



Strategic Petroleum Insights

**Research Note:
OPEC – a Blessing not a Curse
Damaging impact of US Congress
“NOPEC” bill on oil markets, upstream
investment, US strategic interests and
the global economy**

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Research Note

NOPEC Legislation

In recent days the US Congress House Judiciary Committee passed the No Oil producing Exporting Cartels Act (“NOPEC”). The bill will now be placed for vote by the full House. At the same time Democrat and Republican senators (Patrick Leahy (D), Amy Klobuchar (D) and Chick Grassley (R)) have introduced NOPEC legislation in the US Senate.

The objective of these bills is to make it illegal for foreign nations to agree together to limit oil supplies and set the oil price. The US Department of Justice could sue oil producers for antitrust violations, seeking damages from assets held in the USA. The bills effectively remove sovereign immunity protections. Previous attempts to pass NOPEC legislation were blocked by Presidents G.W. Bush and Obama. It remains to be seen at a time of relatively subdued oil prices if the Bills have enough support in the House and the Senate to be passed. There is then the question of the presidential veto. The unpredictable nature of the administration under President Trump opens up the possibility that, if passed by Congress, the NOPEC legislation could be signed into law by the President. On the one hand, Trump has railed against OPEC for cutting production to lift the oil price in December 2018, on the other he has strongly supported Saudi Crown Prince Mohammed bin Salman (MBS), setting aside reported US intelligence assessments that MBS ordered the murder of Saudi journalist Jamal Khashoggi at the Saudi consulate in Istanbul in October 2018. Trump could also keep his strategic options open by signing the bill and granting case-by-case exemptions.

Analysis

The impact of the NOPEC legislation has been analysed using two scenarios run through our quantitative oil supply-demand-price model:

- **Managed Market** scenario with OPEC and some Non-OPEC countries maintaining agreed production cuts to manage the oil market to a stable price in the range \$70-80/b (Brent real terms);
- **Unmanaged Market** scenario without OPEC/Non-OPEC production cuts.

The following main conclusions can be drawn from the modelling work using these two scenarios:

Price instability: In the short term, in the Unmanaged Market case the oil price is expected to fall into the \$40/b range on a weekly/daily basis before recovering to around \$60/b. In the Managed Market case, the oil price is supported between \$75-80/b (Figure 1). The price instability (\$65/b to \$40/b to \$65/b in just two years) arises initially from the excess spare capacity as soon as OPEC ceases production restraints, followed by a deferred decrease in spare capacity as US LTO production is impacted some 9-12 months after the low oil price signal in 2019 (Figures 2 and 3). Price instability in the short term is likely to lead to a deferral of some major deepwater oil field developments in the US Gulf of Mexico, Guyana and Brazil, adversely impacting spare capacity and price stability for more than a decade.

US LTO: USA LTO production is forecast to fall abruptly by 500-700,000 b/d and be 1.5 million b/d less in 2024 than in a Managed Market case. This fall in activity represents a very significant negative economic and employment impact in the US LTO producing areas of Texas, New Mexico Colorado and North Dakota. It is also a significant negative impact on US strategic goals of energy independence. By end 2024, the reduction of US LTO production in the Unmanaged Market case represents a loss of more than \$300 billion in gross revenues over the period 2019 to 2024.

Short-term gain, Long-term economic damage to the US: The short-term benefits to the US economy of lower oil prices will be outweighed by the much greater damage inflicted by reduced wider economic activity, stemming from a decline in upstream investment and activity. A reduction in oil prices is similar to a one-off tax cut on consumer activity – it is a short term boost (months) compared with the abandonment or deferral of much long term (decades) of economic activity in developing and producing oil in the US LTO basins or the Gulf of Mexico. Unstable oil prices make strategic planning much more difficult for any company engaged in producing, refining, distributing or consuming hydrocarbons or selling things (like trucks, ships, cars,

planes) that consume oil in one form or another. In addition, the US will also have to import 1.5 million b/d more oil in 2024 in the Unmanaged Market case.

Threat to Political Stability in the Middle East and elsewhere: Saudi Arabia needs significant oil revenues to sustain social welfare and employment policies in the face of a burgeoning youth population. The recent pressure on the Crown Prince from within and without the Al Saud family will also require extensive generous spending on the military, National Guard, police and Ministry of Interior. We estimate Saudi Arabia needs \$80/b to “break even” under these circumstances, i.e. to support an annual budget of some \$300 billion. Figure 4 shows forecast Saudi oil revenues for the Managed Market and Unmanaged Market cases: the latter generates \$200 billion less revenue over the next five years. Low oil prices reduce the capacity of the Al Saud to buy domestic social peace, and also jeopardise the stability of states partly dependent on Saudi generosity – Pakistan and Egypt in particular. Libya and Iraq could also be destabilised by low oil prices.

