 FILE 25X1

[redacted]

Central Intelligence Agency

Washington, D.C. 20505

DATE 9/3/86 FILE

DOC NO GI M 86-20189

OIR 3

P & PD 1

DIRECTORATE OF INTELLIGENCE

20 AUG 1986

MEMORANDUM FOR: Franklin J. Vargo
Deputy Assistant Secretary for Europe
Department of Commerce

FROM: [redacted] 25X1
Director of Global Issues

SUBJECT: Non-OPEC Oil Producers: Prospects for Reductions in Output [redacted] 25X1

In response to your request we have attached our assessment of the prospects of non-OPEC cooperation with OPEC. We do not expect further significant reductions in output from non-OPEC oil producers. As a result, price stability will continue to depend on OPEC willingness to restrain output. If you or members of your staff have questions concerning the report, please call [redacted] 25X1 [redacted] Chief, Energy Markets Branch, Office of Global Issues [redacted] 25X1

[redacted] 25X1

Attachment:
Non-OPEC Oil Producers: Prospects for Reductions in Output [redacted]
GI M 86-20189, August 1986 [redacted] 25X1

[redacted] 25X1

[redacted] 25X1

[redacted] 25X1

[redacted] 25X1

SUBJECT: Non-OPEC Oil Producers: Limited Prospects for Reduction in Output [redacted] 25X1

OGI/SRD/EMB/[redacted](20 August 1986) 25X1

Distribution:
1 - Franklin Vargo, Commerce
1 - SA/DDCI
1 - EXDIR
1 - D/DCI - DDCI Exec Staff
1 - DDI/PES
1 - NIO/ECON
1 - CPAS/ISS
1 - DD/OGI, D/OGI
1 - OGI/PG/CH
3 - OGI/EXS/PG
5 - CPAS/ICB
1 - CH/SRD
[redacted] 25X1
1 - SRD/EMB

[redacted] 25X1

25X1

Central Intelligence Agency

Washington, D.C. 20505

DIRECTORATE OF INTELLIGENCE

19 August 1986

Non-OPEC Oil Producers: Limited Prospects for Reductions in Output

Summary

Several non-OPEC oil producers have reasserted their commitments to join OPEC's effort to restrain output and boost oil prices on the heels of the new OPEC production allocation agreement. Proposed cutbacks, however, are likely to reduce output by a maximum of 100,000 b/d from current levels--far less than what OPEC is hoping for. Moreover, we believe total non-OPEC production will likely rise during the remainder of the year as increases in exports from the North Sea, Australia, and the USSR will more than offset any voluntary reductions in output from other non-OPEC producers. As a result, price stability will continue to depend on OPEC's willingness to restrain output. [redacted]

25X1

This memorandum was prepared by [redacted] Energy Markets Branch, Office of Global Issues. The information contained herein is updated to 19 August 1986. Comments may be directed to [redacted] Chief, Strategic Resources Division [redacted]

25X1

25X1

GI M 86-20189

25X1

25X1

[redacted] 25X1

Non-OPEC Oil Producers: Limited Prospects for Reductions in Output

Recent Developments

OPEC has not abandoned its effort to gain production restraint from non-OPEC producers. Indeed, Saudi Oil Minister Yamani specified a cut in non-OPEC production as a condition of the quota agreement and conveyed this to the oil-producing countries which had offered to cut their output earlier this year. [redacted] Angola, Egypt, Mexico, Brunei, Malaysia, and Oman recently indicated they will implement the cuts they had promised. Norway recently reaffirmed it may reconsider its oil policy now that OPEC has decided to cut output. [redacted] 25X1

Nonmembers might have renewed incentive to cooperate with OPEC in the near future, having experienced the consequences of a price war. Few producers had capacity to raise production to offset the effects of lower prices, and they all benefit substantially from an increase in prices to about the $15 per barrel range. Poorer producers like Mexico loathe the prospect of oil prices well below $10 per barrel and probably will take steps to at least appear as if they are doing their part to restrain output. [redacted] 25X1

