008.

An increase in the number of OPEC members can provide more guarantee for stability of the price floor in the long term oil market perspective. After the global financial crisis since the second half of 2008, which decreased oil demand by about 1.3mn b/d in year 2009, OPEC decided to cut oil production by 4.2 mn b/d from the beginning of 2009. OPEC managed to assure the market that a reasonable price floor will be preserved, although OPEC never implemented this commitment completely. If the oil price outlook is hopeful, this sector will absorb investments, eliminating the problem of capacity shortage. The joining of new members will therefore be to the industry's benefit. And due to assurances on security of supply, consumers will also benefit. Even international oil companies (IOCs) engaged in upstream sectors of OPEC member countries will be among those who will gain. Through OPEC's expansion, IOCs will have certainty in their price outlook for investment planning. The oil market can still remember how lower oil and gas prices in the fourth quarter of 2008 dented the leading integrated majors' earnings (Table 2). Benchmark oil and gas prices decreased sharply during the quarter, averaging \$58.73/B and \$6.40/mn BTU, respectively, down from \$90.68/B and \$7.40/mn BTU for the same quarter a year earlier.

Table 2: Integrated Oil Company Results, Fourth Quarter 2008

Profits (\$M)	Exxon/Mobil		Royal Dutch Shell		BP		Chevron		ConocoPhillips	
	Q4 08	% Chg	Q4 08	% Chg	Q4 08	% Chg	Q4 08	% Chg	Q4 08	% Chg
Oil and Gas	5,634	-31	4,661	-16	4,756	-40	3,152	-35	24,25	-85
United States	699	-45	238	-76	1,209	-42	1,149	-17	191	-81
Foreign	4,935	-29	4,423	-2	3,547	-39	2,003	-42	959	-38
Refining and Marketing	2,414	6	3,822	-34	4,116	NA	2,088	920	288	-74
United States	-21	NA	-798	NA	-793	NA	1,039	NA	-6	NA
Foreign	2,434	48	1,375	74	1,151	136	1,047	304	295	90
Total Oil & Gas Profits	8,048	-23	5,243	-19	5,172	-21	5,232	4	24,00	-84
Chemicals	155	-86	-19**	NA	-1	-29	-59	-8	NA	NA
Other	-383	NA	-433	NA	-44	NA	-365	NA	-7,54	NA
After-tax Profits	7,821	-23	4,785	-26	2,381	-24	4,865	0.4	31,76	NA
Liquids Production	2,473	-3	1,659	-6	2,440	-0.4	1,707	-2	1,050	4
Natural Gas Output	9,849	-3	9,531	4	8,613	3	4,813	-5	4,899	-2
Refinery Status	5,313	-7	3,123	-18	2,032	2	1,509	2	2,463	-4
Production Sales	6,761	-3	6,403	-4	5,441	-1	3,353	-4	3,141	-0.3

Notes: † '000 b/d; ‡ Mn cfd; * BP profit figures pre-tax; **Shell refining and marketing and chemicals profits exclude one-time items. % Change is year-on-year.

Source: Petroleum Intelligence Weekly, 9 February 2009.

OPEC, in its long term strategy, has emphasized that unstable prices cause difficulty in the interpretation of signals sent by prices. It makes no difference whether such signals are indicative of the market's structural change or is resulting from a temporary phenomenon. Therefore, it is difficult to support long term market stability if prices remain unstable. In its long term strategy, OPEC has also stipulated that when the market is tight, very high prices may influence economic growth, especially in developing countries, threatening future demand growth for oil. Meanwhile, very low prices could also limit the trend of economic development and social welfare of OPEC member countries. Thus, avoidance of a market faced with excess of supply or shortage of supply is necessary. The presence of more members in OPEC would increase the organization's ability to stabilize the market. A good example regarding this issue would be the introduction of the OPEC Price Band in recent years. 1

The existence of a stable market will be in the interests of both crude oil producers and consumers. The producing countries, based on the prediction of stable revenue, could more easily embark on their economic planning for development and social welfare. The consumers will also remain secured from harsh price fluctuations that could impose unexpected costs on their economies.

