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U.S. Oil Boom Divides OPEC

Cartel Struggles to Respond to Rise of Shale Drilling

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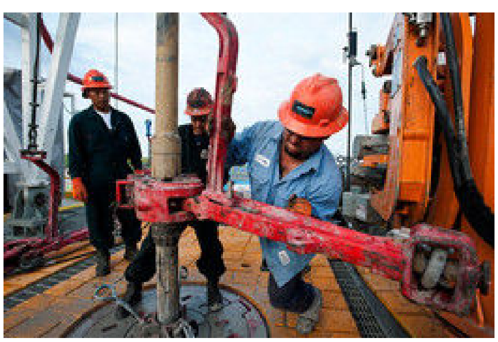
The American energy boom is deepening splits within the Organization of the Petroleum Exporting Countries, threatening to drive a wedge between African and Arab members as OPEC grapples with a revolution in the global oil trade.

The American energy boom is deepening splits within the Organization of the Petroleum Exporting Countries, threatening to drive a wedge between African and Arab members as OPEC grapples with a revolution in the global oil trade. Jerry Dicolo explains. Photo: Getty Images.

OPEC members gathering on Friday in Vienna will confront a disagreement over the impact of rising U.S. shale-oil production, with the most vulnerable countries arguing that the group should prepare for production cuts to prop up prices if they fall any lower.

"We are heading toward some problems," said a Persian Gulf OPEC delegate.

African OPEC members such as Algeria and Nigeria—which produce oil of similar grade to shale oil—are suffering the worst effects from the North American oil boom. Nigeria Oil Minister Diezani Alison-Madueke deemed U.S. shale oil a "grave concern."



Bloomberg News

A drilling operation in Texas's Eagle Ford Shale. U.S. supply is expected to grow faster because of shale-oil output.

Gulf countries, notably Saudi Arabia, pass relatively unscathed—and are the only OPEC members with the flexibility to cut production. But they are unlikely to let that happen at Friday's meeting, several OPEC delegates said.

That would deepen power struggles that have dominated the organization in recent years. Iran, Venezuela and Algeria, who need high oil prices to cover domestic spending and offset falling production, have regularly clashed with Gulf countries led by Saudi Arabia, who have the financial strength to withstand lower prices.

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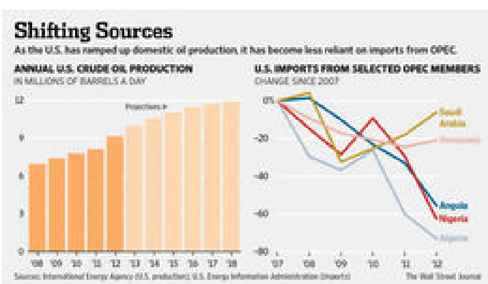
OPEC has overcome past rivalries to rally against an external threat, most notably in 2008 when it agreed to a production cut of more than four million barrels a day to stem a price crash during the financial crisis. But the uneven impact of the North American supply surge makes a collective response—such as a coordinated production cut to support prices—more difficult, said delegates on both sides of the divide.

The U.S. and Canada are set to produce about 21% more oil by 2018 than from this year, according to data from the International Energy Agency.

This marks a historic and largely unexpected reversal. U.S. crude-oil production peaked in 1970 and had declined continuously for more than 20 years when shale oil first began to flow after 2008. U.S. crude production has risen to a 21-year high as hydraulic fracturing, known as fracking, and other technologies have unlocked large resources of oil previously trapped in shale rock in North Dakota and Texas. Shale deposits in other areas, such as Pennsylvania, are yielding mostly natural gas.

OPEC, the source of around one-third of the world's oil, has clearly been taken aback by the shift in U.S. production. In 2010, the organization forecast U.S. and Canadian oil production of 2014 at 11.8 million barrels a day. Just two years later, that forecast had risen to 14.5 million barrels a day.

A rebound in U.S. production would have been unexpected just five years ago because shale oil production requires an oil price that has rarely proved sustainable—typically $70 a barrel or above. But oil prices have remained much higher in the past two years, thanks in part to persistent geopolitical tensions in OPEC producers, such as the Libyan civil war and Persian Gulf tensions.



As U.S. production has grown, exports to the U.S. from three of OPEC's African members, Nigeria, Algeria and Angola, have fallen to their lowest levels in decades, dropping 41% in 2012 from 2011, largely because of shale oil, according to the U.S. Department of Energy. In contrast, Saudi shipments of oil to the U.S. increased 14% in 2012. Saudi Oil Minister Ali al-Naimi said recently that the rise of unconventional energy sources doesn't threaten his country's dominant role in world oil supply because demand also is increasing.

"I don't think anyone should fear new supplies.... The pie is getting bigger, and there is enough to go around," he said.

But the Nigerian oil minister, Ms. Alison-Madueke, sees danger for her country. "Shale oil has been identified as one of the most serious threats for African producers," she said in the U.K. this month. Those producers, she said, could lose 25% of their oil revenue as they are edged out of the U.S.

Nigeria has been hardest hit because its light and low-sulfur crudes compete directly with shale oil, unlike Saudi Arabia's heavier and more sulfurous crude. Other OPEC members who don't serve the U.S. market, such as Iran, are also complaining. Muhammad Ali Khatibi, Iran's envoy to OPEC, told The Wall Street Journal that a combination of rising U.S. shale production and tepid demand is bringing "the price down."

While Saudi Arabia can tolerate lower prices, "there will be some members, like Venezuela, Iran who will struggle at $90," said Amrita Sen, chief oil analyst at London-based Energy Aspects Ltd. The front month Brent contract for July settled at $102.62 a barrel Monday. Venezuela's oil minister said on Monday that he would push for a cut in OPEC production if oil falls below $100 a barrel.

Iran needs high prices to offset the loss of $26 billion of oil revenue last year from tough Western sanctions on its exports, according to estimates from the U.S. Energy Information Administration.

Algeria, which has been rattled by riots over food and housing, needs an oil price of $121 a barrel to cover planned domestic spending—including for roads, jobs and housing—according to the International Monetary Fund.

The country's oil and gas revenue fell by 9% in the first four months of 2013, according to government figures. Algerian Finance Minister Karim Djoudi has said that lower revenue tied to mounting U.S. shale production could force the government to cut domestic spending.

"Cutting subsidies without increasing wages could bring tremendous political animosity," and instability, said Geoff Porter, head of security consultancy North Africa Risk Inc.

OPEC officials said the group is preparing studies to evaluate the impact of U.S. shale oil on demand for its crude. "Definitely, we will review nonconventional shale oil from the U.S.," said Mr. Khatibi, the Iranian envoy.

However, there is no agreement on the size of the challenge. Mr. Khatibi said the North American oil boom has created a global oversupply of 1.5 million barrels a day. Delegates from Gulf nations see the excess at no more than 500,000 barrels a day.

In the past, Saudi Arabia has simply ignored more hawkish members such as Iran and increased oil production when they failed to reach an agreement—as was the case during an acrimonious split two years ago. Saudi Arabia is the only country with sizable flexible production, giving it some influence on prices.

But the group can ill afford new divisions. In 2008, Saudi Arabia was forced to backpedal from a unilateral supply boost after prices crashed by $100 a barrel.

—Summer Said contributed to this article.

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Corrections & Amplifications
Algeria's oil and gas revenue fell by 9% in the first four months of 2013, according to government figures. An earlier version of this article incorrectly gave the year as 2012.

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