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# Russia in OPEC : A Step Towards Oil Market Reform

By Igor Tomberg  
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Russia will take part in the December 17 OPEC Summit in Algeria, which is widely expected to decide on major oil production cuts. The decision would be a natural reaction to the global oil price dip, and Russia is also ready to take a part of its output offline to put a floor under oil prices. Moreover, Russian President D. Medvedev indicated in his speech at a conference on the socioeconomic development of the Urals federal district that Russia might join OPEC or new alliances of hydrocarbon fuel producers that might be established in the future. He said Russia is open to coordination with other oil and gas suppliers including OPEC as the oil and gas export is the key source of revenues for the country's budget and it has to be prepared to defend its interests.

Moscow's entering the orbit of OPEC's efforts to arrest the oil price drop is a necessary response to the situation which has clearly spun out of control.

On December 12, 2008 the oil futures were: 46,41 \$/barrel (-0,98) at InterContinental Exchange Futures in London (IPE Brent Crude) and 46,28 \$/barrel (-1,70) at New York Mercantile Exchange (Light, Sweet Crude Oil).

Negative tendencies at the global oil market will almost certainly persist. The December 11, 2008 IEA oil market report forecasted that this year - for the first time since 1983 - the global oil demand will shrink to 85.8 million bpd. A recovery to the level of 86.3 million bpd is anticipated in 2009. The contraction of demand can drive the oil prices even lower. There is a consensus that the demand will rise slightly in 2009 after the end of the active phase of the current crisis but the majority of analysts expect the actual figures to be lower than projected by the IEA.

OPEC does not go public with its plans on the official level so far but there is no doubt that the participants of the December 17 Summit are going to support a serious oil production slash. OPEC Secretary General Abdallah Salem el-Badri believes the oil market is heavily oversupplied and the cut will be considerable. Russian energy minister S. Shmatko says Russia should study the OPEC position carefully to decide whether it should act in line with OPEC's demands (or recommendations) that suppliers outside the cartel take a consolidated position. He told that Moscow is preparing its own proposals aimed at protecting Russia's national interests and ensuring more fair and stable rules of the game at the oil market.

Russia has taken part in OPEC summits as an observer a number of times but recently it became ready to deepen its ties with the cartel or even to join it.

OPEC President and Algerian Minister of Energy and Mines Chakib Khelil said that Russia's, Norway's, and Mexico's joining OPEC

would help to stabilize the global oil market and that independent suppliers would still have to cut production if they choose to remain independent of OPEC. As for Russia, it will contribute to the global supply reduction automatically as its production is already stagnating.

Moscow's taking a bigger role in the oil cartel " in the form of a full membership or simply tighter coordination of the production and pricing policies " is a form of struggle for the oil market reform espoused by

Russia with increasing vigor. Russian energy minister S. Shmatko said on September 25, 2008 that Russia wants to actively influence the global oil prices: "Being such an important player in the global oil community Russia should factor into the processes, perhaps even in more than one way... We are absolutely convinced that the recent oil price dips and rebounds make us, as a major and highly respected oil power, formulate our own approach and our own position".

Currently Russia's potential to influence oil prices remains limited despite its being a leader among the world's suppliers. More intense cooperation with OPEC (in any form " what really matters is the commitment to pursue common policies) would create a new basis for the stability of oil supplies and prices. Jointly Russia and OPEC account for 85% of the world's proven reserves and 53% of production. In an article in Vedomostil LUKOIL vice-president L. Fedun pointed to a number of technical circumstances which make it difficult for Russia to react flexibly to the market volatility, but a range of options does exist. For example, oil companies can suspend production at the so-called marginal sites as the OPEC countries currently do. Besides some deposits can be converted into reserves to be unsealed only in case oil prices grow high and to be frozen in case they fall again.

L. Fedun is absolutely right that under Russia's conditions the cheapest and most technologically feasible option is to build strategic storage infrastructures on the basis of the Transnet company. Transneft already maintains a reserve of about 40 million tons of the so-called technological oil. Technologically, Russian companies can easily build the potential to regulate the supply and demand balance jointly with OPEC or in the framework of the membership in it.

