Written by Bob Adelmann on October 13, 2014

OPEC Continues to Unravel

With oil production from the Bakken formation in North Dakota now exceeding one million barrels a day and the Eagle Ford and Permian Basin oil fields in Texas producing more than three million barrels per day, prices for crude are dropping worldwide and pushing gasoline prices down along with them.

Crude oil prices on the New York Mercantile Exchange hit a 52-week low of $83.59 a barrel last Friday, while Lundberg just reported average prices for gasoline across the country have dropped to $3.26 per gallon. As recently as May 2, gas in the United States cost $3.72 a gallon.

In response to these falling prices, Saudi Arabia, the largest producer in OPEC, earlier this summer cut its production by 400,000 barrels per day. That did nothing to stem the decline in prices, and so, just last week, OPEC's largest producer decided to recognize reality and unilaterally cut prices to its best customers, leaving its cartel members in disarray.

To add insult to this injury, Saudi Arabia then solicited long-term cut-price contracts with a number of its best customers in order to protect its own market share.

This was met by a decision by Iraq's State Oil Marketing Company on Sunday to cut its price on its Basrah Light crude to its favorite Asian and European buyers by between $3 and $5 a barrel.

This was too much for Venezuela and the country's foreign minister, Rafael Ramirez, called for an urgent meeting to discuss strategy. That call was ignored, and plans remain in place for the regular cartel meeting scheduled for the end of November.

Amy Myers Jaffe, executive director of energy at the University of California, Davis, expressed her astonishment: "There is a price war within OPEC. It is the most fractured I have ever seen OPEC."

A measure of discomfiture among members of the cartel is the recent behavior of Saudi Arabia's longtime oil minister, Ali al-Naimi, who for years provided the soothing ointment needed to keep the cartel together. At regular semiannual meetings Naimi would arrive early to schmooze with the other members and lay the groundwork for agreement as to production quotas and price targets.

Not anymore. At OPEC's last meeting, Naimi showed up late and attended only one session, at which he recommended that an annual meeting would be more than sufficient under the new conditions. Said an observer at that meeting, Naimi's message was clear: "We don't need a meeting. People come and make nice when at the end of the day, Saudi Arabia carries the burden of balancing the oil market." Added the delegate, Naimi "feels there is no point in talking as everyone does as they please."

The new normal was admitted by OPEC member Kuwait when Ali al-Omair, that country's oil minister, admitted on Sunday that the other members of OPEC were just going to have to suck it up and get used to lower, perhaps much lower, oil prices. Omair said prices could drop to $76 per barrel, which gets close to the average production costs per barrel in Russia and the United States.

It was just six years ago this summer that Saudi Arabia found itself in a similar position. At the start of the Great Recession, economies around the globe were contracting and prices for crude had dropped by almost 30 percent between July and September 2008. The cartel officially announced a cut in production to keep prices from falling below $100 per barrel. Following that announcement, however, Saudi's Oil Minister Naimi spent most of the day holding private conversations with nervous customers to assure them that his country would nevertheless supply all the oil that was needed.

Once again, Saudi Arabia appears to be going its own way, against the wishes of the cartel. It remains to be seen whether this signals the death knell for this cartel that dates back to the early 1960s.

Photo showing row of oil pumps in Bahrain: AP Images

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