OPEC and Saudi Arabia show the world who’s the boss

Oil production will not be cut, as there was no formal revision of the 30 barrels a day limit that was set in December 2011. OPEC, the Organization of Petroleum Exporting Countries, managed to surprise everyone, going further than anybody had truly expected in its adoption of a rather unlikely free-market inspired approach.

Indeed, the Organization made a rather explicit decision to shift away from cartel pricing and policies, entrusting the restoration of equilibrium in the oil market to supply and demand forces, affecting only minor price adjustments. The market responded accordingly and the already fast dropping oil prices, already at their lowest since 2010, were allowed to accelerate their descent such that the Brent to USD$ 70/barrel the descent to the point that the WTi (west Texas Intermediate) fell back below USD$ 70/barrel – Brent crude hit USD$ 72. It was only a month ago that OPEC considered price of USD$ 80-90 too low. These values are well below the OPEC desired minimum of USD$ 100/barrel. But if the Saudis will persevere in their strategy, there will be no way to reverse the trend soon. Venezuela, Iran and Russia (non OPEC, but attends summits as observer) were among the countries most interested in achieving production cuts to boost prices; however, there is a sense that the Saudis want to maintain crude oil prices at 80-90 dollars per barrel for one or maybe even two years.

The Saudi strategy is clear; the Kingdom is using oil as a geopolitical weapon because at these prices, several of its OPEC competitors/foes will suffer: Vladimir Putin’s Russia, which has been struggling under financial US and EU sanctions; Venezuela, which under President Nicolas Maduro, has been facing a worrying financial and currency crisis and of course

Iran, the most important and dangerous player, from Saudi Arabia’s perspective, in the Middle East chessboard. Iran, had demanded production cuts to help it stop the hemorrhaging of its State coffers as it too faces the burden of international sanctions. The Saudis have market share on their side with a daily production of 9.7 million barrels, representing nearly a third of the OPEC total of 30.5 million. The Kingdom wants to achieve an overall margin squeeze in order to emerge as the winner in the medium to long term by further increasing its share of global production and while ‘ruining’ some of its competitors. If the mood in Tehran, Moscow and Caracas isn’t especially cheerful today, oil tycoons in Houston and Calgary are also not very pleased.

OPEC and the shale oil and tar sands producers of North America could find full agreement in restoring the USD$ 100/barrel oil price floor; both committed to resist the collapse of oil prices. OPEC, however, has become very concerned by the seeming success of shale oil, which would certainly continue to experience long-term growth, eventually reducing the Organization’s market share by a couple of million barrels a day within a few years, despite growing demand of 1 million barrels day, on average, per year. Shale oil producers in the USA had at first welcomed the price challenge with Saudi Arabia. Last September when oil prices started to drop more dramatically, the US’s largest shale oil operators saw the lower prices as putting pressure on domestic competitors, dissuading newcomers, while ‘bragging’ about their ability to reduce costs and even accelerate, rather than slow down, the extraction of crude oil. However, nobody, it seems had expected oil to drop below USD$ 70. At this price, only the Saudis are laughing. The shale oil producers such as Continental Resources – the largest producer in North Dakota – has been left exposed to the risk of a possible further drop in oil prices because the Company had expected OPEC to push for cuts in order to push oil prices back up to at least USD$ 90 in the short term. Others like EOG Resources stated that they could still be profitable even if oil fell to USD$ 40; similarly, Chesapeake Energy raised its production target of 0.7% as costs of production fall. Yet the Saudis are not convinced by the American optimism.

OPEC Secretary General Abdullah al-Badri, last October 29, said he was convinced that 50% of American shale oil was already “out of business” and that the companies involved would soon close down because they bear much higher costs than OPEC producers. OPEC countries, moreover, are less concerned about the profitability of the wells than they are about the stability of their State budget or current accounts. Extraction costs are a secondary consideration and the Saudis are the best equipped to survive this ‘game’; if it can keep the price of a barrel at USD$ 70 or below, it will slow US production and possibly eliminate the political debate over the Keystone XL Pipeline, given that at such prices, it would not serve anybody’s interests.

At yesterday’s meeting, then, the Saudi minister did not want to contemplate making any cuts whatsoever to production, defying even the most optimistic predictions. Strategic interests and regional rivalries have doubtless influenced the “price war”, reflecting the virtual war that has been played out in the Syrian battlefield between Saudi Arabia and Syrian President Bashar al-Asad’s allies Iran and Russia. The outcome of the summit will have irritated several ayatollahs in the Islamic Republic. With oil prices continuing to fall and the growing burden of years of international economic sanctions, Iran’s coffers have become increasingly empty. Nevertheless, Iranian leaders share the same desire to slow down North American oil production as the Saudis, not wanting to lose market share in the face of growth in the US, the highest in recent years.

The goal would be to force Americans to curb production founded on shale oil. Iran is also aiming to hurt Canadian oil producers in the very Albertan backyard of Prime Minister

Harper, who has been pursuing – inexplicably – an even 'tougher' foreign policy against it than the United States. The Alberta tar sands and shale oil are no longer competitive under 80 dollars a barrel (between 60 and 70 according to other calculations) and with low prices many manufacturers would risk bankruptcy. The fact that Canada initiated a cut in diplomatic relations with Iran in 2012 has worsened relations and made dialogue difficult. The oil tycoons in Calgary may want to have a little chat with Mr. Harper…As for Iran, the lower oil prices may add pressure on the 'Conservatives' to allow President Rowhani, a pragmatist, to make more concessions in nuclear talks with the US in order to reduce the pressure from sanctions. The lower oil prices also hurt jihadists of the Islamic State (selling Iraqi and Syrian oil on the black market obtaining at least USD$ 2 million per day).