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GATT & OPEC

The Organization of the Petroleum Exporting Countries (OPEC)

A CARTEL:

A cartel is defined as a group of firms that gets together to make output and price decisions. A cartel tends to arise in markets where there are few firms and each firm has a significant share of the market. In the U.S., cartels are illegal; however, internationally, there are no restrictions on cartel formation.

TYPE OF CARTEL:

OPEC is Oligopolistic Cartel. Oligopoly means a state of limited competition, in which a market is shared by a small number of producers or sellers.

ABOUT OPEC

BRIEF HISTORY:

- The Organization of the Petroleum Exporting Countries (OPEC) is a permanent, intergovernmental Organization, created at the Baghdad.
- Conference on September 10–14, 1960, by Iran, Iraq, Kuwait, Saudi Arabia and Venezuela.
- 1949, Venezuela and Iran took the earliest steps in the direction of OPEC, by inviting Iraq, Kuwait and Saudi Arabia to improve communication among petroleum-exporting nations as the world recovered from World War II.

AIM AND MISSION

- Aim to regulate the amount of oil that member nations produce and to keep prices at a steady rate.

- Mission of OPEC's objective is to co-ordinate and unify petroleum policies among Member Countries, in order to secure fair and stable prices for petroleum producers; an efficient, economic and regular supply of petroleum to consuming nations; and a fair return on capital to those investing in the industry.

- The Organization of the Petroleum Exporting Countries (OPEC) has had its headquarters in the Vienna, Austria for more than 45 years now. The countries get together twice a year and agree on how much oil each country is allowed to produce.

WHY OPEC WAS ESTABLISHED

- In 1949, Venezuela and Iran took the earliest steps in the direction of OPEC, by inviting Iraq, Kuwait and Saudi Arabia to improve communication among petroleum-exporting nations as the world recovered from World War II.

- The US was simultaneously the world's largest producer and consumer of oil; and the world market was dominated by a group of multinational companies known as the "Seven Sisters", five of which were headquartered in the US. Oil-exporting countries were eventually motivated to form OPEC as a counterweight to this concentration of political and economic power.

- The creation of OPEC was in1960, in response to the control exerted by multinational companies on the oil business at the expense of producing countries.

- By mid 20th century oil prices, production volumes and other key aspects were controlled by seven large international companies known as the "Seven Sisters" (link to History), according to their interests and the political and military situation of these companies' countries of origin.

- Another reason that led to the creation of OPEC was a great vacuum in the world's oil market management, the inability of the Seven Sisters.

WHO CONTROLS OPEC ?

- The member states control the Organisation of Petroleum Exporting Contries (OPEC).
- However, because Saudi Arabia’s crude oil reserves and production capacity dwarf the other members, it has significant influence over OPEC policy.
- OPEC’s influence on the market has been widely criticized because its member countries hold the vast majority of crude oil reserves (about 80%) and nearly half of natural gas reserves in the world.
- As a cartel, OPEC members have a strong incentive to keep oil prices as high as possible, while maintaining their shares of the global market.

- As late as June 2016, OPEC decided to maintain high production levels, and consequently low prices, in an attempt to push higher cost producers out of the market and regain market share.

- Today OPEC controls only about 30% of the worlds production, so their ability to set oil prices by limiting their output has been lost since other countries outside of OPEC can raise production.

- OPEC controls oil prices through its pricing-over-volume strategy.

WHO ARE OIL AND GAS PRICE ISFIXED BY OPEC COUNTRIES ?

- Oil and gas price is not fixed by opec , Although OPEC did in fact set crude oil prices from the early 1970s to the mid-1980s, this is no longer the case.

- It is true that OPEC's member countries do voluntary restrain their crude oil production in order to stabilise the oil market and avoid harmful and unnecessary price fluctuations, but this is not the same thing as setting prices.

- In today's complex global markets, the price of crude oil is set by movements on the three major international petroleum exchanges (new york mercantile exchange, international petroleum exchange in london, singapore international monetary exchange).

WHAT ROLE DOES OPEC PLAYS IN THE WORLD TODAY ?

- A great deal, OPEC is essentially a cartel of major oil producing nations.
- They deliberate on prices to sell their crude oil depending on the quality, capacity of each member-nation's production and of course, the market.
- The US gets most of their oil from these folks.
- There are also intra-politics happening within the nations in the organization.
- Production capacity dictates the level of influence within the organization.
- Most of the time the Middle East controls decisions but the smaller nations still benefit in some manner.

