Oil ministers attend the start of the 166th OPEC Conference on 27 November 2014 in Vienna, Austria.

OPEC Relinquishes Control of the Oil Market
by Kate Dourian

November 2014 was a turning point for OPEC, an organization in which four of the six GCC nations hold considerable sway. Oil prices, which had been trading above $100 per barrel at the start of the year, were in rapid decline; US light tight oil was eroding OPEC's market share and the producer club's main rival, Russia, was producing at full throttle. Markets were oversupplied and OPEC was consistently producing above its ceiling of 30 million barrels per day.

The general expectation amongst oil market pundits was that OPEC would take action to stabilize the market.[1] However, not all 13 ministers during the 166th OPEC meeting in Vienna were of the same mind. OPEC lynchpin Saudi Arabia and its wealthy GCC allies Kuwait, Qatar, and the UAE were no longer willing to take on the burden of cutting their production only to see others, many of whom produce at higher cost, take their market share. The Saudis also let it be known that they would no longer reduce their oil output without the cooperation of other key producers like Mexico and Russia even though previous attempts at coordinated action by OPEC and non-OPEC producers had failed.[2] By the end of December 2014, the price per barrel of oil had fallen by 70 percent compared to the previous June, from more than $100 to just over $32.[3]

The GCC producers, with their huge reserves accumulated during four years of $100-plus oil, could afford to take what they assumed would be short-term pain for longer-term gain. Not so the less fiscally robust producers such as Algeria, Venezuela, and especially Iraq, which is grappling with its own set of challenges. With oil prices trading at their lowest level in more than a decade, the pain was not spread evenly amongst all members, and the clamor for action began no sooner than the ministers had returned to their respective capitals. [4]

The battle for market share

Saudi Arabia has made clear since then that it would not shift its policy even if oil prices fell to $20 per barrel. The battle for market share had begun, and there were casualties on both sides of the OPEC, non-OPEC divide. Indeed, Ali Al-Naimi, the Saudi oil minister, said at a recent industry gathering in Houston that there was no point in pursuing a production cut agreement because few would adhere to it. [5]

An additional factor is the re-entry to the market of Iran, which saw its oil exports fall by more than 1 million barrels per day after the imposition of EU sanctions on the import of Iranian oil in mid-2012, resulting in the loss of both market share and revenues. Back in the market after the lifting of EU and UN Security Council sanctions at the start of 2016, Iran is determined to restore its previous position as OPEC's second largest producer, a ranking now held by Iraq. [6]

In the meantime, OPEC's oil export revenues continue to fall, slumping from a peak of $1.2 trillion in 2012 to just $500 billion in 2015, when demand grew at a very healthy 1.7 percent year-on-year. With oil prices at current levels—ranging between $30 and $40 per barrel since the start of 2016—the market balance and price correction that OPEC believed would come in 2015 has yet to materialize and has likely been postponed to 2017. The International Energy Agency (IEA), which represents the energy consumers of the industrialized world, forecasts annual average demand growth of 1.2 million barrels per day to 2021, which it says represents a very solid outlook in historical terms. However, it is difficult to predict at what price oil markets will balance.

The impact of low prices

OPEC's policy of non-intervention has certainly had an impact on both producing and consuming nations. In the US, light tight oil production is in decline, though not to the extent or the speed anticipated by OPEC in November 2014.[7] The IEA expects US light tight oil production to fall by nearly 600,000 barrels a day this year and by 200,000 b/d next year, reversing impressive gains since 2008, when oil prices hit their historic peak above $147 per barrel and encouraged the rush into shale. While OPEC output has held relatively steady since 2010, US production of light tight oil, extracted in a process called hydraulic fracturing or "fracking" as it's commonly known in the industry, contributed to more than half of overall growth in global oil output.[8] That led to a fall in US imports from foreign oil producers, which had to compete for a shrinking market elsewhere. Competition is particularly fierce in the Asian market, where demand growth is highest. This is the arena in which nearly all of OPEC's Middle Eastern and African producers have to compete for market share, a situation that is likely to be exacerbated as Iran begins to boost its production and exports. The IEA expects Iran to pump an additional 500,000 barrels a day of crude in 2016, which, if attained, would be roughly equal to the expected loss of US light tight oil production.

