

## How to Make OPEC Blink

By Gal Luft

Posted February 2008

Every day, more of the world's oil comes from a secretive gang of countries that couldn't care less about your gasoline bill. Here's how consumers can fight back.

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Talk to the hand: OPEC has little patience for the concerns of oil-consuming countries. Crude oil prices continue to hover around the \$90 mark. And the Organization of Petroleum Exporting Countries (OPEC), a consortium of the world's top oil producers, has something to say to consumers: Tough luck. This message was delivered at last week's OPEC meeting in Vienna, where the cartel's member states ignored consumers' pleas to open the spigot and provide some relief.

For OPEC, whose flush-with-petrodollars members seem unconcerned by the pain inflicted on the global economy by oil's meteoric rise, increasing output is not a matter of capacity, but of will. The cartel owns 78 percent of the world's proven reserves and produces about 40 percent of its oil. Its members have plenty of cash to invest in new production, and OPEC has repeatedly claimed it holds spare production capacity of more than 3 million barrels per day. This claim is impossible to verify, thanks to OPEC's notorious lack of transparency. But, if true, it means OPEC can inject a significant amount of oil into the market almost immediately, dropping prices by as much as \$20 to \$30 a barrel.

But OPEC shows no intention of doing so. Instead, it insists that the market is well supplied and that high oil prices are the doing of speculators in New York and London, as well as SUV-driving soccer moms. When U.S. President George W. Bush visited Saudi Arabia, which yields the most influence within OPEC, in January, his request for more oil was swiftly rebuffed by the country's oil minister.

This kind of behavior is only going to get worse. OPEC's control over the oil market grows by leaps and bounds as the reserves of non-OPEC producers are depleting at twice the rate of the cartel. This is primarily because most of OPEC's members are restricting foreign investment and producing under capacity while non-OPEC producers pump at full speed. Two years ago, the chief economist of the International Energy Agency (IEA), the intergovernmental energy-policy arm of developed countries, warned, "We are ending up with 95 percent of the world relying for its economic well-being on decisions made by five or six countries in the Middle East." Also of concern is the fact that OPEC's declared spare production capacity is about half of what it was five years ago. With the sudden surge of demand from Asia and continuing growth in industrialized nations, there is little chance that OPEC will bring it back to previous levels. There is no reason to invest billions in infrastructure that sits idle most of the time.

Begging the Saudis to open the taps is no recipe for energy security. Instead, the West and Asia should find ways to replace the cartel as the sole provider of swing capacity in the global market. Nearly three quarters of the world's oil is consumed by the United States, the European Union, and Asia (China, Japan, India, and South Korea). These countries should band together in building robust strategic petroleum reserves and creating a stabilization mechanism to release the oil in response to OPEC shenanigans. The West and Asia already own an impressive stockpile of oil. More than 4 billion barrels are held in strategic reserves, roughly a third of which is government-controlled (the rest is held by private industry). The United States alone holds an emergency stockpile of some 700 million barrels, a number it intends to double in the coming years. Japan owns 580 million barrels; South Korea has 150 million; and the EU mandates that each member country keep the equivalent of 90 days of imports. Meanwhile, China is in the process of building a 310 million-barrel reserve, and India, 37 million. The IEA has made clear that the emergency stockpiles of its member countries are for strategic purposes only. But were the United States and Europe to increase their reserves significantly and major Asian nations encouraged to break that constraint and establish larger oil banks, within a few years a new Global Strategic Petroleum Reserve (GSPR) could begin to serve as a liquidity mechanism, replacing the failings of OPEC. Here is how it would work: Each major consuming country would be required to contribute to the GSPR an amount of oil in direct proportion to its consumption. The oil would be stored either within its territory or at a location of its choice. A predetermined amount of oil would serve as a blood bank to be accessed only in times of emergency, while the other share of each country's stockpile would be used as a liquidity mechanism. Energy ministers of major consumers would convene on a regular basis—or their envoys would at an International Energy Agency expanded to include developing Asia—to determine a band within which oil prices may fluctuate. The new consumer bloc would manage the GSPR much like a central bank manages the money supply. When prices rose above the band, oil would be released in a coordinated manner and a framework of allocation would oversee the process. When prices declined, the board would purchase oil to fill the reserve.

Building a GSPR will be costly and it will take years to complete. It may also seem to many an unnecessary market intervention. Others may dismiss buyer-side collaborations as ineffective and disruptive to free-market principles. But the world doesn't have a free market for oil. It has OPEC. Furthermore, there is suggestive evidence that, when faced with a unified response from large consuming countries, OPEC can change its ways. In the two decades following the 1973 Arab oil embargo, consumers were forced to cut back demand thanks to high prices. But they also went further, limiting demand through a variety of means, including alternative energies and high energy taxes. OPEC eventually retaliated, initiating a price war in 1984 and 1985. When that effort failed, the cartel became increasingly concerned about the long-term stability of demand. By the 1990s, OPEC was calling for a compromise that would ensure demand for its oil while protecting consumers' interests. The IEA, which was established in the wake of the embargo, is another demonstration that, when consumers work in unison, they are better off than when they are subject to OPEC's bad habits. In the weeks after Hurricane

Katrina hit the United States, it was the IEA, not OPEC, that enabled the release of 2 million barrels of oil per day to keep the U.S. economy afloat.

OPEC will no doubt try to undercut any attempt by consuming nations to form a unified effort against its power by cutting back production—rendering ineffective any attempts to lower the price of oil. But history shows that organized consuming nations can wield considerable power, too. Cooperation is the only way to deter the cartel from exploiting its growing control over the global oil market. Think of a global reserve as an insurance policy, one that would increase the leverage of the West and Asia while counterbalancing OPEC. The alternative is an ever-increasing dependence on a cartel that could care less about consumers. The choice seems obvious.

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