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).

The ISIS led war in Iraq keeps oil prices high and protects OPEC interests

The Saudis have not liked the United States’ re-orientation of strategic interests in the Middle East – thanks to its greater energy autonomy. Syria and Iran have been at the heart of this re-orientation of American priorities – a shift that the Saudis might well describe as a ‘betrayal’ from what has been their historical ally in the Middle East. Obama’s decision not to intervene militarily against Syrian President Bashar al-Asad has left the Saudis more isolated as Washington chose to follow Russia's plan for the elimination of Syrian chemical weapons. And of course, the rift between Riyadh and Washington over Syria has only widened by the possibility of talks between the U.S. and Iran over how to contain the threat of the Islamic State (formerly known as ISIS), a radical Islamic group, which has declared an intent to establish a 'Caliphate' (an Islamic State) stretching from West Africa to Central Asia. Meanwhile, Saudi Arabia has been producing oil at rates not seen since the 1970's.

Saudi Arabia's Fellow Gulf Cooperation Council members Kuwait and the UAE are also producing at record levels, in order to compensate for the sharp drop in production in such countries as Libya, where the pervasive anarchy and emergence of militias at the expense of an ever weaker central authority, has forced massive drops in oil production. The Saudis have used their oil supremacy – at prices that remain stubbornly above USD 100/barrel – to back up their aggressive, and disruptive, regional policy. The International Energy Agency has upgraded the Kingdom's oil output capacity from 12 million to 12.5 million bpd thanks to Saudi Aramco's Manifa offshore field. The Saudis are producing at over 10 million bpd, while Kuwait and UAE are producing at some 2.8 million barrels a day (bpd). By happy coincidence, Venezuela, Algeria and Angola have also been producing at lower levels while non-OPEC oil supplies have also dropped, leaving China and India wondering who might be able to sustain the kind of levels they need to grow in the mid and long terms.

This has only served to boost their reliance on Sheikhs of Arabia, who will in turn exploit it to their strategic advantage. The Saudis have better technology allowing them to increase production further while its fellow Gulf rivals have no proven methods to increase extraction for at least the remainder of this decade. Saudi Arabia is China's main oil supplier and as the European Union starts to show signs of an economic and industrial recovery, the Kingdom's influence can only grow. This raises the paradox of Saudi foreign policy and its strongest domestic ‘Awakening’ fears. Why would the Saudis be so keen to sponsor the most radical and reactionary of fundamentalists in Syria?

There is, in effect, an ‘oil war’ between the rising Shiite Iran and Iraq have been waging against Saudi Arabia, OPEC’s leader and point of reference for Sunni Islam in order to increase oil and gas production to weaken the Saudis’ geopolitical influence. The “oil war” of the Shiites could be a game changer in the battle for supremacy with the Sunnis in the Middle East.

In recent years, and certainly in the past few months, the key events in the Middle East have revolved much less around peace-building between Israel and the Palestinians and more on energy and military-strategic considerations related, in some way, to the rivalry between the Iranians and the Saudis. The Iranians have been especially determined to disrupt the old balance that has kept them in isolation for years by securing better relations with the West while maintaining a nuclear program to please hardliners such as Supreme Leader Ayatollah Khamane’i.
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After decades of isolation for Iran – and wars for Iraq – that have stunted both countries’ growth and development it is not surprising that both countries consider the increase of oil and gas exports to serve as the primary tool to resume growth. But oil in the Middle East is not just a source of energy: it is a strategic weapon. Not long ago, the Saudis, for example, triggered a collapse in oil prices in order to weaken then Iranian President Ahmadinejad foreign and nuclear policy ambitions. Similarly, as Iraq and Iran were starting to increase oil production this year, this would have hurt Saudi Arabia, which needs high oil prices in order to maintain expensive social welfare programs that were expanded in scope and value to avert the effects of the ‘Arab Spring’ revolts.

In the new long-term energy scenario, characterized by oversupply, new oil powers have emerged beyond OPEC as a result of new technology allowing for the tapping of unconventional sources such as shale gas and oil (Brazil, Kazakhstan). At the same time, economic growth has not returned to pre 2008 crisis levels, leading to excess supply and an automatic weakening of Saudi Arabia. In the Middle East oil States, including Iran (but much less so than Saudi Arabia) oil export revenues are essential in maintaining the social order and the massive welfare benefits. Oil revenues also give these states the necessary ‘currency’ to play their regional and international political games from Syria to Lebanon, Egypt and beyond.

The emergence of ISIS, therefore, has been something of a boon to Saudi Arabia and to OPEC. Cynics and conspiracy theorists may even go as far as suggesting that some Saudis have aided ISIS, helping it expand beyond the Syrian borders, where the group acquired a great deal of combat experience, to Iraq in order to prevent or slow down, the rise in Iraq’s oil exports. Indeed, while Iraq is producing at a rate of three million barrels a day (bpd), the government said it wants to boost production to about nine million BpD, which is just about on par with the Saudis. Iran and Russia, meanwhile, want to establish a pipeline linking the oil and gas fields of Iraq and Iran to the Mediterranean via-Syria. ISIS has achieved a number of military successes in Iraq, taking Mosul and Tikrit, reaching the gates of Baghdad. ISIS was stopped from accessing oil by the Kurds’ mighty ‘Peshmerga militia, which has maintained the safety of hydrocarbon resources of Kirkuk and the surrounding area.

The price of oil has increased but should the expanding ISIS conflict extend to the areas that are richest in hydrocarbons – far north and far south (where the Russians have interests….) the increases will be far sharper than at present. In fact, ISIS will be trying to move south because that is where the richest oil reserves are located; some 2.5 million BPD, exported toward Asian ports via the Persian Gulf from Basra. If war reaches Basra, cutting oil production and supply routes, it would leave a 2 million BPD shortfall that would require the International Energy Agency to take action. Some oil companies, fearing the safety of staff and related security repercussions, may act as happened in Libya: they will leave even before the war reaches them. Iran will, suddenly gain more negotiating currency, as it will be called to make up some much of the shortfall but this will also require the Americans to negotiate more seriously with Iran over the nuclear issue and ending most of the sanctions targeting Iran. Both steps are necessary in order to restore Iranian oil exports, and promote hydrocarbon industry investment, toward the West and beyond.