NOPEC: Providing a Tool to Counter the OPEC Cartel

Summary

The COVID-19 pandemic has brought global economies to a standstill, and the simultaneous ongoing oil price war between Saudi Arabia and Russia has thrown the global oil market into further turmoil. While Congress is providing emergency relief to individuals and businesses due to the economic fallout of the pandemic, the U.S. government is also exploring more unorthodox policy options to prevent the further collapse of the oil market, and the Texas Railroad Commission is being urged by some producers to curb the state’s oil output.

Senior administration figures have discussed the possibility of drawing Saudi Arabia out of the Organization of the Petroleum Exporting Countries (OPEC) and into a bipartite alliance with the United States. Policymakers should be hesitant to engage in a strategy that will neither solve the damaging levels of oil price volatility resulting from the current oil market structure, nor cure the low prices caused by the precipitous drop in demand. Saudi Arabia has consistently used oil as a policy tool to achieve its own goals, even to the detriment of the United States, and policymakers should not view a bipartite agreement as an enduring relationship given the kingdom’s fickle nature.

Moreover, the oil market is neither free nor transparent. OPEC has a long history of manipulating the price of oil in support of its own goals, which has resulted in significant price volatility and makes it extremely difficult for U.S. businesses and consumers to plan and invest. Rather than acceding to voices that want short-term relief by joining in government-orchestrated manipulation, policymakers should explore solutions that promote long-term stability and that reiterate the United States’ commitment to free and fair markets.

One such solution is the No Oil Producing and Exporting Cartels Act (NOPEC). If passed, NOPEC would amend the Sherman Act to disallow OPEC from using a sovereign immunity defense and the Acts of State doctrine to evade U.S. antitrust law. NOPEC would enable the Department of Justice to crack down on oil market manipulation and would allow the United States to take action against any foreign state and/or their state-run oil companies, including Russia and members of OPEC, for price fixing and other anti-competitive activities.

The mere threat of NOPEC has already been sufficient to modify OPEC’s behavior.¹ It has also reportedly discouraged Russia from formalizing coordination of the 10 non-OPEC petrostates that make up the OPEC+ alliance with OPEC itself.² Enacting this legislation would give the government a much-needed ‘stick’ to help ensure a free, transparent, and stable oil market where producers can compete without a substantially reduced risk of sudden swings in supply (likely resulting in swings in price) that affect U.S. consumers and industries like automakers, delivery companies, and airlines. American companies

compete best when they use their innovation and operational efficiency to compete against other profit-maximizing firms in a free market.

Economic Impact of OPEC Market Manipulation

The domestic oil industry in the United States is dominated by private firms, which make investment decisions based on price and market demand expectations. These firms are subject to normal economic and budget restrictions and are constrained by rule of law. It is difficult, however, for these profit-maximizing firms to make effective investment and operational decisions if their competitors are not also independent profit-maximizing firms.

OPEC, however, is dominated by national oil companies (NOCs), state-owned enterprises that frequently operate in pursuit of political priorities rather than economic profits. OPEC nations are deeply dependent on oil revenues to fund government budgets. This direct government participation in the oil industry means generating oil revenue for public spending is often a higher priority than maximizing profits. In addition, these countries are able to use foreign reserves to weather low price environments, unlike private companies who do not have the backing of the government purse. It is difficult for American or other private companies to make investment and operational decisions when the monarchs and dictators who run most of OPEC’s member states can make unilateral decisions on a whim that can reshape the oil market.

The history of manipulation of the oil market by OPEC nations is replete with examples of actions that benefitted member states at the world’s expense. The first, most notable instance was the oil embargo that began in response to the U.S. involvement in the 1973 Arab-Israeli war. This interruption resulted in a tripling of global oil prices between 1973 and 1974, which prompted a global recession that was particularly harsh on the United States.3

More recently, despite talk of Saudi Arabia’s response to the oil spike of 2008, in which increased production prompted relief from high prices, it is often overlooked that the road leading to prices of nearly $150 per barrel in July 2008 was paved with supply cuts by OPEC nations. This drastic increase was a contributing factor to the Great Recession, and any price relief offered by production increases were scant comfort as the United States GDP declined by nearly 2 percent, the worst economic crisis since the Great Depression.4

OPEC has also used production coordination to punish new entrants to the market. In response to rising U.S. output due to innovations in domestic shale production, OPEC announced in November 2014 that it would maintain high levels of production in order to maintain market share and throttle U.S. shale producers. The price of oil fell from more than $100 per barrel in June 2014 to just $26 by February 2016, with more than 200 U.S. energy companies declaring bankruptcy, and approximately 150,000 jobs lost.5 A worse scenario is potentially unfolding today, with oil trading at less than $20 per barrel.6

The decision by OPEC+ to engage in a price war, prioritizing market share over price stability, will inflict serious harm on U.S. producers who are already struggling. North American energy exploration and

