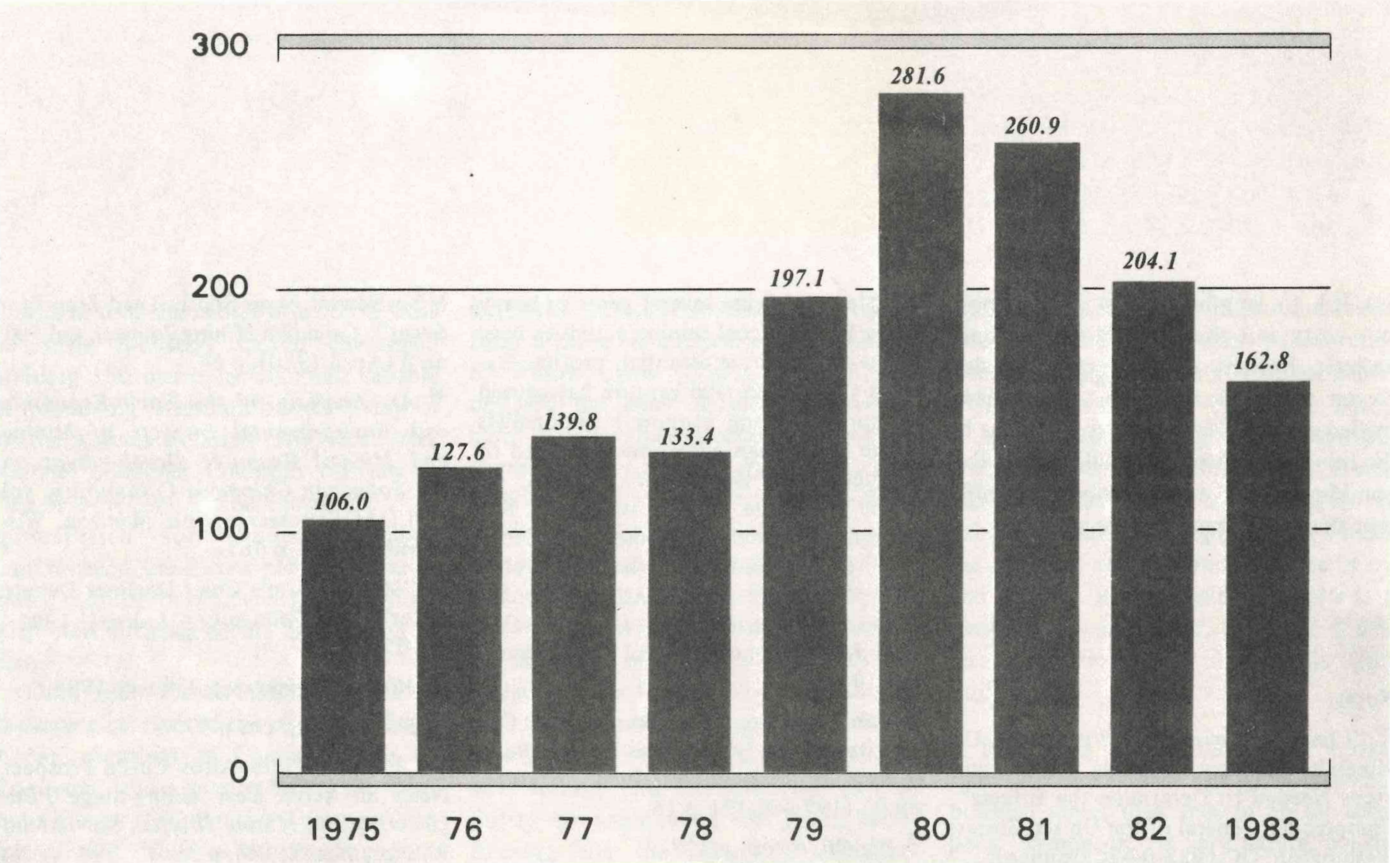
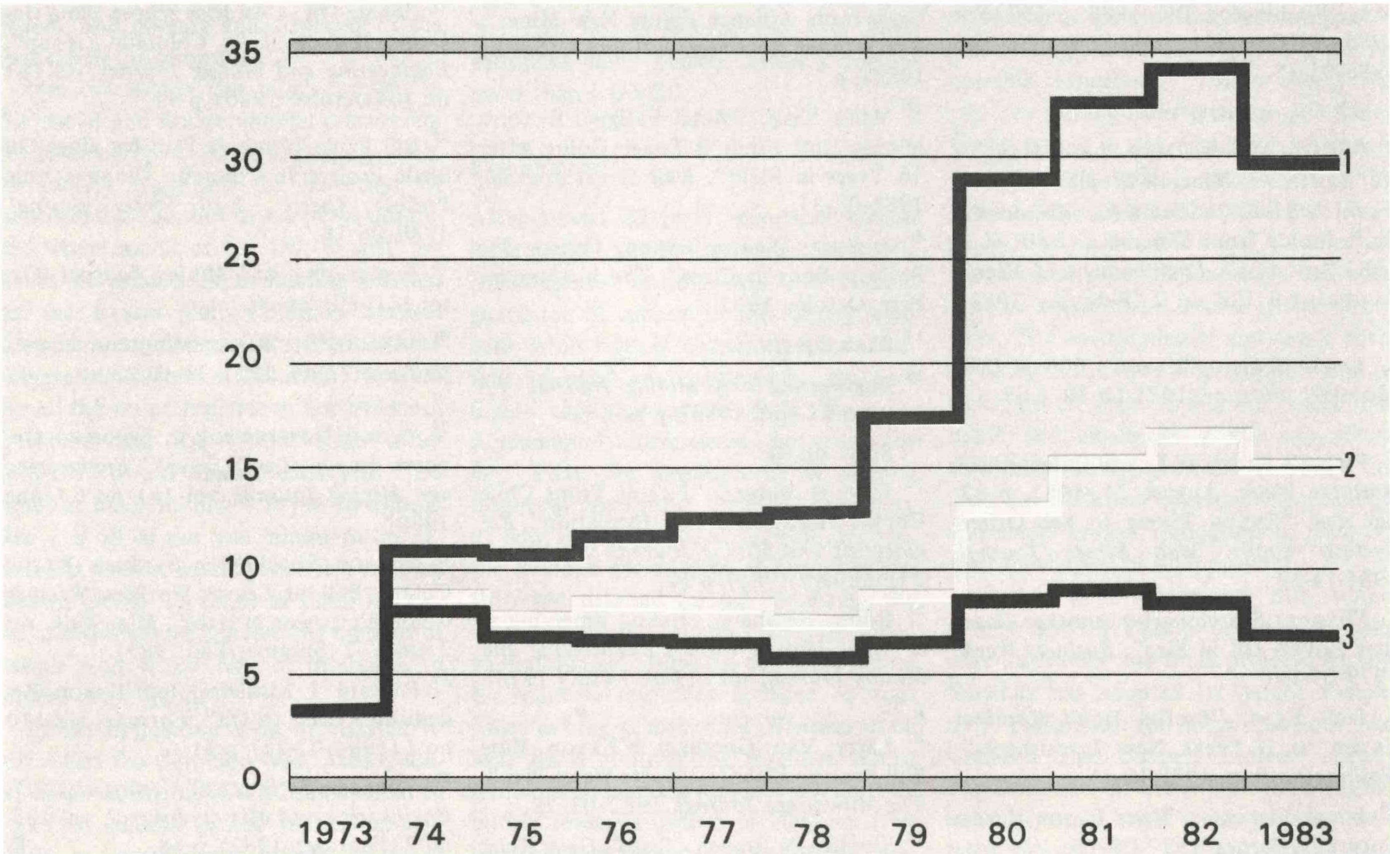
OPEC's petroleum export values 1975-1983 (G USD)



