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INTERNATIONAL CONFERENCE ON

THE ENERGY EMERGENCY: OIL AND MONEY, 1980

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Supply and Demand Panel

Opening Remarks

by

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Every energy conference has an oil supply and demand panel. But this one is different. It brings together through our speakers the two principal players in the world oil game: producers and consumers. Mr. Janabi who will speak on oil supplies is the head of the economics and finance department of the OPEC Secretariat and Mr. Franssen who will discuss the outlook for oil demand is about to join the International Energy in Paris as its chief economist.

As you may remember, at one time these two organizations were perceived in some quarters as being confrontational. Fortunately this perception no longer exists and of course, it was never correct. One might assume that, given their basically different membership and purposes, the two organizations would disagree on the global outlook for oil supply and demand. Yet, their respective economic analyses agree on at least some aspects, such as the limited availability of oil supplies and the consequent need to reduce the growth in demand. Messrs. Janabi and Franssen will discuss these issues for the intermediate and long term. Not surprisingly, their comments will offer little cheer to those who must import OPEC oil. But before I turn the floor over to them I would like to comment briefly on the current oil situation and the short term oil outlook.

Much dismay has understandably been expressed in the oil importing countries over the three OPEC price increases so far this year in the face of declining world oil demand, rising world oil stocks and significant increases in non-OPEC oil output. This is viewed as clear evidence that OPEC is a cartel, or at least a tight oligopoly, which has the power to set prices more or less at will, rather than in response to market forces. This perception is not without base. After all, OPEC exports accounted last year for 84% of world oil trade. Hence, any price level or floor agreed by OPEC members automatically becomes the world price level or floor. But this is merely restating the obvious.

A more interesting as well as more controversial explanation for OPEC's recent ability to raise prices in the face of softening market conditions is that its members have restricted output in order to prevent the development of a surplus with its attendant downward pressure on prices. OPEC members are certainly in a position to do this, as their official and unofficial spokesmen have often enough said, and some members have actually done so. But is this really the principal factor in this year's price increases?

It is of course a matter of record that OPEC production has declined sharply and steadily since last December. Preliminary figures for May indicate a crude oil production level of about 27 million B/D which would be some 3.5 million B/D below the December 1979 level. But nearly two million B/D, or 55%, of that decline was borne by one single country--Iran. Needless to say, Iran's decline is not the result of a concerted OPEC strategy but reflects a combination of unique economic, political and technical factors: Iran insists on pricing its oil above that of other exporters, its exports are formally boycotted by the U.S. and probably informally by some of the U.S.'s allies, and production seems to have been adversely affected by lack of spare parts, the exit of experienced technicians and, possibly, sabotage.

The effect of this extraordinary development in Iran has been to shield other OPEC members to a large extent from the market pressure generated by the decline in world oil consumption and the rise in non-OPEC production. It has also somewhat blunted the expected impact of the continuing high Saudi Arabia production level on the pricing policies of other OPEC members. Thus, the spill-over effect of the Iranian revolution on the world oil market is far from over--for OPEC or for its customers. For the next several months additional Iranian oil will not be needed to balance oil supply and demand and if Iran were to make a sudden comeback now into the market with a volume approaching its 1979 export level other OPEC members would have to make room for it. If, however, by year end, Iranian exports are no higher than now--some 500,000 B/D--the world oil market would become tight once more, unless demand in the first quarter of 1981 should drop again, following this year's 2.5-3.0 million B/D decline. This is not likely to occur without an overall recession in the OECD area which so far is not generally forecast.

A major reason why a tightness might develop by year end is that if Iranian exports should still be only minimal by then, oil refiners and distributors may not wish to reduce their inventories by the "normal" first quarter seasonal withdrawal, since in the absence of additional Iranian exports stock levels will have already been reduced by then from their current high level. OPEC members could of course easily offset the continued unavailability of Iranian oil by again raising their production level. In April, OPEC production from countries other than Iran and Saudi Arabia was nearly 2 million B/D below the December 1979 level. But these countries may not perceive such an increase in production to compensate for the loss of Iranian exports to be in their longer term self interest.

Thus, 18 months after the Iranian revolution its fall-out on world oil supplies remains the biggest single obstacle to an improvement in perceived market stability, fully commensurate with developments on the demand side. If we consider that just two years ago Iran was the world's second largest oil exporter and that its current exports are only about one tenth of what they were then, this impact is not surprising.

While it is unlikely that the Iranian economy will be able to operate effectively much longer on this level of oil exports, under present conditions in Iran this may be irrelevant as a policy consideration.

Taken altogether, these developments are a further indication that OPEC prices continue to be far more influenced by uncontrollable extraneous events than by its members' coordinated planning.