



Written by [Bob Adelman](#) on December 28, 2014

Collapse in Oil and Natural Gas Prices Hitting OPEC the Hardest

As prices for crude oil and natural gas continued their precipitous fall over the last five weeks, most commentators have been focusing on the impact — real or predicted — on the oil and gas industry in the United States. Little noticed, however, was [the report](#) from the U.S. Energy Information Administration (EIA) about how those declines are likely to affect OPEC.



OPEC's total revenues, which hit an all-time high of \$900 billion in 2012, are expected to *decline by half* next year, to just \$446 billion. And that projection is based on the assumption that oil prices will average \$68 a barrel in 2015. In the futures market on Friday, December 26, crude oil closed at \$55.14 a barrel.

Last week alone, crude prices fell 4.2 percent. Over the last five weeks, crude cratered 28 percent — a breathtaking decline. Meanwhile, natural gas prices have dropped to \$3 per million British thermal units (MBTU), a level not seen in more than two years.

One U.S. company caught in the undertow is Hercules Offshore, Inc., of Houston. Founded in 2004 just before the fracking revolution really started taking off, the company announced it is now laying off 324 of its 2,100 employees because of the drop in demand for its offshore drilling rigs. The company's executive vice president, Jim Noe, put it bluntly: "We've never see this glut of supply and dislocation in [the] oil markets."

This is just the beginning, according to Tom Runiewicz, an economist at oil industry forecaster HIS Global Insight. He estimates that companies such as Hercules providing support services to oil and gas drilling companies could be forced to lay off 40,000 jobs by the end of next year, while equipment manufacturers could lose another 5,000 to 6,000 jobs as the industry shrinks to reflect the new reality.

According to Mark Mills, a senior fellow at the Manhattan Institute, nearly a million Americans now work directly in the oil and gas industry, while another 10 million provide support in the areas of equipment manufacture, pipeline construction, rail transportation, and residential construction, as well as health and food services. The industry is contributing between \$300 and \$400 billion to the economy every year, without which, according to Mills, GDP growth in the United States would still be negative and the economy still in recession.

The growth in the industry, propelled by the fracking boom, has been remarkable. In just two years, U.S. daily oil output has risen by two million barrels, from seven million barrels per day to over nine million. And natural gas, another byproduct of the fracking boom, is now so abundant, wrote Mills, "that the U.S. now has a permanent competitive global advantage both for domestic industries and exports...."



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The U.S. is [now] a net exporter of refined petroleum products (gasoline, diesel, jet fuel) for the first time since 1949.”

But the declines already announced by Hercules and predicted elsewhere in the junk bond sector that has been supporting the industry fade into the woodwork compared to the impact being felt by OPEC. On Christmas Day Saudi Arabia announced its 2015 budget, which assumed that oil prices would average \$80 a barrel for the next 12 months. That’s \$20 a barrel below its break-even point needed to balance its budget; but it has run out of options. As Travis Holum, writing for *Marketwatch*, noted:

OPEC is really stuck between a rock and a hard place when it comes to oil prices. If it cuts production, this could raise prices temporarily, but producers in the U.S. and around the world would go back to drilling as they’ve done in the last few years ... long term, OPEC would lose market share and power.

The other option is to stay the course and try to get U.S. shale producers, Russia, and other marginal producers to give up drilling ... maintaining OPEC’s long-term gain.

By staying the course, OPEC might inflict minor temporary damage on U.S. producers, with layoffs and some bankruptcies among highly leveraged companies, but with a regional impact limited to oil- and natural gas-producing states such as North Dakota and Texas. However, for OPEC’s cartel members such as Venezuela, Iraq, and Ecuador, staying the course and letting oil and natural gas prices find a bottom on their own would result in massive dislocations and national bankruptcies. All three countries were already running deficits in 2013 when oil prices were high, and now the situations there have turned from inconvenient to critical.

In Venezuela, for example, where oil accounts for 95 percent of its export earnings and 25 percent of its gross domestic product, the veneer of civilization is already wearing very thin. On December 1, CNBC reported that OPEC’s decision to “stay the course” and continue to pump oil regardless of price, “may mean ‘game over’ for the [Venezuelan] economy.” It added:

As the price of oil hits a four-year low at \$70 a barrel, [Venezuela] is set to implode ... bringing deeper political instability and chaos.

Venezuelan economist Angel Garcia Banchs told CNBC:

It will be a year of extreme scarcity. What’s coming to Venezuela is chaos that will probably lead to barbarity and people looting.

If the price of oil stabilizes at around \$55 a barrel, as the futures market seems to be indicating, U.S. producers will manage to escape long-term damage. But for OPEC, the unravelling will have far more lasting and damaging impacts, as those countries will no longer be able to fund their welfare states with their oil revenues. The unwinding of those welfare states will be painful to watch. If oil prices drop further, that unwinding will become excruciating.

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