

The Power of Oil: The Declining Influence of OPEC

For the majority of the last century, oil has controlled the destinies of the major powers in global affairs. From the British Empire's fight for the Suez Canal to the oil embargo faced by the United States, the power of oil was seen as a tool for world dominance. It may not be the central factor in a nation's decision making, but it can often be used as a powerful bargaining chip. From its founding in 1960, the Organization of the Petroleum Exporting Countries (OPEC) has sought to use its collective strength of producing a product that much of the world depends on to secure better pricing deals. Looking at the behavior of OPEC, beyond the economic advantage the organization provides its membership, it has also used its control for political reasons. At its height, OPEC oversaw a dependence on oil, characterized by the U.S. energy boom following World War II, through which they were able to create an energy crisis in the U.S. The power they wielded, however, could have been a double-edged sword as it led to a global push for domestic energy independence. Combine this with debilitating internal politics and the growing volatility of the oil market, OPEC's influence in world affairs has been diminished, but the future of OPEC remains unclear.

Origins

In the late 1950s, seven multinational oil companies extracted oil from major countries all over the world while controlling the price they paid their hosts and five of them were American.¹ These companies would collaborate with each other in order to keep the price of oil higher than their cost of production, but at times, individual members would attempt to cut

¹ Dauster, William (1981). *The Origins Of OPEC: An Economic History*.

prices to further their position in the market.² This instability would naturally lead to less revenues of the host country and created a strong sense of inequity among some of the major oil exporting nations. Favoring more local production in the West, these companies would also continue to cut the prices of the oil produced in the Middle East and Venezuela, the largest oil-producing areas behind the US and Russia.³

The economic turmoil created by the oil companies combined with the West's support of the new nation of Israel further infuriated many of the Middle East Arab states.⁴ In order to form a more organized approach to dealing with the growing Western influence in their region, and more particular to combat the power of Western oil companies, the Middle East and Venezuela formed OPEC as part of the Baghdad Conference.⁵ In doing so, the countries were seeking to organize their efforts to securing the best prices from the oil companies for the oil they provided, rather than have them dictated. This collective bargaining of the different member countries would become a powerful force in both the business *and* the politics of the world.

Membership and Organization

The history of the membership in OPEC is an interesting insight into how the group grew in influence as it added more high oil-producing countries to its ranks. The Founding Members, the designation for the original signers of the Baghdad agreement in 1960 and provides significant power over membership, include Iran, Saudi Arabia, Venezuela, Iraq, and Kuwait.⁶

² Dauster, William (1981). *The Origins Of OPEC: An Economic History*.

³ *Ibid.*

⁴ *Ibid.*

⁵ *Ibid.*

⁶ OPEC Membership. *OPEC.org*.

Over the next several years other nations joined including Qatar (1961), Indonesia (1962), Libya (1962), the United Arab Emirates (1967), Algeria (1969), Nigeria (1971), Ecuador (1973), Gabon (1975), Angola (2007) and Equatorial Guinea (2017).⁷ While several nations have suspended their membership over different periods of time, only Indonesia currently remains suspended due to its refusal to participate in production cuts.⁸ This puts total membership at fourteen nations from three regions (the Middle East, South America, and Africa). The Founding Members must all agree to the addition of a new nation to the membership, in concurrence with a super-majority of the other members.⁹

The Founding Members unanimously agreed to form a statute that sets out the mission and organization of OPEC in 1961 in the second meeting of OPEC at Caracas, Venezuela, and the organization as a whole has amended it fourteen times.¹⁰ The original headquarters of OPEC's Secretariat, the executive organ of the organization was to be in Baghdad, however, Venezuela pushed for a neutral location and thus the Secretariat is now located in Vienna following issues with Switzerland authorities to move there.¹¹ The statute states that the primary role of OPEC is to harmonize petroleum policies of member nations to protect their interests in the global market.¹² Further, the document describes the need for members "ensure stable oil prices, secure fair returns to producing countries and investors in the oil industry, and provide a steady petroleum supply to consumers."¹³ The OPEC Secretariat includes the Secretary General which

