Latest Drop in Oil Prices Puts OPEC in a Bind

Within minutes of comments made by Saudi Arabia's oil minister on Friday, crude oil prices for present and future delivery dropped like a stone. By the end of trading on Tuesday, crude oil had lost more than six percent of its value, ending just above $65 a barrel, down from over $70.

What spooked the markets were these comments from energy minister Khalid Al-Falih, made during a panel discussion on energy on Friday:

> It is the intent of all producers [members of the OPEC cartel and another 10 non-members who are supporting OPEC at the moment] to ensure that the oil market remains healthy, and if that means adjusting our policy in June, we are certainly prepared to do it….
>
> Two years ago we pulled supply [off the world market]. I think in the near future there will be time to release supply. It's likely that [release] will happen in the second half of this year. We've had intensive discussions [with Russia's energy minister Alexander Novak], and I think we're aligned on that.
>
> Whether it's a million barrels [a day], more or less, we think we'll have to wait until June before making that announcement.

That is any cartel's primary problem: enlisting the support of disparate parties, and then keeping that support over time.

Ironically, OPEC began in 1949 when Iran and Venezuela — the latter currently much in the news — invited oil producers Iraq, Kuwait, and Saudi Arabia to "improve communication" between them. The cartel cut its teeth with its 1973-74 oil embargo against the United States in retaliation for its support of Israel in the Yom Kippur War.

That embargo resulted in a quadrupling of the price of crude oil and forced American consumers to endure hardships, some of which remain today: gasoline rationing through alternate days based on license plate numbers, Sunday gas station closures, lower highway speed limits (the "double nickel" 55 mph on interstate highways), smaller cars, daylight saving time, retricted usage of heating and air conditioning, government investment in mass transit, and, of course, increased use of "renewables" to replace oil, gas, and coal as energy sources.

Today OPEC is a shell of its former self, thanks to the energy production revolution continuing in the United States. Oil reserves previously unavailable through conventional means rapidly became not only available but highly profitable to develop and expand. It was as if proven reserves in the United States had doubled and then doubled again thanks to the fracking revolution.

On June 22 OPEC will be holding that cartel together as best it can in Vienna, with "rebalancing" the world oil market the primary topic. It's based on the assumption that the cartel still rules that market.

But to American oil producers, what OPEC decides or doesn't decide matters less and less. Right now most energy CEOs are budgeting for oil at $50 to $55 a barrel, with anything above that as pure gravy. In the Permian Basin, the country's biggest oil field, the breakeven point for a new well is $45 a barrel, with those points being much lower for wells that have already been drilled and being expanded through the use of increasingly efficient fracking techniques.

OPEC's problem was stated succinctly by Muhammad Ghulam, an oil analyst at Raymond James investment firm: "It's really cheap to drill in the United States. You could see prices plunge 20 percent tomorrow and there'd still be a decent amount of increases in production [by U.S. producers]."

So, no matter what OPEC decides at its meeting in Vienna on June 22, it will continue to lose market share and influence to U.S. energy producers. If it decides to keep in place its present agreement to keep oil off the world market, U.S. producers will continue to expand production. If the cartel decides to end the agreement, or "modify" it to make up for reductions in production from Iran and Venezuela, U.S. producers will continue to expand production.

The game has changed; the world energy equation no longer works in OPEC's favor. Inevitably, inexorably, U.S. oil production will bring energy prices down, to the benefit of every consumer of energy in the world.

Photo: AlexLMX/iStock/Getty Images Plus

An Ivy League graduate and former investment advisor, Bob is a regular contributor to The New American *magazine and blogs frequently at LightFromTheRight.com, primarily on economics and politics. He can be reached at badelmann@thenewamerican.com.*