

A Crumbling Giant

OPEC and the New Oil Crisis

Manfred Sieg

The current oil price reduction could have positive implications for the international economy, argues Manfred Sieg, editor-in-chief of the Bonn publication "Energy Report" and an expert on commodity issues. He sees favourable results for the balance of payments situation in most Third World oil importing nations and also a drop in the international level of interest rates. For the oil producing nations foreign currency earnings will drop and could slow down their development programmes. He warns, however, that if oil prices continue to decline it may result in a decreasing will to conserve energy in the countries of the Western world. Another disadvantage for the Western world from the declining prices would be their loss in earnings from the recycling of petrodollars, which is not dealt with here. Sieg sees the pressure on oil prices as a victory for the forces of the market.

After long and difficult negotiations in London, the Organization of the Petroleum Exporting Countries, OPEC, was able to reach agreement after all on a new bench price for oil and on production quotas for individual member nations. The bench price was set at 29 US dollars for "Arabian light" crude oil (previously 34 US dollars), and production of all OPEC countries together should not exceed 17.5 million barrels per day.

All those who had prophesied a break-up of OPEC — and they included not a few experts in the Western industrial nations — have been proven wrong, at least for the present. However the compromise did not come easy for the OPEC countries. Nevertheless they were able to subordinate individual national interests to the interest of the organization as a whole. After all they are well aware that as individual nations they would have a much weaker position against the big international oil companies and the industrial nations than they have now as an organization.

Just how difficult it was to reach a compromise is seen in the following examples.

The OPEC nations Venezuela and Nigeria both have large external debts and can hardly afford further reductions of their foreign currency earnings; yet they will have to accept these cuts if they do not want to become even more dependent economically on foreign countries. They must do this in a year in which elections are to be held in their countries. Even Saudi Arabia is experiencing increasing difficulties. A few years ago Saudi Arabia stopped the wasteful practice of burning off the natural gas associated with petroleum production instead the gas is now used to generate electricity. But this could become the Achilles heel of

Saudi electricity supplies, because if oil production should be reduced significantly below five million barrels then an insufficient quantity of associated natural gas would be produced to generate the electricity power needed by the country.

Interestingly enough, Libya, often portrayed in the West as a troublemaker among the OPEC nations, played a significant role in getting through a compromise by mediating between Saudi Arabia and Iran, the two main opponents within OPEC.

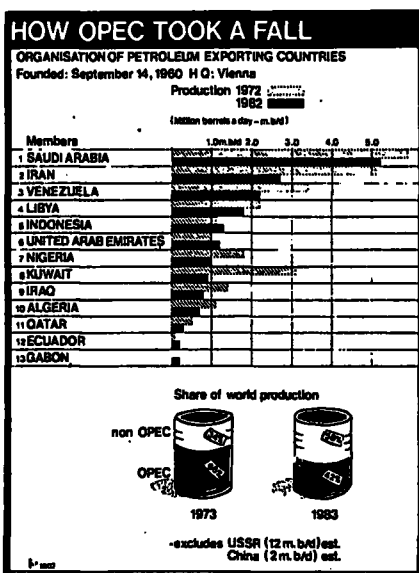
Nevertheless, the compromise remains vulnerable. For example, the new bench price of 29 US dollars is still one dollar over the price of a barrel of oil on the "free" spot markets. In addition, OPEC decided on an overall production quota of 17.5 million barrels per day. However,

the member nations are now selling more than 13 million barrels. In the view of many energy experts, they will not be able to increase sales to more than 16 million barrels daily in the course of the year. Another difficulty for the compromise is seen in the probability that the oil producing nations outside OPEC will increase their oil production from 22.2 million barrels per day to at least 23 million barrels. At the same time, according to estimates of the International Energy Agency in Paris, world oil demand will continue to decrease — by about two per cent to the level of only 44.7 million barrels per day. In addition, it is very questionable whether the oil companies, will increase their reserve stocks during this quarter (April to June), as it is normal for them to do. According to the International Energy Agency, supplies in the Western world are, on the average, sufficient for 102 days at the present time, while in 1979 stocks for only 83 days were on hand.

The current oil price reductions have very positive implications for the international economy. The balance of payments of most nations will thereby be improved, especially of the countries of the Third World that have to import oil. Above all, the international level of interest rates will probably decline. High interest rates are a heavy burden for most countries of the Third World because nearly all of them have large external debts.

Of course, reduced oil prices have a different meaning for the oil producing nations: foreign currency earnings will drop and it is possible that they will experience delays in their development planning. However these disadvantages will be partly compensated by the expected decline in interest rates. A good example is Mexico. The country's external debt amounts to about 80 billion dollars. The reduction in oil prices of one US dollar per barrel will cut Mexico's yearly earnings by 500 million US dollars if production levels remain the same. On the other hand, if the international level of interest rates drops by one percentage point, it will mean a savings of 800 million US dollars per year for Mexico.

The oil producing nations Norway and Britain are also affected; in the past, they have profited from the oil price explosion initiated by OPEC. British oil reserves in the North Sea have brought about a positive balance of payments for the United Kingdom, which last year amounted to the equivalent of 18 billion DM. In the meantime one third of Norway's earnings are due to the export of oil and natural gas.



A collapse of OPEC and the resulting price war among the oil nations — which is still expected by some in the West — would not benefit anyone in the end, not even the industrial nations. For example, the production of North Sea oil only became profitable after the oil price increases of 1973/74. The current oil price reductions will mean a cut in earnings from oil and gas exports of the equivalent of about 800 million DM for Norway and about 4 billion DM for Britain.

