

Opec and other opec
styled cartels
economics essay



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The aim of this paper is to give a better idea about cartels by presenting the world's biggest and most effective cartel the Organization of Petroleum Exporting Countries and other groups of countries that seeing the strength of OPEC wanted to create similar organizations to maximize their economic benefits from exports. The essay analyses the difficulties of setting up such organizations, the foreign reactions, the inner challenges of running it because of the interest differences of members and in some cases the moral questions raised against a cartel. It shows how many circumstances have to be in place for a cartel to gain economic advantage or to affect world prices.

The History of the Organization of Petroleum Exporting Countries

The Organization of Petroleum Exporting Countries was formed in 1960. The aim of the organization is to defend the economic interest of its members.

Before the foundation of this organization in the 1950s a so called posted price system was in place between international oil companies (IOCs) and governments. Under this system governments could calculate in advance the amount of taxes paid by oil companies. However posted prices were fixed while oil prices were fluctuating. After abiding to these terms for almost a decade economic and financial pressure eventually forced international oil companies to reduce posted prices in 1959. Their unilateral actions raised objections from governments.

The foundation of OPEC

Representatives of oil-exporting countries met later in 1959 at the first Arab Oil Congress. Their aim was to elaborate actions against oil companies.

However cooperation between the countries was made difficult by the

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structural differences between their oil industries. Besides the structural differences political differences over investment and production shares made the job of the congress even more difficult. The competition between the members was peaked in the debate between Venezuela and Middle Eastern exporters. These disagreement between oil-exporters resulted in the failure of the first attempt to institutionalize coordination.

Not long after the first unsuccessful attempt another price cut by the international oil companies made five oil exporting-countries (Venezuela, Saudi Arabia, Iran, Iraq, Kuwait) to put aside their disagreements and increase their bargaining power through close cooperation in order to defend their economic interest. As a result in 1960 the Organization of Petroleum Exporting Countries was established and their very first action was to issue a statement asking for the restoration of posted prices to their early 1959 levels. Besides this they also demanded the stabilization of oil prices by the regulation of production.

The next ten years passed with the struggle between OPEC and IOCs. The United States' government did not recognize OPEC and forbade domestic oil companies to do business with the organization. Furthermore the U. S. government imposed sanctions at the expense of OPEC members in order to stop other countries from joining the organization. As a result IOCs feeling empowered by the U. S. support continued their practices of dealing with host governments individually to decrease their bargaining power. However OPEC decided to take actions by encouraging member states to obtain any kind of advantage they can on their own which later can be used by others as a precedent during negotiations. This tactic helped OPEC members to

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increase their level of bargaining step by step and in ten years they considerably increased their oil revenues as well. The organization started to become internationally acknowledged and new countries started to join their ranks.

By the 1970s OPEC became so successful that they could operate as a cartel and set have a strong effect on oil prices. In 1973 during the Arab-Israel war provided the opportunity to take control over crude oil pricing.

The challenges faced by OPEC

After taking the control over oil pricing the organization faced both external and internal challenges. First of all the United States was not content at all with their strong power which made it possible for OPEC to effect world economics through oil prices. The U. S. in alliance with other oil-importing countries waged a verbal war against the organization and accused them of causing a worldwide economic decline. Besides the external challenges the members of the organization had huge disagreements over OPEC's strategy. This was caused by the structural differences of the member states. While countries such as Saudi Arabia with small population and huge oil reserves wanted to set low prices to ensure long term demand for crude oil other countries with small reserves and big population such as Algeria lobbied for high oil prices to maximize their short term revenues in order to support their domestic development programs. There were some countries who besides having high reserves favored high prices for the same development reasons. Examples for these are Iran and Libya.

The downturn of their dominance

The fear from oil shortages during the revolution in Iran, one of the biggest OPEC members, caused a panic buying at the end of the 1970s. The demand for oil was so big that prices doubled in one year. Huge increase in prices during the panic drew new sellers to the market. At the increased price level it was worthwhile exploiting oil reserves in the North Sea. As new entrants appeared on the market oil importers substituted OPEC oil with that of the new entrants because of the instable Middle Eastern markets.

OPEC tried to sustain its powerful status and adapt to the new situation by introducing a so called oil production sharing strategy. With this strategy they wanted to control oil prices by regulating oil supply. As part of the strategy a voluntary production-sharing plan was introduced in 1982. This had no restraining power on OPEC members and the governments, each driven by their own interest, did not conform to the voluntary regulations. Seeing the inefficiency of the voluntary system a mandatory quota system was introduced in 1983. This resulted in the reduction of oil prices for the first time in almost 15 years. OPEC members hoped that in this way they can increase consumer demand.

