OPEC: Making a case for controlling output

Earl L. Wright

Meeting at OPEC headquarters with OPEC representatives:

- Dr. Abdulrahman Al-Kheraigi, Media Relations Officer (PR & Information Dept.)
- Omar Farouk Ibrahim, Ph.D., Head- PR & Information Department
- Mohammad Alipour-Jeddi, Head-Petroleum Market Analysis Department
- Dr. Maizar RAHMAN, Indonesian Governor for OPEC (Acting for the Secretary General)
- Mohamed HAMEL, Head-Energy Studies Department
- Karin CHACIN, Head-Office of the Secretary General

Article information from Earl L. Wright.

Anyone who thinks that OPEC is made up of bearded, robed men who sit around and laughingly play dice with the world’s economic well-being needs to look at the way this sophisticated organization works. Love them or hate them, it’s important to know what the organization is about, and why, from their point of view, it exists at all.

OPEC was founded in 1960 by Iran, Iraq, Saudi Arabia, Kuwait and Venezuela. It was a joint effort to combat the monopoly of the "7 Sisters" oil companies which included Exxon, Royal Dutch/Shell, Texaco, Gulf, Mobil, British Petroleum and Socal. Between 1961 and 1975 eight other countries joined: Qatar, Indonesia, Libya, United Arab Emirates, Algeria, Nigeria, Ecuador and Gabon. Gabon pulled out in 1993 and Ecuador in 1995. Membership since 1995 has remained at 11 (see bottom box).

Despite the power that gushes from their oil wells, OPEC is sensitive to world opinion.

“IT is clear that the OPEC Secretariat and two planning heads, as well as the public relations people, met with us to justify their existence,” says Earl Wright. “They made a case that they are very responsible members of the worldwide economic community, contributing to economic stability versus economic chaos and instability.

“They say their pricing is justified because it allows them to make long-term investment commitments that will lead to the stability of pricing and supplies.

“In trying to create a stable supply of energy, they claim they are acting in the best interests of all the developed countries.”

Often accused of being a cartel, they refute this emphatically, insisting they do not have the power of a cartel. “They cannot dictate that all members price their product the same way or commit to a certain level of production,” says Wright. “Compliance is voluntary and members are not penalized for cheating.”

Prices and production quotas are set at OPEC’s semiannual meetings by the unanimous vote of the Member Countries.
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Supply & Demand

Pricing is a touchy subject for a large part of the world that is dependent on oil imports. OPEC defends its pricing policy. “They are certain that their current oil pricing between $22-$28 per barrel is the appropriate pricing for energy at the present time,” says Wright.

They attribute today’s high prices to events that are not within their control. “There are extraordinary situations occurring in the United States as well as in the world marketplace that accounts for the current high prices, they say.” In the US, these situations are a lack of refinery capabilities and the inability of certain refineries to deliver to different markets due to the composition of some gasoline.

“In the rest of the world, extraordinary spikes in demand from time to time and unusual situations that attract speculators and traders are what’s causing the current abnormal and unexpected high level of energy prices.”

Demand can only go one way: up. “OPEC is forecasting that the demand for oil in the next decade will increase by 25 -50 percent,” Wright reports. “By 2025 there will be a demand of 105 million barrels per day. Two-thirds of that will be going to Asia and other developing countries. This happens to be their upside estimate. They believe they have the capabilities of meeting that demand.

“If hybrid cars grow in popularity, the demand could drop by 5 million barrels per day just due to the advancement of technology,” says Wright.

OPEC keeps a sharp eye on what is happening in other oil-producing countries. “They anticipate that Russia will provide 55 million barrels per day, at their best. By 2015, the plateauing of all energy resources from Russia and other non-OPEC countries will occur. After 2015, OPEC says they will have to step up and make up for the growth in demand.

“They see OPEC oil as the hedge against Russia not being able to deliver as much oil as people anticipate. OPEC’s members currently produce around 27 million to 28 million barrels per day of oil, or some 40 per cent of the world total output, which stands at about 75 million barrels per day.

