OPEC - Non-OPEC Cooperation: A Recipe for Success

Dr. Ibrahim A. Al Muhanna
Saudi Energy Consultants

Arab Gulf States Institute in Washington (AGSIW)
March 10, 2017

Your Excellency, Ladies, and Gentlemen,

I would like first to thank Ambassador Marcelle Wahba for inviting me to speak today, at this most distinguished gathering.

I have just arrived from CERA Week in Houston, which was very insightful with a great deal of debate about the outlook for the international oil market and a clear divide between the pessimists and optimists. The discussions focused on whether OPEC and non-OPEC countries will improve their compliance with the agreement and continue to cooperate or if the deal will start to unravel.

I fall into the optimist camp. I believe there is a great deal of commitment between OPEC and non-OPEC countries to adhere to the late 2016 production cut agreement and my view was reinforced further in Houston because of the numerous sideline meetings at the conference that took place among the many oil ministers in attendance from both OPEC and non-OPEC countries: Saudi Arabia, the UAE, Nigeria, Iraq, Russia, Mexico etc. All the ministers emphasized the need to continue cooperation and achieve one hundred percent compliance in order for the market rebalancing to gather pace and maintain stable markets.

I would like to talk briefly about the history of cooperation among oil producers, at times when diplomacy worked – and when it didn't. Then I will turn to the future.

Ladies and gentlemen, whenever there are concerns about high levels of oversupply, high inventories, and low oil prices, OPEC and non-OPEC producers start communicating to find a framework to work together. Sometimes they fail, but occasionally they get good results. It takes a great amount of time, effort, and, above all, leadership to succeed.

In the late 1980s, OPEC and non-OPEC members started meeting at both the ministerial and experts levels. The list of non-OPEC producers who attended meetings included Angola, China, Colombia, Egypt, Malaysia, Mexico, and Oman. In addition, the province of Alberta, the states of Texas and Alaska, the Soviet Union, Norway, and Yemen also attended as observers. Oman, was taking the leading role.

The independent oil producers pledged to take the necessary measures to reduce production. However, due to internal conflicts within OPEC, over many issues, such as quotas, parities, and the ceiling, it did not work. And then the Iraqi invasion of Kuwait in 1990 changed the equation.

The first real success of cooperation between OPEC and non-OPEC producers was during the 1998-99 crisis. Saudi Arabia, Mexico, and Venezuela forged an energy alliance and worked tirelessly for 15 months. Norway was also working behind the scenes.

After many meetings in different places around the globe between the three countries, on March 11 and 12, 1999 Algeria and Iran joined the meeting in The Hague, Netherlands. An agreement was hammered out and it received the support of the other OPEC members and some non-OPEC producers. The total cut agreed was more than 4 million barrels per day (mb/d) and prices picked up for the rest of the year and the years after.

The second example of successful OPEC and Non-OPEC cooperation was the most recent agreement reached at the end of 2016 in response to the oil market collapse in 2014. This time Saudi Arabia, Russia, Qatar, and Algeria were leading the efforts. After many attempts, ideas, and meetings for more than two years they were finally are able to achieve an agreement, much to the surprise of the market.

While the market and media only started focusing on the possibility of an agreement in early 2016, in fact, OPEC and non-OPEC officials had been in regular communication and discussing potential action much earlier. This second agreement was by far more complicated to reach than the 1998-99 one, with many complexities such as civil unrest in Nigeria and Libya that disrupted oil operations in their countries and arguments for special consideration for Iran. In the end, an enormous amount of political will to reach an agreement prevailed.

On December 10, 2016, non-OPEC producers joined OPEC in agreeing to cut production. The 23 countries decided to reduce supplies by around 1.8 mb/d and for the first time in the group's history a joint monitoring system was established. It has led to improving oil prices and is expected to lead to a rebalancing of oversupplied oil markets by the middle of this year.

Ladies and gentlemen, from the experience of the last 30 years, we can conclude that successful cooperation among OPEC and non-OPEC oil producers is always a clear possibility. However, it needs six ingredients, to reach a successful outcome.

First: Persistently, distorted oil markets marked by oversupply and low oil prices that *cannot be managed by OPEC alone*.

Second: The participating countries are severely affected by the negative economic impact of oversupply and prolonged lower oil prices. *Their shared economic pain is a uniting factor.*

Third: Political understanding at the highest government level with a willingness to take coordinated action.

Fourth: Goodwill and political support among the leaders of the countries heading up the effort.

Fifth**:** A small number of countries willing to take a leading role and make the necessary arrangements.

Sixth: Energy ministers with a clear mandate to make a deal and who clearly understand the issues acting on good faith with good personal relationship.

Ladies and gentlemen, I believe past experience can serve as a good guide to the present and the future. It is clear that, over the past 150 years, the oil industry always needs leadership and an anchor to take action when there is a critical need to balance market supplies or avert an economic or financial crisis. It was the case with the Texas Railroad Commission, the Seven Sisters, and OPEC. Today, it is a new club of OPEC and Non-OPEC producers.

During times of an oil price crisis and oversupply in oil markets, whether triggered by a global economic slowdown, or most recently the unforeseen advent of technology-driven shale oil, an anchor group needs to take coordinated action to adjust the supply balance and the trajectory of prices to mitigate the damage to world economies.

This cooperation and the diplomatic efforts are in the energy industry's best interests worldwide. They assist in the vital long-range planning required for the energy industry investments to meet global demand. This will reflect positively on national and global economies alike, of all countries.

I would like to conclude with a brief look at the future and address some issues that were raised by the pessimist camp. Going into the third month of the agreement it is clear there need to have better compliance with the pledged cuts by some countries than we have seen so far.

During various meetings in Houston there were firm commitments to fully implement cuts by several major producers. Countries that have been slow to reduce supplies are now promising to implement cutbacks to ensure that they meet the total amount pledged for the six-month period.

So while the market is currently focused on monthly data and compliance, both OPEC and non-OPEC producers are expected to meet their targets. The countries combined pledged to reduce production by just under 1.8 mb/d, or approximately 325 million barrels over the six months. That volume is more than the current surplus that has been weighing on oil prices for over two years, so a rebalancing is in sight.

There was much discussion about the need for OPEC and non-OPEC producers to extend the production cut agreement to the second half of the year, and this issue will be looked at during the meeting of the ministerial monitoring committee in Kuwait on March 26 and will be decided at the May 25 OPEC meeting.

There was a general consensus in Houston that a stronger and earlier-than-expected rebound in shale oil production is underway, which could slow the rebalancing. We should not be misled by the large inland builds in U.S. commercial stocks. First, global oil stocks are declining, with floating storage at sea significantly drawn down over the past month. Second, Arab Gulf supplies exported to the U.S. Gulf Coast region in the first quarter were produced and contracted for in November and December so lower output since January will only be reflected in import arrivals in late March and April given internal pipeline transit and sailing times of around 60 days. So I think we need a bit more time to see the full impact of the OPEC and non-OPEC cuts on U.S. and global inventories.

Thank you for your kind attention.