Threat to strategic allies of the US in the Middle East: Saudi Arabia, Kuwait and the UAE are key strategic allies for the US in the Middle East. Relationships are likely to be further damaged should the NOPEC legislation be signed into law and implemented.

Threat to global financial markets: Figure 5 shows the reduction in liquidity due to an unmanaged oil market with lower oil prices. We estimate \$1 trillion dollars less oil money in circulation in 2019 and 2020 alone in the Unmanaged Markets case compared with that of the Managed Market. Higher oil prices benefit both oil producing and consuming countries – note the USA is both a major oil producer and a major oil consumer. Higher oil prices cause more capital flows into major oil producers such as Saudi Arabia with much of the capital recycled back to OECD countries in increased capital spending and placement of excess capital in investment. The additional capital is deployed by the banking system, reducing interest rates, further increasing liquidity. Higher oil prices boost liquidity which economic growth, asset prices and equity markets. Conversely, lower oil prices tend to be deflationary and reduce economic growth (IMF March 2018 and Goldman Sachs Research Note November 2018).

In short, a Managed Market with stable oil price in the \$75-80/b range yields better outcomes for short and long term price stability, the US economy, the global economy and social and political stability in fragile states in the Middle East, Asia, Africa and South America. An Unmanaged Market introduces short and long-term price instability that will be damaging to the global economy, reduces global liquidity with risks to equity and bond markets, and risks instability in the Middle East and Africa - conflicts with significant long-term costs to Europe and the USA. An unmanaged oil market damages US interests economically and strategically.

OPEC is a blessing not a curse.

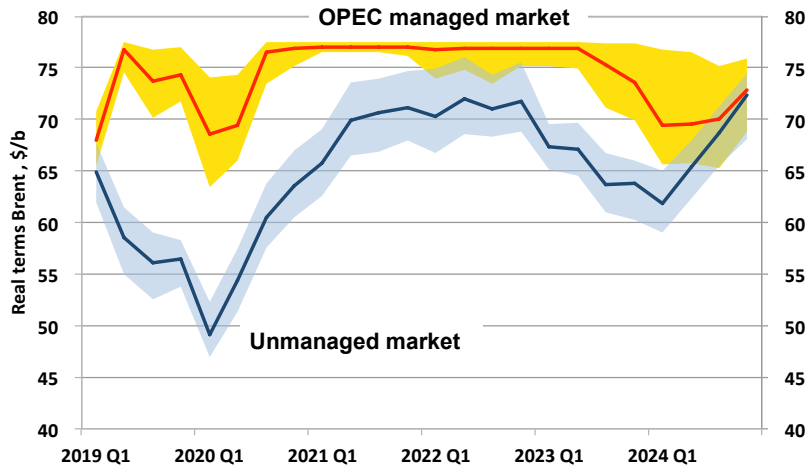


Figure 1: Oil price outcomes for the Managed Market and the Unmanaged Market scenarios (colour bands are 90% confidence bands with the P50 shown as solid line).

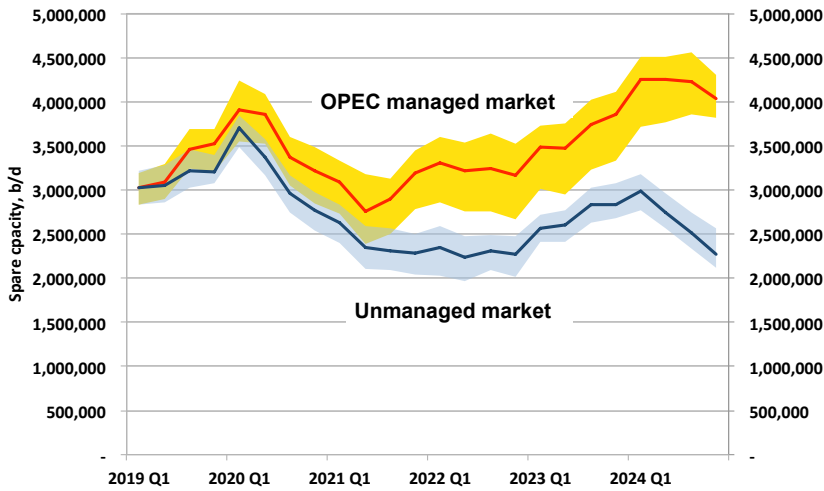


Figure 2: Global spare capacity forecasts for the Managed Market and the Unmanaged Market scenarios.

