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OPEC Cartel Failure Drops Oil Prices, Rattles Markets

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Following the failure of a meeting by members of the oil cartel known as OPEC (Organization of the Petroleum Exporting Countries) in Vienna last week to extend its production cuts, Saudi Arabia's oil company, Aramco, announced price cuts across all markets and an increase in its production.

The failure came on the heels of an announcement by the International Energy Agency (IEA) that it had reversed its previous estimate that demand for oil would increase in 2020 and predicted that worldwide oil demand would drop by 700,000 barrels a day instead. That announcement was historic, the biggest drop in demand in a decade.

It also occurred at a time when the concerns over COVID 19/coronavirus had reached panic proportions, leaving hotel rooms, airlines, and tour companies facing sharp declines in passenger bookings.

In other words, the timing was perfect for what happened next. Oil prices dropped by more than 20 percent over the weekend, feeding concerns that the coronavirus was going to turn into a worldwide pandemic of historic proportions. This led to trading curbs being applied within minutes of the opening of the stock market on Wall Street on Monday morning as stock prices at the open fell by more than seven percent.

Cartels are notoriously precarious instruments as they depend upon their members to agree to subordinate their own separate interests in the short run to gain both market share and profits in the long run. But when early overtures to Russian president Vladimir Putin by Saudi officials to extend the present agreement to restrict production and then to expand it failed, the meeting in Vienna ended suddenly.

Saudi officials declared war on Russia through price cuts and promises to expand production into an already oversupplied world market, seeking to punish the recalcitrant non-member for failing to go along with the members of the cartel. The *Wall Street Journal* noted that "the price cuts are aimed directly at Russia's market share, Saudi officials said … [while in addition planning] to boost its crude output as well."

Some are blaming the Saudis for the drop in oil prices because of its attack on Russia, while others are blaming Putin for not going along with extending the production-cut agreement. But the real cause of the drop in oil prices is the failure of the cartel to keep oil prices above free market levels. The cartel has been successful in keeping prices abnormally high since 2016, when the agreement to limit oil production was first announced. Keith Johnson, writing for *Foreign Policy* magazine, expressed it this way: "Friday's collapse was a stunning setback for OPEC which has since 2016 aggressively managed the supply of oil to keep prices from falling too far." In other words, up until Friday, the cartel had succeeded in keeping oil prices inordinately high.

But with the collapse of the agreement and the acrimony following the ending of the two-day meeting in Vienna on Friday, the world is about to see what oil prices should be without the OPEC cartel's intervention.

Some members will be severely impacted, including Saudi Arabia (which needs oil prices higher than $80 a barrel to balance its budget) and Russia (which requires oil prices above $40 a barrel to pay its bills). In the United States, frackers will be facing the challenge of lower — perhaps much lower — oil prices. But lower oil prices have enormous advantages, not the least of which is the increased incentive by producers to lower their operating costs in order to stay profitable in a lower price environment.

The obvious beneficiary of lower oil prices is the American vehicle owner. But any industry that is energy dependent will also enjoy the surprise bonus. In general any reduction in energy costs lowers the cost of production of goods, thus allowing consumers to stretch their budgets and improve their standards of living.

A free market in energy will not only continue to drive efficiencies; it will also drive improvements such as self-driving cars and over-the-road trucks. It will provide consumers with more choices and options when deciding when and where to spend their discretionary income. Those producers unable to meet the new challenges of lower oil prices will make way for those who can.

In general the collapse of the OPEC cartel, as evidenced by its failure to extend its anti-free market oil production agreement last week, will ultimately result in a higher standard of living for consumers across the globe. It is to be heralded not only as an historic event but as an unalloyed victory for the free market.

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