

Is opec meeting its stated objectives? essay



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IS OPEC MEETING ITS STATED OBJECTIVES? SUBMITTED TO JAMES MILNE IN PARTIAL FULLFILLMENT OF THE COURSE WORK: INTERNAL & EXTERNAL ENVIRONMENTS OF THE OIL AND GAS INDUSTRY LEADING TO THE AWARD OF MSc IN OIL AND GAS MANAGEMENT CHIOMA ONOSHAKPOR 1-12-2011

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10 IS OPEC MEETING ITS STATED OBJECTIVES?

BACKGROUND/INTRODUCTION The Organization of the Petroleum Exporting Countries (OPEC) was created at the Baghdad Conference on September 10-14, 1960, by Iran, Iraq, Kuwait, Saudi Arabia and Venezuela. These five Members were joined later by nine other Members which includes; Qatar, Indonesia, Libya, United Arab Emirates, Algeria, Nigeria, Ecuador, Angola and Gabon. The first headquarters was in

Geneva, Switzerland, and lasted for five years. It was later moved to Vienna, Austria, on September 1, 1965. **AIMS AND OBJECTIVES** Her act states that the primary aims of OPEC is to (1) Make uniform the petroleum policies of its Member Countries as part of its effort to defend their interests (2) Members of the Cartel shall work in unity to ensure stable oil prices, obtain adequate returns to producing countries and investors in the oil industry, and (3)

Provide a sturdy petroleum supply to consumers. (OPEC's Website). HOW IT FUNCTIONS Every member country (12 as of today) is represented by its minister of oil, mines and energy.

Conferences are held twice every year in March and September and may be more when there is an urgent need to. These conferences has the highest authority of the Cartel where petroleum policies are adjusted and re-adjusted to satisfy both consumers and producers and an effort to stabilize crude oil prices are made. These meetings are overseen by the executive secretary at time (t). Based on these stated objectives, I would be analyzing whether or not OPEC is really meeting its stated aims and objectives and if not WHY.

What are the challenges OPEC is facing, what are their weaknesses and their strengths? IS OPEC MEETING ITS STATED OBJECTIVES?

LITERATURE DOES OPEC FAIL TO CONTROL CRUDE OIL PRICES? As far back as 1972, crude oil price was below \$3. 50 per bbl. The Arab Oil embargo came on board when the Yom kippur War started. On October 5th, 1973, Syria and Egypt attacked Isreal and United States and many other western countries supported Isreal. Arab exporting countries in response to the support to Isreal, imposed an embargo on the countries supporting Isreal. They stopped exporting as much as 5MMbbl/day. The other producing countries increased production to an excess of 1MMbbl/day. In 1974, there was still a loss of 4MMbbl/day. This increase in demand caused prices to get up o \$12. 00bbl/day. OPEC watched while it happened. The crisis in Iran and Iraq between 1979 and 1980 also increased oil prices due to shortages in supply of crude. 2-2. 5MMb/d was lost at the early stages and grew up to 6. 5MMb/d in 1980. In 1982, the joint effects of the Iranian revolution and the <https://assignbuster.com/is-opec-meeting-its-stated-objectives-essay/>

Iraq-Iran war caused the price to more than double from \$14.00/b/d to \$35/b/d. It would have been very feasible to achieve this goal if member countries were controllable. I mean if they could stick to their giving quota but because they literally cannot be punished without any direct effect on the oil production, they behave anyhow.

Obviously, conflicts of interest among member-countries have helped in reducing the success of OPEC in managing the quota system.

Notwithstanding the common interests that join them, there are also some individual objectives that definitely split them. (Mana and Mani, 2000). OPEC members such as Libya, Nigeria, Venezuela and Algeria have plans to enlarge their production above their giving quota, in order to increase export revenue and due to more oil well discoveries in West Africa, Central Asia and Russia, OPEC's ability to manage price effectively is deficient. Clarke, 2007, p123) (Yergin, 1991, pp 745-746) says ' Despite OPEC becoming even more restraining around 1984, the quota system didn't work. Other alternative to fuels like coal, nuclear, power and natural gas and non-OPEC supply were still competing for IS OPEC MEETING ITS STATED OBJECTIVES? markets with oil; and shortage was still retreating demand. As you might expect, as the various OPEC exporters watched their income diminish, quota swindling among them became more apparent. They tried to make up their revenue loss due to price by a reduction in volume.