Constraints to Cooperation

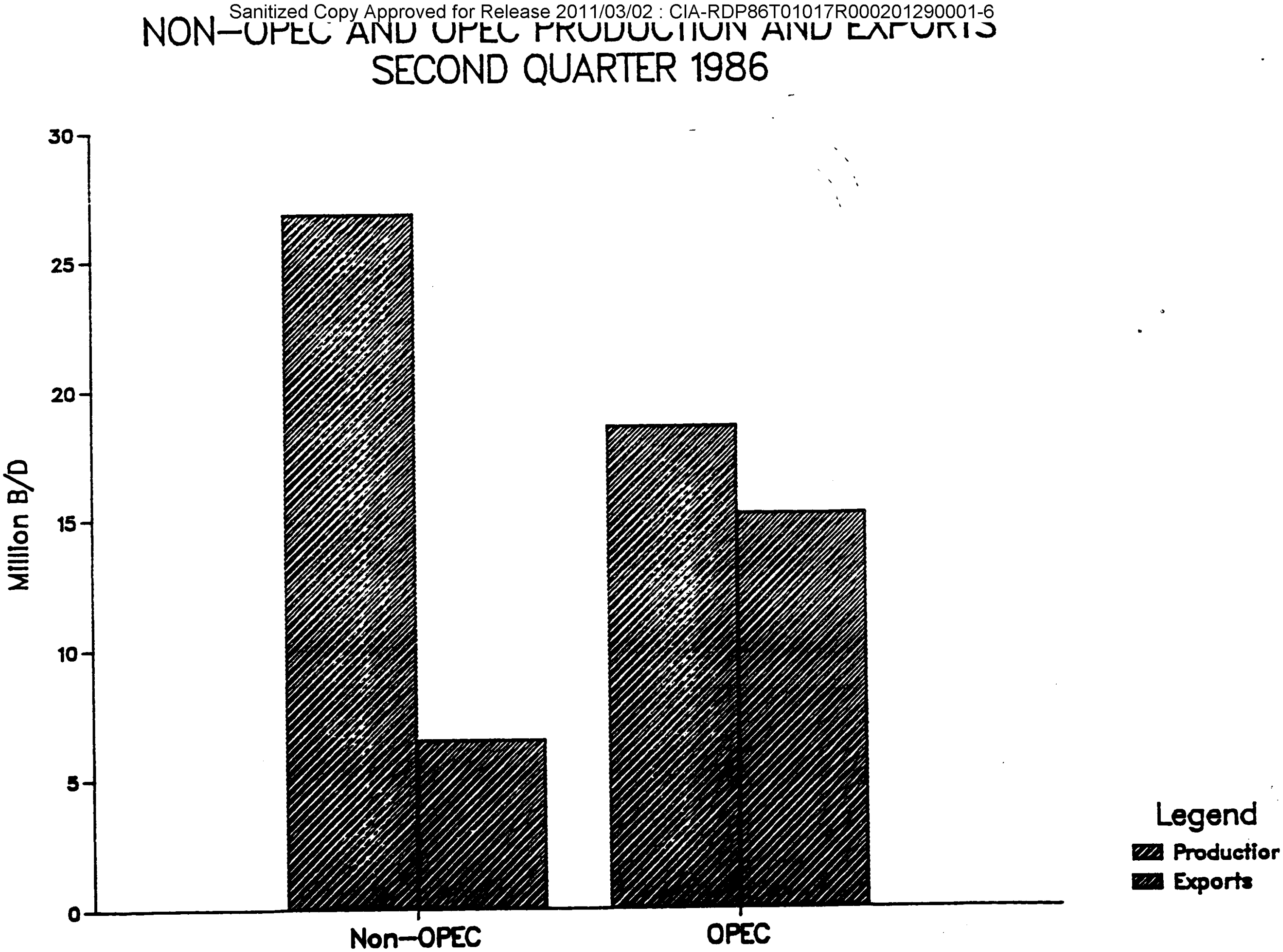
The non-OPEC producers face a number of constraints to cooperating with OPEC that will likely limit the amount of production actually reduced. The major non-OPEC producers, for example, are also large oil consumers and most of their production is used to fulfill domestic needs, leaving only modest amounts available for export. Non-OPEC production is currently averaging roughly 26.6 million b/d, but net exports are running only about 6.5 million b/d, leaving little room for substantial cutbacks (figure 1). Total non-OPEC production is already down roughly 1.2 million b/d below capacity. Marketing problems for several countries, including Mexico and Egypt, have kept oil output about 300,000 b/d below capacity. Maintenance programs, especially in the UK North Sea, are reportedly responsible for another 600,000 b/d decline in output. We estimate only about 200,000 b/d of output, mostly in the United States and Canada, has been shut in because oil prices fell below operating costs. [redacted] 25X1

