OPEC refuses to cut production: How does that affect U.S. motorists, oil producers?

By Rob Nikolewski

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As expected, delegates for OPEC, the Organization of Petroleum Exporting Countries, meeting in Vienna, Austria on Friday maintained their decision to keep oil production high.

That means crude will keep sloshing around the globe, North American producers will stay under pressure to stay profitable and motorists can keep expecting to pay less at the pump than a year ago.

“I'm not surprised at all,” said Sam Margolin, lead analyst for refining and marketing at the New York investment banking firm of Cowen and Company. “I think OPEC sees its strategy as starting to become effective and it's way too early for them to change anything.”

Led by oil behemoth Saudi Arabia, OPEC delegates decided to keep in place the policy passed at their last meeting in Vienna and called on its 12 members to maintain a ceiling of producing 30 million barrels a day instead of cutting production, which would lead to a cut in global supply and therefore, a rise in the price of oil.

By not cutting, more oil pours in the international market, lowering the price of crude and, in turn, gasoline prices.

Even though prices have increased since dropping below $2 a gallon at most gas stations across the country back in January, the national average is currently $2.75 a gallon. At this time last year it was $3.60 a gallon when the international price for oil was $115 a barrel.

“There are a number of other things that affect what the price of gasoline is going to be but (today's OPEC decision) is not bad news for motorists, that's for sure,” said Tom Petrie, chairman of Petrie Partners, a investment banking firm in Denver that offers advice to the oil and gas industry. “If they had decided to cut back now, that would be bad news.”

A target of OPEC's stand-pat decision is U.S. shale oil producers, whose hydraulic fracturing and horizontal drilling techniques in recent years have challenged Saudi Arabia and other OPEC members in the Persian Gulf for global energy dominance.

The low-price environment in recent months has hurt North American producers, forcing them to lay off thousands of employees and slash rig counts by nearly 60 percent.

At least four shale oil companies have declared bankruptcy since OPEC's decision last November.

But oil prices have been creeping up since falling into the mid-$40 a barrel range in January. The price of Brent crude — the international standard — is up to $61.66 and the price of West Texas Intermediate crude — the price that U.S. suppliers deal with — is up to $57.68 a barrel and a number of energy analysts expect it to keep rising, which would lessen the pressure on North American producers.

Joseph Dancy, adjunct professor of energy and environmental law at Southern Methodist University, predicted in March that West Texas Intermediate would climb to the $70-$75 a barrel range by the end of this year.

"Folks thought that much too bullish. I will stick with those numbers," Dancy said in an email to Watchdog.org. "A number of domestic drillers can get decent returns at those price levels in shale plays. Producers are getting much more efficient and costs are coming down."

Despite the economic pain felt since OPEC made its "let if flow" decision last November, North American shale oil producers have proven to be remarkably resilient, using innovative ways to reduce their production costs.

For example, producers in the Eagle Ford shale formation in South Texas say they have reduced their break-even point to extract oil and natural gas to $56 a barrel and it may go as low as $41 a barrel by year's end.

Before the OPEC decision last November, it was estimated the break-even point for most shale-oil producers in the United States was between $75-$80 a barrel.

But there are also geopolitical reasons for OPEC and the Saudis to keep production high.

"I think the real truth may be that they're trying to increase production wherever they can and turn the thumbscrews on the U.S., but equally important in some respects to Iran and Russia," Petrie told Watchdog.org Friday morning.

Iran is a member of OPEC but Saudi Arabia and Iran have long been rivals, jostling for political and religious influence in the Middle East. Iran's Islamic population is largely made up of Shiites while Sunnis make up a majority of Saudi Arabia's population.

Russia is not a member of OPEC but is a major global supplier of oil and, along with Iran, supports the regime of Bashar al-Assad in Syria. The Saudis support rebels forces who want to oust Assad.

“I think the Saudis want to keep the pressure on Iran and do everything it can to undermine both Iran and Russia’s ability to create problems in Syria and they’re hoping the passage of more time, with as much production is coming out, will put the price down to the low 50s for a while and that will give a rollover in U.S. production,” Petrie said.

Another geopolitical aspect?

Oddly enough, a majority of the 12 OPEC members don’t like the “no cut” policy because it’s estimated at least seven need the price of oil above $100 a barrel to pay for their social programs:

Fiscal break-even oil price	
Libya	$184.10
Iran	$130.70
Algeria	$130.50
Nigeria	$122.70
Venezuela	$117.50
Saudi Arabia	$106.00
Iraq	$100.60
Russia	$98.00
Qatar	$60.00
Kuwait	$54.00
Source: IMF, Deutsche Bank (Venezuela), Fitch Ratings (Russia)	

“Keeping things the same, what does it tell you? It tells you all those countries should recalibrate their forecasts about oil prices,” said Steve Hanke, professor of applied economics at Johns Hopkins University and senior fellow at the Cato Institute.

“They should take another look at them and make some calculations about optimal pumping rates and optimal production rates. If they don’t, they’ll continue to be sub-optimal. That’s the nub of the problem.”

OPEC’s next meeting is scheduled for December 4.