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OPEC behavior, 1998–2001

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Abstract

Price volatility has been a central feature of the world oil market over the past several years. Oil prices plunged to around $10/barrel in late 1998 and early 1999, then recovered and soared above $30/barrel in 2000. After seriously misjudging the oil market in 1997–98 and contributing to an oil price collapse, OPEC rallied in 1999–2000 and successfully pushed prices upward but overshot its target. In the first half of 2001 OPEC maintained high but more stable oil prices. Later in the year OPEC struggled to manage falling prices set off by a global recession made worse by the attacks of September 11 and the war on terrorism.

The oil price collapse caused serious damage to OPEC economies. Price recovery became a survival priority, and this was the prime motivation for a more successful effort to reduce production in 1999 in order to raise prices. Because of accumulated debts and expanded government services, and their failure to diversify their economies, most OPEC Gulf states have now become dependent on higher oil prices to fund their revenue needs. This explains OPEC's shift in strategy from market share to target price around $25/barrel and the adoption of a higher price band. But is the target price too high for the present world economy? Will it encourage or discourage the long-term growth in oil demand upon which OPEC depends? Political factors are also important in OPEC's improved discipline, including changes in government in Venezuela and other states, a Saudi-Iranian rapprochement, and increased professionalism on the part of OPEC itself in managing and reacting to the oil market.

Nevertheless, OPEC has difficulty in exercising its market power. It has only one instrument—adjusting supply—to meet seasonal demand changes for crude oil, changes in Iraqi exports, price movements, and shifting economic conditions. The oil market is a difficult market to manage, and OPEC still works with imperfect data and limited instruments. There are important aspects of the market over which it has little control. Price volatility is therefore likely to continue in the years ahead.

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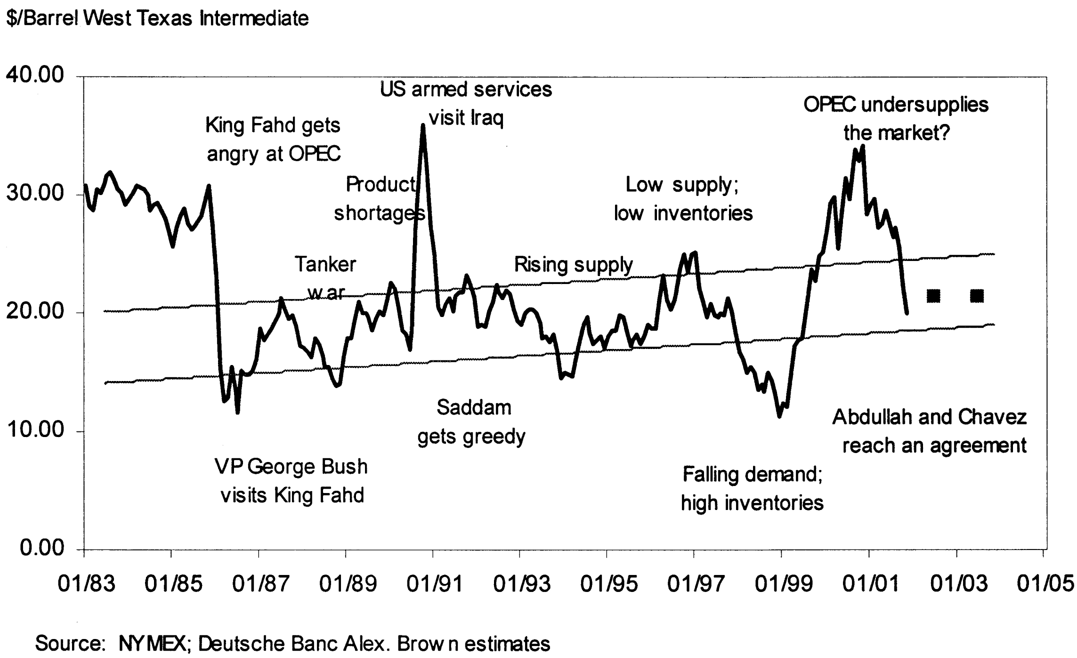

Fig. 1. Crude oil prices, 1983–2001.

1. Introduction

Price volatility has been a central feature of the world oil market over the past several years. Oil prices plunged to around $10/barrel in late 1998 and early 1999, then recovered and soared above $30/barrel in 2000 (see Fig. 1). What economic and political factors explain recent oil market developments, and what has been the role of the Organization of Petroleum Exporting Countries (OPEC), which controls 77% of world oil reserves and provides 35–40% of world oil production? After seriously misjudging the oil market in 1997–98 and contributing to an oil price collapse, OPEC rallied in 1999–2000 and successfully pushed prices upward but overshot its target. In the first half of 2001 OPEC maintained high but more stable oil prices. Later in the year OPEC struggled to manage falling prices set off by a global recession made worse by the September 11 attacks and the war on terrorism. Has a revived OPEC entered a new phase as a more effective cartel?

2. OPEC and the oil price collapse of 1998–99

When OPEC oil ministers met in Jakarta, November 26-December 1, 1997, with the Brent oil price at $20/barrel, they decided to increase their oil output ceiling from 25 to 27.5 million