OPEC is one of the oldest organizations in developing countries, having survived half a century since its establishment. In 2008, this organization possessed 79.3% of global proven crude oil reserves and was responsible for 60.3% of the world's crude oil exports. It is clear that increasing the number of OPEC member countries will reduce the political pressure on members which possess a bigger share of production to maintain a high level of spare capacity. Larger big members would not have to spend a significant portion of their oil revenue to keep online excess capacity. This task could also be shared between smaller members. It seems that from the security of supply point of view, it is best not to put all the eggs in one basket.

Undoubtedly, the continuation of the organization's survival is due to two reasons: first, the fundamental role played by oil in the world economy and second, the role of OPEC member countries in providing this vital commodity. Therefore, the importance of OPEC on the international scene can not be overlooked. This has enabled OPEC to adopt a position vis-à-vis international issues concerning oil and energy.

The environmental issue is a case that has been emphasized in OPEC's long term strategies. It is of high importance for member countries to continue their active role with respect to climatic change. And they should perform their duties in this respect regarding common principles and different responsibilities. OPEC has also requested that the international community meets commitments for minimizing the negative impact of their environmental policies on developing countries, especially oil exporting states. Providing assistance to these countries to diversify their economy, technology transfer, and capacity building can be cited as being among these commitments. Regarding anxieties related to air quality and climatic change, OPEC has always stressed the implementation of policies based on technology.

OPEC's efforts to establish cooperation with the World Trade Organization (WTO) is yet another example that can be mentioned in this regard. Based on OPEC's long term strategy, implementing an active role by OPEC in commerce has great significance, especially as far as developing countries are concerned. OPEC member countries must continue to consolidate and promote economic growth and social development using the relative advantage resulting from their natural resources. The collective interests of member countries lie in pursuing such policies. Thus, any other country becoming an OPEC member can also benefit from the outcomes and the effects of the organization's policies.

Joining new members to OPEC from different parts of world can help to build a more international image of the organization. Because of the role that the OPEC plays in the global scene, this organization is keen to be known as an international organization rather than a regional or intergovernmental one. In fact OPEC's decisions about levels of production have a global effect, because international oil markets are inter-related and oil can be transferred from one market to another. And also by building more and more sophisticated refineries, crude oil is becoming more like a homogenous commodity, so that the supply and demand of a specific type of a crude in one corner of the global oil market will affect the fundamentals of other crudes in another part of the global oil market. So it is to the benefit of OPEC to gain a higher level of international validity by taking in new members across the continents.

OPEC is highly experienced in the research and analysis of oil issues. Holding regular expert meetings in the organization's secretariat, discussing oil industry issues, identifying challenges and presenting solutions constitute a part of the duties entrusted to the OPEC secretariat. The secretariat library and documents center is a useful resource for such studies. Any new country joining this organization can use these facilities. In its long term strategy, OPEC has announced that the national oil companies active in OPEC member countries should cooperate with each other in the fields of technology, know-how and sharing their experiences. Employing advanced technology in member countries can lead to the reduction of production costs and increased recovery rates, opening new horizons. This way exploration and production can be conducted with greater success and lower costs, improving competitiveness. Increasing coordination among OPEC members is of vital importance. Cooperation must continue in the fields of technology and analysis at the highest education level. In a role identified for itself in the long term strategy, OPEC believes that it should elevate cooperation between its members and establish dialogue at the level of oil and energy ministers and national oil companies. The creation of such an attractive perspective can encourage other developing crude oil exporting countries to join OPEC.

Note:

1. See B B Alizadeh: 'OPEC Price Band Mechanism: To Repeat The Success' (MEES, 9 February 2009); and 'Signals Of A New Floor And Ceiling For Crude Oil Prices' (MEES, 7 December 2009)