POLITICS AND BARRELS
OPEC-RUSSIA PRODUCTION DECISION
LEAVES MARKET IN THE DARK

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After a week of media frenzy, political infighting, geopolitical pressure and pure market fundamentals, OPEC and Russia have agreed to increase overall crude oil production by around 1 million barrels per day. The latter is based on an agreement to keep to an overall 100% compliance rate of the former Russia-OPEC production deal, which was set in place to rebalance the global oil market. With hindsight, the success of the so-called N-OPEC deal was much higher than expected, reaching a compliance at times of 180%. International analysts and even US president Donald Trump have been critical lately of the NOPEC deal success, blaming them for not only pushing oil prices up for consumers but also threatening global economic growth. The latter should have been taken with a pinch of salt, as the oil cartel members are still not able to rule the market on their own. The coming weeks and months, a multitude of analysis will be written, focusing on the underlying issues that have led NOPEC on 22-23 June to go back to their former production targets. One thing has been clear, at least to people roaming the rooms of the Vienna Hofburg, even that a compromise was reached, a political crisis is looming within the oil cartel. Saudi Arabia and Iran are still on a collision course, which will become very clear after that the first US sanctions on Iran will be re-implemented. It could become a very hot summer with a potential autumn feeling for the Iranian regime very soon.

OPEC’s future, especially its production cut agreement, was in doubt the last weeks. In the weeks before the OPEC meeting in Vienna, pressure was building up to force leading OPEC members, especially Saudi Arabia, to consider to open up the taps to get more crude volumes on the market. Not only Western politicians, such as Trump, but also Russian officials entered the fray by indicating a willingness to increase production unilaterally. At the same time, Asian consumers started to complain about high crude oil prices, as they were getting the brunt of the tightening market. Still, OPEC’s reaction was rather cool. As OPEC’s secretary general Barkindo or OPEC’s chairman Mazrouie, de UAE minister of energy, amply stated to the press “OPEC will be able to address all needs in the market when this situation occurs.” No real openness towards less compliance or higher production volumes was given. At the same time, OPEC’s second largest producer Iran stated that it would vehemently oppose any changes to the current regime. Tehran indicated that any move by Saudi Arabia or others would be seen as a direct attack on Iran. Still, room for discussion was still given.

The latter situation changed dramatically when the oil ministers and their advisors flocked the rooms of 5* hotels in Vienna, preparing for the meeting on Friday last week. During the traditional preparations in Vienna, called OPEC International Summit, the temperature feel from lukewarm to levels of an Arctic Freeze. Shortly after starting the Summit in the Hofburg, the former residency of Austrian Emperor Franz Jozef and his well-known wife Sisi (Elizabeth), conflicts emerged and political infighting entered the streets. A direct repeat of the well-documented confrontation between Saudi Arabia and the hardliners Iran-Venezuela in Riyadh 2007 (OPEC Heads of State Summit) looked to be possible. The anti-production increase camp, led by Iran and Venezuela, put their foot down by stating that no production deal would be able to be reached if volumes would be increased. This internal turmoil, confronting Saudi Arabia’s leading role in the oil cartel, threatened to blow up the meeting fully.

After direct and unofficial meetings between Iran, Saudi Arabia and the UAE, a compromise was indicated. The official OPEC meeting results were already reached the day before it became clear. Without indicating any real numbers, OPEC presented a production increase of around 1 million bpd, of which the cartel would be delivering around 600,000 bpd. The remaining 400,000 bpd would be a feel-good gift to Non-OPEC leader Russia. Without real figures stipulating which member will be delivering how much extra, the deal is diffuse and for some cosmetic. The current deal is not a deal, but a diplomatic way of pushing the real deal-making to a future date. OPEC members are all able to agree with additional volumes, as compliance rates are very high at present, and demand is still up. By not indicating any specific volumes for a respective member country, Iran and others could agree, without losing face. This option is needed to give Tehran, Caracas and others, the possibility to go home and present it as a unanimous OPEC deal. If specifics would have been given, it would have become crystal clear that additional volumes would not come from Iran or Venezuela, but from its adversaries, Saudi Arabia and the UAE. The latter two are the two only options at present.

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5 https://www.ft.com/content/6052a4c4-73f4-11e8-b6ad-3823e4384287
By addressing a unanimous deal, pushed forward by Saudi Arabia’s minister of oil Khalid Al Falih and his UAE counterpart Al Mazrouie, OPEC also could still show itself as strong and willing to deliver results. Without bringing Tehran onboard the cartel could already be facing the toughest test since decades. A potential split was on the horizon, leaving OPEC in shambles, Russia looking for guidance and US shale on top. Still, OPEC is not yet out of troubles at all. Global oil markets have slightly readjusted to the new situation, as officially 1 million bpd will be entering the market soon. Some price pressure emerged the last days, but overall, stability is again in place. For the short term, market fundamentals seem to be in place, leaving less room for volatility. MSM agrees with this picture and is putting the message into the market. When looking at reality on the ground, the situation has become however very worrying.

