Oil producers believe they must bring the industrial nations to their senses—for the sake of the whole world's future.

OPEC Is Acting in Self-Defense

Loring Allen

Two hundred oil specialists from around the world met in Vienna late last fall to talk with the Organization of Petroleum Exporting Countries, OPEC. As owners of two-thirds of world oil reserves and seven-eighths of oil exports, OPEC's members can make the future they want come true. Their conference in Venezuela last month only confirms this.

OPEC's headquarters is a squat, square building along the Danube Canal almost in the shadow of St. Stephen's Cathedral. Thirty-five countries sent official representatives, and though the United States sought no invitation, twenty Americans were on hand—about half from oil companies, the others researchers and scholars. The speeches were somber, even gloomy, reflecting troubled waters ahead.

The power struggle between OPEC and the oil companies began in 1970 and brought victory to OPEC with the quadrupled price of 1974. From 1974 through 1978 the market settled down. Crude-oil extraction rose slightly and prices inched up. But the purchasing power of oil declined by nearly a half. Because of enlarged demand and shrinking supplies from Iran, the oil world of 1985 suddenly became the world of 1980. Prices in 1979 almost doubled; oil's 1974 purchasing power returned. Events have foreshortened the time during which both OPEC and oil imports can adjust to the future. World crude-oil supplies are limited now, can expand only slightly, and will soon decline. The trend of price is up. OPEC will soon take "whatever measures are necessary" to protect the purchasing power of its oil. Oil-importing countries must conserve oil and urgently press substitutes. OPEC stands ready to cooperate on oil whenever the oil-importing countries begin to bargain seriously on world economic reform.

OPEC's basic assumption is that the world is running out of oil. Present proven crude-oil reserves are less than 700 billion barrels, of which 450 billion are in the thirteen OPEC members. Extraction in OPEC in late 1979 was running a little less than 35 million barrels a day, 12.5 billion barrels a year. Supplies at current consumption rates are sufficient to last until 2015.

Non-OPEC non-Communist oil extraction was 6.5 billion barrels of that area's proven reserves of less than 200 billion barrels, enough to last until 2010. Soviet oil, already at peak extraction, will soon decline and will be gone by the turn of the century. If the world continues to use oil at the present 64 million barrels a day, proven reserves will disappear in about 2010.

His Excellency Dr. Mana Saeed Al-Otaiba, minister of petroleum and mineral resources of the United Arab Emirates and president of the OPEC Conference of Oil Ministers, told the seminar participants that "OPEC cannot forever continue to raise its oil production to make up the balance between supply and demand...OPEC has a limit for its production increase." Other oil ministers repeated the warning.

Most oil experts believe that as much oil may remain undiscovered as has been discovered so far. New technology may permit recovery of a higher percentage of the oil in the ground. Both will require huge investments, and the oil will be very high in cost. In addition, even supposing that a trillion more barrels turn up, present consumption rates would still exhaust world oil by about 2050. James Akins, former U.S. ambassador to Saudi Arabia, now an oil consultant, said that "the decline in production of conventional oil will almost certainly start before the end of this century and by 2025 will be of relatively little importance in the world total energy scene." The experts disagree on dates, a decade or two one way or the other. But all agree that the wrenching adjustments to a world without oil as a fuel will come before the midpoint of the next century.

OPEC makes it clear that it will not exhaust its oil to suit the convenience of oil-importing countries. The basic goal of OPEC members is to modernize and develop their economies so they can continue to grow without oil. They will extract and sell oil to suit that need, not

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LORING ALLEN, Professor of Economics at the University of Missouri, St. Louis, traveled to Vienna for the seminar he describes here. His book *OPEC Oil* was published in November.

the desires of buyers. Up to now, however, OPEC has been the residual supplier. It set the price and sold what buyers wanted at the price. The result has been fluctuating and growing extraction of crude oil.

OPEC is now undergoing a sea change. The Vienna meeting was one of the signs. Instead of concentrating on price and letting extraction follow the caprice of the market, members will determine the amount of oil they need to export at the estimated market price to cover their developmental needs. Then, setting a minimum price, they will let the market set the actual price. OPEC expects that chronic excess demand will force market prices up and up.

