CHAPTER V

THE IMPACTS ON OIL PRODUCING COUNTRIES

Higher oil prices may have caused undesirable outcomes to both countries and developed and developing worlds whose survival and development on the use of crude oil. The impacts on rising oil prices, on the other hand, have contributed to advantageous consequences for those who produce, extract and export oil on a regular basis. To point out, these oil producing countries can be categorized into two major groups which are OPEC and Non OPEC countries. And this chapter will unveil the background, significance as well as influences exerted by these oil merchants.

A. Background of OPEC and Non OPEC

1. OPEC as an Oil Cartel

OPEC is a Multinational organization established in 1960 to coordinate the petroleum production and export policies of its members. Iran, Iraq, Kuwait, Saudi Arabia, and Venezuela were the original members; they were joined by Qatar (1961), Indonesia and Libya (1962), Abu Dhabi (1967; membership transferred to the United Arab Emirates, 1974), Algeria (1967), and Nigeria (1971). Ecuador (1973) and Gabon (1975) are no longer OPEC members. Policy decisions are taken by consensus at its Vienna headquarters. In 1973 OPEC began a series of oil price increases in retaliation for Western support of Israel in the 1973 Arab-Israeli war, and OPEC members' income greatly increased as a result. Internal dissent, the development of alternative energy sources in the West, and Western exploitation of oil sources in non-OPEC countries subsequently combined to reduce the organization's influence. OPEC countries supply about two-fifths of the world's oil consumption and possess about two third of the preserved oil.

Since the mid-eighties, the Organization of Petroleum Exporting Countries (OPEC) has been acting as a swing oil producer of the world. That is, OPEC produces only to fill the gap between global oil demand and production. Over the years, the swing production arrangement resulted in OPEC having a lot of idle capacity. This helped OPEC to gain control over oil prices. Whenever the inventory level of oil stocks in industrialized nations, particularly the members of Organization of Economic Cooperation and Development (OECD) went up, OPEC reduced output. This artificial scarcity that OPEC manages to create did not allow oil prices to fall.

The same idle capacity has been used to pump extra oil into the market to prevent dramatic price rises during times of unexpected supply interventions. Most of this idle capacity is in Saudi Arabia, the largest member within OPEC. The country has effectively used its idle capacity in the past to prevent any price increase during the Iran-Iraq war, the Gulf War and the recent Venezuelan crisis. But that situation seems to be changing now, with OPEC unable to control the surging global oil prices. OPEC members have been pumping oil as fast as they can with hardly any idle capacity left. Saudi Arabia is the only country that has some spare capacity left. The idle capacity stands at just 0.5 million barrels per day (mbpd) as against 3 mbpd few years back[20].

So even though there is no shortage of crude oil, the fact that there is no safety net, has made the oil traders jittery. This has led to them demanding a risk premium and so the high price by non-OPEC countries.

2. Non-OPEC countries

Non OPEC countries refers to oil exporting countries that are not members of OPEC (the Organization of the Petroleum Exporting Countries), these countries are also recognized another influential actor in determining the price of oil. Countries in this category include Algeria, Indonesia, Iran, Iraq, Kuwait, Libya, Nigeria, Qatar, Saudi Arabia, the United Arab Emirates, and Venezuela. These non-OPEC countries contain less than one-fourth of the world's proven oil reserves but produce nearly 60 percent of the world's oil.

They also possess most of the world's capacity for refining crude oil into petroleum products such as gasoline and heating oil. Because non-OPEC countries have smaller reserves which are being depleted more rapidly than in OPEC, their overall reserves-to-production ratio , an indicator of how long proven reserves would last at current production rates , is much lower (about 14 years for non-OPEC and 73

[20] S Subramanian & Vivek Kaul, "Why global oil prices are rising,"1 September 2005, http://www.rediff.com/money/2005/sep/01oil.htm.

years for OPEC). In the future, non-OPEC production is expected to increase less rapidly than in OPEC and, as a result, shrink to less than 50 percent of total world oil production by 2015[21].

B. Oil Impacts on Economy in Oil Producing Countries

Basically, there will be a transfer of income from oil consumers to oil producers.With regard to impacts upon oil supplies, it is the fact that these countries, possessing abundance of crude and manufacturing it as exportation, have been tremendously benefited from the rise in oil price. Besides the OPEC cartel, oil- wealth states, like, particularly Russia and those major exporters from various continents have also enjoyed the rapid rise in price at the expense of others. Primarily, there has not yet negative outcome on the economy. Instead, their economies have been strengthened attributable to enormous income and high level of economic growth, thanks to price of oil increases. As mentioned earlier, if one loses, there must be someone who gains and this theory can universally applied to this game of petro-politics.