The serious problem, though, is that the supply and demand mechanism itself does not play that big a role in the present-day oil market. Oil happens to be a commodity conveniently used in exchange speculations. The volume of oil-related derivatives market is 20 times that of its actual sales. In January, 2004 " July, 2008 the number of open positions at NYMEX increased from 900,000 to 2.9 million. The extreme volatility over the past several months was mainly due to the swelling of the speculative activity at NYMEX.

In an interview to Oil and Capital<sup>2</sup> Academician Nodari Simonia described the multi-layer character of oil price which can be understood as a superposition of the fundamental and the speculative components. The current price-forming mechanism has been functioning since WTI brought the Texas crude to NYMEX in 1983. As a result the oil price-forming process shifted from the Middle East to the West, and Western countries gained control over the oil market previously dominated by OPEC. In other words, the transition to oil trade at exchanges shifted the control over prices from suppliers to consumers. Reverting to the traditional situation in which supplies can set sound prices is the motivation common to the oil-exporting countries. The motivation is strengthened by the obvious imbalances of the oil market caused by financial globalization.

Gazprombank board consultant A. Konoplyanik writes in Vremya Novostey<sup>3</sup> that currently the oil price is set outside of the oil market by financial investors detached from the oil sector, and they do not regard oil derivatives as systemically important securities. Thus, the oil price is determined by the inflow and outflow of speculative capitals to the "paper oil" market. The center of the competition which used to determine the oil price has drifted from oil hedgers and traders to global financial players seeking maximal returns on their global investments across the entire spectrum of financial instruments. The cumulative financial might of the players - US retirement funds and insurance companies " is so enormous that ridding the oil market of their grip would take a truly global overhaul of

the rules of the game. The liquidity inflows and outflows in oil markets and the resultant price volatilities actually mirror broader disproportions in global financial markets. Similarly the housing bubble in the US was only the first stone which triggered an avalanche.

A study by Cambridge Energy Research Associates (CERA) shows that in case the oil price stays at \$75 or less in five years the oil supply will decrease by approximately 250 million tons " or 9% of the current global output " annually. Inevitably, the result will be an undersupplied demand and a new oil bubble ruinous for the global economy. Some 300 million tons of capacities have to be phased in annually to offset the natural production decline. Since the epoch of "easy oil" is over practically across the globe, reaching the ocean shelf and developing technologically difficult terrains will require huge investments which can be realistically expected only given fair " consequently, fairly high " oil prices.

For the first time ever President Medvedev's speech in Kurgan signals on the top official level Russia's readiness to become an OPEC country. Clearly, the meaning of the statement is not limited to expressing

regard for OPEC which has been inviting Russia for quite some time. The statement is also an attempt to play on oil prices and sends a message to the West. The possible new organizations invoked by President Medvedev signify a reference to the "gas OPEC" which has a chance to be institutionalized by the forum of gas-exporting countries convening in Moscow on December 23. The Russian President demonstrated Russia's will to exert influence over transit, market structure, and prices in the gas sphere commensurate with the country's energy potential.

Rapprochement with OPEC and the establishment of its gas analog are important but not the only necessary steps towards the reform of commodity markets and, from a wider perspective, towards the long-overdue reform of the global financial market. Importantly, the range of instruments to be used in the process should include financial institutions. A way must be found to ensure the stability of the financial institutions like the recently opened St.

Petersburg commodity exchange whose mission is to inject cash into the future-oriented productive sectors of the economy. One of the promising ideas is the departure from the US dollar monopoly in the commodity trade and the transition to payments in other currencies. Ruble could service the trade between Russia and the CIS as well as Vietnam, the ruble-yuan pair " Russia's trade with China, etc.

Generally, a lot could be done to manage the prices for the commodities produced in Russia, but this is a somewhat broader theme.

Dr. Igor Tomberg is a Senior Research Specialist with the Institute of World Economy and International Relations of the Russian Academy of Science and a Professor at the Moscow State Institute of International Relations of the Ministry of Foreign Affairs of Russia

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