Ali M. Jaidah is the managing director of the Qatar General Petroleum Corporation. From 1977 to 1979 he was the secretary-general of OPEC. I interviewed him in July, 1978, when he said: "Either the United States acts to improve the position of the dollar and all the industrial countries halt their inflation, or OPEC must act" (*Worldview*, March, 1979). This time Jaidah spoke even more boldly: "Oil prices are subject to fluctuations at the whim of variations in currency exchange rates...it is becoming increasingly important, therefore, that OPEC reverts back, at least as a unit of account, to a basket of currencies." The basket would include depreciating currencies such as the dollar as well as appreciating currencies such as the German mark and Japanese yen. He added: "the purchasing power of OPEC revenues has to be stabilized against inflation by some sort of index." Indexation, however, would only provide the floor for oil prices. Jaidah continued: "Furthermore, oil prices may be expected to increase in real terms in the light of the scarcity of hydrocarbons as well as the continuous rise in the cost of alternatives."

The basket of currencies and indexation will guarantee the future purchasing power of OPEC oil. This stability is important to OPEC because members lost purchasing power from 1974 through 1978. Price increases by OPEC were less than 20 per cent. The oil price fell a bit in 1974, rose slightly in 1975, but did not increase from October, 1975, through the end of 1976. Then, after a small increase, the oil price stayed the same through 1977 and 1978. The export prices of industrial countries between 1974 and 1978 climbed rapidly, nearly 12 per cent per year. The OPEC import price index rose even faster because of the nature of the imports as well as price discrimination. As Nordine Ait Laoussine of Algeria has demonstrated, the purchasing power of OPEC oil at the end of 1978 was about half its 1974 value.

Had OPEC indexed the price in 1974, it would have been about the same as it was in late 1979, $24 a barrel. That price is nearly double what it was at the end of 1978. Expanded demand and reduced Iranian supplies quickly pushed the price above the OPEC scheduled price increases for 1979. Even the prices set in June, plus the Saudi Arabian move to expand extraction by a million barrels a day to full capacity, plus recovery of three-quarters of Iran's oil could not constrain price. Libya, Algeria, and Nigeria in October and November breached the OPEC maximum of $23.50 a barrel set in June. Most other OPEC members moved to the OPEC ceiling price. Saudi Arabia was the exception, holding its price to the OPEC minimum. But prices in the spot market, through which OPEC and the companies sold increasing amounts of oil, rose to over $40 a barrel. The return of 1974 purchasing power in 1979, however, did not recoup the billions of dollars that rising import prices had cost OPEC.

OPEC lost also by pricing in dollars. The dollar's value declined 30 per cent relative to the mark and 20 per cent relative to the yen from January, 1974, to November, 1979. By importing from nondollar countries, OPEC faced not only the inflation of the exporting country, but also the fall in the value of the dollars they earn relative to the exporter's currency.

If OPEC indexes the price of oil, oil-importing countries can expect crude-oil prices to advance at least as fast as their rate of inflation. If that rate is 10 per cent per year, not unreasonable by recent experience, the minimum price in 1985 will reach $42.50 a barrel and, in 1990, $68.50 a barrel. Neither of these prices would add to inflation; they would simply match it.

Most oil people, including Ali Jaidah, believe that the real price of oil will increase. OPEC extraction—in keeping the tension in the market high as shortage moves to chronic shortage and from chronic to acute shortage—will force up the price of oil relative to other goods, approaching the rising prices of oil alternatives. If the real price of oil increases at 5 per cent per year, in addition to inflation, in the first half of the 1980's and 10 per cent per year in the last half, the price of oil will be $55.50 in 1985 and $138 a barrel in 1990. These price increases would add to inflation.

OPEC members feel compelled to protect the purchasing power of oil because their development needs extend further into the future than the life of oil. In the next two or three decades they will be able to take only a few steps up the development ladder, with much of the development task still ahead. OPEC is determined not to let inflation, currency changes, and buyer influence in the oil market force them to subsidize living standards in importing countries and wasteful use of their oil at the expense of their own development.