In accordance to the given statistics, oil revenue from oil producing countries nearly doubled between 2002 and 2005, increasing by some $ 215 billion. What to do next is that they recycled petro- dollar into financial market, 2002-2005 by $225 billion, while $117 billion account for Russia. Economic growth calls for increasingly influential role in an anarchic international arena somehow. Apparently,

[21] Energy Information Administration (EIA), “Non OPEC Fact Sheet,” March 1998, http://www.converger.com/eiacab/nonopec.htm.

it assures political and economic stability and increasing bargaining power, thus becoming another important and vital actor as price keep on rising. In addition, by achieving economic prosperity would likewise contribute further to development, which would be undertaken in a variety of aspects.

Politically, above and beyond revitalizing their roles in an international society, foreign policy would be directed more independently. It is widely seen that leaders like Hugo Chavez, Vlardimir Putin, Iranian or Bolivian presidents started to behave differently with more freedom. Realizing petro power, being enhanced, these non conformist leaders no longer comply with a force of globalization, liberalization and other regimes reinforced by the west, especially the US. As a result, it is noticeable that they have turned to deny politically constructed world order and started to act aggressively against American domination.

This radical aggression supplements the theory that the price of oil, changes in agreement with their behaviors, yet in opposite direction with freedom of other world citizen. In other word, the more it oil price rises, the more defiant the oil powers are, and conversely more restrictions on the others, as constrained by limitation of activities, involving the use of energy. For a more vivid scenario, in some countries, money from oil is spent upon creation of alternative politics. In Venezuela, Chavez has spent oil revenue in the formation of social populist programs to maintain domestic popularity, strategically selling cheap oil to, neighboring allies in exchange for political support. In addition, some believe that most money extracted from oil has been secretly transferred to terrorist group, as to accompany them in conducting war against imperialist powers in battle, defined as a clash of civilization.

C.The Impacts of Oil Price Increase during 2004- 2006 on Oil Producing Countries

I. Venezuela

Perhaps the most important thing to know about Venezuela is that it is an oil exporting country, the fifth largest in the world, with the largest reserves of conventional oil (light and heavy crude) in the western hemisphere and the largest reserves of non-conventional oil (extra-heavy crude) in the world. This fact is of immense importance to understanding Venezuela because it has shaped practically every aspect of the country, its history, its economy, its politics, and its culture.

When Hugo Chavez first came to power, in February 1999, among his highest priorities was to strengthen OPEC and raise the international price of oil. Oil had dropped to less than $10 per barrel, to a large extent because Venezuela was ignoring its OPEC oil production quotas during the previous government of Rafael Caldera. Also, non-OPEC members such as Mexico and Russia, were increasing their production considerably, further driving down the price of oil. Chavez immediately put Ali Rodriguez in charge of the Ministry of Energy and Mines (MEM), which oversees PDVSA[22] and oil policy. Within the new government's first 100 days, Rodriguez visited most OPEC and non-OPEC oil producing countries and returned with a commitment from most these countries to reduce production or abide by their OPEC quotas. The price of oil immediately went up, from an average price of $12.28/barrel for 1998 to $17.47/barrel for 1999, one of the largest non-war related increases of the past decade. Later, Chavez and Rodriguez managed to convince OPEC to introduce a price band system, of $22 to $28 per barrel, which OPEC would try to maintain.

The following year, 2000, President Chavez spent much time traveling to both OPEC and non-OPEC countries, to consolidate their commitment to restrained oil production and to convince them to attend the second-ever gathering of OPEC heads of state, to be held in Caracas. On September 27 of 2000, Chavez opened and hosted this second OPEC summit. For the Chavez government, the summit had the following six objectives.

1. Reestablish a dialogue between Venezuela and its partners in OPEC
2. Recuperate the credibility of Venezuela in OPEC
3. Strengthen OPEC
4. Defend oil prices
5. Reassume a leadership position within OPEC
6. Consolidate relations between Venezuela and the Arab/Islamic world

[22] Petróleos de Venezuela, S.A., (PDVSA, pronounced "Pedevesa", peh-deh-VEH-sah) is the Venezuelan state-owned petroleum company.

Given the strengthened position of OPEC in the world today, it is safe to say that the summit's objectives were largely achieved. Ultimately, the renaissance of OPEC could be a large part of what motivated the U.S. to attack Iraq. That is, if OPEC had remained as defunct as it was when Chavez came to power, it is quite possible that the Bush administration would never have considered controlling Iraq's oil reserves much of an issue. But with the return of OPEC, the consequent rise in oil prices, and the general lack of control the U.S. government felt in the face of an energy crisis and the attack on the World Trade Center, "breaking OPEC's back" became a top priority.