In response to the obvious cheating among member countries, OPEC engaged the services of an international accounting firm to keep watch over the quota. Their responsibility was to monitor every account, invoice and bill of lading. But unfortunately, they didn't have access to this information; in

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fact, they were denied entry into some of these countries and even those that granted visas, denied them access into major facilities. Meanwhile, for some of the oil exporters, it was a period for trade by barter, oil traded unwaveringly for industrial goods, weapons and planes.

This helped in over flooding the world market with crude. It is difficult really for OPEC to control crude oil prices because of external factors like NYMEX (New York mercantile exchange), IPS (International petroleum exchange in London), SIMEX (Singapore international monetary exchange) and wars and conflicts in producing nations. DOES OPEC HARMONIZE PETROLEUM POLICIES OF ITS MEMBER COUNTRIES? OPEC member countries tried to stay within their giving quotas in 1987 and the price remained stable for almost the whole year. The cartel experienced war between 2 of its member countries (Iraq and Iran).

After the war, Iraq managed to recuperate and started producing again. They refused to adhere to the quota system in order to meet up for lost revenue. Subsequently, UAE had some issues and could not meet with the demands of Abu Dhabi and Dubai. They then began to produce in excess. Prices started to rise again in early 1988. In 1989, there was a bit of production discipline among member countries and an increase in demand. This helped boost prices. The problem for OPEC still remains balancing supply and demand and getting a quota that will be satisfactory to all member countries (Worldwide Petroleum Industry Outlook, pp277-278). Van Vactor, 2010) makes use of the hawks' and ' doves' analysis of OPEC members by cartel watchers to make a point. The hawks group consist of those that IS OPEC MEETING ITS STATED OBJECTIVES? have little reserves hence little production. They include <https://assignbuster.com/is-opec-meeting-its-stated-objectives-essay/>

countries like Venezuela and Iran. They are in support of higher prices of present day crude and not bothered about the volatility of the market, therefore are in favour of policies to increase price. This is definitely for obvious reasons: their crude is running out, wiser to make money from what they have presently and invest in some other areas of their economy.

The doves on the other hand consist of those that have large reserves that can last a live time e. g. Saudi Arabia and Kuwait. They have more production quota and are in favour of policies to stabilize the market because they are not in a hurry to make immediate gain. From the material above, it shows that OPEC doesn't have the power to harmonize these policies because (1) they don't have absolute control as any country can pull out at any time (as in the case of Ecuador and Algeria) or decide not to be the swing producer anymore for her country's own benefit e. . Saudi Arabia. (2) The internal division amongst the cartel due to conflict of interest makes it difficult to unify any kind of policy. DOES OPEC PROVIDE REGULAR SUPPLY OF PETROLEUM TO CONSUMING COUNTRIES AND A FAIR RETURN TO PRODUCING COUNTRIES? (Raymond Learsy 2005 cited in Empires of Oil) makes a sharp thrust at OPEC. He attacks its methods, its status (said to be in violation of WTO global rules) and the alleged manipulation of crude prices to the detriment of consumers (especially those developing economies bereft of oil resources).

Rises in the oil price are taken as confirmation of OPEC's manipulative strategies. Oil scarcity is simply a suitable parable. It is sponsored by OPEC's speculators and watchers, passed on by a group of analyst that are easy to fool, unscrupulous politicians and uninformed expert. (Clarke, 2007) (Yergin, <https://assignbuster.com/is-opec-meeting-its-stated-objectives-essay/>)

1991) suggests that; the statement from the conference contained the new modus operandi: OPEC was no longer interested in protecting crude price; now IS OPEC MEETING ITS STATED OBJECTIVES? ts goal was to ' secure for themselves a good share in the world oil market in harmony with the required revenue for member countries' development. OPEC is now in a fight to get back target markets which have been lost to non-OPEC. Supply security is essential to consumers. They need to be assured that they will have consistent influx of crude to enable their refineries and other facilities function. OPEC sees the need to fill this vacuum amongst other personal desires and have always tried to fulfil them.

