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IRAN'S OPEC ORDEAL: WHAT WILL IT BE?

Anu Sharma
Research Associate, CAPS

Longstanding tensions between West Asian rival nations Saudi Arabia and Iran have once again acted as the stumbling block in the recent informal meeting of Organisation of Petroleum Exporting Countries (OPEC) talks held on September 26, 2016 on the side-lines of the International Energy Forum in Algiers. The meeting happened in the background of the need to control the output limit of oil production amongst the OPEC member nations. Tehran had argued in OPEC that it should be allowed to ramp up the production to at least 4 million barrels per day after years of restrictions under western sanctions. A previous effort to limit oil productions was stalled in the April 2016 meeting of OPEC nations at Doha.

It seems that this Algiers meeting of OPEC comes at a crucial moment when OPEC members had gathered to discuss issues related to oil prices which have witnessed a slump as a result of global economic slowdown, excess supply from traditional producers as well as competition from Shale producers in the US. OPEC has agreed to the outline of a deal that will cut production for the first time in eight years, surprising traders who had expected a continuation of the pump-at-will policy which the group adopted in 2014.[1]

The economies of both Iran and Saudi Arabia draw heavily on the revenues they earn from their oil trade. The growing rift between Iran and Saudi Arabia has become the main source of the lowered oil prices since January this year. Iran and Saudi Arabia had been entangled in a diplomatic battle related to the execution of Shi'a cleric Nimr-al-Nimr by Saudi Arabia. This has made the situation in West Asia more volatile. There was a fall in the crude futures when Saudi Arabia severed diplomatic ties with Iran in January 2016. The situation worsened when Kuwait and United Arab Emirates (UAE) reeled in support for Riyadh's actions. The internal divisions have prevented OPEC from making production cuts even as prices plunged to an 11-year low. This appears more entrenched now than ever before.

OPEC was created in 1960 by five founding members—Iran, Iraq, Kuwait, Saudi Arabia and

Venezuela with the mission "to coordinate and unify the petroleum policies of member countries and to ensure stabilisation of oil markets in order to secure an efficient, economic and regular supply of petroleum to consumers, a steady income to producers and a fair return on capital to those investing in the petroleum industry." By 1971, Qatar, Indonesia, Libya, UAE, Algeria and Nigeria also joined the organisation.[2]

Most of the analysts are wary of the fact that conflict between Iran and Saudi Arabia is escalating in OPEC. Iran recently rejected an offer from Saudi Arabia to limit its oil output. However, according to OPEC sources, Iran, whose production stagnated at 3.6 million barrels per day, insisted on having the right to ramp up the production to around 4.1-4.2 million barrels per day, while OPEC gulf members wanted its output to be frozen below 4 million.[3] This makes Iran the third largest oil producer nation in OPEC after Saudi Arabia and Iraq. However, Iran desperately wants to increase its production share in OPEC as compared to what it produces now. However, since 2011 Iran had faced drastic decline in the oil revenue. Harsh energy and financial sanctions by European Union and the US had led to a decline in Iranian oil exports to 1.3 million barrels per day in 2013.[4]

The removal of sanctions worked in favour of Iran, but still Iranian economy under Rouhani government is facing severe pressure with the declining oil prices, similar challenge is also being faced by Saudi Arabia. Major percentage of Saudi Arabian economy is also dependent on its oil revenues. But these dipping oil prices have put a strain on Saudi economy considering that the alternative sources to sustain it need to be developed. As against this, Iran is more reliant on oil and due to sanctions the situation has worsened for it.

This recent agreement by the OPEC nations—with the exemption of Iran, Nigeria and Libya—had resulted in a surge of 5% increase in world oil prices. Under the agreement, oil production is expected to be reduced to 32.5 to 33.0 million barrels per day from 35.0 million barrels per day production at present. Saudi Arabia, the largest oil producer in the region is expected to give up 350,000 barrels per day but the exact number of all the nations is still unclear.[5]

The fall in the global prices is resulting due to the fall in global oil demand as a result of excess oil production. The continued supply by the OPEC nations has led to a gap in the demand and supply of oil thereby having a downward pressure on the global oil prices. In short, fall in the global demand of oil along with the continued oil supply has led to an excess oil supply, impacting price which continues to fall. Nonetheless, if Iran sticks to its oil production output, it will be in a way responsible for keeping oil prices down which might act in favour of consumers like India but for a short period of time. As with the excess oil production, the prices will continue to fall and therefore it is in Iran's interests to go ahead with the output control in order to get better price for its production.

(Disclaimer: The views and opinions expressed in this article are those of the author and do not necessarily reflect the position of the Centre for Air Power Studies [CAPS])

Notes

[1] Grant Smith, Angela Rascouet&Wael Mahdi, "OPEC agrees to first oil output cut in eight years", September 29, 2016, http://www.bloomberg.com/news/articles/2016-09-28/opec-said-to-agree-on-first-oil-output-cut-in-eight-years. Accessed on September 29, 2016.

[2] "Our Mission", http://www.opec.org/opec_web/en/about_us/23.htm.Accessed on September 28, 2016.

[3] Rania El Gamal, Alex Lawler and Vladimir Soldatkin, "OPEC set for no deal as Iran rejects Saudi oil output offer", *Reuters*, September 27, 2016, http://www.reuters.com/article/us-opec-meeting-saudi-idUSKCN11X0LL.Accessed on September 28, 2016.

[4] Davis RamilJalilvand, "5 reasons Iran will be able to wait out low oil prices", March 17, 2016, http://www.al-monitor.com/pulse/originals/2016/03/iran-oil-price-crash-endure-saudi-arabia.html. Accessed on September 28, 2016.

[5] Patrick Gillespie and John Defterios, "OPEC agrees to cut production: oil prices surge", *CNN*, September 28, 2016, http://money.cnn.com/2016/09/28/investing/oil-surges-after-opec-informal-meeting/. Accessed on September 30, 2016.