To OPEC it is more than just economic self-interest; it is also a moral issue. They recognize that unimpeded competitive markets may in the long run confer great benefits on every one. They also recognize that actual markets are amoral and serve the interests of those who control them. Justice is not served when oil-importing countries use their great economic power to keep the price of oil low, the prices of their exports high and rising, and behave in world financial markets to prejudice the welfare of oil exporters. If OPEC can stop this inequity, it will.

If OPEC restrains extraction to maintain tension in the market—and, in any case, extraction stabilizes or declines for want of oil—oil-consuming countries have

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only one escape: oil conservation. They must use less oil and substitute other energy forms. OPEC members pledge to extract as much oil as they can, consistent with their national interests, if they see conscientious efforts in the oil-importing countries to conserve oil.

OPEC applauds the promise of the seven industrial countries at the Tokyo Summit Conference in June, 1979, to constrain oil imports. President Carter even agreed to keep U.S. imports to the present amount through 1985. But OPEC knows that these countries can keep their promises only if they save oil for the most vital uses and force the expansion of energy demand onto coal, natural gas, and nuclear energy. The substitution will require large investments in physical plant and a great deal of time. OPEC fears that oil demand in the decade or two of tooling up for substitutes will exceed its desire and capacity to extract oil.

Both coal and nuclear energy expansion face strong opposition from those concerned with safety and the environment. Nuclear energy is already far behind schedule. The accident at Three Mile Island and rising costs have broken the trend of world nuclear expansion and threaten to undermine its future use. Coal production stagnates in the U.S. despite the widely accepted view that only by expanding it greatly can the serious problems ahead be averted. Coal liquefaction is not even under way. OPEC cannot understand why oil-consuming countries are not moving at breakneck speed to replace oil.

The energy-production ratio has declined in industrial countries, but not fast or far enough. Germans resist speed limits and fuel economy. But they at least pay a higher price for gasoline than do Americans, for whom the cost is only 40 per cent that paid by West Europeans and Japanese. Oil-importing countries seem to act as though oil is a problem that will resolve itself with only modest conservation and substitution policies. OPEC thinks that they are still living in a pre-1974 dream world, reinforced by OPEC's willingness from 1974 through 1978 to supply oil as needed at declining real prices. If oil-importing countries will not conserve oil, then OPEC will conserve for them. If oil-importing countries will not develop substitutes, then OPEC will create conditions in which they use substitutes or have nothing at all. OPEC suggests that oil-importing countries buy its relatively abundant natural gas in liquefied form. OPEC sees no alternative to halting oil's expansion now and preparing for its decline in the near future. As one expert put it: "There is plenty of energy; it is time which is short."

The word cooperation comes easily to the lips of everyone in OPEC and among officials of oil-importing countries. But the word has different meanings. To oil-importing countries it means a deal with OPEC in which sufficient supplies are assured at reasonable and stable prices. To OPEC it means no less than the reform of the world economy and a new international economic order.

David Howell, Britain's secretary of state for energy, told the seminar: "We should be able to concentrate on discussions of the problems related to energy. If we complicate our task by linkages with other extremely important but essentially separate issues, we shall probably get nowhere fast." To which Rene Ortiz of Ecuador, secretary-general of OPEC, responded: "world stability can only be achieved by facing up to the various problems at hand in a frank and and decisive manner...as these problems are interrelated, that is, development, the acquisition of advanced technology, financial and monetary reform, world trade and raw materials, along with various aspects of the energy problem. It is only by collaborating and sharing responsibilities that a harmonious global development can be secured. Therefore, when those [industrial] nations awake to these new realities, it may be possible for an era of cooperation, linked to a frank and fruitful dialogue, to begin."

OPEC says it will not abandon the less-developed countries' drive for world economic reform. The poor countries stood by OPEC during the barrage of criti-

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cism following the OPEC capture of the oil price in 1973. They made no secret of their support, despite the devastating effect of the oil price increases, rejoicing that some poor countries had at last made the rich countries knuckle under. And they hoped that OPEC would pull them along into the catbird seat too. OPEC has promised to do just that.