That's why they have in their cartel, the position of a swing producer to always make up for sufficient or insufficient crude in the oil market. As one of the past secretary general of OPEC in 2003 rightly puts it; OPEC has a commitment to security. In 2003 with the fighting in Iraq, everyone expected that there would be a drop in OPEC's total output for that year, thereby causing a steep in price, but to the disappointment of many, the oil market was sufficiently supplied crude and prices were stable. (WOO, 2003) 2008 OIL CRISIS/RECESSION

In 2008, the financial crisis in the world could very well be linked to oil as oil prices got as high as \$147 per barrel in July and as low as \$88 per barrel in October of the same year. Everyone looked for someone to blame for the awkward drop in price in such a short while. Unfortunately, OPEC amongst US-IRANIAN tension, falling dollar, was the escape goat whose name appeared on every financial analyst's page except in the Middle East and

part of Africa for obvious reasons-they are member countries with the Secretary General of the cartel from one of the continents.

In that year, about \$12-\$16 billion was lost every working day. The Saudi stock market lost 17% and Qatar also lost about 19% as well as other OPEC member countries, so the question remains ' who is to blame for the 2008 financial crisis? ' As OPEC's secretary general, Abdalla Salem El-Badri says in WOO (World Oil Outlook 2010); these financial issues/ global recession are major and not for OPEC to offer up solutions to these core global economic questions. On the contrary, O'kefee (CNN money, 2008) reports: In 2007, when crude oil price almost doubled, OPEC was actually cutting down on production.

They produced 1.5% less in 2007 IS OPEC MEETING ITS STATED OBJECTIVES? regardless of adding two countries, Ecuador and Angola, to its defences. That particular action at a time such as this, with the increase in demand helped in raising the prices up. Adam Sieminski, chief energy economist for Deutsche Bank, thinks they made a mistake. He also thinks OPEC's drop in production a year before the economic meltdown, is the No. 1 reason for the price fluctuation in the year 2008. The Saudis are to blame for trying to run the world market, they underestimated the world's demand and also overestimated non-OPEC supply.

The reporter thinks it's insincere for OPEC's management to propose that reduced production had nothing to do with rising prices. OPEC has 44% of the world's oil daily production and, by its own calculation, owns 78% of the proven reserves of the world. It is insincere for OPEC's management to

propose that crude oil price hike had nothing to do with reduction in their production. He added that in a tense and stiff market as this, it is unlikely that the largest group of producers will drop output and not affect prices directly.

And in deed, the Saudis promised to increase production by some 500, 000 bbl/day. Gal Luft (MESH, 2008) summarizes thus; if OPEC indeed has a magnificent financial bail out plan, as of this writing attest to be an outright letdown. Quite obviously, the OPEC leadership is in constant conflict with America and her oil policies, the clash of interest here is not the primary cause. It is so very easy to lay the blame for America's financial calamity on OPEC because it hides from view the plain truth that this economic crisis is about our greed and not theirs.

Any attempt to cover-up this awkward truth will only hinder us from learning the appropriate lesson and therefore undercut our path to recovery. As Pogo once said " we have encountered the adversary and he is us. " OPEC'S

REACTION TO THE 2008 FINANCIAL CRISIS AND ITS RESULT (A)

INTRODUCTION OF REGULATORY REFORMS TO FINANCIAL MARKETS AND

COMODITY TRADING MARKETS; These laws are meant to reduce price

speculation in the market amongst producing and consuming countries. It is assumed that the price fluctuation was as a result of the introduction of oil as a commodity for trading in the futures market.

