Angola’s entry into OPEC: a win-win agreement

- Despite (it would appear) the advice to the contrary by certain of its major partners, Angola has become a member of the Organization of the Petroleum Exporting Countries (OPEC) since the beginning of the year. While Angola (along with other producers) had participated in OPEC meetings as an observer for several years, this announcement nevertheless came as something of a surprise.

- Will Angola’s entry in OPEC lead to a shift in the balance of forces in the world oil sector? What will be the consequences of this move for the principal sector players? In any case, the situation appears to be “win-win” for OPEC and Angola, despite a few obstacles that still must be overcome. On the other hand, Angola’s entry into OPEC could ultimately pose some problems for the other parties concerned.
Angola has altered the OPEC / non-OPEC balance of forces

Angola is not just any oil producer. In a few short years, it has become one of the largest exporters and one of the stars in the so-called “non-OPEC” segment, whose importance in the analyses of the oil sector is well known. With production of 1.5 Mbd and, most importantly, an outlook for a rapid expansion to the 2 Mbd level within one to two years and an ambitious objective of 3 Mbd before 2010, Angola represented (along with the Former Soviet Union (FSU) countries) the bulk of the potential increase in non-OPEC production (which, we would again note, is viewed as the virtual counterweight to the control of the market by OPEC).

Since 1 January 2007, the weight of OPEC has therefore increased by 1.5 Mbd while the weight of the non-OPEC producers has fallen by the same amount. It will therefore be necessary to reconsider the manner in which oil statistics are interpreted. For example, Angola’s shift from the “non-OPEC production” category to the “OPEC production” category will certainly call for a re-examination of the method by which the market fundamentals are analysed. A forecast for an around 1.3 Mbd increase in non-OPEC production accompanied by a roughly equivalent increase in world demand implies that the need for supplemental OPEC production will be virtually zero. However, with Angola counted in OPEC, the conclusions reached could be different. The importance of the “expected increase in non-OPEC production” variable in price forecasts will therefore have to be reconsidered in light of this shift in the balance of forces.

What are the advantages for Angola of OPEC membership?

Angola will probably face a few challenges as a result of its entry into OPEC. However, it apparently seems convinced that choosing this strategic option will prove profitable.

A few disadvantages …

On one hand, in geopolitical terms, the United States (even if it has not reacted officially) will not be pleased with Angola’s entry into OPEC, despite the fact that the two countries enjoy good relations. This is all the more the case with the current Bush administration, for which Angola had been an important part of its strategy of reducing the United States’ “addiction to Middle Eastern oil”.

On the other hand, in purely oil terms, Angola, as a non-OPEC producer, could up until now produce at its full capacity and therefore potentially behave, in the words of economists, as a “stowaway” (benefiting from OPEC actions without having to sacrifice a portion of its production). It will now possibly have to submit to the quota system at some point in the future, in the same manner as the other members of OPEC. Of course, everything will depend on the timing and rigour of the application of such a measure. Nevertheless, this could potentially pose problems, including in connection with the foreign oil companies operating in Angola. In this case, why did Angola put itself in such a position? What are the Angolan government’s objectives?

... offset by the expected benefits?

The first benefit is certainly, as was explicitly stated by the Angolan minister himself, financial in nature. Angola is seeking to defend the price of what will become its principal source of hard currency for decades, in the same manner as the other members of OPEC.
Additionally, this move has probably been an occasion for the Angolan government, whose position has been strengthened by the comfortable level of oil revenues and the improvement in the domestic political situation, to demonstrate its autonomy vis-à-vis its major partners. Angola has a tradition of militancy, and its current objectives include having the national oil company Sonangol play a very active role in the development of the hydrocarbon sector. The government is also seeking to accelerate the development of the Angolan economy and to boost Angola’s role in Africa.

The decision to join OPEC also probably involved political motivations, reflecting the expected benefits in terms of prestige and bargaining power that should come from joining an organisation that is considered to have to power to influence the prices of an eminently strategic product. Looking back over the history of the international oil sector, certain producing countries have successfully used their membership in OPEC to their advantage. On the domestic level, OPEC membership is often considered as a sign of international recognition that flatters national pride.

Finally, there is the sentiment of being better protected and carrying more weight when one belongs to a group whose strategic importance is once again being recognised in light of the outlook for tighter international oil supplies. In more prosaic terms, this could provide a sentiment of having a better bargaining positioning and even protection in the context of discussions with foreign governments (above all those interested in exploiting Angola’s natural resources) and with the other sector heavyweights such as the major international oil companies that pump Angola’s oil. In this type of negotiations, OPEC membership can provide additional protective leverage.

Granted, Angola could potentially face the necessity of reducing its production or at least slowing the rhythm of its increase. The Angolan government was obliged to evaluate the pros and cons here. Joining OPEC was therefore a thought-out decision. However, this was not the case for the foreign companies operating in Angola, who could be alarmed at the possibility of future production restrictions. These companies will now have to factor this possibility into their future forecasts and prepare for discussions on this subject with the Angolan government.

**The long-term imperative**

It could also be imagined that Angola is seeking to position itself in a longer-term perspective. In effect, even if it possesses highly promising oil acreage (above all in deep water), Angola still has relatively modest reserves (close to nine billion barrels) compared to the other OPEC members. From this viewpoint, certain observers are expressing their surprise at the rhythm at which production is slated to increase (3 Mbd by 2010?) and the very rapid arrival at peak production for such a recent arrival on the international oil scene. For equivalent or more modest objectives, countries such as Libya, Kuwait and Nigeria have reserves that are three to seven times greater. Granted, these production objectives are after deduction for commitments made to the various partners that are developing the discoveries. However, we cannot rule out the possibility that the Angolan authorities could reconsider the best way to manage its reservoirs in case reserves do not increase as expected. In this case, it would be better to be a member of OPEC.

**A good deal for OPEC also?**

With Angola as a member, OPEC will increase its capacity for action. This is particularly the case given that current conditions are facilitating Angola’s entry. Demand for oil is trending
upward, above all in the so-called emerging economies, and the improvement in member countries’ revenues is providing the manoeuvring room needed to give OPEC time and flexibility in its negotiations for the full integration of Angola. For OPEC, Angola is therefore an additional card to play in order to influence the oil markets.

OPEC has already suspended its quota system for the last two years. The decisions to reduce the production ceilings taken at the end of 2006 were based on the OPEC members’ real production levels. This enabled OPEC to avoid the quota problem in a pragmatic manner. The OPEC members do not appear to be preoccupied in principle by potential market share losses. Consequently, negotiations concerning new quotas (even if scheduled) are not an urgent priority for OPEC. The organisation’s new Secretary General has just reconfirmed this.

Setting a quota for Angola (or for the other members for that matter) is therefore not a burning issue for the moment. Once again according to the OPEC Secretary General, Angola will continue to be regarded as a non-OPEC country as concerns production in 2007. In reality, it could be supposed that internal discussions will continue during this interval in order to resolve the delicate question of whether OPEC will allow Angola to reach the 2 Mbd level before having to come into line with the quota system. In other words, it is necessary to set the production level that will serve as a reference in case of new actions by OPEC on the market in 2008. However, except in case of serious deterioration on the market that would force all the OPEC members to contribute to a cut in production, it can be reasonably estimated that an OPEC that is not faced with such constraints will take its time in resolving this question. It could even integrate this issue into the overall discussion of new quotas for all its members.

In any case, OPEC has nothing to lose, as this additional production capacity had already been programmed and factored into the organisation’s forecasts as virtually certain.
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