OPEC is not above the law

Testimony by Ariel Cohen, PhD, Senior Fellow at the Atlantic Council, at the *Accountability for OPEC: "The NOPEC Act"* Hearings at the Regulatory Reform, Commercial and Anti-Trust Law Subcommittee of the House Judiciary Committee

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Chairman Goodlatte, ranking member Nadler, and honorable members of the Subcommittee, thank you for inviting me here today. My name is Ariel Cohen[1], and I am a Non-Resident Senior Fellow at the Atlantic Council. The views expressed here are mine alone, and I am grateful for the opportunity to provide my assessment of OPEC and the destabilizing effects of that organization's multi-decade oil market manipulation on global security.

The monopolization of strategic resources by powerful entities is a phenomenon as old as trade itself. From China's infamous Salt Commission in 758 AD to Standard Oil and U.S. Steel at the turn of the 20th century, history is replete with cautionary tales of distorted commodities markets and their deleterious effects on populations and on commerce. More than mere market failures, however, the concentrated control of basic necessities is a threat to our very way of life. Oil today, much like salt in ancient China or steel in 1900, is a strategic resource with no large-scale substitute yet – until electric propulsion and fuel choice replaces the current dependence on gasoline and diesel fuel. Given that oil is the lifeblood of the international trade system, the United States and the global community at large can no longer afford to leave this critical market vulnerable to manipulation.

OPEC and its allies and partners, which now include Russia – the world's largest crude oil producer – pose a significant threat to international order. Accounting for over 40 percent of global oil supply and nearly 80 percent of the world's proven reserves, the oil cartel and its allies wield an unprecedented – and unacceptable – capability to determine energy market outcomes. Although OPEC is not a monopoly in the pure economic theory sense – there are indeed multiple sellers of oil across the globe – it is a de facto oligopoly and a market maker that meets the economic definition of a monopoly power, i.e., an entity with sufficient leverage to control outputs, pricing, , and investment in a particular industry.

[1] The views expressed here are my own, and do not reflect the position of The Atlantic Council.

OPEC member countries use this quasi-monopolistic power to quash competition and assure the cash flow of their respective governments – many of whom are direct geopolitical competitors of the United States. Members of OPEC and its allies, such as Iran, spend tens of billions of dollars on a yearly basis to support terror, or build a formidable nuclear arsenal aimed at the United States, as Russia is currently doing. Far from serving as the guarantor of oil price stability it claims to be, OPEC is a collusive entity which sows uncertainty in the global oil markets, undermines U.S. energy security, and emboldens our enemies. I therefore come to you in direct support of the proposed NOPEC legislation.

In the second half of 2014 oil prices crashed – the combined result of weak global economic growth and an influx of supply from U.S. shale. The world looked to OPEC to correct the massive downturn, which saw prices slide from over $110 per barrel in June of that year to $50 by January 2015. Rather than pulling back supply to increase prices, OPEC opted to maintain production levels in an effort to snuff out North America's fledgling shale industry. The results were disastrous: Prices fell to below $30/bbl by January 2016. Investment in the energy sector collapsed, spilling over into other commodities and roiling the global banking sector. While low oil prices are in many ways beneficial to the U.S. economy, the rapidity of the price drop amplified by OPEC and its allies in an effort to protect market share against American competition deepened the global recession.

Today we are being subjected to a more familiar and possibly more dangerous form of OPEC market manipulation: coordinated supply cuts. This kind of weaponization of the flow of supply was also carried out in 1973 and 1979 during the two Arab Oil Embargos: the first followed the Yom Kippur War against Israel in the Middle East, and the second time followed the fall of the Shah in Iran. Since OPEC and Russia reached their decision to restrict output in late 2016, the price of Brent crude has almost doubled, from $40/bbl to just under $80/bbl today. OPEC cuts have eliminated 1.8 million barrels per day from circulation – two percent of the global supply – amidst shrinking worldwide stockpiles and growing demand. Production-cut compliance within OPEC and its eleven non-member state alliance – informally known as the Vienna Group – stand at an astonishing 163 percent, with all but two member countries meeting their quota obligations, a testament to the organization's resolve. Last month, Russia reported its first period of 100 percent compliance, reaching its agreed-to cuts of 300,000 barrels per day. OPEC and its allies are expected to further extend supply restrictions when they meet in Vienna later this year.

Artificially high oil prices threaten U.S. energy security. The United States remains the world's leading consumer of oil – accounting for twenty percent of the world's daily demand – and relies heavily on energy imports to meet its needs. Oil price spikes like those orchestrated by the OPEC cartel harm the many American industries which rely on petroleum products for feedstock – such as the plastics and fertilizers, as well as the automotive and airline sectors.

Higher gasoline prices mean American consumers are left with lower disposable income which they could otherwise use to invest or pay down debt. Former Chairmen of the Federal Reserve Janet Yellen described the negative consequences of high oil prices in 2011:

> "Higher oil prices lower American income overall because the United States is a major oil importer and hence much of the proceeds are transferred abroad. . . . Thus, an increase in the price of crude oil acts like a tax on U.S. households, and . . .tends to have a dampening effect on consumer spending. ...Staff analysis at the Federal Reserve Board indicates that a[n]...increase in retail gasoline prices. . .reduces household disposable income ... and hence tends to exert a significant drag on consumer spending."

Beyond the economic harm inflicted on American industries and consumers, high oil prices pose grave risks to international security. Some of this country's most dangerous geopolitical competitors are de facto petro-states – meaning that they rely disproportionately on oil and gas revenue to meet their fiscal responsibilities. High energy prices grant these petro-states increased flexibility to pursue destructive foreign and domestic policy agendas.

