The Oil Drum: Europe
DISCUSSIONS ABOUT ENERGY AND OUR FUTURE

What should OPEC do?

Posted by Euan Mearns on December 11, 2008 - 10:54am in The Oil Drum: Europe
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When OPEC meet on 17th December, how will they go about deciding the size of the inevitable production cuts?

All OPEC states want the oil price to rise from current $44 / bbl (WTI). Some states will also be concerned that the price target is affordable by their OECD customers. But set against a backdrop of global economic turmoil and volatility in all markets, how do they judge the size of the production cut required to deliver the target price? Saudi Arabia is reported to **favor a price of $75 / bbl**, just short of the cost of **new marginal supply in the OECD**. Achieving this price in the medium term would keep OPEC in the driving seat.

This short post is intended to be a discussion thread. Below the fold, I outline one radical idea for OPEC to achieve their goal in the short term.

At this point it is worth recalling that the recent oil shock is fundamentally different, compared to the oil shocks of the 1970s. Back then the order of events was as follows:

1. Strong demand
2. OPEC cut supply
3. Price spike
4. Inflation and recession

And the situation now:

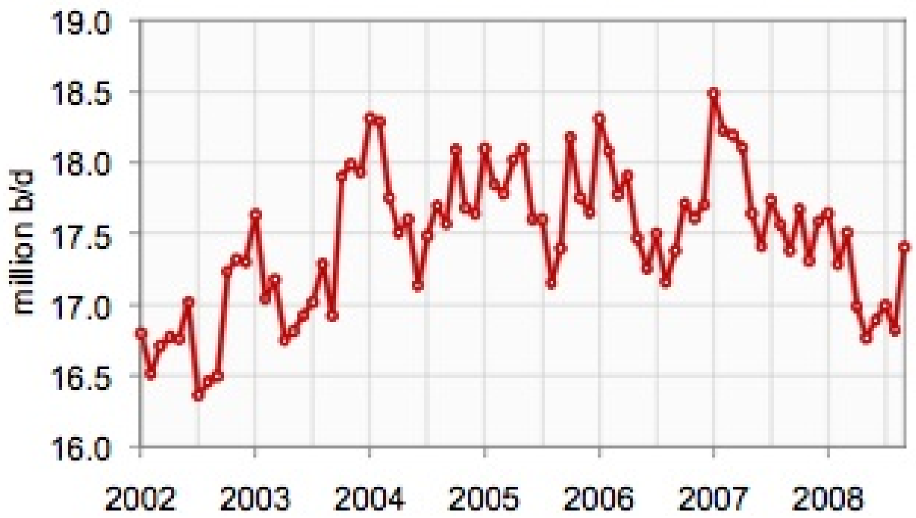
1. Strong demand
2. Price spike
3. Inflation and recession
4. OPEC cut supply

It is also worth recalling that with the passage of every year, the share of global production and oil exports is swinging towards the OPEC countries. If Russia and Brazil, who are both in talks with OPEC over **collaboration on oil prices**, are included, then the exporting countries are in a very strong position indeed.

Chart 32: OPEC Liquids Exports January 2002 - August 2008

Source: derived from the IEA, EIA and JODI Database

Chart 31: Non-OPEC Liquids Exports January 2002 - Sept. 2008



Source: derived from the IEA, EIA and JODI Database

OPEC and non-OPEC liquids exports. Both charts from Rembrandt Koppelaar's November ***[Oil Watch Monthly](#)***.

And so here is the not so very radical proposal. If OPEC ± Russia and Brazil want $75 / bbl, then they should consider setting this as a minimum price (adjusted for local variations in crude oil quality). The market would then adjust the call on OPEC crude at that price. OPEC quotas would then have to be set on a % pro-rata basis instead of the current production allocation. And OPEC would be free to adjust the minimum price at any point in the future, although if the price exceeds the set minimum it will mean that the world is once again pumping at maximum capacity.

The risk to OPEC would be that the World cannot afford $75 / bbl, and consumption will continue to fall, thus eroding their market share.

OECD governments may dislike the thought of such a market intervention, but would need reminding that the freedom of our markets is already severely compromised and that a prolonged period of low oil price may jeopardise future supplies and undermine moves to alternative forms of energy.

Food for thought.