OPEC members have continued and amplified the rhetoric and policy proposals of the less-developed countries. They elected themselves spokesmen for the poor. Individually and collectively, they mounted foreign aid programs to a hundred countries amounting, in the last six years, to about $40 billion, ten times as much relative to income as that provided by developed countries. All this is not pure altruism. Despite their monetary wealth, all OPEC members have poor, underdeveloped economies. They will share in the greater benefits the new order will confer.

OPEC believes that developments in oil markets—short crude-oil supplies and rising prices—will encourage oil-importing countries to talk about oil and reform. Eventually, advanced countries must pay the price of negotiating on the broader issues of development and making changes in the world economy. OPEC is unabashedly using oil as a lever to get the industrial countries to the bargaining table. Washington and European capitals are writing many plans on how to get on with oil talks, yielding price and supply assurances without concessions on nonoil problems. Meanwhile, OPEC seems content to wait, expecting that the future will bring both oil talks and world economic reform.

OPEC is not a monolith. Despite the propensity of American political leaders and economists to depict it as a cartel and vest it with sinister powers, it is really a loose coalition. James Atkins told the seminar: "OPEC is hardly an organization, much less a cartel. It has never cut production to maintain prices. It is selling its product—an irreplaceable one—at prices still well below the cost of production of alternatives." OPEC is a shell; a discussion club of thirteen oil ministers, whose governments then honor the agreements among the ministers, if it suits their fancy.

There are big and little rifts in OPEC. Members have never been able to agree on production controls (thereby, of course, disqualifying OPEC as a cartel). If members do not agree on price, they set whatever price they please. The price range in November, 1979, ranged from $18 (Saudi Arabia) to $26.57 (Libya, Algeria, and Nigeria), 13 per cent above what the ministers had agreed on in June. The most important disagreement divides the high-price hawks—Iran and fellow travelers—and the low-price doves—Saudi Arabia and some of its Arabian Gulf friends.

The reason for the division within OPEC is not differing views of reality, of the future of oil markets, or of the world economy. Rather, it lies in efforts by nations to use their oil to pursue political and strategic interests outside OPEC common economic interests. Saudi Arabia hopes to use its oil to achieve a Middle Eastern peace acceptable to all Arabs. It is paying with abundant oil and revenue losses—probably around $10 billion in 1979—through low prices. Saudi Arabian recalcitrance could prevent the fulfillment of the future that the consensus of ministers and OPEC professionals foresee.

Saudi Arabia is moving, however, toward those in OPEC intent on making OPEC more effective in defending and promoting its members' economic interests. Sheikh Ahmed Zaki Yamani, the Saudi Arabian oil minister, heads the OPEC Committee on Long-Range Strategy formed in 1978. He has stated publicly that the committee may recommend to the ministers systematic annual increases of 5 per cent or more in the real price of oil. Despite occasional dissidence by Saudi Arabia and others, OPEC cooperation has conferred such great benefits on all members that no country will threaten OPEC stability or in the end act against its own compelling economic interests.

OPEC would prefer to see a future in which the industrial countries eliminate their inflation, restrain their demand for oil, stabilize currency values, and improve the world economy. Under these circumstances, OPEC could then manage the price and extraction of crude oil without taking onerous measures that they know will meet resistance and arouse hostility. But OPEC has all but lost confidence in the ability and willingness of the United States and other industrial countries to behave so as to avoid damaging its members. Thus, OPEC must act.

The Vienna meeting was one of many warnings that OPEC will act soon. Spokesmen for OPEC and its members have been traveling around the world exhorting countries to conserve oil, reduce inflation, stabilize the world monetary system, and reform the world economy. The longer the oil-importing countries put off action, the greater the certainty that OPEC will act decisively to protect its interests.

Those actions, when they come a month or three years from now, may include one or all of the following measures: pricing crude oil in a stable basket of currencies, although retaining the dollar for transactions; tying the oil price to an index of inflation in industrial countries or of OPEC import prices; specifying additional increases in price, forcing the real price up; restricting extraction and export of crude oil to maintain a taut oil market at the price set; urgently calling for new negotiations for world economic reform, offering simultaneously to talk about oil.

In self-defense, OPEC would finally become a cartel, resulting in either a potentially dangerous conflict or another try at genuine international cooperation. [WV]