⁷ *Ibid.*

⁸ Reuters (2017). *Indonesia to Keep OPEC Membership Frozen: Deputy Energy Minister.*

⁹ OPEC Membership. *OPEC.org.*

¹⁰ OPEC Statute. *OPEC.org.*

¹¹ Dauster, William (1981). *The Origins Of OPEC: An Economic History.*

¹² OPEC Statute. *OPEC.org.*

¹³ OPEC Statute. *OPEC.org.*

is the chief executive officer of OPEC operations.¹⁴ Further, there is a Research Division to support continuing data, development, and research studies for members and a Support Services Division which provides standard operations and business support.¹⁵ There are currently 138 employees of OPEC.¹⁶ The authority of OPEC over oil supply, the power of its individual members, and its organization have allowed OPEC to become a dominating force in international relations, both between members and the world.

Behavior and Power

The general understanding of OPEC is that it is simply an economic “cartel” that attempts to assert its authority over oil production to secure better pricing within the international market. However, in 2011, Christopher Elsner of the U.S. Department of Energy published an empirical study of OPEC with the International Association for Energy Economics that explored OPEC through an international relations lens. Elsner uses power cycle theory, which explores how the changing dynamic between individual actors within an entity effects the behavior of the entity, to explain that OPEC acts more politically than economically.¹⁷ Elsner states that only in extreme volatility of oil prices will OPEC members work together and become economic actors, but mostly the more powerful actors at a given time will act politically and therefore effects the relations of OPEC as a whole.¹⁸

This theory helps to explain that when prices are volatile, OPEC will vote to increase or decrease production to their benefit. It also helps explain that when prices are not as volatile,

¹⁴ OPEC Secretariat. *OPEC.org*.

¹⁵ *Ibid.*

¹⁶ *Ibid.*

¹⁷ Elsner, Christopher (2011). *International Association for Energy Economics*.

¹⁸ *Ibid.*

powerful individual members such as Iraq, Iran, and Saudi Arabia will become more political in their actions – with each other and the world – which can affect the authority of OPEC over production or their own domestic policies.¹⁹ The ability for OPEC to work together is how it derives its power as a whole to control oil supply and demand, but the power cycle theory explains that certain states may attempt to gain more power and therefor diminish OPEC's authority. The latter of this, in combination with increasing volatility and a push for energy independence are the keys to the declining influence of OPEC. The former is what allowed OPEC to use global dependence on oil to greatly influence international relations and even to create the energy crisis in the U.S.

Global Dependence

Richard Heinburg and David Fridley provide an excellent description of how the world, and particularly the U.S., became dependent on oil in their book *Our Renewable Future*. They explain that “liquid fuels made from petroleum mobilized the economy as never before.”²⁰ The use of cars, trucks, airplanes, ships, and diesel trains exploded following World War II and so did the demand for oil to power these. Oil also began to be used in many other parts of the economy such as mining, forestry, and fishing and was used to create plastics, chemicals, lubricants and medicines.²¹ Heinburg and Fridley describe how oil and its byproducts were used in daily life and that cities and buildings were designed to better use the machines and products

¹⁹ Elsner, Christopher (2011). *International Association for Energy Economics*.

²⁰ Heinburg, Richard and David Fridley (2016). *Our Renewable Future*. Pages 4-7.

²¹ *Ibid*.

that use oil.²² Effectively, the modern world had become utterly dependent on oil as it was believed there would never be a shortage or a change in the production.

This dependence on oil means that nations that consume a large portion of oil, such as the U.S., were also dependent on the production of it and thus on the nations that produce it. In the 1950s, the U.S. predicted that domestic oil production would peak in the 1970s and so it began to greatly increase oil imports from foreign countries to supply the growing demand.²³ OPEC, being a collection of the largest oil producers and exporters, was able to wreak havoc on the world using its economic advantage to exact a political toll and demonstrate its height of power.

