As oil prices fall back to $50 a barrel, the markets are calling OPEC's bluff. Many of them live in nostalgia for the 1970s, when OPEC briefly (and from its members' perspective, fatally) called the shots.

It was all so simple back then: all the OPEC countries had to do was reduce their output and up would go the price. Incredibly, political and industrial leaders in the consuming countries believed it. Worse, they thought that the OPEC price shocks were just the beginning of a long inevitable upward path, based upon nonsense like “peak oil”. They set up the IEA to coordinate their response.

In the 2000s, similar follies were widespread. As the price marched up to $100 and then peaked at over $140, the same beliefs prevailed. This time there was a twist: not only would OPEC gain ever more market power, but the consumers in western world would be protected by what they claimed would be relatively cheap renewables – priced into the market by OPEC.

Since oil prices crashed in later 2014, it has taken time for reality to sink in - just as it did in the 1980s. There is no peak oil. There is too much of it - more than enough to fry the planet. Higher prices lead to higher supplies and technical innovations - hence the rapid expansion of shale oil and gas. As the price falls, costs fall. As the price falls reduce the revenues to the oil producers and create big budget deficits, they pump more not less to try to stem the losses. This is how markets work, whether OPEC likes it or not.

$50 is a high price for oil, not a low one. Over the full history of the oil industry, the average price has been around $36 in today's prices. For most of the history of the oil industry, prices have gradually fallen with technical developments and new supplies. Only twice has this trend been interrupted - in the 1970s, and from around 2004 to 2014. In both cases the consequences for OPEC have been short-term gain, and long term losses.

Can OPEC fix it again? When they meet later this month to take a look at their agreement to cut production, the answer is at best only for a few months. Their position is pretty hopeless.

Let's look at the reasons why, which are elaborated in my new book Burn Out – the endgame for fossil fuels. From its current high vantage point of $50, oil remains very expensive relative to its marginal costs. There is plenty of oil at $20 or even $10. At $50 US shale is still in the market, despite all the assumptions that OPEC could force it out at $70. Its costs keep falling. What shale brings is a completely different cost structure: it is a fast and flexible technology, not the slow and rigid one of convention production. It is much more the swing producer now, than even Saudi Arabia. OPEC has not destroyed US shale.

Even without shale, OPEC would find it hard to get its act together. Cartels are notoriously difficult to maintain. The incentives to free ride are enormous. The obstacles to enforcing agreements are much worse when price is falling. It turns out that the two great spikes in oil prices, set against the long trend of gradually falling oil prices over the history of the industry, are very special aberrations. They are not normal.
Nor are they likely to return, because not only is there more and more supply available, but the demand for oil is being gradually eroded. Oil is used mainly for transport and petrochemicals. On transport, the gradual march of digital technologies is moving the world towards electricity. Everything is gradually going digital and everything digital is effectively electric. Transport will not escape this trend. On petrochemicals, the world is turning to gas and away from oil, before new materials come on the scene. The tide for oil is very gradually going out.

The medium term trend for oil prices is likely to be down not up. In a few years time the price may still be $50, or it maybe less. Instead of pretending that it can lay down production quotas from it headquarters in Vienna, and then magically its members (and Russia) will comply, despite all the incentives and evidence to the contrary, OPEC would serve its members better if it gave serious thought to managing the consequences of getting back to a normal and gradually falling price, and managing the fall out to its members budgets.

OPEC might also reflect on the falling away of one more pillar in its scaffolding. OPEC was always about the Saudi willingness and ability to swing its production. Saudi’s ability to do this depended on the umbrella provided by its economic and military relationships with the US. Trump no longer needs Saudi Arabia. The US is heading towards energy independence, and more oil and gas exports.

OPEC might reflect why this has happened: it is because oil prices rose unnaturally high between 2004-14. As with the 1970s, it has reaped what it sowed. Markets work.

Perhaps in this new world, OPEC should just close itself down. It is not capable of running a sustainable cartel, and cartels are almost always fragile and encourage their members to rely on market power rather than serious economic reform. In the longer run of history OPEC has not only been a failure in its own terms in trying to rig the oil market, but it has helped to sow the political seeds of revolt in its own members. The best use of the meeting in late May would perhaps be to decide that it should reduce its role to being a trade body.

Burn Out - The endgame for fossil fuels
Yale University Press in March 2017. Click to order.

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