Opec and its influence on oil prices

Oil is the blood of world economy. Out of top 10 Fortune 500 companies' list published in July 2010, five are Petroleum companies. Therefore any increase in world oil prices impacts every sector of the economy causing inflation. The Oil policies form an important part of national policy making in all oil consuming countries. Some countries provide subsidy on oil and petroleum products to promote domestic industries and check inflation, whereas some countries impose tax on oil consumption to check demand and conserve. Economies all over the world constantly monitor the oil price movements.

Organisation of Petroleum Exporting Countries or OPEC has the largest oil reserves in the world and is responsible for the supply and prices of petroleum products to major extent.

Organisation of Petroleum Exporting Countries

History

The Organization of the Petroleum Exporting Countries (OPEC) is a cartel of twelve developing countries made up of Algeria, Angola, Ecuador, Iran, Iraq, Kuwait, Libya, Nigeria, Qatar, Saudi Arabia, the United Arab Emirates, and Venezuela. OPEC has maintained its headquarters in Vienna since 1965 and hosts regular meetings among the oil ministers of its Member Countries. Indonesia withdrew in 2008 after it became a net importer of oil, but stated it would likely return if it became a net exporter in the world again.

According to its statutes, one of the principal goals is the determination of the best means for safeguarding the cartel's interests, individually and collectively. It also pursues ways and means of ensuring the stabilization of prices in international oil markets with a view to eliminating harmful and unnecessary fluctuations; giving due regard at all times to the interests of the producing nations and to the necessity of securing a steady income to the producing countries; an efficient and regular supply of petroleum to consuming nations, and a fair return on their capital to those investing in the petroleum industry

Objectives of OPEC

To coordinate & unify the petroleum policies of the member countries and to determine the best means for safeguarding their individual and collective interests.

To seek ways and means of ensuring the stabilization of prices in international oil markets, with a view to eliminating harmful and unnecessary fluctuation; and

To provide an efficient, economic and regular supply of petroleum to consuming nations and a fair return on capital to those investing in the petroleum industry.

Functioning of OPEC

As stated in the objectives the OPEC countries work together to ensure supply of petroleum to the consuming nations and strives to maintain stable world oil prices by regulating supply according to the market demand.

Representatives of the OPEC member countries meet at the OPEC Conference to co-ordinate and unify their petroleum policies in order to promote stability and harmony in the oil market. The Conference is the supreme authority of the organisation. It consists of delegations headed by the minister of oil, mines & energy of the member countries. The conference generally meets twice a year in March and September and in extraordinary sessions whenever required. It is responsible for formulation and implementation of policies for the member countries.

OPEC's influence on the market has been widely criticized, since it became effective in determining production and prices. Arab members of OPEC alarmed the developed world when they used the " oil weapon" during the Yom Kippur War by implementing oil embargoes and initiating the 1973 oil crisis. Although largely political explanations for the timing and extent of the OPEC price increases are also valid, from OPEC's point of view, these changes were triggered largely by previous unilateral changes in the world financial system and the ensuing period of high inflation in both the developed and developing world. This explanation encompasses OPEC actions both before and after the outbreak of hostilities in October 1973, and concludes that " OPEC countries were only ' staying even' by dramatically raising the dollar price of oil."

Oil Embargo of 1973

The persistence of the Arab-Israeli conflict finally triggered a response that transformed OPEC into a formidable political force. After the Six Day War of 1967, the Arab members of OPEC formed a separate, overlapping group, the Organization of Arab Petroleum Exporting Countries, for the purpose of centering policy and exerting pressure on the West over its support of Israel. Egypt and Syria, though not major oil-exporting countries, joined the latter grouping to help articulate its objectives. Later, the Yom Kippur War of 1973 galvanized Arab opinion. Furious at the emergency re-supply effort that had enabled Israel to withstand Egyptian and Syrian forces, the Arab world imposed the 1973 oil embargo against the United States and Western Europe, while non-Arab OPEC members did not.

Oil Glut of 1980

After 1980, oil prices began a six-year decline that culminated with a 46 percent price drop in 1986. This was due to reduced demand and over-production that produced a glut on the world market. Around this period, Iraq also increased its oil production to help pay for the Iran-Iraq War. Overall OPEC lost its unity and thus its net oil export revenues fell in the 1980s

War & Price Slump

Leading up to 1990-91 Gulf War, Iraqi President Saddam Hussein advocated that OPEC push world oil prices up, thereby helping Iraq, and other member states, service debts. But the division of OPEC countries occasioned by the Iraq-Iran War and the Iraqi invasion of Kuwait marked a low point in the cohesion of OPEC. Once supply disruption fears that accompanied these conflicts dissipated, oil prices began to slide dramatically.