How Much Influence Does OPEC Have On The Global Price of Oil?

- A: In the short term, the Organization of Petroleum-Exporting Countries (OPEC) has significant influence on the price of oil. Over the long term, its ability to influence the price of oil is quite limited, primarily because individual countries have different incentives than OPEC as a whole.

- For example, if OPEC and OPEC countries are unsatisfied with the price of oil, it is in their interests to cut the supply of oil so prices rise. However, no individual country actually wants to reduce supply, as this would mean reduced revenue. Ideally, they want the price of oil to rise while they raise revenue.

- B: However, in time the price migrates lower as supply is not meaningfully cut. In the end, the forces of supply and demand determine the equilibrium price. OPEC announcements can temporarily affect the price by altering expectations. In recent years, OPEC's share of world oil production has declined, especially with new production coming from the United States and Canada.

India Asks OPEC For Price Discount

- Minister of State for Petroleum and Natural Gas, Dharmendra Pradhan India has asked the OPEC, for price discount, saying higher crude oil prices will boost a shift towards renewable energy already gaining ground in the country, a government statement quoted the oil minister.
- India imports about 86% of its crude, 70% of natural gas and 95% of cooking gas from the OPEC countries. Indian refineries process 235 million metric ton of crude annually or 4.7 million barrel per day (bpd) capacity.
- They import 4 million bpd of crude and refine it and market it both in domestic and international markets.
- energy mix in India in last 3 years has changed with renewables coming in a big way and pricing of solar energy coming down to 4 cents per unit. There is huge pressure to shift focus to solar, wind, electric vehicles and hybrid cars.

Can Opec Still Control the Price

- The OPEC cartel has pursued a high price strategy in an oil market under pressure from rising demand.
- While it may have encountered short-run capacity constraints, OPEC did not commit to increase oil output and bring the price to a lower, more manageable level. Instead, it has actually cut oil output intermittently.
- Since last November, it decided to reduce its rate of production by 1.7 million barrels per day , in an apparent effort to keep the price of crude oil from falling below roughly $50 per barrel, and it still has given no guidance as to what it regards as an upper bound. This conduct tests the limits of what the market will bear; it does not aim to keep the price stable.

- Hence, price volatility does not imply weakness by the cartel. In the four years since the price began to exceed OPEC's previous target price band of $22 to $28 per barrel, its oil revenue more than tripled from $183 billion in 2002 to $580 billion in 2006 while the cartel increased oil output by a mere 17 percent.

- High prices are prone to be volatile and difficult to control, and $50 to $60 is extremely expensive for a barrel of crude oil.

Reference : Economic Geography- K. Siddhartha
Economic Geography- P. Roy

General Agreement on Tariffs and Trade (GATT): Origin, Objectives, Issues and Challenges

Origin of GATT:

Inspired by the success of agreement for international monetary co-operation as reflected in the formation of the IMF, similar co-operation as reflected in international trade also was desired by many trading nations for expansion of world trade.

It was thought that for healthy world trade, attempt must be made to relax the existing trade restrictions, such as tariffs.

As such, at the International Conference on Trade and Employment held in 1946 at Havana, a proposal for establishing an agency called the International Trade Organisation (ITO) was made with the miscellaneous and general objective of augmenting and maintaining world trade and employment.

Though the Havana Charter for ITO was designed as a sort of international trade constitution, it was not translated into practice due to various difficulties and lack of common agreement.

However, some of the countries took up one of the important issues of the Havana Charter regarding relaxation of trade restrictions by incorporating it into a General Agreement on Tariffs and Trade (GATT). This was signed in 1947 by some twenty-three major trading nations, including India. GATT membership has now gone up to more than 64.

As the name itself suggests, the General Agreement was concerned only with tariffs and trade restrictions and related international matters. It serves as an important international forum for carrying on negotiations on tariffs.

Under GATT, member nations meet at regular intervals to negotiate agreements to reduce quotas, tariffs and such other restrictions on international trade. GATT, by its very nature, is a contractual agreement among parties (or nations). It is a treaty that is collectively administered by the contracting nations.

However, it has become a permanent international organisation for safeguarding the conduct of international trade and an institution for the multilateral expansion of trade.

Objectives of GATT:

By reducing tariff barriers and eliminating discrimination in international trade, the GATT aims at:

1. Expansion of international trade,

2. Increase of world production by ensuring full employment in the participating nations,

3. Development and full utilisation of world resources, and

4. Raising standard of living of the world community as a whole.

However, the articles of the GATT do not provide directives for attaining these objectives. These are to be indirectly achieved by the GATT through the promotion of free (unrestricted) and multilateral international trade.