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4 https://fred.stlouisfed.org/series/GDPA
6 https://www.ft.com/content/bc938195-82d3-43eb-b031-740028451382
production companies have approximately $86 billion in debt maturing over the next four years – and 62 percent of those maturities are in junk bonds.\(^7\) Falling demand caused by COVID-19 has added further stress to the industry, with oil patch bankruptcies in 2019 jumping 50 percent over 2018 levels.\(^8\)

**The Oil Price War**

Since January, the global oil market’s stability has been disrupted by two significant factors. First, economic activity has declined substantially in the wake of the pandemic, and travel restrictions put in place by governments to control the spread of COVID-19 have drastically reduced oil demand. Second, competing desires within OPEC+ have resulted in Saudi Arabia, as the lowest cost producer with spare capacity, choosing to maximize production to wrest market share from competitors.

In late February 2020, OPEC began negotiating its next agreement to fix production levels, when a disagreement between Russia and Saudi Arabia stalled talks. While Russia is not a member of OPEC, it has been operating in concert with the OPEC cartel on production levels since January 1, 2017. In response to U.S. sanctions against its oil and gas industry,\(^9\) Russia sought to increase OPEC+ production in order to punish U.S. shale producers. Russia’s desire to increase production triggered a significant—and unexpected—response from Saudi Arabia. There have been reports that this was a much more planned and concerted effort because Saudi Arabian stocks have not fallen which required pre-planning of production, as well as the recent settling of the fight between Riyadh and Kuwait allowing them to restart a shared oil field.\(^10\)

On March 8, 2020, Saudi Arabia announced price discounts of $6 to $8 per barrel to customers in certain markets, and on March 10, it announced its intention to increase production from 9.7 to 12.3 million barrels per day. This led to a near-30 percent drop in the price of crude oil,\(^11\) which followed a decline of more than 60 percent over the past year.

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\(^8\) [https://www.haynesboone.com/Publications/energy-bankruptcy-monitors-and-surveys](https://www.haynesboone.com/Publications/energy-bankruptcy-monitors-and-surveys)


\(^10\) [https://www.ft.com/content/1da60fa2-3d63-439e-abd4-1391a2047972](https://www.ft.com/content/1da60fa2-3d63-439e-abd4-1391a2047972)

The steep decline in oil prices, coupled with an already-sliding global economy due to the COVID-19 pandemic, triggered a broader market response. That same day, the Dow Jones Industrial Average dropped by over 2,000 points, its single-largest daily point drop at that point.\textsuperscript{12} Stock market trading on the New York Stock Exchange was suspended after a 7 percent decline at market opening triggered ‘circuit breakers’ put in place following the 2008 financial collapse. The price war threatens to induce bankruptcies and job losses in the oil and gas sector and the auto industry, which has invested in new automotive technology based on expectations of oil prices that did not account for the recent discord within OPEC+. This is all happening as the U.S. economy is already reeling from the effects of COVID-19.

Background on Saudi Arabia and OPEC’s Market Manipulation

OPEC was founded in September 1960 by Iraq, Iran, Kuwait, Saudi Arabia, and Venezuela. Today, OPEC’s official membership has grown to 13 member countries.\textsuperscript{13} Collectively, OPEC’s members control more than 1.2 trillion barrels of proved oil reserves, approximately 79 percent of the global total.\textsuperscript{14}

Despite its control of such a large share of the global oil resource base, OPEC members’ combined production has historically accounted for less than half of global crude oil production. From an economic perspective, this would be justifiable if resources within OPEC states were among the world’s most costly. Instead, the opposite is true: OPEC member states have among the lowest oil production costs globally, generally requiring little incremental expenditure on exploration.\textsuperscript{15}

OPEC’s influence and importance stems from its ability and willingness to exercise its market power. At its most effective, it has functioned as a suppliers’ cartel that exerts oligopoly power over the global oil trade. It does so by setting production quotas for the bloc and for individual member states to limit global oil supply, thus artificially tightening the market. This raises the price of oil, ensuring greater economic rents for oil exporters and higher costs for net importers. This strategy has worked to sustain periods of stable high prices, and also to allow for rapid spikes such as the 1973-74 and 1979-80 oil crises.

Sometimes, OPEC’s influence is exercised by lowering prices dramatically, often when Saudi Arabia is looking to maintain or grow its share of the global oil market. In addition to OPEC’s 2014 response to the emergence of U.S. shale production, Saudi Arabia also engineered a collapse of our domestic oil sector in the 1980s. In response to a growing budget deficit, Saudi Arabia dramatically increased production in 1986—sparking a four-month, 67 percent plunge that left oil just above $10 a barrel.\textsuperscript{16} As a result, the U.S. oil industry was again harmed, and the kingdom retained its preeminent position in the global oil market.