After oil prices slumped at around $15 a barrel in the late 1990s, concerted diplomacy, sometimes attributed to Venezuela's president Hugo Chávez, achieved a coordinated scaling back of oil production beginning in 1998. In 2000, Chávez hosted the first summit of heads of state of OPEC in 25 years. The next year, however, the September 11, 2001 attacks against the United States, the following invasion of Afghanistan, and 2003 invasion of Iraq and subsequent occupation prompted a surge in oil prices to levels far higher than those targeted by OPEC during the preceding period. Indonesia withdrew from OPEC to protect its oil supply interests.

On November 19, 2007, global oil prices reacted strongly as OPEC members spoke openly about potentially converting their cash reserves to the euro and away from the US dollar.

Production Disputes

The economic needs of the OPEC member states often affects the internal politics behind OPEC production quotas. Various members have pushed for reductions in production quotas to increase the price of oil and thus their own revenues. These demands conflict with Saudi Arabia's stated long-term strategy of being a partner with the world's economic powers to ensure a steady flow of oil that would support economic expansion. Part of the basis for this policy is the Saudi concern that expensive oil or oil of uncertain supply will drive developed nations to conserve and develop alternative fuels. To this point, former Saudi Oil Minister Sheikh Yamani famously said in 1973: " The stone age didn't end because we ran out of stones."

One such production dispute occurred on September 10, 2008, when the Saudis reportedly walked out of OPEC negotiating session where the cartel voted to reduce production. Although Saudi Arabian OPEC delegates officially endorsed the new quotas, they stated anonymously that they would not observe them. The New York Times quoted one such anonymous OPEC delegate as saying " Saudi Arabia will meet the market's demand. We will see what the market requires and we will not leave a customer without oil. The policy has not changed."

Members

Current Members

OPEC has twelve third world member countries, six in the Middle East, four in Africa, and two in South America.

Former Members

http://upload. wikimedia. org/wikipedia/commons/thumb/0/04/Flag_of_Gabon. svg/22px-Flag_of_Gabon. svg. png Gabon

http://upload. wikimedia. org/wikipedia/commons/thumb/9/9f/Flag_of_Indonesia. svg/22px-Flag_of_Indonesia. svg. png Indonesia

The United States was a de facto member during its formal occupation of Iraq via the Coalition Provisional Authority.

Indonesia left OPEC in 2008 because it ceased to be a net exporter of oil. It could not fulfill the demand of its own country’s needs, as growth in demand outstripped output. The situation was made worse because of weak legal certainty and corruption that deterred foreign investors from investing in new reserves in Indonesia. In recent times, the government has increased financial incentives for foreign firms to invest in exploration and extraction but has found itself forced to import more supplies from the likes of Iran, Saudi Arabia and Kuwait. Indonesia’s departure from OPEC will not likely affect the amount of oil it produces or imports. The country’s growing dependence on imports is proving increasingly expensive as global prices soar

Influence of OPEC on Price

Oil Economics

OPEC is a swing producer and its decisions have had considerable influence on international oil prices. For example, in the 1973 energy crisis OPEC refused to ship oil to western countries that had supported Israel in the Yom Kippur War or 6 Day War, which Israel had fought against Egypt and Syria. This refusal caused a fourfold increase in the price of oil, which lasted five months, starting on October 17, 1973, and ending on March 18, 1974. OPEC nations then agreed, on January 7, 1975, to raise crude oil prices by 10%. At that time, OPEC nations – including many whom had recently nationalized their oil industries – joined the call for a new international economic order to be initiated by coalitions of primary producers. Concluding the First OPEC Summit in Algiers they called for stable and just commodity prices, an international food and agriculture program, technology transfer from North to South, and the democratization of the economic system. Overall, the evidence suggests that OPEC did act as a cartel, when it adopted output rationing in order to maintain price.

Since currently worldwide oil sales are denominated in U. S. dollars, changes in the value of the dollar against other world currencies affect OPEC's decisions on how much oil to produce. For example, when the dollar falls relative to the other currencies, OPEC-member states receive smaller revenues in other currencies for their oil, causing substantial cuts in their purchasing power. After the introduction of the Euro, pre-invasion Iraq decided it wanted to be paid for its oil in euros instead of US dollars causing OPEC to consider changing its oil exchange currency to Euros, although after

Iraq's invasion, the interim government reversed this policy, and the subsequent Iraq governments stuck to the US dollar. Member states Iran and Venezuela have undergone similar shifts from the dollar to the Euro.

OPEC Basket

What Does OPEC Basket Mean?