However the quota system was not exempt of flaws and drawbacks. For example Ecuador decided to leave the organization in order to avoid obligations set by the system even on small producers. But not only small producers were given a hard time by the quota system. OPEC's biggest producer, Saudi Arabia, declared the system as being an unacceptable restraint on the country's sovereign rights and refused to abide the rules. By

not taking part in the quota system the Saudis were not able to maintain
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constant production amounts and they had to alter their production quantities periodically based on the remaining demand that was left after other members sold the amount specified in the quota agreement.

The position of swing producer was very unfavorable for Saudi Arabia because in case of a decrease in demand they had to decrease their production more than the other members.

This was unaffordable for their economy which was heavily dependent on the income generated by oil exports. Finally in 1986 Saudi Arabia decided to conduct their production considering only their domestic needs. The result was a decrease in world oil prices.

Cracks in the organization caused by political differences

Political tension within the organization was present right from the beginning and peaked during the first Gulf War. The conflict between Iraq and Iran during most part of the 80's divided the organization so much that there was a point when they couldn't agree on a new secretary-general. Meetings during this time were so hostile that the usefulness of the organization was considerable reduced.

The end of the first Gulf War indicated hopes that conflict within the organization may be settled. However the peace did not lasted for long as Iran invaded Kuwait in 1990 and the organization became ineffective again.

Over production has been a continuous problem for the organization. Some member state (e. g. Venezuela, Nigeria, Iraq, Indonesia) use their internal

political turmoil and consequent disruptions in oil supply to hide their over production.

Conclusion

As a conclusion it can be said that OPEC, the world biggest cartel, has been struggling to control the international oil market because of its failure to coordinate and successfully control the activity of its members. Furthermore they are facing constant challenges to their dominance which has been decreasing since the 80's.

Oil, besides being extremely profitable to sell is one of the most important strategic resource, is sought at all parts of the world and as the price rises more and more fields become worth to exploit. After the fall of the Soviet Union, Central Asian countries attracted foreign investors to search and exploit their oil and gas fields. This created more pressure on OPEC and its price structure. In an attempt to keep up with the challenging environment members started to open their markets to FDI and let International Oil Companies in their countries.

However the biggest failure of OPEC members is that they have failed to developed other fields of their economy. They have not prepared a strategy to for the future when they will not be able to rely on the revenues generated by oil exports. As long as the demand for oil is constant and prices are high their economies are safe but their afterwards they may find their selves in an extremely difficult situation

Until governments and the public concentrates exclusively on oil pricing they won't be able to dedicate intellectual and financial resources to promote <https://assignbuster.com/opec-and-other-opec-styled-cartels-economics-essay/>

other parts of their industry such as the research and development or the usage of alternative energy sources. With concerns about global warming and pollution consumers are encouraged to change their preferences to new energy resources.

OPEC members' extreme reliance on revenues generated by oil leaves their economy vulnerable to changes and political conflicts.

Other OPEC styled cartels

The Asian rice cartel

On May 1, 2008 the prime minister of Thailand, Samak Sundaravej, announced in Bangkok that the Thai government would try to join fellow rice-producing countries, Vietnam, Cambodia, Myanmar and Laos, in a cartel partnership to gain greater control over the international prices of the commodity.

“ We don't aspire to be like OPEC, but we hope to be just a group of five to help each other in trading rice on the world market,” said Mr. Samak in a report given to The Nation newspaper. (<http://www.nytimes.com/2008/05/01/business/worldbusiness/01cartel.html>)

Thailand, the world's largest rice exporter, for many years has been thinking about creating a cartel similar to OPEC to influence the price of rice with the help of its dominant position, just like OPEC members do.

“ Though we are the food centre of the world, we have had little influence on the price,” a government spokesman said. “ With the oil price rising so

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much, we import expensive oil but sell rice very cheaply and that's unfair to us and hurts our trade balance." (<http://www.nytimes.com/2008/05/01/business/worldbusiness/01cartel.html>)

However if the nations are successful in their attempt to create a cartel that would have serious consequences on the rice market by keeping prices at their current peak and deepening the food crisis that has hit the poorest inhabitants of Thailand and other poor Asian people.