At other times, it has had difficulty coordinating production targets, as seen by the low-price environment in 2016 in which OPEC was operating without an official overall quota or individual country targets. But even so, in many such periods, OPEC members have contributed to dramatic oil price volatility through infighting between member countries, political instability disrupting oil supply, wars in many of their members’ states, and, at times, deliberate actions to impact the oil market.

\textsuperscript{12} \url{https://www.cnbc.com/2020/03/08/dow-futures-drop-700-points-as-all-out-oil-price-war-adds-to-coronavirus-stress.html}

\textsuperscript{13} \url{https://www.opec.org/opec_web/en/about_us/25.htm}

\textsuperscript{14} \url{https://www.opec.org/opec_web/en/data_graphs/330.htm}

\textsuperscript{15} Reuters, “Oil production cost estimates by country,” July 28, 2009.

This behavior has had dramatic effects on the global economy, including recessionary outcomes that have been seen in both high and low oil price scenarios. In addition to the 1986 and 2014 low price scenarios outlined above, high price scenarios such as the 2008 production cuts coincided with the historic rise in oil prices to $147 even before the Great Recession. This was also the case of OPEC supply cuts and embargoes in 1973 -1974, 1979, and has helped support prices for OPEC+ nations from 2017 until the beginning of the 2020 price war last month.

**NOPEC as a Solution**

As demonstrated by both its past and current actions, Saudi Arabia does not have U.S. interests at heart. The United States should act to discourage market manipulation, reduce market volatility, and create a fairer and freer market with transparency and price discovery. Its passage would demonstrate that the United States is serious about combatting oil market manipulation, and would give the U.S. government another arrow in its quiver as it seeks to hold both countries to account when they are contributing to instability in oil markets.

These countries are cognizant of the potential power of NOPEC, and both countries have expressed concern over the possibility of U.S. antitrust enforcement. In December 2018, Russian energy minister Alexander Novak referenced NOPEC as the reason the country would not formalize its cooperation with the OPEC cartel, noting that it would require “additional bureaucratic brouhaha in relation to financing, cartel [sic], with the U.S. side.” And on the advice of the cartel’s lawyers when discussing NOPEC at a workshop in the summer of 2018, OPEC members agreed to stop explicitly referencing oil prices in its discussions, referring vaguely to it instead in terms of oil market stability. The OPEC Secretariat subsequently sent a letter to his fellow OPEC+ ministers on August 1 that year, asking them to “refrain from any reference to prices in their commentary about our collective efforts or oil market condition.” While Saudi Arabia was pursuing an initial public offering of Saudi Aramco, it chose not to list on an American exchange partially out of fear of U.S. antitrust action from NOPEC.

While NOPEC has already demonstrated its efficacy, an independent white paper commissioned by SAFE found NOPEC to be a “relatively modest” application of antitrust law and not outside the norm of previous action toward cartels and price fixing. Authors Harry First, the Charles L. Dennison Professor of Law at New York University and the former antitrust bureau chief of the New York state attorney general’s office, and Darren Bush, the Leonard B. Rosenberg Professor of Law at the University of Houston Law Center, also noted that by limiting authorization to sue to the federal government, NOPEC does not expose OPEC “to the full panoply of enforcement that the antitrust laws ordinarily provide.” The paper concludes that concerns of asymmetric retaliation from litigated states are disproportionate, ultimately stating that NOPEC would form an important part of a global effort to stop cartels that harm U.S. consumers and reduce economic welfare.

Cozying up with Saudi Arabia now would reject American free-market values in favor of short-term opportunism, which is unlikely to work in any case due to the demand destruction caused by COVID-19. Instead, NOPEC is a smarter approach that would give the United States some leverage over OPEC’s activities, stopping this cycle of boom and bust caused by unforeseen market manipulation. NOPEC would:

1. Make interference in the oil market by OPEC and any allies illegal to the extent that such action directly and meaningfully affects the United States;
2. Eliminate the sovereign immunity defense from the U.S. antitrust statute, which currently prohibits lawsuits against a sovereign state in U.S. courts without its consent;
3. Clarify that OPEC and other colluding states are not protected under the Act of State doctrine, a rule that prohibits U.S. courts from hearing lawsuits against a foreign government for acts that government commits within its own borders, and;
4. Provide the U.S. Attorney General, not private litigants, with the exclusive right to act legally against OPEC. This ensures that the President will have the ability to pursue litigation in accordance with U.S. foreign policy and national security interests, but also prevents federal courts from being overwhelmed by private-party lawsuits.

This moderate, common-sense legislation would give the government broader policy options for addressing the price war, rather than adopting a short-term approach with long-term strategic consequences. Moreover, NOPEC would act as a strong statement of the United States’ commitment to its principles of free and fair markets, and provide a deterrent to governments that direct their oil companies to act contrary to such principles.