A weighted average of oil prices collected from various oil producing countries. This average is determined according to the production and exports of each country and is used as a reference point by OPEC to monitor worldwide oil market conditions.

The new OPEC Reference Basket (ORB)

Introduced on 16 June 2005, is currently made up of the following:

Saharan Blend (Algeria), Girassol (Angola), Oriente (Ecuador), Iran Heavy (Islamic Republic of Iran), Basra Light (Iraq), Kuwait Export (Kuwait), Es Sider (Libya), Bonny Light (Nigeria), Qatar Marine (Qatar), Arab Light (Saudi Arabia), Murban (UAE) and Merey (Venezuela).

Production Allocation

OPEC Reserves

OPEC's ability to control the price of oil has diminished somewhat since the Gulf War due to the subsequent discovery and development of large oil reserves in Alaska, the North Sea, Canada, the Gulf of Mexico, the opening up of Russia, and market modernization. As of November 2010, OPEC members collectively hold 79% of world crude oil reserves and 44% of the world's crude oil production, affording them considerable control over the global market. The next largest group of producers, members of the OECD and the Post-Soviet states produced only 23. 8% and 14. 8%, respectively, of the world's total oil production. As early as 2003, concerns that OPEC members had little excess pumping capacity sparked speculation that their influence on crude oil prices would begin to slip.

International Petroleum Exchanges

Impact of Kyoto Protocol on OPEC

The possible losses that OPEC countries may incur have triggered a debate on the green paradox (Sinn 2008). This paradox is based on the assumption that suppliers of oil feel threatened by a decline of future prices due to gradual reduction of oil consumption in abating countries. If this reduction reduces the discounted value of the oil price in the future more than at present, the oil producing countries will expand production in the short run which will increase oil consumption and thus accelerate global warming.

Impact of OPEC on India

Iran is India's second biggest crude oil supplier after Saudi Arabia, accounting for about 13 per cent of its total crude oil imports. If the present issue of payment with Iran remains unsolved it would potentially hit Indian imports of 400, 000 barrels per day of Iranian crude oil, forcing Asia's third-largest economy to look for more expensive alternatives that would swell its already high current account deficit.

After King Abdullah visited India in 2006, India has steadily moved its oil imports to make Saudi Arabia its largest oil source by 2010. Given a growing convergence with Saudi Arabia even on security issues, India is likely to find that both the Saudis and the UAE would be more than willing to make up the loss of oil imports from Iran.

Key Words

Cartel – A formal (explicit) agreement among competing firms. It is a formal organization of producers and manufacturers that agree to fix prices, marketing, and production. Cartels usually occur in an oligopolistic industry, where there is a small number of sellers and usually involve homogeneous products. Cartel members may agree on such matters as price fixing, total industry output, market shares, allocation of customers, allocation of territories, bid rigging, establishment of common sales agencies, and the division of profits or combination of these. The aim of such collusion (also called the cartel agreement) is to increase individual members' profits by reducing competition.

Statute – A formal written enactment of a legislative authority that governs a state, city, or county. Typically, statutes command or prohibit something, or declare policy. The word is often used to distinguish law made by legislative bodies from case law, decided by courts, and regulations issued by government agencies. Statutes are sometimes referred to as legislation or " black letter law". As a source of law, statutes are considered primary authority (as opposed to secondary authority). Ideally all Statutes must be in Harmony with the fundamental law of the land (Constitutional).

OECD – The Organisation for Economic Co-operation and Development is an international economic organisation of 34 countries founded in 1961 to stimulate economic progress and world trade. It defines itself as a forum of countries committed to democracy and the market economy, providing a platform to compare policy experiences, seeking answers to common problems, identifying good practices, and coordinating domestic and international policies of its member

De facto – A Latin expression that means “ by [the] fact.” In law, it means “ in practice but not necessarily ordained by law” or “ in practice or actuality, but without being officially established.” It is commonly used in contrast to de jure (which means “ concerning the law”) when referring to matters of law, governance, or technique (such as standards) that are found in the common experience as created or developed without or contrary to a regulation. When discussing a legal situation, de jure designates what the law says, while de facto designates action of what happens in practice. It is analogous and similar to the expressions “ for all intents and purposes” or “ in fact.”

Swing producer – A supplier or a close oligopolistic group of suppliers of any commodity, controlling its global deposits and possessing large spare manufacturing capacity. A swing producer is able to increase or decrease commodity supply at minimal additional cost for himself, and thus able to influence prices and balance the markets, providing downside protection in the short to middle term. In the long term, however, the price of commodity is subject to major changes over time, particularly tied to the overall business cycle.

Oligopoly – A market form in which a market or industry is dominated by a small number of sellers known as oligopolists.