

# Saudi Arabia and the Cartel of One

JOHN KEMP

Opec's failure to reach a new agreement on production and the public sniping among ministers about who was responsible have prompted an outpouring of comment about whether the organisation is in crisis and can regain its relevance.

Discussions about the future are linked to speculation about whether the breakdown was due to narrow technical differences about forecast consumption in the second half of the year, as the secretary-general has insisted, or is part of an escalating geostrategic confrontation between Saudi Arabia and Iran that brings in the United States and Venezuela.

No one yet knows whether the meeting's failure was due to a miscalculation on the part of Saudi Arabia or Iran -- or if the breakdown actually suited the political purposes of both sides. But it has highlighted some important structural truths about where real power lies and the issues facing the organisation in the years ahead.

Opec is not the swing producer in the oil market. In recent years, that role has been performed almost exclusively by Saudi Arabia -- to some extent in conjunction with its close allies Kuwait and the UAE. Talk about "the call on Opec" is outdated and misleading. It is really "the call on Saudi Arabia and its allies".

Opec is not currently a cartel in any normal sense of the word. Cartels exist when producers in an industry with actual or potential excess capacity agree to shut in some current production and jointly plan future increases in order to raise prices. But this does not describe Opec.

In the six years since 2005, the market has exhibited only limited amounts of spare capacity, except in the depths of the recession. Of the spare capacity that exists, almost all has been concentrated in a single country, Saudi Arabia.

Even at the trough of the recession, when production cuts were biggest, other members of the organisation shut in less than 1 million barrels per day (b/d) of capacity between them, according to the U.S. Energy Information Administration. In contrast, Saudi Arabia has almost never had less than 1 million barrels of spare capacity, and often more than 2-4 million. If there is a "cartel" it is a cartel of one.

## UNEVEN BURDEN-SHARING

Opec is best characterised as a burden-sharing mechanism. As one of the world's top two exporters, the largest in the organisation, and the only one with significant spare capacity, Saudi Arabia cannot escape the role of swing producer, however uncomfortable and irksome. The kingdom's policymakers (not Opec) decide how much oil is made available to the market and at what price.

Opec is simply a mechanism in which Saudi Arabia can appeal for a degree of burden-sharing, asking others to shut in some capacity so the kingdom itself does not have to shutter quite so much.

The results have been mixed. Past experience suggests appeals only work when prices crash and threaten the economic and political interests of all members (1998, 2008) hence the adage about Opec being like a tea bag "it only works in hot water".

Past experience also suggests that burden-sharing is very uneven. Most burden-sharing has been undertaken by Saudi Arabia's closest allies (Kuwait, Qatar and the UAE). Other members have poor compliance with cutback agreements. In past years, price hawks Iran and Venezuela



Iranian head of delegation Mohammad Aliabadi (down) sits during the 159th meeting of Opec Conference in Opec headquarters in Vienna on Wednesday.

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were serial quota-busters. It is only because of production problems and flat or declining output that both have ceased to be perennial over-producers. Now both countries just produce to capacity.

## QUOTAS DIED LONG AGO

There is no evidence Opec coordinates capacity expansions. The organisation's total capacity has risen 1.33 million b/d compared with the start of 2005. But Saudi Arabia accounts for all that increase and more (1.75 million b/d). Its three GCC allies have added another 0.4 million b/d of capacity. Other members have seen their capacity shrink more than 0.8 million b/d, mostly as a result of aging fields and investment problems. Iran and Venezuela have seen their capacity shrink by 600,000 b/d.

The idea that Opec in some sense "shares out

the market" has been dead for some time. Various analysts and commentators have worried openly about what the breakdown at this week's meeting means for the quota system. One senior Gulf delegate was reported saying this "means death to the existing quota system, an invitation for countries to do anything they want until the next Opec meeting"

But the quota system died many years ago as either a means of curbing output or allocating future market shares -- as the failure to agree terms on which Iraq could rejoin it and Venezuela's output problems have demonstrated.

## CONSENSUS TOO EXPENSIVE

In reality, the other Opec members maximise their production, while Saudi Arabia and its Gulf allies decide how much of their own capacity to hold back to achieve their objectives for prices

and global inventories.