The Energy Crisis

Late in 1973, Israel launched a large scale and successful invasion of Egypt in the Yom Kippur War, a string of successful wars in which Israel attacked or defended against its Arab neighbors.²⁴ Walter Rosenbaum, in his book *American Energy: The Politics of 21st Century Policy* describes the politics of this war as it preludes the global energy crisis. OPEC, a primarily Arab organization, was angered by Israel's treatment of its Arab neighbors. Further, the Organization was resentful of President Nixon's protection of Israel and his urging of other Western nations to do the same.²⁵ In response, OPEC used its economic authority to cut oil production by five percent monthly until Israel changed its foreign policies.²⁶ As explained through the power cycle theory, Saudi Arabia, the more dominant producer in OPEC, cut exports by 10% on top of the

²² Heinburg, Richard and David Fridley (2016). *Our Renewable Future*. Pages 4-7.

²³ Rosenbaum, Walter (2015). *American Energy: The Politics of 21st Century Policy*. Pages 36-38.

²⁴ *Ibid.*

²⁵ *Ibid.*

²⁶ *Ibid.*

reduction of production and threatened to end all shipments to the U.S. until Nixon changed his Israeli policies.²⁷

This shock to the market was felt throughout the West, but primarily in the heavily dependent United States. The U.S. was losing two million barrels daily, with the price of gas rising 152 percent between 1970 and 1979 and compounded by the 800 percent increase in the cost of a barrel imported crude oil.²⁸ The Nixon and the subsequent Ford administrations, in order to conserve and ration energy assumed authority to allocate and price petroleum products, mandated year-round daylight savings time, required a national fifty-five mile-per-hour speed limit, created new energy management agencies, expanded research into solar energy, and encouraged nuclear energy production.²⁹ The Carter administration, though short lived, sought to make energy supply a top priority and instituted numerous new policies.³⁰ The result of these new policies and agencies was that the United States understood the vulnerability it had in regards to energy and the expansion of federal power to combat it.

The U.S. response, while tough on the day-to-day lives of its citizens, was crucial to survive OPEC's boycott. Rather than succumb to the Organization's demands, the West adapted its economy to contend with OPEC's influence. While the energy crisis demonstrates its height of power, OPEC failed to recognize that using its economic authority for political purpose could not be sustained if the West resisted its demands. By 1980, under President Reagan, the United States began a push for greater independence of its energy sources and OPEC could no longer

²⁷ Rosenbaum, Walter (2015). *American Energy: The Politics of 21st Century Policy*. Pages 36-38.

²⁸ *Ibid.*

²⁹ *Ibid.*

³⁰ *Ibid.*

sustain its boycott as members were no longer making profit.³¹ OPEC's economic attack over politics actually led to its own loss of influence as the West began to increase its own domestic energy production and move toward alternative sources. This, combined with debilitating internal politics and increasing oil volatility, has led to the fall of OPEC from its seat of power in international relations.

Energy Independence

Since the failure of OPEC's energy embargo on the West, particularly the U.S., there has been a steady decline of OPEC's influence and power. The first cause of this is likely self-created: the push for independence of energy sources in order to avoid another energy crisis. OPEC overplayed its authority, and allowed those that were once dependent on it to form new policies of energy independence. In the United States, this independence was of little interest throughout the 1990s because of stable or falling energy prices and little public interest in energy issues.³² OPEC was unable to control for the falling prices, as the United States and others began to shift where their oil imports came from given the price variations.

The increasing demand for oil products in the U.S., the reduction of OPEC supply to maintain profitable supply, and the new demand coming from China and India created a new crisis in the U.S. during the 2000s. The Bush Administration oversaw two new policy initiatives that created a new system of planning for energy policy. The National Energy Policy and the Energy Policy Act were cornerstones of the energy plan, including a policy planning committee, incentives for renewable energy research, greater conservation measures, and aggressive

³¹ Rosenbaum, Walter (2015). *American Energy: The Politics of 21st Century Policy*. Pages 39-43.