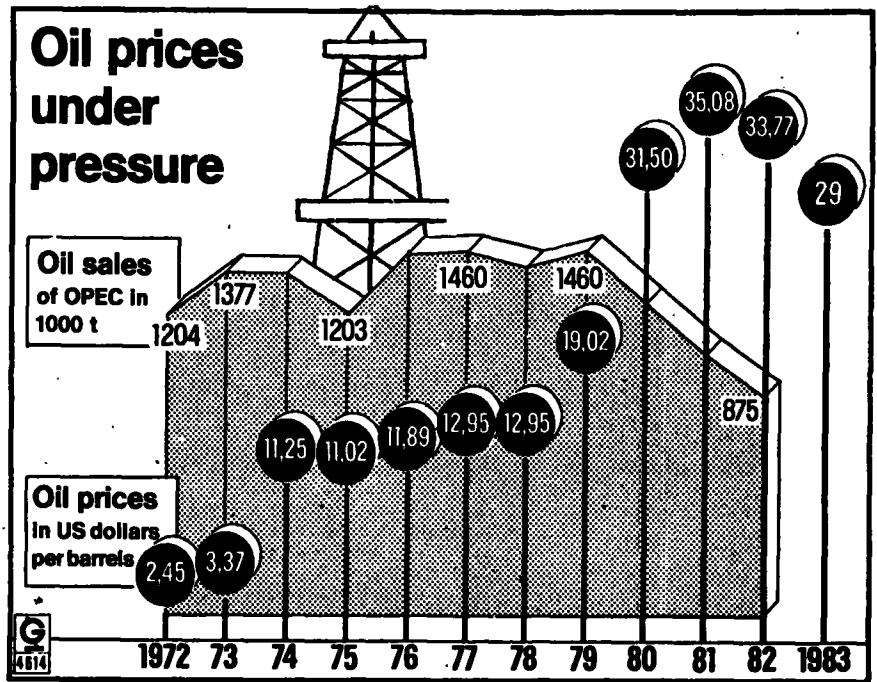
If the oil price were to drop below 25 US dollars per barrel, as some experts are still predicting, then production in

the whole of the North Sea would become unprofitable. Worse still investments in production in the northern part of the North Sea, which make sense in the long run on account of the finite quantities of world oil reserves, would not be made at all. Such sources only become profitable when the price increases to 40 US dollars per barrel. In the meantime, however, 30 small and medium-size fields in the southern part of the North Sea, which represent proven reserves, will not be developed at all because they are not profitable.

Last year Norway already began to feel the declining interest of the oil companies in North Sea oil: At an earlier time, these same companies queued up at the Oslo Energy Ministry at the beginning of the concession rounds. But this time only 15 companies applied for concessions.

If oil prices continue to decline, then a further disadvantage would result from the decreasing will to conserve energy in the countries of the Western world. For example last year it could be observed in the Federal Republic of Germany that the German motorists have evidently accustomed themselves to high petrol prices. For the first time since the oil price crisis of 1979, the average annual kilometres driven by German motorists increased, after this average had declined considerably in 1980 and 1981.

If there were to be an improvement in the situation of the international economy, then a new oil price rise with all of its negative effects would be predetermined. This not least of all because the present glut on the world markets is due not only to the poor state of the international economy but also to the supplies policies of the big international oil companies. In view of the high international level of interest rates, they have reduced their



stores considerably during last year — in the order of 4.5 to 5 million barrels per day. The countries that would suffer most from an oil price war would be the countries that import oil because, for example, they would receive less development aid.

In the past few years, the OPEC nations on the average have placed 2.5 percent of their gross national products at the disposal of the other Third World countries in the form of development aid, and the leaders, for example Qatar, have contributed up to ten percent. The industrial nations, on the other hand, on the average have contributed only 0.35 percent (the Federal Republic of Germany up to 0.47 percent) of their gross national products as development aid, even though for years they have committed themselves in a more or less binding way, to contribute at least 0.7 percent of their annual GNP to development aid.

Large price increases and decreases can only be avoided by an understanding between the oil producing nations and the most important consumer nations on production quotas and the development of oil prices. An agreement of this kind seems to be indispensable to the health of the international economy, because the interdependence of all nations is increasing. As a result, extreme fluctuations in oil prices have serious consequences for the

international economy and for the international finance system. Until now, however, all attempts in the direction of an understanding have failed — for example, the "Conference on International Economic Cooperation" in Paris in 1977. The mutual distrust between the Third World and the industrial nations was simply too great. A second attempt, the so-called Taif-Proposal, which was drafted under the chairmanship of the Saudi Arabian Oil Minister Sheik Ahmed Zaki Yamani, failed even before it was voted on by OPEC on account of the beginning of the Iraqi-Iranian war. This proposal provided for an indexing of the oil price so that price increases would be linked with increases in prosperity, that is, the gross national products, of the industrial nations and also linked with international inflation rates.

Nevertheless, there are some bright spots. A step in the right direction is the European-Arab dialogue, which however, has had a rather hesitant start until now. A more encouraging fact, however, is the increasing awareness among Western politicians that such an agreement is necessary. They believe that if there had already been an agreement on price developments in 1979, then there could hardly have been a price jump of 150 per cent and the present crisis of the international economy could probably have been largely avoided.