Written by Bob Adelmann on May 15, 2017

# Russia, Saudi Arabia Release Trial Balloon: Extend Production Cut by a Year

In a joint statement released on Monday, oil ministers from Russia and Saudi Arabia said the present crude oil production reduction agreement reached last November should be extended for another year. The original target was a reduction of world crude inventories down to its five-year average. Since the present agreement didn't come close, it should be extended, said Saudi energy minister Khalid al-Falih:

> There has been a marked reduction to the [world's] inventories, but we're not where we want to be in reaching the five-year average. The agreement needs to be extended, as we will not reach the desired inventory by the end of June [2017].

His claim that there has been a "marked reduction" in global supplies was contradicted by OPEC itself in a report released last Thursday. World stockpiles of crude increased by 31 million barrels from the last quarter, resulting in an excess supply of 276 million barrels above its five-year average. Any assent to extend the agreement must include vastly larger cuts from OPEC members even to begin to whittle away at that overhang and bring the market back into "balance."

The present agreement was supposed to reduce OPEC production by 1.8 million barrels per day (bpd), but it failed miserably. Thanks to cheating (several members boosted their daily production in advance of the cuts so they wouldn't feel as much pain when the agreement kicked in on January 1), and exemptions granted to Iran, Libya, and Nigeria, the actual net reduction was about 800,000 bpd. That translates to one percent of the world's crude oil output. That was enough to push crude prices slightly higher for a couple of months but not enough to keep them moving higher. Instead crude oil prices on the world market fell, touching $45 a barrel in early May.

Albert Einstein is famous for many things, including his definition of insanity: doing the same thing over and over again and expecting different results. Russia and the cartel are reaching out to non-members in an effort to persuade them to join the production-cut agreement. Those efforts have recently been focused on Egypt and Turkmenistan, whose total daily production amounts to just 700,000 bpd. Eleven non-member states are being targeted by the cartel in what increasingly appears to be a last-gasp effort to cut world inventories and raise crude oil prices.

OPEC itself sees the problem: U.S. oil producers are coming back online far faster than originally anticipated. In last Thursday's report it said:

> U.S. oil and gas companies have already stepped up activities in 2017 as they start to increase their spending amid a recovery in oil prices. In addition to the growth in the U.S., higher oil production is expected in Canada and Brazil.

Because of those "stepped up activities," OPEC said that the U.S. energy industry is likely to exceed earlier estimates substantially. Its previous estimate was that U.S. production of crude would increase by 285,000 barrels a day in 2017. Now it looks like U.S. production will increase by 820,000 barrels a day, neatly wiping out the reduction that OPEC's present agreement was alleged to have accomplished.

Even that upwardly revised estimate could fall short of reality. In North Dakota alone, production has surged by nearly 10 percent just since December, thanks partly to the removal of the kink in the Dakota Access pipeline that is allowing it to come to full capacity next month. It's also driven by continued improvements in technology that is now making lifting costs in the Bakken oil field very competitive with those of OPEC. With more than 100 oil fields in the United States enjoying the same technological improvements, the United States is simply replacing whatever the OPEC agreement takes out of world production, making OPEC increasingly irrelevant.

In other words, the present OPEC agreement, midst much fanfare, birthed a gnat. There's little likelihood that extending it will accomplish much more. As Michael McCarthy, chief analyst for CMC Markets, a London-based financial derivatives dealer, put it in a breathtaking understatement: "OPEC no longer has the clout it once had."

*An Ivy League graduate and former investment advisor, Bob is a regular contributor to* The New American *magazine and blogs frequently at LightFromTheRight.com, primarily on economics and politics. He can be reached at badelmann@thenewamerican.com.*

Related article:

OPEC Increasingly Irrelevant as Cartel Seeks to Extend Output-cut Deal