Source: *Facts and Figures, a comparative statistical analysis,* OPEC Secretariat, Vienna, December 1984.

1 Nominal price – Arabian Light price (yearly average)
2 Marker Crude price deflated by OECD export price index
3 Marker Crude price deflated by OPEC import price index

Sources: 3, 28.



Information on the world oil industry is available in a numer of OPEC-publications available from the organization's Public Information Department. Address: OPEC, Obere Donaustrasse 93. A-1020 Vienna, Austria.

SPECIAL REPORT

OPEC in crisis?

By Paul Aarts

OPEC is now perceived by many Western observers as having one foot in the grave. In this article Paul Aarts makes a critical reflection on these images of the oil exporter's organization.

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Until lately, OPEC-watchers – very much all alike – judged the international oil market in terms of "the OECD cartel that was able to bend the world to its will". However, long term developments in the energy market – reaching back to the early sixties at which time the big oil corporations started to make large scale investments in exploration and exploitation of conventional oil reserves outside the OPEC-area – led to a gradual abatement of OPEC's position of power. Even before the increase in world oil prices, the major oil companies moved to secure and tighten their grip on coal and uranium reserves, coal conversion and solar technologies, oil shale and oil sands resources, too. In the course of the 1960s and 1970s, a virtually enlarged energy monopoly was created.

Apart from the question whether a world without OPEC would have been better off (see below), the first thing we ought to do is trying to correct the deep-rooted prejudice that OPEC has been an effective "cartel". This correction will be made on both a formal level – what kind of instruments does a cartel use? – and on the level of actual developments, in particular in the field of pricing and production policies.

"In its proper sense OPEC can not be considered as a cartel", Prof Robert Mabro – not just anybody in the circle of oil specialists – once said. Even the hardly OPEC-minded magazine *Fortune* agrees on this point. Whatever kind of definition you work with, one can merely speak of a cartel if its member countries act on the basis of a common production and pricing policy, *combined with* the availability of instruments which control sticking to agreements *as well as* having at hand a strict enforcement system being able to bring defectives in harness. Pure technically spoken, OPEC has never functioned as a cartel. The first time it made a – weak – attempt to do so, was in April 1982 and March 1983 when a production ceiling was adopted, though soon followed by cheating on agreed quotas and thus scarcely effective. Last year's – and ever continuing – turmoil in the oil market can be partly explained by this phenomenon.

If OPEC is no cartel, then what is it? A definition that comes near to the mark is given by another oil expert, Prof Edith Penrose. She characterizes OPEC (from 1974 until 1981/82) as a ". . . loose oligopoly (. . .) depending fundamentally on oil producers being willing to restrain competition among themselves".[1] Thanks to the existence of a sellers' market (demand exceeding supply) the "OPEC system" was reasonably successful for some time. However, since the early 1980s the situation has changed and OPEC is being forced into an utmost defensive position.

Price follower

Thus, not only on a more formal level viewing OPEC as a cartel is inaccurate, but also the actual developments in the field of, for instance, pricing policies do not give the slightest occasion to lament about OPEC's "monopoly power". Maybe with the exception of the first jump in oil prices in 1973–74 – when one could perceive a coincidence of interests of the US government and large US oil companies on the one hand, and the oil producing countries on the other hand – OPEC never acted as a *price-setter*. The organization has been unable even to maintain the purchasing power of its petrodollars. On the contrary, it dropped rapidly during the years 1974–78 and it was not till the price rises of 1979 that the real value was brought up to the 1974-level again. Remarkably, despite regular nominal price increases, the petrodollars' real value did rise but marginally since that time (until late 1980; after that purchasing power started to fall again).

The second "oil crisis" in 1979–80 in no way resulted from an OPEC action nor from a real shortage in the oil market. Sluggishly, OPEC *followed* rocketing spot market prices by raising official prices at intervals. If OPEC were truly a cartel, it might have made use of the panic-stricken situation to reap unprecented profits. For example, Saudi Arabia, Kuwait and Iraq could have caused even larger price increases simply by not augmenting their production (counterbalancing reduced Iranian production in 1979). However, these countries took contrary action: they raised production levels in order to put a brake on the market folly. According to some observers, this prevented oil prices from shooting-up to over 50 USD.