Large-scale rice producers and exporters in Thailand and Vietnam would benefit considerably if high prices would stay as they are, but for other places that have a heavy reliance on imported rice such as Singapore, Hong Kong and the Philippines it would be an adverse scenario. Independent from foreign reactions the Thai government can rely on the support of the farmers from rural areas of the country who see an opportunity in a possible cartel.

While many countries are engaged in trading corn, wheat and other grains, rice is exported by only a few countries. Even though China, India and Indonesia are the largest producers they combined population exceed 2.5 billion. As a result they can barely afford to export any of the rice they produce. On the other hand Thailand is in a very fortunate position. Thai farmers who have fields in vast, fertile deltas are able to harvest 3 or 4 times a year. As a result Thailand is the largest exporter of rice, exporting 10 million tons a year. The second is Vietnam, exporting 5 million tons a year, and the third is the United States, exporting 3.5 million tons.

The flaws of the plan

However it seems that a rice cartel, especially an ASEAN rice cartel could not be as dominant as its members would like. Even though Thailand is the biggest exporter in the world its plan to form a cartel would not include the second and third biggest rice exporter in the world (India and U. S.). It is hardly believable that these two countries and many others left out of a potential cartel would just stand and watch while Thailand is fixing the prices. A big difference between rice and oil is that rice is renewable. As a result if a cartel was formed it would be only a question of time before adversely affected countries would work out methods to increase their yields or some other countries would appear on the market with either rice or a substitute product. Another problem for a potential cartel would be that unlike oil, rice is perishable and they could not afford to keep reserves or withhold stocks for economic or price setting reasons. Furthermore it would be extremely difficult for the organization to manage supplies. While OPEC deals with a small number of large producers, rice is produced by many small farmers and because of the changeful weather rice yields cannot be pre calculated. Finally, just like in the case of OPEC, the potential members of a rice cartel have different levels of development and in some cases different economic and political systems.

Even though there are a lot of barriers and pitfalls to a potential rice cartel the issue still has been raised because it would bring huge financial benefits to members, further political power to the governments and electoral powers to parties raising the issue during the elections.

The moral of a cartel

The possible creation of a cartel and the global price of rice is not just a political issue but a humanitarian as well. While the cartel of the OPEC countries has merely an economic and financial effect on people, a possible rice cartel that keeps prices constantly high can have life a changing effect on hundreds of millions of people for who rice is the only affordable food.

Another important issue is the education of children in these very poor countries. The only way out from poverty for these people is education. However important it is for children to go to schools regularly most families cannot afford to let their young ones to school because all help is needed at home to put something to eat on the table at the end of the day. That is why some countries like Cambodia came up with the idea of giving breakfast to students in order to attract them to school. The rice portions at the beginning of the school day are such a big help for the families that they are willingly sending their children and students are happy to walk several miles a day for a portion of rice.

“ Most of the students come to school for the breakfast,” said Taoch Champa, a 31-year-old teacher. (http://www.nytimes.com/2008/04/30/world/asia/30cambodia.html?_r=1&ref=worldbusiness)

The breakfast program was an instant hit in Cambodia when it was introduced in 2007. Besides increasing attendance the proportion of girls has increased as well and tardiness ceased to exist because of the before class food distribution. Furthermore well-fed students achieved better results. But the soaring food prices (especially the price of rice) puts the whole system in

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jeopardy. The budget of these schools is so tight that they simply cannot afford to continue the breakfast program if the price of rice stays high. With the creation of a cartel food the whole program would have to be suspended indefinitely in Cambodia and some other countries that won't be part of the organization. Poor Cambodian people are so accustomed to food shortages that they can live on a bare minimum of nutrition. Now if the program collapses experts say that there is no danger of starvation among children but poor families simply cannot afford to send their children to school, instead they have to go to the woods to gather food.

“ The rice cartel summit”

Not long after the idea was created the trade officials of ASEAN nations meet in Bali to discuss the matter. At this meeting a decision was made to cooperate. Under cooperation they mean to work on stabilizing global rice prices while at the same time safeguarding exports. Furthermore their aim is to find ways to increase output in the long run. After the meeting Indonesia's trade minister, Mari Pangestu, claimed that they have recognized the importance of having stable prices and an agreement was reached to continue fair trade practices. Besides the many agreements, nations failed to come up with any measures to tackle increasing rice prices in the short term. This failure is down fact that it is difficult for countries within the organization to work out solutions for regional problems lately.