³² *Ibid.*

domestic fossil fuel exploration and mining.³³ The new shock helped American's behavior change, as Jennifer Horton writes in her *How Stuff Works* article. She writes that "They've started buying smaller, more fuel-efficient cars, and they've traded their houses out in the suburbs for homes more convenient to where they work."³⁴ Further, In January 2008, sales of large cars were down 26.5 percent, while small-car and crossover vehicle sales were up 6.5 percent and 15.1 percent, respectively.³⁵

The policies allowed the United States, and other Western nations, to produce more of their energy domestically and not rely on oil exporters like OPEC. Technology innovations have also allowed the U.S. to produce more natural gas and although production has expanded over the last decade, demand is still higher but the country imports the balance from Canada as opposed to an OPEC nation.³⁶ The creation of new, domestic forms of energy, both fossil and renewable, combined with changing behavior has allowed the West to escape the bargaining power of OPEC and become more independent. Combine this with recent oil volatility, OPEC is continuing to lose influence in world affairs.

Oil Volatility

The price of oil often fluctuates, but this fluctuation cause issues in OPEC's ability to work collectively as some members wish to reduce production while other want to increase. Their dependence on their own profits to support their citizens effects the power cycle of the membership. While they are a part of an organization, their individual needs can sometimes

³³ Rosenbaum, Walter (2015). *American Energy: The Politics of 21st Century Policy*. Pages 39-43.

³⁴ Horton, Jennifer. *Is the United States Addicted to Gasoline?*

³⁵ *Ibid.*

³⁶ Union of Concerned Scientists. *Uses of Natural Gas*.

effect the organization as a whole. Earlier in its existence, OPEC was able to use this volatility to its advantage with its collective bargaining powers. The new-found independence of its clients, however, has made the price decline an issue for OPEC and has caused shifts in the power dynamics.

The *New York Times* created an expose on the declining oil prices and the effects OPEC faced. As mentioned above, the power cycle theory has continued to allow Saudi Arabia to dictate much of the policy changes and they remain the highest producer within the organization. Clifford Krauss, the writer for the *New York Times*, describes how over the last few years there has been a significant downturn in oil prices and that executives believe it could years before there's a bounce from the current average of \$65/barrel to the typical \$100/barrel.³⁷ Given that OPEC currently produces and exports about 40 percent of the world's oil supply, the Organization is facing extreme profit loss.³⁸

As mentioned earlier, the power cycle theory explains why Saudi Arabia has been able to change OPEC policies despite the growing difference between members. Before the recent decline, OPEC members were following their own individual policies for production and exports with Saudi Arabia producing at record-breaking levels.³⁹ In November 2016 Saudi Arabia bent to the low oil prices and persuaded OPEC members to cut production with the pretense that they would limit the most production of the group.⁴⁰ Previous attempts to limit production were

³⁷ Krauss, Clifford (2017). *Oil Prices: What to Make of the Volatility*.

³⁸ *Ibid.*

³⁹ *Ibid.*

⁴⁰ *Ibid.*

undermined by individual members refusing to comply with such limits, but both Iran and Venezuela, the two usual subversives within OPEC, have complied with the limitations.⁴¹

The act of unity that OPEC was able to muster has allowed it to maintain some control over their collective bargaining power. Saudi Arabia, the long-time top power in the Organization, demonstrated that it would take the brunt of the limitation in order to secure the votes of other members. When oil prices and demand are high, OPEC's power is stronger. The energy independence of other nations, however, has prevented it from reaching back to its height of power in the 1970s. When they are low, OPEC's influence continues to dwindle as it scrambles to form a united front to remain profitable. Debilitating internal politics make this unity difficult to manage and further exacerbates OPEC's declining influence.

Internal Politics

The member nations, which have each found it difficult to maintain a profitable supply given the growing energy independence of clients and the price volatility, also have found themselves at odds with one another. These internal politics, explained by power cycle theory which demonstrates that individual nations may seek more power over others, have caused OPEC to lose its ability to act as a collective, organized body. The United States' new level of domestic production combined with Saudi Arabia's push to reduce production to offset the decline in prices, has angered members such as Iran and Venezuela who depend on high prices and production to support their economies.⁴²

⁴¹ Krauss, Clifford (2017). *Oil Prices: What to Make of the Volatility*.