Many commercial banks and investment bodies are now interested in making money off the derivative market (swaps, options, futures) or paper market as some would say. They are watching the rise and fall of oil prices in order to

get high return on investment (ROI) on their invested monies into the derivative market. (WOO, 2010) report says that; At the 12th International Energy Forum (IEF) Ministerial Meeting in Cancun, Mexico, in 2010, there was a general consensus that the price fluctuation and volatility experienced in 2008 and part of 2009 should be prevented in the future.

Producers and consumers accentuated this fact because the lack of stability was not in the interest of both parties. While some disagreement remains over what was actually behind the volatility, it has become increasingly accepted that non-fundamental factors were at play'. Although there were discrepancies as to what actually caused the volatility, they concluded that they were secondary factors. Two forums were held in November 2010 jointly by IEA/IEF/OPEC in London as part of the Cancun declaration.

Workshop on Understanding the New Dynamic: ' How the physical and financial markets for Energy interact' and ' Energy Market Regulation: Clarity and Coordination'. Another meeting was held in Saudi Arabia with 86 countries deciding to become members of IEF in February of 2011. (IEEJ, 2011) Hopefully, these talks will help the countries involved exchange ideas about the energy market supply/demand forecast. (B) DIALOGUE AND COOPERATION Dialogue between producers and consumers seems to be a major player in stabilizing markets and in pushing global sustainable economic growth, at least from OPEC's point of view.

The market is becoming global and mutually supporting, however, strong relationships between producers and consumers are a necessary component to the stability of the market. A good knowledge of matters such as

environmental protection, demand and supply security, and transfer of know-how are achieved as a result of such dialogues. Indeed, the advantages of dialogue are very glaring. This is seen clearly in OPEC's collaboration with a host of OPEC and non-OPEC countries and other international organizations. (WOO, 2010).

The major clash of interest between OPEC and non-OPEC countries makes this point a joke. OPEC countries would like to drop production in order to stabilize the market but non-OPEC countries would want to meet the needs of consumers and flood the market without looking back. (c) REDUCTION OF OIL PRICE; in a bit to fight the price increase at the fall of 2008, OPEC decided to cut down on production to increase demand and therefore affect the price positively. They realized that this move wasn't very clever because the more they cut production, the more they lost market share to non-OPEC countries.

They started fighting to regain market share because they weren't able to influence non-OPEC countries to follow them in their course. To be able to control oil price, you need to control the market and you only control market when you provide consumers with the quantity they require. CONCLUSION I honestly think OPEC may find it difficult in fulfilling their stated objectives based on the literature available above. They can only try. As any other cartel, its success lies on being committed strictly to its objectives.

Starting from making sure production quotas are adhered to strictly to making sure they maintain a good relationship with consumers and non-OPEC supply countries. Very difficult targets, as presently it seems that OPEC

is following the oil market and not the other way round. Crude oil prices have been in backwardation (a situation where forward prices keep going down) since February this year as opposed to the expected state of Contango required (a situation where forward prices keep going high). According to Forecast, in December 2011 and January 2012, Brent crude prices will be \$108.37 and \$107.9 respectively as compared to \$109.56 as at 15th November 2011. This means that the oil physical market for Brent crude which can therefore be extrapolated to other types of crude is currently experiencing some instability. IS OPEC MEETING ITS STATED OBJECTIVES?

The maximum time frame for a commercial cartel to live is 5 years but OPEC has managed to stay afloat to celebrate its 50th anniversary. (Van Vacker, 2008). They should be celebrated for that. From the available literature most of which are not in this paper due to word constraint, I think the era of OPEC is gone in terms of determining oil price.

The 'MARKET' is the new thing on board which is advancing with modern innovation and information technology. This is a different topic on its own open for research. With the joint effort between IEF/IEA and OPEC, there should be progress in trying to stabilize the oil paper market. REFERENCES Clarke, D. , 2007. Empires of Oil, Corporate Oil in Barbarian worlds. London: Profile books Ltd. Gal Luft, 2008, Financial crisis; OPEC to blame? Middle East Survey Harvard, Available from: http://blogs.law.harvard.edu/mesh/2008/10/financial_crisis_opec_to_lame/ (Accessed: Nov 20, noon)

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