As a conclusion after the summit it can be said that some ASEAN countries want a rice cartel while others don't. The solution of the organization for this problem was to suggest cooperation for its members. However they have not laid any rules to this cooperation which is now down to the countries to

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interpret. With no concrete measures taken the issue does not stand on solid foundations at all.

The Gas Cartel

Early phases

The Gas Exporting Countries Forum, GECF, was established in Teheran in 2001. It has 16 members, all major gas exporters, like Russia, Qatar, Nigeria, Algeria. This group has been largely informal, even though Russian president at that time Vladimir Putin was considering the formation of a stronger alliance since the very beginning. He had to wait until the Doha meeting, in 2007, where the issue of a strong alliance and cooperation between members was raised. Members saw an opportunity in the increasing demand for gas (Paris based International Energy Agency forecasted that the demand for gas will grow annually by 2% until the year 2030) accompanied with decreasing oil supplies.

The decision of GECF members, who produce around 60% of the world's gas exports, to set up a committee with the task of studying and analyzing pricing policies raised major concerns from countries around the world who saw this move as a step towards the creation of an OPEC styled cartel that could reshape the global energy market. The European Union, a major Russian gas importer, was among the first the to oppose the move of the GECF.

The gas and the oil market differ from each other in a lot of aspects. Experts claim that such a powerful gas cartel as the OPEC has been would be difficult to set up because there isn't such a big demand for gas from all parts of the <https://assignbuster.com/opec-and-other-opec-styled-cartels-economics-essay/>

world than there is for oil. Another distinction is that gas is not traded on the open market like oil is but based on contractual agreements between parties. The drawback of these agreements is that prices are set in advance for some years depending on the contract. Currently gas is transported through pipelines, which prevents the growth of the market. But a new technology will enable dealers to transport gas in a liquefied form that is frozen, opening up new transportation modes.

The fears of major gas importing countries

The members of the European Union, countries that depend on Russian and Algerian gas, have strongly opposed an alliance especially if it turns into a price determining cartel. Besides the EU, Americans have also raised their concerns. They have been accusing Moscow of using its energy resources as a tool to regain some of its international power. As it can be seen in the case of OPEC, cartels are not just about economics. Some of the members can acquire geopolitical dominance as well and Russia expects just that from a gas cartel. The fears of the EU and the U. S. are based on precedent Russian actions, when they cut off gas supply to other countries during the time of winter in order to have bigger bargaining power and reach favorable agreements during negotiations.

The creation of the gas cartel

By 2009 eleven natural gas exporters, Algeria, Bolivia, Egypt, Equatorial Guinea, Iran, Libya, Nigeria, Qatar, Russia, Trinidad and Tobago, and Venezuela, all members of the GECF, have formed a cartel. A Russian energy expert was elected to be the first secretary of the cartel. But it still remains to be seen how effective they can be because many GECF members rely on <https://assignbuster.com/opec-and-other-opec-styled-cartels-economics-essay/>

FDI to develop their natural gas industries and so they won't agree on decisions that may hurt their customers.

The second problem is the upper mentioned transportability. Unlike oil, gas cannot be poured into a container and shipped even to the furthest market. It is transported via pipeline systems that require billions of dollars of investment to set up. These circumstances restrict prevent gas exporters to regional markets. That is why for example European and Japanese gas prices greatly differ. While OPEC can increase the world price of oil by reducing the daily output a gas cartel does not have such a power. Gas exporter can affect only their regional market. They don't have bigger price setting power collectively than they have individually. For example if Russia wants to charge The Ukraine more, joining forces with Bolivia will not help him at all.

However if gas exporters would join forces regionally they could have the power to control markets. For example in the case of the EU if Russia would cooperate with Norway and Algeria they could control almost 100% of the European natural gas market.

Conclusion

- Even the OPEC which has been the most successful cartel in recent history has lost some of its power in the recent decades. As it can be seen in the essay the other two OPEC style cartels have considerable less favorable circumstances than OPEC has or had. Because of this their power can be questioned right from the beginning. As a conclusion I think that these

examples show us that the world economy has so many participants who <https://assignbuster.com/opec-and-other-opec-styled-cartels-economics-essay/>

have a lot of different advantages over each other that it is extremely difficult, if not impossible, to create a cartel which will have major global dominance in one field and whose members will not fight constantly over economic, financial or political issues.

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