Saudi officials cloaked their dominant role by consulting with the rest of the organisation on output increases but it has long been clear that the decision to cooperate (or not) is theirs and that the consultation is a one-way exercise.

If Saudi Arabia adjusts output (up or down) there is nothing the other members can do to offset it. Iran, Venezuela and the smaller members lack the spare capacity to raise production and they cannot afford to cut back given their parlous fiscal state.

Saudi officials went to Vienna effectively asking other countries to endorse a Saudi output increase of as much as 1.5 million b/d in a bid to cool prices.

Price hawks had nothing to gain from agreeing to the increase (since they cannot participate in it) except extending their influence by keeping the organisation relevant. Likewise, Saudi Arabia and its allies had nothing to gain from allowing the hawks to exercise a veto over its production policy other than maintaining a sense of unity that has become ever more fictional.

## NO VETO FOR IRAN, ALLIES

Saudi Arabia has generally preferred to maintain the consensus, presumably because it wants to preserve the organisation's usefulness as a burden-sharing mechanism during future downturns in oil demand and prices. But for a variety of reasons the kingdom decided the increasingly ephemeral benefits of maintaining consensus were exceeded by the costs of doing nothing.

The kingdom has been under intense pressure from Washington to pump more to stem rising prices. Officials seem genuinely concerned about the impact on consumption from a renewed recession in the short-term and a renewed policy of substitution and demand destruction in the OECD countries in the long-term.

While Saudi Arabia's proposal for an increase was turned down 7 to 4 (Nigeria abstained), not all voices in Opec are equal. The Saudi delegation must have been amazed to find countries representing just 45 percent of the organisation's current production and 37 percent of its theoretical capacity trying to wield a veto over Saudi production policy.

In the short to medium term, there are few costs for breaching the consensus and acting unilaterally. With oil markets set to remain strong in the next few months and years, there appears to be little imminent need for burden-sharing, so alienating other organisation members, many of whom have never provided much burden-sharing support carries few costs.

Ironically, the main risk to the outlook is that soaring oil prices help send the world economy back into recession. Burden-sharing would become important again. But the best way to avoid a price spike and recession scenario is to raise output now and ignore the hawks. Little wonder Saudi Arabia saw no upside and much downside in allowing the hawks to veto or water down a big output increase.

Apart from dealing with occasional recessions, Opec will only be relevant again if other members develop spare capacity -- something for which most lack the financial and technical resources. Until then, Opec and the other members need Saudi Arabia more than the kingdom needs them.

John Kemp is a Reuters market analyst. The views expressed are his own.

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# Paris to become a "laboratory" for urban design

REUTERS, Paris

Paris, the city that has inspired legions of artists and creative thinkers over the centuries is looking to the future -- searching for urban design projects at the forefront of innovation and utility.

From urban mushroom gardens to Wifi-enabled hammocks on the Champs-Elysees, 40 temporary projects will be installed from July to December throughout the French capital and its residents asked to express opinions on their long-term suitability.

"The idea is to make the city a 'living lab', an experimental laboratory," said Jean-Louis Missika, the deputy mayor in charge of innovation, research and universities.

"Some projects will have zero utility, while others will be enormously popular, I'm sure."

That may be the case with the parking detectors that can guide hard-pressed Parisian drivers to nearby empty parking spaces, or a streetside booth where people can record video messages and send them to friends or loved ones.

Other projects are more whimsical,

from the "U-Farm" mushroom grower that relies on coffee grounds or the mobile aqua garden that can raise both vegetables and fish.

The city of Paris has subsidized about half of the design projects to the tune of up to 30,000 euros (\$43,820).

Tourist sites have not been ignored in the attempt to modernize the city. A multimedia terminal will help guide visitors through the famous Montparnasse cemetery, final resting place for literary greats like Charles Baudelaire, Simone de Beauvoir and Jean-Paul Sartre.

And in the bustling plaza outside Saint-Sulpice, the beloved Left Bank church that dates from the 17th century, tourists can send virtual postcards from a kiosk.

While some may pooh-pooh the practicality or esthetics of some of the design projects, the point is to experiment, said Deputy Mayor Missika.

After all, he said, even the Eiffel Tower -- now the most recognized symbol of Paris by people all over the world -- created controversy when it was first erected.

"Every century has had its revolution."



REUTERS

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