Our View: An OPEC Temper Tantrum

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OPEC Secretary General Haitham Al Ghais characterized the International Energy Agency's five-year forecast of oil supply and demand, released this month, as a "dangerous narrative" because it shows global oil use peaking by the decade's end. Al Ghais wrote that the forecast would discourage investment in oil exploration and that reduction would lead to higher prices and greater price volatility.

The secretary general's statement is a plaintive cry from the executive of an organization confronting irrelevance. The agreement between OPEC and OPEC+ countries, like all pacts among commodity-producing nations, has lasted only a few years. Al Ghais' words are the clearest admission yet by oil producers that they are losing control of the market.

The feeling of irrelevance is plainly growing in the halls of OPEC. The IEA's forecasts get worldwide attention. OPEC's do not. Thus, these remarks from Fatih Birol, the IEA's executive director, undoubtedly struck a raw nerve with Al Ghais:

> "As the pandemic rebound loses steam, clean energy transitions advance, and the structure of China's economy shifts, growth in global oil demand is slowing down and set to reach its peak by 2030. This year, we expect demand to rise by around 1 million barrels per day," said IEA Executive Director Fatih Birol. "This report's projections, based on the latest data, show a major supply surplus emerging this decade, suggesting that oil companies may want to make sure their business strategies and plans are prepared for the changes taking place."[1]

An Argus Media op-ed quoted Birol similarly and then included these additional observations from his agency:

> The IEA expects non-Opec+ supply—particularly from the Americas—to exceed demand growth over the rest of this decade. With Opec+ spare crude capacity projected to reach almost "unprecedented levels" of 8mn b/d by 2030, "such a massive cushion could upend the current Opec+ market management strategy aimed at supporting prices," the IEA says.[2]

The Argus piece also noted that OPEC has lost its competitive advantage compared to oil companies, citing a Goldman Sachs report. It explains that large oil companies can be more profitable today with prices at $80 per barrel than they were ten years ago when prices were $100. This development reverses economic thinking regarding oil, which has held that ever-rising costs

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[1] "Slowing demand growth and surging supply put global oil markets on course for major surplus this decade," *IEA News*, June 12, 2024 [https://tinyurl.com/v3dm99uz].

[2] "Opinion: Last Man Standing," Argus Media, June 14, 2024.

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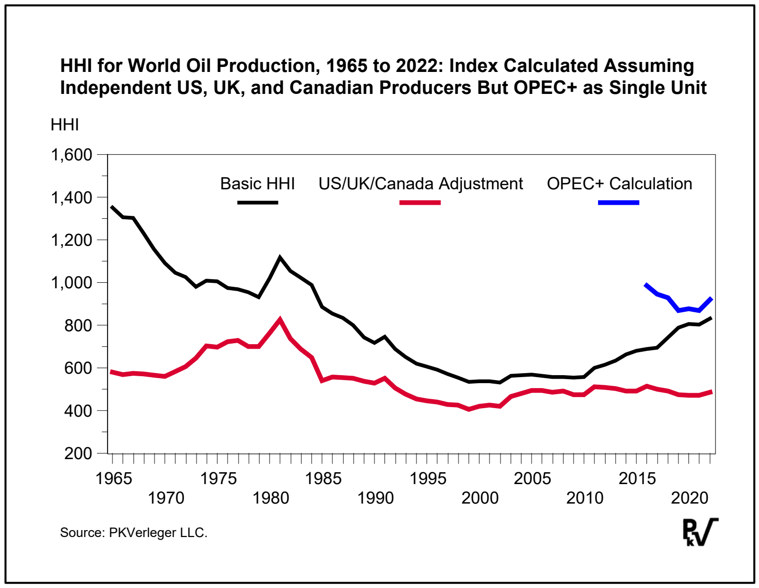
for developing oil resources provided a perfect framework for increased market control by OPEC and then OPEC+.

The changed situation is captured by the Herfindahl-Hirschman Index (HHI), the standard measure of a market's competitive condition today. Competition authorities focus on HHI values above 800 as indicating some ability to sustain prices above marginal conditions.

The figure here shows three measures of the world oil market's concentration. The simplest depiction (the black line labeled "Basic HHI") treats each producing nation as a single producer in calculating the index. The Basic HHI data show the oil market was concentrated in the 1970s. The concentration then eased gradually over the next thirty years until around 2010, putting prices under downward pressure for the first twenty years. Concentration then steadily increased through 2023.



However, the basic calculation overstates the concentration because it treats at least three of the indexed countries—the United States, the United Kingdom, and Canada—as single producers. They are not. Production in these nations is undertaken by individual companies, none of whom have received government direction as to how much oil they can produce since the early 1970s. The second calculation (the red line labeled "US/UK/Canada Adjustment") presents an adjusted HHI that accounts for the competitive conditions in some oil-producing nations. Under this scenario, the economic pressures would keep world oil prices low, as indeed they were from 2010 to 2022.

Concentration increased, though, when OPEC+ was formed. Our third calculation (the blue line labeled "OPEC+ Calculation") assesses the oil market concentration in which Kuwait, Russia, Saudi Arabia, and the UAE coordinate their production to sustain higher prices. Their cooperation boosts the HHI to a level where the group has market power if its members work together.

The key requirement is "work together." If the IEA forecast is correct, OPEC nations must live in a no-growth environment in which lower-cost producers capture more and more of their market. We know of no **restrictive commodity agreement**, the technical description of OPEC+, that has survived under such conditions. Efforts to stabilize tin, rubber, coffee, and other commodity prices have all foundered in these circumstances.

The OPEC secretary general's objection seems to be that the IEA refuses to project a higher growth rate for consumption, one that would allow oil-exporting countries to boost output. The IEA, for example, expects world oil use to grow by 2.2 million barrels per day between 2024 and 2030, while

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OPEC optimistically projects growth of 5.5 million barrels per day. The IEA's seeming ignorance prompted Al Ghais to lash out: "Everyone is free to have an opinion, but it is important that this is based on the realities we see before us today."[3]

Apparently, the truth (the stagnating demand for OPEC+ oil, its decline in stature and influence, and the increasing competition from the majors and independents) stings. As it stands, exporting countries are likely looking at lower prices for longer, especially as private-sector firms drive down costs even more in the United States and other countries while continuing to boost their production.

[3] Haitham Al Ghais, "Peak oil demand not on the horizon," EA Forum, June 13, 2024 [https://tinyurl.com/mpbvp8k6].

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