

Saudi Oil Politics

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Brief Analysis

Recently, the Organization of the Petroleum Exporting Countries (OPEC) announced in Vienna its most substantial production cuts in years. But as important as this rare demonstration of solidarity -- and the resultant hike in long slumping oil prices -- is what the meeting reveals about the emerging Saudi-Iranian cooperation and its implications for the region. The agreement to cut production, and the steps that led to it, show the kingdom's focus on consolidating its position as the primary political and economic force in the Arab world.

OPEC's Future

The motive behind the production cuts is clear: One of the weakest oil markets in years placed severe pressure on all exporters, especially Iran and Saudi Arabia (which derives 88 percent of its export revenue from petroleum). Until recently, however, oil analysts doubted that the Iranians and Saudis could agree on who would suffer the brunt of the cuts. The Saudis had insisted that 8 million barrels per day represented an inviolable production floor. At the same time, the Iranians contended that their 1998 quota assignment had been based on erroneous calculations, and wanted a higher output cap based on their own figures.

Yet, the pain inflicted by the drastic drop in oil prices on both the Saudi and Iranian economies compelled policymakers to reevaluate their stance. In a series of high-level meetings in Riyadh and Amsterdam that preceded the OPEC gathering, the Saudis agreed to renegotiate Iran's quota, and they stunned many analysts by offering to slash their own production by 585,000 barrels a day. This cut pushed Saudi daily output below the magic 8 million barrels per day mark. On the surface, this may seem like a clear victory for the Iranians, but in reality, this move was merely a logical step for the Saudis. Indeed, the short-term effects were positive for Saudi Arabia: Its oil revenue has risen since the agreement. On March 26, right after the OPEC agreement, the spot price for Saudi crude had jumped to \$12.27. It has remained at around the \$12 mark, up approximately \$5 from the start of the year. This increase in price more than offset the reduction in the volume sold by Saudi Arabia.

The production cuts were negotiated by Saudi Arabia and Iran before the Vienna conference, and without substantial input from other OPEC members except for the Algerians and Venezuelans. The Vienna meeting merely rubber-stamped what the Saudis and Iranians had achieved separately. This is another piece of evidence that the cartel may be drifting toward irrelevance. OPEC is being supplemented -- if not moved toward the sidelines -- by ad hoc consultations among a smaller group of major producers. In March, Saudi oil minister Ali Naimi announced the formation of an "informal" group of oil producers, including the main exporters regardless of OPEC membership -- a not so-subtle threat to the preeminence of OPEC.

The more active Saudi role in the oil production pact was a sign that Saudi Arabia is reasserting its power in the oil market. To enhance its oil power, Saudi Arabia has been expanding its excess capacity (that is, the production capacity not used at present) -- now up to 2.7 million barrels per day. This excess capacity gives Saudi Arabia the capability to threaten to flood the market if other states do not agree to production cuts. Not only could the Saudis flood the market in the short term, they are also positioned to dominate it in the long term. If oil-producing countries ceased cooperating to keep prices high, with each country instead going full-bore to raise output, Saudi Arabia's vast

reserves of low-cost oil mean it would dominate the market at the expense of others. As one senior Nigerian oil official confided to this author on the sideline of the OPEC conference, "You Saudis are the only ones who could one day drive us all [the Venezuelans, Mexicans, Norwegians, and all non-Middle East countries] out of business."

Saudi-Iranian Relations

More important to Saudi Crown Prince Abdullah than any short-term impact is the long-term political value of the agreement with Iran that made possible the recent OPEC accord. The concession to Iran -- allowing it to use an artificially high base from which to calculate its production cuts -- was an important strategic move in Saudi Arabia's emerging regional policy. Saudi Arabia plans to make use of Iran's high hopes for its relations with the kingdom. The scale of these hopes can be seen in a comment made to this author by a highly placed individual in the Iranian government: "President Khatami and Crown Prince Abdallah have in mind a partnership to act as a counterweight to the alliance between Israel and Turkey." More realistically, the move sets the stage for next month's visit by the Iranian leader to Riyadh, the first by an Iranian president in twenty years. An initial draft for a defense cooperation agreement will likely be studied at the Riyadh summit so the final document can be ratified in early June, when Prince Sultan, the powerful Saudi defense minister, will travel to Tehran -- the first such visit since 1979 by a Saudi defense minister.

Whereas some analysts may consider such an alliance threatening to American interests, in actuality, many benefits could accrue to the United States as a result of Saudi-Iranian cooperation. These include better petroleum policy coordination and thus more balance in the world market, benefitting the hard-hit U.S. oil producers without putting much of a burden on U.S. oil consumers; increased regional stability; and a more solid containment of Iraq. And if those in Iran interested in better relations with the United States were setting foreign policy (which so far does not seem to be the case), the Saudis would be glad to act as a conduit and catalyst for improved U.S.-Iranian relations. Despite the possibilities, however, it must be remembered that Iran and Saudi Arabia have age-old political and religious rivalries. So far, they have only agreed to talk and to cooperate on oil. The planned "defense cooperation pact" does not imply the same comprehensive and close alliance that it would in the West. In the beginning, it could mean little more than a statement of friendship, an intent to explore further rapprochement, and perhaps even some token joint military exercises. Certainly Saudi Arabia would take care to ensure that any agreement with Iran did not endanger the close defense cooperation with the United States.

Conclusions

Through all of these developments, one fact seems clear: Saudi Arabia is taking a more aggressive stand in both regional politics and the international oil market. Cooperation of some sort with Iran is only a natural development in the regional environment of strategic positioning, given Iran's importance as an oil producer and its strategic weight (a large population, a substantial economy, and a significant military). In any case, Crown Prince Abdullah's ultimate goal is to reposition Saudi Arabia on solid economic grounds so that it may become the preeminent powerhouse in the Arab world.

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