The Inevitable Demise of the OPEC Cartel

Following the death of Total SA's CEO, Christophe de Margerie, on October 20, OPEC sent this letter to the board of the multinational oil and gas company expressing sorrow over the loss:

> It is with the deepest regret that the Organization of the Petroleum Exporting Countries (OPEC) learned of the tragic death of Christophe de Margerie, Chairman and Chief Executive Officer of French oil major, Total SA, who died when his corporate jet struck a snow plough on a runway at Moscow's Ynukovo airport late on Monday 20 October.

Missing from the letter was any mention of the demise of OPEC, which has been slowly imploding for years. Recent events have significantly speeded up the process, which is making OPEC more of a spectacle and much less of a major player in the world's energy markets.

Tim Treadgold, who follows the world's energy markets, wrote less than a month ago in *Forbes* that he was breaking a journalist's unspoken rule: Never forecast the demise of an institution (as was done to Mark Twain — "reports of my death are greatly exaggerated") until it's a hard provable fact with a coroner's report in hand:

> At grave risk of committing [that] cardinal sin … this time it might be different because OPEC is steadily losing control of the oil market.

The reasons are manifestly obvious to even the most inattentive observer: With Saudi Arabia's failed attempt to halt the accelerating decline in the world price of crude oil by cutting its production by 400,000 barrels a day last summer, and then its capitulation by announcing cuts in its prices, that country — once the "swing producer" in OPEC — has given up any attempt at coordinating its efforts with other members of the cartel and is going it alone. Its oil minister has even called for OPEC to cut back on its semi-annual meetings, as they appear to the public to be more and more obviously just a meeting of oil ministers without impact — a club of the former good old oil boys. When Iran's oil minister called for an emergency meeting prior to the one scheduled for November, it was ignored.

Price cuts by other cartel members are not being met with sanctions from the cartel. Instead those cuts are being matched and sometimes more than matched by other cartel members.

Said Treadgold:

> Today's oil crisis is [now] one with a twist: countries which once dictated terms to the rest of the world … are now facing an existential dilemma.

This can't happen too soon, according to Harold Hamm, the CEO of Continental Resources which has been driving development of the Bakken Shale in North Dakota. Expressing his delight at OPEC's imminent demise in an editorial at *Investor's Business Daily* over the weekend, Hamm wrote:

> OPEC is becoming a toothless tiger.
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> The underappreciated reason for this bullish turn of events is the U.S. energy revolution and the technologies that make this all possible….
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> America is no longer a bit player in global energy production. Now our country is well-positioned for energy independence by the end of the decade and then for world energy supremacy for decades to come.

Because of those technologies, oil production in the United States has increased by more than 65 percent in just the last five years. Hamm said this gives the United States an unprecedented opportunity to end OPEC altogether:

> We can and should use our nearly unlimited oil and gas supplies to drive a stake through the heart of OPEC — forever.

Hamm needn't worry. The free market in oil pricing has been driving that stake into OPEC's heart for years. As the International Energy Agency just noted, their forecast for demand for oil in 2015 has been adjusted downward in anticipation of lackluster demand from struggling economies such as Japan and China while estimates of supplies has been adjusted upward to reflect continuing production gains from the United States. At the time of the oil embargo of 1973 engineered by Saudi Arabia and other OPEC members, world demand for oil was less than 60 million barrels per day (bpd). OPEC was supplying nearly half of that and so was in a position to punish supporters of Israel in the Yom Kippur War by tripling its prices and placing embargoes on exports to the United States and the U.K.

That was then. This is now: Demand is more than 90 million bpd while OPEC supplies less than a third of that, and Saudi Arabia only supplies a third of OPEC's output. Put simply, Saudi Arabia has been out-produced by the United States while its own production has remained stagnant. Its oilfields are near maximum production now, and little if any investment in the new fracking technology is taking place there. It's just a matter of time before Saudi Arabia and OPEC itself are relegated to mere footnotes in the world history of oil.

Jeff Colgan thinks that those footnotes have already been written. Colgan, a professor at American University, did a research paper studying price behavior of OPEC's members since 1982 and published his results in the *Washington Post* in October 2013:

> OPEC rarely if ever influences its members' oil production rates. It has almost no impact on prices….
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> I found that … members cheat on their quotes a whopping 95 percent of the time; [that] changes in OPEC quotes have little impact on changes in production; and [that] members of OPEC produce oil at about the same rate as non-members of the group….
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> Any of these findings would cast doubt on OPEC's status as a cartel; collectively they are damning.

So what's the big deal? Why all the falderol and all the attention given by the press to OPEC's meetings at elegant venues around the world? Said Colgan:

> OPEC is a political club.
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> It perpetuates a "rational myth" about its cartel power [in order] to generate political benefits and prestige for its members.

This is one more advantage the fracking revolution is enjoying: It is exposing OPEC as the king without his clothes. It's been a long time coming. The unraveling of the OPEC cartel this time appears to be terminal.

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