Other factors that will limit production cuts from non-OPEC oil producers include:

GI M 86-20189 [redacted] 25X1

[redacted] 25X1

Figure 1



25X1

[redacted] 25X1

- o Divergent interests and no formal mechanism for communication or coordination. The countries are a disparate group that range from LDC's which depend heavily on oil for revenue to industrial nations with larger, more diversified economies.
- o Growing financial difficulties and budget deficits. It would be difficult politically for their governments to agree to production cuts when there are no guarantees that all other oil producers will follow suit.
- o Technical limits to reducing current output. For example, certain fields in Norway--particularly Statfjord--produce associated gas, all of which is sold under long term contract.
- o Strong pressure from the United States, which advocates a hands-off policy in the oil market. The North Sea producers are members of the IEA and would be particularly susceptible to such pressure. [redacted] 25X1

Cooperation will be Limited

In our judgment, several nonmembers combined will probably reduce output by only a maximum of 100,000 b/d on a voluntary basis this year (table 1). Cuts by smaller producers such as Malaysia and Oman will be slight, token gestures to OPEC. Mexico said it would hold its exports to 1.35 million b/d for 1986--a 10 percent reduction from last year. Yet exports for the first half of 1986 were only 1.3 million b/d, and Mexico could keep sales during the second half at 1.4 million b/d and honor its commitment to OPEC. Egypt will base its "cutbacks" on already planned reductions in output for 1986--reductions from current production are unlikely. Promises of cooperation from others like Angola and China were probably lip service, in our view, and are unlikely to translate into significant decreases in output (see Annex: Positions of Non-OPEC Producers). [redacted] 25X1

Expected increases in output from other non-OPEC producers, however, will more than offset voluntary production cuts, causing total non-OPEC production to rise by as much as 500,000 b/d from current levels over the coming months to about 27.1 million b/d. North Sea production was a low 3.3 million b/d in June due to summer maintenance programs. We expect UK production to rise by at least 300,000 b/d in the next month or two, reflecting an end to the summer maintenance programs. Also, a recent tax revision in Australia has triggered a resumption of exports of about 100,000 b/d, and the USSR has steadily increased exports in recent weeks. [redacted] 25X1

Consequently, changes in nonmember production will fall far short of OPEC's expectations and are unlikely to affect price movements significantly this year. The burden of price stability will remain on OPEC. It is unclear at this point how these circumstances will affect OPEC's discipline. If another price

[redacted] 25X1

[redacted] 25X1

war should ensue, Saudi Arabia might believe that non-OPEC producers have not learned their lesson and attempt to keep prices at very low levels for a prolonged period. [redacted] 25X1

If OPEC Reneges...

OPEC's recent agreement is tentative and could rapidly collapse if members cheat on their quotas. The Saudis, who probably believe they have taught producers the consequences of indiscipline, would probably renew the market share fight and force prices down again if violations occurred. Kuwait and Indonesia made explicit that their participation in the new accord was contingent on strict adherence to quotas and that cheating by any member would absolve them of quota obligations. If OPEC members were to participate in the struggle for market share and attempt to force their remaining capacity onto the market, oil prices could fall to about $5 per barrel. In the absence of producer cooperation, [redacted] 25X1 oil prices could remain below $10 per barrel for two years 25X1 before market forces lead to a rebound. [redacted] 25X1