The Russian Federation is a textbook case of how strong oil prices can engender aggressive foreign policy action. June of 2008 saw Brent crude reach its all-time high of $160/bbl. Just two months later, Russia launched its invasion of Georgia, killing hundreds, and putting NATO on its highest state of military readiness since the Yugoslav war. An oil price drop followed shortly thereafter – bringing oil to under $50/bbl by December – and dampened Russian aggressiveness. Five years of relative calm ended in 2013 when oil broke and maintained a price point above $100. The Euromaidan revolution in Ukraine exploded shortly thereafter. In March of 2014 Russia annexed Crimea and entered eastern Ukraine – Brent crude prices stood near the decade's peak of $107/bbl.

Russia's costly commitments in eastern Ukraine and the Crimea are now compounded by further military expenditures in Syria, where Putin has pledged his support of President Bashar-al-

Assad. While Russia has run a budget deficit since 2012 – a function of low oil prices and consistent annual increases in military spending as a percentage of GDP (climbing from 3.7 percent of GDP in 2012 to 5.4 percent in 2016 according to the World Bank) Russia may attain its first budgetary surplus at the end of this fiscal year. Oil and gas income, which account for some 40 percent of Russia's federal budget revenue, stood at USD 8.5 billion in 2017. This year, thanks to OPEC and Russia's sustained production cuts, the Russian Ministry of Finance is anticipating a five-fold increase in petro revenues – nearly USD 45 billion. The Russian Economy grew 1.3 % year-on-year in Q1 of 2018, representing its 6th straight quarter of growth after two years of recession.

With its defense sector the primary beneficiary of Russian deficit spending over the past decade, there is little doubt that this new influx of oil and gas revenues generated by the Kremlin's agreement with OPEC, will support Russia's ongoing nuclear and conventional military build-up. These funds fuel confrontation with the West, and world-wide propaganda activities, spearheaded by the RT multi-lingual TV broadcasting network.

Oil and gas exports also fuel Russia's continuous occupation of parts of Ukraine in violation of international law, aggressive behavior in Central and Eastern Europe, Eurasia and the Middle East, specifically in Syria, where the Assad regime has repeatedly used chemical weapons. These Russian policies put continuous pressure on the U.S. and its allies, from the Baltic Sea to the Mediterranean. Finally, domestic crackdowns on human rights, such as freedom of assembly, which ignore Russia's constitutional guarantees and the build-up of a massive domestic militarized police force (the National Guard), are all funded by the oil and gas bonanza.

Iran is yet another beneficiary of The Vienna Group's artificial oil price inflation. The Islamic Republic is a well-documented exporter of terrorism. It arms, equips, trains, finances, or gives safe haven to organizations such as Hamas, Hezbollah, the Houthi rebels, and even Al-Qaeda, and it now boasts a medium range ballistic missile capability to complement its temporarily halted nuclear weapons program. The Islamic Republic is currently capable of targeting U.S. forces in the Middle East, as well as our Gulf Cooperation Council allies, and Israel. Parts of Europe are also in the range of the Iranian missile arsenal, and Tehran is working on longer-range delivery capabilities.

Teheran's engagement in a host of destabilizing conflicts across the Middle East – from Syria to Yemen to Lebanon and Iraq – depends on oil and gas revenues to meet 30 percent of its fiscal needs. Meanwhile, at home, the Iranian crackdown against the domestic opposition has resulted in 58 dead, 8,000 arrested, and a numerous but unknown number tortured. For this repressive regime in Tehran, 2017 became an oil exports bonanza. Between March and December of 2017, hydrocarbon revenue yielded $13 billion for the Iranian regime, during which exports hovered at around 2.2 million bpd. Even with the Trump Administration's recent announcement to revoke sanctions relief, Iran continues to ramp up production. Last month, the Islamic Republic exported 2.7 million bpd, with every 100,000 barrels equating to $8 million in today's prices. Though the latest U.S. restrictions will certainly hinder Iranian oil exports, it is unlikely that we will see a return to 2012 levels (1.5 mmbd).

Even without adequate buy-in from the international community, U.S. imposed sanctions on Iran's hydrocarbon sector are expected to result in a 20 percent cut in oil exports – between 400,000 and 500,000 barrels a day. With oil prices at their highest point in over 3.5 years, sanction pressure may not be sufficient to hamstring Iran's oil production and exports, and thus are likely to be insufficient to deter the Islamic Republic's destabilizing policies across the region.

To conclude, the United States can no longer allow OPEC and its allies to operate with immunity from sensible anti-trust legislation. The consequences of one group controlling 40 percent of the world's oil production and 80 percent of proven reserves are too menacing to ignore.

1. The economic outcomes are too negative for American industries and American consumers. Too many critical sectors depend on fuel as an input – from refiners to airlines to auto manufacturers and the petrochemical industry. Everyday Americans, who already spend 5 percent of their annual household income at the pump, will have less disposable income available for saving or paying down debt. No U.S. citizen is immune from OPEC-driven market volatility.
2. The geo-political outcomes hurt U.S. interests and our allies. Hydrocarbon revenues are primary sources of income for some of America's chief global adversaries. An increasingly belligerent Russia and emboldened Iran – both of whom are pursuing agendas of regional destabilization inimical to U.S policy objectives – benefit tremendously from OPEC-driven price increases.

Honorable Members of the Committee, we can no longer afford to leave oil markets susceptible to the manipulation of malevolent monopolists, whose interests run contrary to that of the United Stats and the International community at large. I stand in full support of NOPEC legislation.
Thank you.