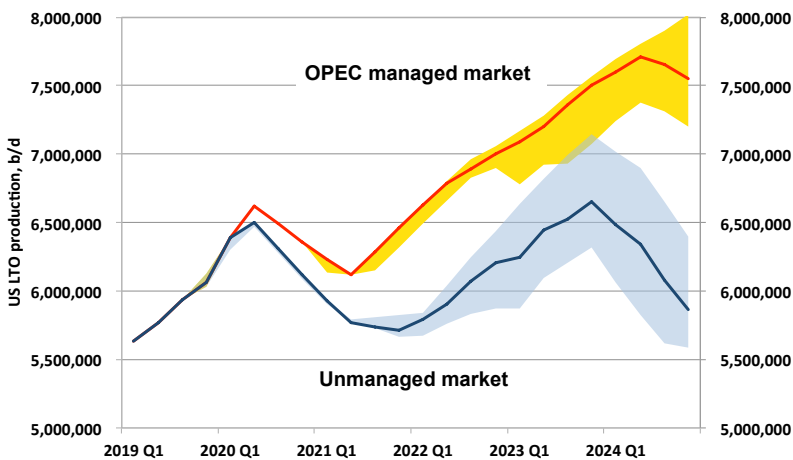


Figure 3: US light tight oil production forecasts for the Managed Market and the Unmanaged Market scenarios.

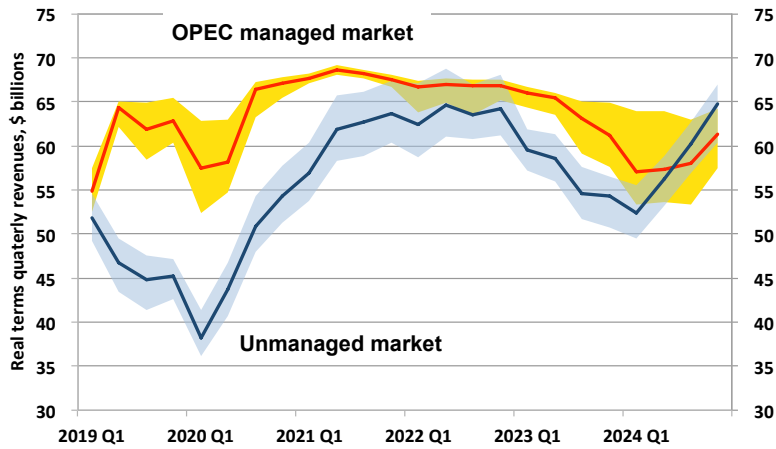


Figure 4: Forecast Saudi Arabia net oil revenues for the Managed Market and the Unmanaged Market scenarios.

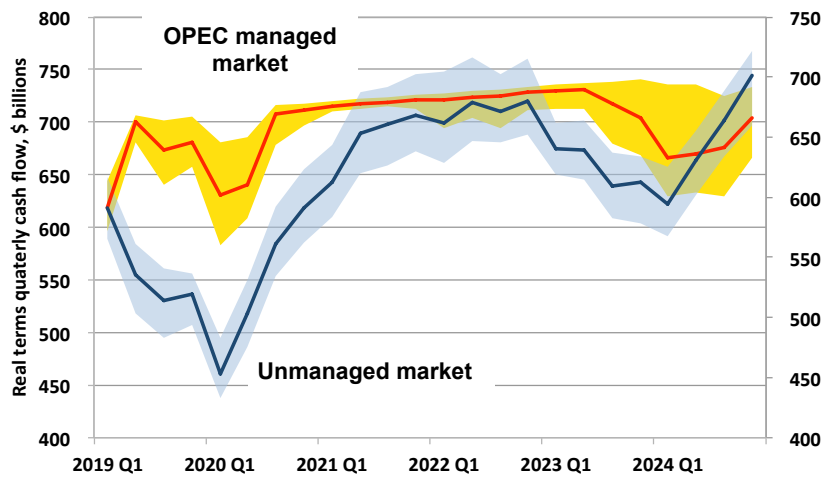


Figure 5: Forecast global gross oil revenue monetary flows for the Managed Market and the Unmanaged Market scenarios.