Energy demand is tied to GDP growth. “For every 2.5 percent growth in GDP in the world, there will be a little less than 1 percent energy growth demand. The world economies are forecast to grow at 3.6 percent per year. At this rate, OPEC believes their reserves are adequate to meet the next 30 years of demand.”

Wright reports that OPEC plans to invest profits in finding new proven reserves within their countries. “Having some stability in pricing is extremely important for them to make the investments necessary for additional oil exploration as well as investments in natural gas. My guess is that current ranges of $5 Mcf (one thousand cubic feet) or higher must exist for them to make the investments in LNG infrastructure (liquefied natural gas), which they feel will be an important part of their energy exploration,” says Wright.

“In general, this group came across to me as relatively cautious and concerned about their ability to take the profits from their current situation and invest in the future.”

Each country invests its profits according to need. “Indonesia’s profits from their energy sales go into building infrastructure for the country,” says Wright.
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“Algeria has two purposes for their profits. One is to provide a cushion if oil prices were to fall below $19 a barrel. They have created enough reserves to fund the deficit a sharp decline in prices would create in the budget. Secondly, they use profits for further oil and energy investment.”

“Algeria has increased its production from 800,000 barrels of oil per day to 1.5 million barrels per day. In addition, they have invested significant sums in creating a more viable agricultural base for their country.

“Iran has created an oil stabilization fund in case oil prices drop below $22-$23 a barrel. They say profits have been invested in ‘promising sectors of their economy.’ What is meant by ‘promising sectors’ is unknown,” says Wright.

Functions/structure

OPEC is made up of 11 member countries which are heavily reliant on oil revenues. Therefore, their objective is to bring stability to the oil market by adjusting their output to help ensure a balance between supply and demand.

The oil and energy ministers of the OPEC members meet twice a year or more frequently if necessary to decide on the organization’s output level. Delegates have supreme authority in the decision-making process.

Non-OPEC countries are welcome at the meetings. The Board of Governors is responsible for running OPEC.

The Secretariat is financed by the member countries (MCs) with equal contributions and staffed by nationals of MCs called officers, and by support staff, recruited locally and abroad, together with secretarial and clerical staff.

The chief executive officer is elected for three years by unanimous vote. He is the CEO, Secretary General and official spokesman for the organization. He reports to other members of OPEC and the Secretariat.

The Secretariat consists of the Secretary General and the research division headed by the director of research and comprising the petroleum market analysis, energy studies and data services departments. Other functions include the PR & information department, the administration & Human Resources Department, and the Office of the Secretary General.

The economic commission assists in promoting stability in the international oil market. It is composed of a commission board, national representatives, and staff. The commission board consists of the Secretary General, the national representatives appointed by the Member Countries, and OPEC a commission coordinator who is ex-officio the Director of the Research Division.

“The economic commission board meets twice a year prior to the regular meetings to make certain everyone has an understanding of the economic issues in front of them,” says Wright.

The OPEC News Agency (OPECNA) is a key part of the organization. It was established in 1980 to project a positive image of OPEC. “As such, it is the organization’s propaganda arm. They counteract what they consider to be misinformation in the community and monitor news about OPEC throughout the world.”
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The agency’s news is gathered by a worldwide network of experienced correspondents and stringers based in the member countries and in London, Paris, New York and Singapore. “They have four or five correspondents in the United States,” says Wright. OPECNA provides data to Reuters, Dow Jones and Bloomberg to make certain they have the correct spin on OPEC activities. Subscriptions cost about $110 per month.

Organization of the Oil Exporting Countries

Quick Facts

Year formed: 1960

Headquarters: Vienna, Austria

OPEC Secretariat: A permanent intergovernmental body, the Secretariat has been based in Vienna since 1965, providing research and administrative support to the member countries. The Secretariat also disseminates news and information to the World at large.

Official language: English

Members: Algeria, Indonesia, Iran, Iraq, Kuwait, Libya, Nigeria, Qatar, Saudi Arabia, United Arab Emirates, Venezuela

Members’ collective output: 40% of world’s oil production

Collective reserves: More than 3/4 of world’s proven oil reserves