"Free market"

So, if not OPEC is the wrong-doer, then who is responsible for the recurrent imbalances in the international oil market? This is a question frequently overlooked in most analyses. Both in 1973–74 and in 1979–80 and 1982–83 in particular, inventory policies of the oil corporations (and other large companies) induced considerable fluctuations on the spot market. Usually, oil companies' stock management follows a procyclical pattern – i e building up inventories when prices are rising or expected to rise (thus leading to a sizeable surge in demand), and drawing down their stocks when prices are falling or expected to fall (producing a sizeable surge in supplies). For example, at the time of the Iranian revolution multinational oil companies decided to increase their inventories – beyond the level of consumption – thus overheating the market and causing panic. Spot market prices reached the unprecedented level of 38 USD. Thus even though OPEC production was stepped-up (4 per cent), huge inventory building created artificial shortages of oil. In the early part of 1980 petroleum stocks' total in the OECD-countries amounted to more than 5 billion barrels, that is to say almost half of OPEC's production in 1979.

Since that time a sustained drawdown on stocks took place, resulting in an artificial surplus of oil. This led to a sagging of spot prices which ultimately forced OPEC producers to reduce their official selling prices in March 1983. In this context one can hardly overestimate the importance of the "free market". According to Texaco's president, Mr Alfred DeCrane, spot and "spot-influenced" markets now account for over 40 per cent (some sources say 60 per cent) of crude and products trade, up from just 5 to 8 per cent three years ago.[2] The *Petroleum Economist* writes:

> "This is the era of spot prices: contractual price provisions are based on them, and national downstream product price regulations use them as benchmarks (. . .) Spot prices, in turn, are bound to be strongly influenced by the cumulative global force of companies' and consumers' stock decisions. It appears that the tail is wagging the dog."[3]

Besides crude oil futures trading business – involving only 'paper' transactions – is on the rise. The inherently speculative character of this market can scarcely be expected to contribute to a well-balanced development of oil prices.

Without OPEC

What would a world without OPEC have looked like? One could conceive a number of arguments supporting the thesis that the oil dependent Western world benefitted, and continues to benefit, from the continued existence of this organization.

First, it seems plausible to argue that had there been no OPEC, oil prices would have remained at a low level, leading to exploding demand and enormous pressure on supplies. Research done by the influential Massachusetts Institute of Technology shows that – in a non-OPEC world – turbulence in the international oil market would have been much more severe.[4] For certain, oil price increases – triggered off by unfettered consumption in the industrialized countries – forstalled excessive crisis-ridden situations.

Second, thanks to higher levels of oil prices capitalist countries were able to develop their own conventional and alternative sources of energy, thus improving their overall strategic position vis-à-vis OPEC. Big Oil in particular is now about to reap the fruits of this course of things.[5]

Third, a world without OPEC – or a world with OPEC having the disposal of much less revenues – would not have known the most profitable export boom and rush of contractors to the oil capitals of the Middle East and North Africa.

Last years' turmoil in the oil market, caused by Norway "mistakenly" lowering its North Sea price, once again pressed OPEC in a defensive position. No one can predict how successful OPEC's efforts to regulate production will be. Durability of toilsome reached quota agreements is to a high extent dependent on its member countries' discipline. In the worst case scenario, a battle for markets might crop up, attended with considerable discounts off the official selling price and ultimately putting a risk oil exploration and exploitation in areas outside the Middle East, where production costs are much higher. Same as in the past, lasting closed ranks of OPEC members now too is in the interest of the West. Meanwhile, OPEC's stabilizing role in the international oil market is too often overlooked.

Notes:

1 *Petroleum Intelligence Weekly*, 1983-08-08, Special Supplement, p 2.

2 *Petroleum Intelligence Weekly*, 1983-06-20, p 6.

3 *Petroleum Economist*, June 1983, p 213.

4 See *Technology Review*, Volume 83, No 1, October 1980, as reported in *OPEC Bulletin*, March 1982.

5 Paul Aarts & Michael Renner, "Background to OPEC's current crisis – who benefits really", in *IFDA Dossier*, 37, September/October 1983, pp 67–72. (Also published in *Development*, 1983: 2, pp 45–48). ■