For oil importing nations, lower prices have brought welcome economic respite. The IEA calculates that every one dollar fall in the oil price is worth $15 billion in savings to importing countries. The weaker oil prices offer a chance for governments to introduce price reforms and ease fuel subsidies, a particularly costly burden on developing countries that are heavily reliant on imported crude and refined products.

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Yet there are risks associated with a protracted period of low oil prices, which if they persist could have an impact on security of future supply. Deferred investments now, which we are seeing, will have consequences several years down the line. Upstream investments fell by 20 percent in 2015 and are likely to fall by 17 percent this year.[9] This would be the first time in three decades that investment has fallen two years in a row. Given that an annual $630 billion in upstream oil and gas investment is needed just to compensate for declining production from existing fields and to keep future output at today's levels, the magnitude of the challenge is evident. In the medium-term the incremental barrel will come not from US shale deposits, which are expected to go into decline sometime during the next decade, but from the Middle East and specifically from the GCC states, Iraq, and Iran. Indeed, the UAE, Iraq, and Iran are the three countries that are expected to be the main contributors to the 800,000 barrels a day of additional oil to be brought on by OPEC by 2021.[10] That, of course, assumes a measure of wider political stability in the region.

Despite rapid growth in renewable energy such as wind, solar, and nuclear, between now and 2040 oil, gas, and coal will still dominate the energy landscape, each comprising roughly 25 percent of the market. Low oil prices may also complicate the transition to a low-carbon energy world, which has gained impetus following the successful climate summit known as COP21 in Paris last December.[11] But the good news is that renewable energy costs, particularly costs of solar energy, are coming down to levels that are competitive with fossil fuels even without subsidies.

The respective governments of the GCC states have taken advantage of the lower oil price to start removing energy subsidies and ease the burden on their budgets, which are already strained by falling revenues and the need to maintain social spending and create jobs for a youthful population. While the GCC oil producers still possess ample foreign reserves to tide them over until the market turns around, the UAE is the only country to have diversified its economy away from oil and gas over the years and is therefore less vulnerable to oil price fluctuations.

The other GCC states have taken heed. Subsidies, which encouraged rampant energy consumption and threatened to erode export volumes, are being dismantled across the region, even in Saudi Arabia, where the thought of raising the price of petrol would have been unthinkable a year ago. Yet the resulting price increases, the impact of which has been softened by the low international oil price, have not led to social unrest. If anything, they have forced the nations that were considered the typical rentier states to imagine a world beyond oil and take action to prepare for such a future. This may ultimately lead to stronger and more balanced economies and perhaps stave off the risk of relying on a single commodity over which they no longer have absolute control.

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1 Goldman Sachs pre-OPEC comment in Myles Udland, "CANCEL THANKSGIVING: The Most Important OPEC Meeting In Years Is Happening On Thursday," *Business Insider,* 24 November 2014.

2 "MEES Interview With Ali Naimi: 'OPEC Will Never Plan To Cut'," *Middle East Economic Survey* 57 Issue: 51/52, 22 December 2014.

3 International Energy Agency internal data

4 Aomar Ouali, "Algeria Calls for OPEC to Cut Oil Production," *PennEnergy*, Associated Press, 29 December 2014.

5 Luc Cohen and Liz Hampton, "Saudi's Naimi Rules out Production Cuts; Sees 'freeze' Expanding," *Reuters*, 24 February 2016.

6 "OPEC Monthly Oil Market Report," Organization of the Petroleum Exporting Countries, 10 February 2016, 56-57.

7 "Medium-Term Oil Market Report 2016: Market Analysis and Forecasts to 2021," *International Energy Agency*, 22 February 2016.

8 IEA Executive Director Fatih Birol, "World Energy Outlook 2015," London, November 10, 2015

9 "Medium-Term Oil Market Report 2016: Market Analysis and Forecasts to 2021," *International Energy Agency,* 22 February 2016.

10 Ibid.

11 "World Energy Outlook 2016," *International Energy Agency*, 16 November 2016.