

In a capitalist and extremely competitive world, where monopolies stagger to flourish in countries, leave aside the globe, we have been witness to an oligopoly (market characterised by a small number of firms who realise they are interdependent in their pricing and output policies) which can safely be called as the centre of the global economy! With 4%^[1] worldwide energy needs getting satisfied from this resource, it far exceeds its numerical importance as it acts as a base to determine the price of virtually every commodity produced in the world.

The world market of oil is perhaps the starkest and rarest of examples in human history where producers have such a great influence that the slightest of change from one could lead to geopolitical supply disruptions. The primary aim of this article is to understand the working and mechanism of OPEC which completed its 60 years in 2020 and has been able to increase its importance manifold by coming together and forming a tight cartel over the global oil market.

The Golden years of OPEC seemed to end in 2014 when due to an inconclusive meeting the Saudi Oil Minister ended the price determination mechanism which led to prices falling from 130\$ per barrel to around 30\$ per barrel^[2]. It is no surprise that the pandemic and consequent lockdowns led to a sharp decrease in demand where the oil price stumbled to negative terrain, something which no economist in the world ever imagined could have happened. The question therefore arises is it in the greater interest of the world community that a price maker such as OPEC remains?



Image source: Market feed news

The greatest merit of OPEC cartelising the oil market was that the world was assured of a stable supply of an extremely necessary commodity and market shocks did not result in consequent price hikes due to the spare capacity of OPEC which acted as a shock neutraliser. The same was witnessed during the Arab, Gulf and Iraq wars when major supply disruptions could have potentially shaken the world. In a post- OPEC scenario, the counterfactual figures adjusting for the collective gains indicates that the volatility in rates is expected to be higher and the cost of lack of spare capacity grows significantly with net global welfare loss values in the order of \$250-\$450 billion (Oxford Institute for Energy Studies, 2020).

Analysing an intra-OPEC post dissolution scenario, counterfactual figures indicate a greater net benefit for larger producers like Saudi Arabia to the tune of 2.6% greater market share, averaging 15% throughout (Oxford Institute for Energy Studies, 2020), mainly due to its large low-cost oil reserve bases. Perhaps, another reason could be that Saudi Arabia, the major benevolent spare capacity would not have the burden of

maintaining price stabilises by cutting its own profit shares as it practices in OPEC.

However the greatest impact on the breaking of collective power of OPEC would be the inherent increase in market share of USA and Russia as they already hold substantially larger oil producing capacities than all individual OPEC producers. The United States' consequent dominance over the single most important market, which till now it did not enjoy, would certainly make it more effective to propagate its role as a hegemon and counter the rise of China.



Image source: Jacobin

On the contrary, for whatever the OPEC receives criticism over, it still regulates and stabilises the global market economy through its systematic rationing of the oil market. If OPEC abandons its balancing role in a falling market characterised by a slowdown in global oil demand amid increasing oil supplies, the price response is expected to be sharper, more persistent and steeper. Such an increased volatility and elasticity of a non-elastic good causes not only micro level but macro level problems, leading to a complete disruption of the world economy. The presence of spare capacity has had a smoothing effect on global oil price movements, with prices in the absence of the spare capacity cushion exhibiting much sharper price cycles and resulting in more frequent oil shocks.

While the cartel seems to be coming under sharp criticism over sitting over the most valuable world resource, it does play an effective underground regulatory role which seems to be helping the lesser- developed and developing economies more than the developed world. Furthermore, not only does it counterbalances different world powers but sheer economic interests of the governments in the Middle East lead to a prudent policy compromise which has largely been successful in maintaining peace and stability in the Middle East and effectively worldwide.

It is no secret that Middle Eastern countries have long been proxies of world powers and the only uniting factor which disincentives them to go towards war is the prudent economic interests in the form of oil which most of them share. Nonetheless, it will be increasingly interesting to watch OPEC and its economic, political and diplomatic moves closely, especially in a post-covid, polarised world!

^[1] <https://www.energy.gov/science-innovation/energy-sources>

^[2] <https://www.reuters.com/article/us-opec-meeting-idUSKCN0JA00320141128>

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