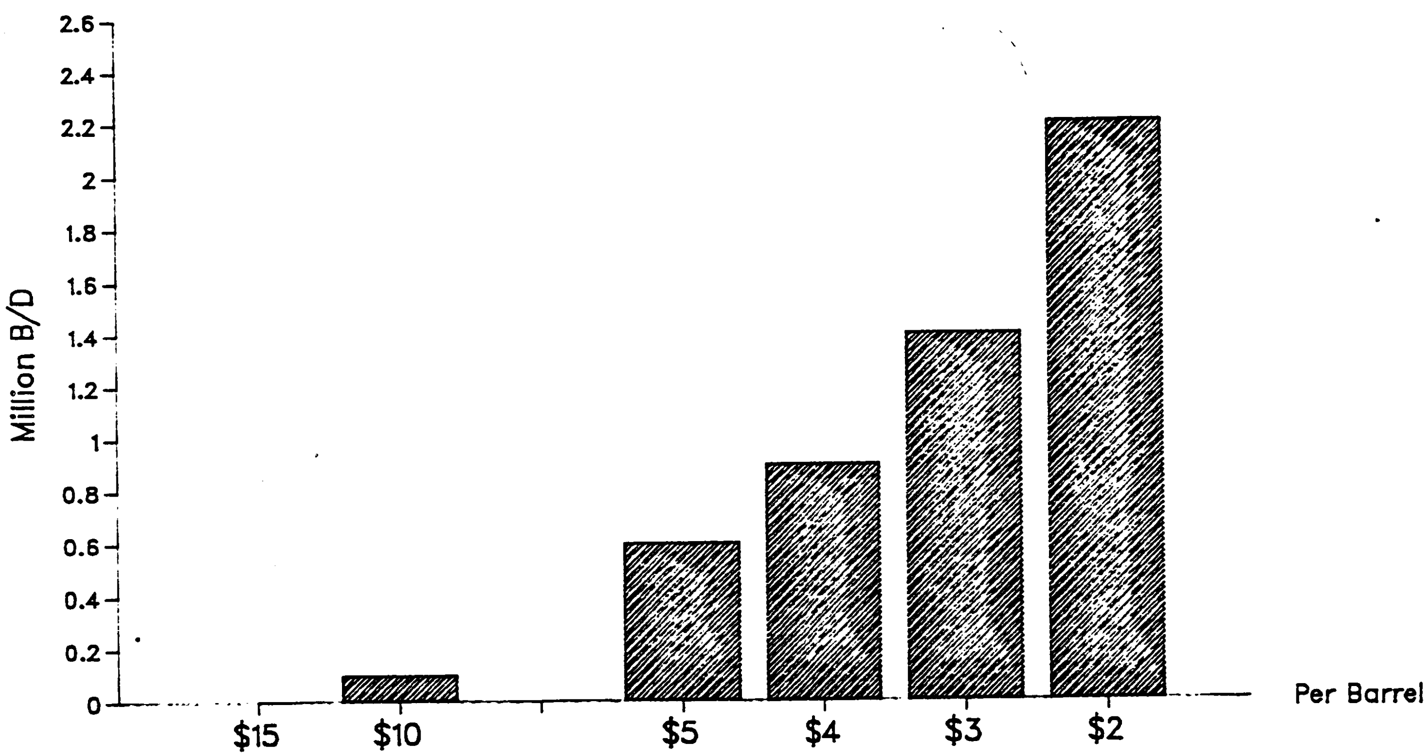
If OPEC's agreement collapsed, nonmembers would likely remove any production restraint and join the price war. Should prices erode and approach $5 per barrel, additional output in high-cost areas like the United States and some production in the North Sea and Canada would be significantly affected for the first time. During the first year or so we expect, however, that the additional loss of non-OPEC supply--even at prices around $5 per barrel--would be relatively small, perhaps about 500,000 to 1 million b/d. In the North Sea, for example, only about 500,000 b/d of UK production would be unprofitable at $5 per barrel (figure 2). But much of this would probably be produced anyway. Also, shutting in production would entail considerable costs, which might induce operators to continue producing despite short-term losses. [redacted] 25X1

[redacted] 25X1

Sanitized Copy Approved for Release 2011/03/02 : CIA-RDP86T01017R000201290001-6

Figure 2

UK NORTH SEA: ESTIMATED PRODUCTION CUTBACKS AT VARIOUS PRICES



Based on average first half 1986 production level of 2.76 million b/d.
Assumes production is lost when prices fall below operating cost.
The cost figures used are 1985 figures and overestimate current effective operating costs.
SOURCE: Wood Mackenzie North Sea Report.

