Special Bulletin

A Japanese Perspective on the International Energy Landscape (486) June 26, 2020

Future Challenges for OPEC Feting 60th Anniversary

Ken Koyama, PhD
Chief Economist, Managing Director
The Institute of Energy Economics, Japan

In September 1960, oil ministers from Iran, Iraq, Kuwait, Saudi Arabia and Venezuela met in the Iraqi capital of Baghdad to create the Organization of the Petroleum Exporting Countries (OPEC). The original objective of OPEC was the five oil-producing countries' cooperation in protecting their national interests in a manner to counter the "Seven Sisters", oil majors that dominated the international oil market then.

OPEC's power peaked in the 1970s that featured crude oil price spikes amid two oil crises and sellers' dominance in the international oil market. Since OPEC adjusted production in response to the loosening of the international oil supply-demand balance in the first half of the 1980s in a turnaround from the 1970s, the oil cartel has served as a supply/demand adjuster in the international oil market. OPEC held 70% of proven recoverable oil reserves in the world at the end of 2019 and accounted for 37% of the international oil production in the year. Even more important is the fact that OPEC centering Saudi Arabia has owned almost all the world's surplus production capacity holding the key to supply/demand adjustment. While various views exist about the roles of OPEC in the international energy market, I always believe that OPEC has played an extremely important role in stabilizing the oil market and that its presence and influence cannot be disregarded.

To fete its 60th anniversary, OPEC sponsored a special webinar workshop titled "Contributions to the Global Economy and Energy Markets" on June 23. Some 10 famed energy experts participated in the two sessions of the workshop as moderators or panelists for a active discussion on the abovementioned title. I had an opportunity to take part in the webinar as a panelist. In the following, I would like to make some comments on OPEC's roles and challenges from the perspective of today's international energy situation, based on the workshop discussion.

The history of the international oil market provides a review of who has managed surplus production capacity on the market and how such surplus capacity has been managed. Standard Oil managed the market until the early 20th century, followed by control by the Texas Railroad Commission, the Seven Sisters' joint control on Middle Eastern oil, OPEC's supply/demand adjustment based on production quotas, supply/ demand adjustment by Saudi Arabia as a swing producer and current joint production cuts by the OPEC-plus group. It is important that if some surplus production capacity management mechanism that always exists fails to work, crude oil prices always crash. This point was indicated when crude oil prices crashed as soon as the OPEC-plus joint production cut framework collapsed amid the expanding COVID-19 pandemic last March. The key West Texas Intermediate oil futures price turned negative in an abnormal situation in April, rebounded in May and rose back above $40 per barrel recently. Behind the recent oil price rise have been an oil demand recovery and the OPEC-plus group's large-scale production cuts implemented since May. In this sense, OPEC still plays an extremely important role in oil market supply/demand adjustment.

Crude oil price stabilization through supply/demand adjustment is significant for oil-producing countries that depend heavily on oil revenue. As extremely low or high prices amplify the so-called "boom and bust cycle" to affect the world economy, however, market stabilization is significant for the stability of the world economy and international energy markets, as well as for oil-producing countries. An interesting study finding is that if without oil supply/demand adjustment by OPEC, crude oil volatility would increase to exert adverse effects on the world economy.

Oil is not only the world's largest energy source but also its largest internationally traded good. Given that crude oil prices are an important macroeconomic variable that greatly influences the world economy, oil is a particularly important good or energy source. Oil market stabilization has thus been an important challenge for global energy governance. Due to its production adjustment, OPEC is in some case called a cartel that is criticized frequently by those who give top priority to free market functions. Since oil or the oil market is important, however, market forces cannot be left to determine prices in some cases. As argued frequently, "the best cure for high oil prices is high oil prices, and the best cure for low oil prices is low oil prices." This means that high oil prices invite supply expansion and demand contraction that push down prices (and vice versa). I fully agree with the argument. If market forces are left to determine prices, however, substantial time may be taken to stabilize or rebalance the market. During the long stabilization or rebalancing process, however, excessively high or low prices may bring about huge losses to the world economy and international energy markets. If this cannot be disregarded, a supply/demand adjuster's role attracts attention. The extraordinary oil price crash under the coronavirus pandemic was difficult to leave untouched or disregarded. The current OPEC-plus production cuts, though designed to directly protect oil-producing economies, may contribute to stabilizing the world economy.

Supply/demand adjustment, though playing a major role, is always accompanied by costs. The first cost results from idling production capacity acquired in exchange for heavy investment. An oil producer may voluntarily idle capacity for a production adjustment while others do not participate in the adjustment. It may also pay a cost by losing its market share to rivals during the production adjustment. Since oil-producing countries basically rival each other, those cutting production may lose their market shares to the others. Therefore, the history of production adjustment has represented "cheating" and "relevant countermeasures". Despite such costs, OPEC has continued to adjust production in some manners because of the benefits from production management exceeding the costs. Those benefits include a direct economic benefit or oil revenue increase through the stabilization of prices, contributions to the world economy and the acquisition of "power" to exert influence on the oil market.

In this sense, OPEC is likely to continue playing a key role in stabilizing the international oil market and crude oil prices in the future. However, its path would be rocky. The first and short-term challenge is that how long the present large-scale production cuts should be continued is uncertain because of difficulties in foreseeing the impact of the pandemic. As indicated by the history of oil production adjustment, it is not easy for oil-producing countries to maintain large-scale production cuts over a sustained period. A more long-term or structural challenge is that oil, though remaining important, would lose its relative importance in global energy mix. Peak oil demand is attracting attention again due partly to the pandemic. If absolute oil demand declines in addition to oil's relative share of energy demand, OPEC challenges may enter a new phase. Decarbonization initiatives and their impact on oil will also be important. At the age of 60, OPEC faces numerous new challenges.

Contact: report@tky.ieej.or.jp
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