⁴² Statfor Analysis (2013). *OPEC's Declining Influence*.

Saudi Arabia has also been a part of several internal conflicts within the OPEC that has prevented cooperation. One of the major conflicts are between them and another significant power within the organization: Iran. Saudi Arabia has continued to support economic sanctions against its fellow OPEC member, a topic of discussion at many OPEC summits and often the reason Iran refuses to follow OPEC policies that typically favor Saudi Arabia.⁴³ The relationship between the two nations has spilled into the functioning of OPEC, yet another piece of evidence that the power cycle theory is at work. Consistently, both Iran and Venezuela have complained that Saudi Arabia supports the West too much and has led to a collapse in cooperation and furthered the decline in its influence.⁴⁴

A more recent episode that demonstrated growing internal conflict of OPEC members is the Qatar issue. The Gulf States were a key alliance within OPEC, allowing Saudi Arabia to exert even greater influence. The Gulf Cooperation Council (GCC) has not met behind closed doors as they usually do to agree to oil policies before OPEC summits in several months as a feud between Saudi Arabia and Qatar continues without much explanation.⁴⁵ Both Saudi Arabia and the UAE have cut all ties with Qatar, saying it favors terrorism and Iran, while Kuwait and Oman (all members of GCC and OPEC) have refused to take sides in the dispute.⁴⁶ The politics of all of this have prevented cooperation of the Gulf States which has spilled into OPEC. Iran has been seeking to use the dispute to increase its power within the Organization, in line with the power cycle theory, by forging an alliance with Iraq which could challenge Saudi Arabia for dominance

⁴³ Stratfor Analysis (2013). *OPEC's Declining Influence*.

⁴⁴ *Ibid.*

⁴⁵ El Gamal, Rania (2017). *OPEC Chatroom Dead as Qatar Crisis Hurts Gulf Oil Cooperation*.

⁴⁶ *Ibid.*

in OPEC.⁴⁷ All of this, combined with the continuing volatility of oil prices and energy independence of other nations, has led to sharp decline in OPEC's influence and has put its future into question.

The Future of OPEC

The future of OPEC is hard to predict but is very much dependent on the price of oil in the long term. The volatility of oil is the largest factor in determining the power of OPEC, as the Organization is only successful if the economies of the oil-rich nations remain solvent. Further, OPEC as a whole is only successful if the individual nations that compose it are able to overcome their economic, political, and religious differences in order to collectively bargain and synchronize policies. The changing power dynamics could prove to be beneficial for the long-term success of OPEC but could also lead to even more deadlock and even a breakup of the different regional and ethnic blocks within the Organization. The pressures of volatility and politics may be end of OPEC's influence, or it may be a test of its resolve to overcome changes in the world's economy.

As traditional users of petroleum like the West begin to diversify their energy sources, OPEC will have to seek new clients (such as China or India) to support their Organization or begin producing and exporting other forms of energy. The latter of these options could be difficult if the members are interested in remaining united as the options are possible in non-member nations. Mainly, the future of OPEC is dependent on if their traditional clients, particularly the U.S., continue to diversify their energy sources. As the U.S. expands domestic natural gas and renewable production, OPEC's power and influence will continue to dwindle.

⁴⁷ El Gamal, Rania (2017). *OPEC Chatroom Dead as Qatar Crisis Hurts Gulf Oil Cooperation*.

Perhaps in OPEC's, the International Energy Agency's 2017 *World Energy Outlook* predicts that the U.S. production will stagnate in the 2020s along with other non-OPEC nations, leaving OPEC to fill in the gap in the market.⁴⁸ If the U.S. continues to rely on their domestic production without focusing on renewable systems, OPEC is poised to return as an influential power. The future, it seems, is hard to predict but OPEC will likely continue to face difficulties that have allowed it to lose its influence and may not be able to recover.

⁴⁸ International Energy Agency (2017), *World Energy Outlook*.

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