As such, the rules adopted by GATT are based on the following fundamental principles:

1. Trade should be conducted in a non-discriminatory way;

2. The use of quantitative restrictions should be condemned; and

3. Disagreements should be resolved through consultations.

In short, members of GATT agree to reduce trade barriers and to eliminate discrimination in international trade so that multilateral and free trade may be promoted, leading to wider dimensions of world trade and prosperity.

Most Favoured Nations Clause:

In general terms, members of GATT agree that reduction in tariffs and elimination of discrimination in international commerce should be on a reciprocal and mutually advantageous basis.

To ensure against discrimination, members agree to grant to each other unconditional most favoured nation status in all import and export duties, with certain exceptions. Article I of the Agreement deals with the 'most favoured nation clause meaning that any advantage, favour, privilege or immunity granted by a contracting party to any product originating in or designed for any other country shall be accorded immediately and unconditionally to a like product originating in or destined for the territories of all other contacting parties.

Thus, the principle of most favoured nation implies that each nation should be treated as the most favoured nation. As such, the contracting parties are forbidden from granting any new preference. And the negotiations and concessions materialised under bilateral agreements should be extended to all member countries on an equal basis so that the concessions are multilateralised. It also signifies that the permitted quantitative restrictions should be administered without favouring any party.

GATT permits such restrictions only for:

(i) Safeguarding exchange reserves when a country has balance of payments difficulties.

(ii) Restricting imports that would harm domestic price supports and production control programmes of a country.

GATT also lays down that state trading should be non-discriminatory. However, the formation of customs unions or free trade areas are allowed by the General Agreement provided their purpose is to facilitate trade between the constituent territories and not to raise barriers to the trade of other member nations.

(iii) Underdeveloped countries to further their economic development under procedures approved by GATT.

Tariff Negotiations:

GATT recognises that tariffs are the main impediments to the growth of international trade. Thus, the contracting parties are authorised to occasionally negotiate for a substantial reduction of tariffs.

The following guidelines are to be followed in tariff negotiations:

1. Reduction in tariffs is to be negotiated on a reciprocal and mutually advantageous basis.

2. The negotiations should be either for reduction of tariffs or binding of low tariffs. Binding of low tariffs is advantageous as traders will be assured of the continuance of low tariffs so that they can take up business expansion and productive investments without any risk (of high tariff).

3. Each member has to work in good faith and not raise its tariffs and other qualitative measures with a view to increasing its bargaining power in tariff negotiations (when anticipated).

The GATT adopted the bilateral-multilateral technique of negotiating reduction in tariffs. It was a bilateral method in the sense that the negotiations were carried on a nation-to-nation basis. In fact, the contracting parties formed pairs among

themselves and each pair conducted negotiations on a selective commodity-by-commodity basis. The negotiations had multilateral aspects also as the tariff reductions agreed within bilateral pairs of negotiating parties were made generally applicable to all contracting parties through the 'most-favoured nation clause.'

The bilateral-multilateral method of tariff negotiations was in vogue till the operation of the Kennedy Round, on May 4, 1964. Before Kennedy Round five main tariff negotiating conferences had been held which effected agreements (bindings) to reduce or to stabilise about 60,000 tariff rates between the participating countries.

The bilateral-multilateral technique of tariff reduction has the following drawbacks:

1. It leads to unfavourable terms of trade to the underdeveloped primary producing nations on account of their weak bargaining position in a bilateral agreement with an advanced nation. The principle of reciprocity was injurious to their interest.

2. It creates uncertainty and instability in the tariff structure of various countries.

3. It causes injustice to the already low-tariff countries, as they are in a very weak bargaining position and have little to offer in exchange for concessions offered by other countries (previously with high tariffs).

4. It is a very slow method of reducing tariffs. Hence the achievements made during a long period of 14 years of its operation are not very substantial or encouraging.

In fact, at the ministerial meeting of the contracting parties in 1961, it was agreed that the reduction of tariffs on a most favoured nation basis should be continued

but in view of the changing conditions of world trade, the traditional GATT technique for tariff negotiation on a commodity-by-commodity and nation-by-nation basis are inadequate and inappropriate. Hence, ultimately the bilateral aspect of negotiations was given up in Kennedy Round.

Reference:

Economic Geography- K. Siddhartha

Economic Geography- P. Roy