25X1

[redacted] 25X1

* *

Annex
Positions of Non-OPEC Producers

Cooperating Nations

Mexico	Mexico has reiterated its "offer" to cut exports to 1.35 million b/d. This spring exports fell to 1.1 million b/d due to marketing problems, but have rebounded since then to about 1.4. Mexico earlier this year set its export target at 1.35 million b/d. [redacted] 25X1
Egypt	Production has been steadily declining since January to roughly 600,000 b/d in July due to pricing problems. Promised only to keep output below 900,000 b/d. Imposed a production cap of 860,000 b/d for FY 1986-1987 to prevent the overworking of older fields. [redacted] 25X1
Angola	Indicated in June that it would be prepared to cut crude oil output from its current level of 300,000 b/d. No amount specified. [redacted] 25X1
Malaysia	Following OPEC's decision to cut output, Malaysia announced it would reduce output by 10 percent, but only if prices "increase significantly." Implies a potential production cut of 50,000 b/d from its current level of 510,000 b/d. [redacted] 25X1
Oman	Agreed in May to reduce production by 50,000-100,000 b/d. Has since increased production by 50,000 b/d to 550,000 b/d but may cut back by some amount now that OPEC has reached an agreement. [redacted] 25X1 [redacted] 25X1
Brunei	Reportedly agreed in May to reduce output by 10,000 b/d from its production level of 180,000 b/d. [redacted] 25X1 [redacted] 25X1

Non-Cooperating Nations

Norway	Announced it will decide whether to cooperate with OPEC by 1 September. Indicated in June it would not alter current production but might slow down the rate of production growth as a form of cooperation. [redacted] 25X1
United Kingdom	Refuses to take measures that would help raise prices but probably would not oppose independent actions by companies regarding production volumes

[redacted] 25X1

	that would serve this purpose. The summer maintenance program brought UK production levels to a three-year low in June. [redacted] 25X1
Canada	Refuses to cooperate with OPEC. Has seen some shut in of high-cost production but, overall, not much change in output. [redacted] 25X1
Australia	Production fell by about 120,000 b/d this summer because of domestic oil strikes and a high tax structure which makes some production for export uneconomic. [redacted] 25X1
China	Will try to keep exports at 600,000 b/d to earn needed hard currency. No change in exports expected during rest of the year. [redacted] 25X1
USSR	Facing a substantial deterioration in hard currency earnings and an improved production situation, Moscow could raise exports by roughly 100,000 b/d during the rest of the year. [redacted] 25X1

Note: Any "cooperation" described in this table is contingent upon evidence that OPEC is holding to its agreement.

* *

Table 1
Non-OPEC Oil Production, 1986

(million b/d)

Country	Available Capacity	II Quarter Output	Projected IV Quarter Production Level with Selected Cooperation	Changes in Output
Mexico	3.0	2.8	2.8	0
Egypt	0.9	0.8	0.8	0
Angola	0.3	0.3	0.3	0
Malaysia	0.51	0.51	0.46	-0.05
Oman	0.55	0.55	0.50	-0.05
Brunei	0.18	0.18	0.17	-Negl
Total Reductions				**-0.1**
North Sea	4.0	3.4	3.8	0.4
US	10.7	10.5	10.5	0
Canada	1.8	1.8	1.8	0
Australia	0.6	0.5	0.6	0.1
Net Communist Exports	1.6	1.6	1.7	0.1
Other	3.7	3.7	3.7	0
Total Additions				**0.6**
Total	**27.8**	**26.6**	**27.1**	**0.5**