First of all, it has become a sine qua non that OPEC is able to deliver whatever volumes are being asked. No critical analysis has been done the last days on one crucial factor: Is OPEC leader Saudi Arabia able to deliver the already expected 300-600,000 bpd without any problems? If the Kingdom is not able to, or has difficulties the coming months, Saudi’s spare production capacity could also become a major focal point. The last decades Saudi Arabia always has been credited with this magical spare capacity number, based on expectations of 12.5 million bpd in place, but no proof ever was put in the market. Since decades Saudi production never was above 11 million bpd. Looking at current infrastructure problems (corrosion, scaling, sludging) or in-field issues (fouling), some critical assessments should be made before totally supporting a very rosy future.6

Secondly, other OPEC producers are also struggling to keep production levels at slated levels. Some volumes are available in the UAE or maybe Angola, but the majority of the cartel members are looking at very different situations. Venezuela’s oil sector is in shambles, reaching total destruction of production soon. Nigeria is facing still Delta based opposition, illicit oil trade and corruption, all keeping production down. Former shining star Iraq and Libya are both hit by internal strife, civil war and lagging production levels. Iran, with a vast potential in place, will be facing a brick wall soon if US sanctions will be fully in place. Taking all of these OPEC factors into account, no real large-scale volume increase should be expected soon. A direr situation is more possible, as Saudi Arabia and its ally UAE, are not able to counter future production loss anymore.7

Thirdly, Russia’s support for the current production deal compromise is a win-win situation. Russian companies will be given the opportunity to increase officially some of their production. This will take some pressure of Russian president Putin, as he is non-OPEC’s leader and architect, together with his counterpart Al Falih, of the NOPEC deal. The current compromise not only has given Moscow some room to assist its own companies, but also has removed another risk. As Russia has been very vocal in stating that it could increase production substantially, while reality on the ground is slightly

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different, the deal blocks the option that Moscow needs to show its capabilities. Without a need to open up the taps Russia still is involved as a major partner.

Overall, the OPEC has been a political show, not a market fundamentals-inspired engagement. Without addressing the upstream fundamentals normally being assessed by analysts and consultants, OPEC has been able to renew its deal with non-OPEC. The main outstanding issue, OPEC’s cohesion, has however not been addressed at all. No links have been made between the ongoing Iran-Saudi confrontation, the role of the upcoming US sanctions on Iran, or the political-economic implosion in several other OPEC countries. The coming weeks, OPEC’s focus will not be on the full implementation of the new deal, as the main leaders are not totally unhappy with higher price levels if supply is lagging behind. The next years, due to a lack of investments in upstream the last years, production will be lower than is needed to counter still growing global demand for oil.

OPEC officials, in Vienna, but especially in Riyadh, Tehran, Baghdad and Abu Dhabi, will be focusing their main attention how to deal with the fact that Iran’s oil volumes will not be available in the market. Tehran’s obstructivism in Vienna was, in addition to the conflict with Saudi Arabia over MENA power projections, also caused by the fear that Arab producers (aka Saudi Arabia and the UAE) will take over market share in Europe and Asia from Iran. Tehran is trying to make it as difficult as possible for its fellow OPEC members to reap the rewards. In how far Iran is willing to take this potential conflict is not yet clear. First signs are however that a very hard conflict is brewing, possibly threatening not only unanimity inside of OPEC but potentially ripping the cartel apart.

If Riyadh and Tehran are going head-to-head, OPEC’s future is at risk. This time not due to Peak Oil or Renewables, but regional and geopolitical conflict. The last time, Western diplomats have been able to assist in bringing the parties back on the table. This time, the only savior will not come from Washington or Brussels, but from Moscow. The new Russian Tsar holds the power to break or make the oil cartel, a fact that was not dreamt off several years ago. Russian chess playing will decide if OPEC will survive or a deadly conflict will ensue. Putin will have to choose between backing his regional power partner Iran (Syria) or go for a long-term strategic partner such as Saudi Arabia. The cards have not yet been put on the table, but the oil quartet made of Putin-Novak-MBS-Al Falih looks to be a better poker option than Putin-Novak going for a full-house with Tehran. On the sidelines, rumors of a discussion between OPEC (Saudi) and Russia of the latter joining the cartel as member or associate member seems already to have blocked any Russia-Iran train. The Arab OPEC members will for sure be pushing for a stronger Russian link with OPEC, as this would directly loosen the hold that Iran has on Moscow.

Vienna, historically a city of war and peace, based on regional and cultural cooperation, again was the place for history-in-the-making. This time, barrels and financials were substituted by geopolitics and interpersonal connections. Al Falih’s disappearance for several hours at the start of the Summit was not meant to give him a break, it was an

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8 https://www.ft.com/content/f6ca52c0-785f-11e8-bc55-50daf11b720d
option to have face-time with his counterpart in Moscow. The deal was closed via phone, the rest was just meant for the media.
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