# Opec Meeting Reveals Further Degeneration of the MENA Region

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*This is a guest post by Derik Andreoli, Senior Analyst Mercator International, LLC*

Upon exiting the most recent Opec summit, the visibly frustrated Saudi Oil Minister, Mr. Ali Naimi, proclaimed it to be "one of the worst meetings we have ever had." In the lead up to the meeting, oil traders had come to believe that Opec would increase production quotas to cover the shortfall of light, sweet Libyan crude going into Europe's peak demand season. This led traders to the conclusion that tight markets would loosen (relatively), and as a consequence, oil traders bid down the price for 'paper barrels' (oil futures) by a couple of dollars.

While hindsight may be 20/20, foresight is rarely better than 50/50, and in this case, the market was wrong. Opec failed to revise production quotas, and upon learning of this decision, traders quickly bid the price back up. A couple days later, Saudi Arabia announced that they would break with Opec by lifting production above their allotted quota. Oil traders reacted by bidding the price back down, and in the end, prices had settled back to previous levels as if the summit had never happened. But the story isn't over until all the holes in the plot have been filled, and all the nagging questions answered.

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Why, for instance, would Saudi Arabia announce that they planned to lift production above Opec's stated quota? Why not just covertly lift production? After all, when it comes to the Middle East, oil markets are deliberately opaque, and in fact, Opec quotas are regularly flouted. Furthermore, from a purely financial perspective, such bold announcements make no sense at all. If we assume that Saudi Arabia exports somewhere around 6.25 million barrels of oil per day, we can easily calculate that at $100 per barrel, Saudi Arabia nets a daily petro-income of $625 million. If they were to covertly lift production by 200,000 barrels per day (as they and other Opec members have done in the past), Saudi income would increase by $20 million.

By announcing their intentions to lift production, however, the price slid $3 per barrel, and the Saudi daily income was reduced by roughly $19 million per day, a 3% decline (assuming exports at 6.25 mbd). To maintain a stable income under this scenario, Saudi exports would need to be lifted by roughly 200,000 barrels per day. Hence, the Saudi announcement makes little sense from a business perspective. Of course the Saudi Arabian Oil Company is more than a business, it is the fulcrum of Saudi Arabia's geopolitical power, and being the only nation with significant spare production capacity provides the Saudis with a point of leverage which they use to their political advantage.

And there is no more important time to manipulate these geopolitical levers than now. Saudi Arabia is not immune to the wave of populist uprisings sparked by high food prices, high unemployment, and corruption that has crashed onto the shores of Egypt, Libya, Yemen, Bahrain, Syria and so on. In fact, Saudi Arabia shares a common border with Egypt, Yemen, and Bahrain, and is situated just across the Arabian Gulf (Persian Gulf in the West) from Iran. While geographically proximate to Shia-ruled Iran, Sunni-ruled Saudi Arabia could hardly be more distant in ideological/theological terms.

The Shia-Sunni rift dates back to the death of the Prophet Muhammad and the disagreement over successorship which followed. The Shia believed that the leadership should stay within the family while the Sunnis believed that a group of elites should decide who the rightful successor should be. Over the years, Sunni and Shia elites have fanned the flames of division for political gain, and the fire has become so hot that there is little hope that the flames will be extinguished any time soon.

Though the majority of the Saudi population is Sunni, Shia predominate in the oil-rich Eastern section of the country. Similarly, Shiites comprise the majority of the populations of Kuwait, the UAE, and Bahrain, yet these border states are, like Saudi Arabia, ruled by Sunnis.

This is of particular concern because the flames of the populist uprisings are being stoked by Shia-dominated, Shia-ruled Iran that hopes that the populist uprisings will create a power vacuum that will be Shia-filled. This is why Saudi Arabia sent troups into Bahrain. This is also why Yemen President Ali Abdullah Saleh was evacuated to Saudi Arabia after being wounded in a rocket attack after months of peaceful protests gave way to violence. The threat of regime change in such a geopolitically charged environment also explains why Riyadh has committed to doling out over $130 billion for housing and social programs aimed at easing rising domestic tensions (and why the Saudis require high oil prices to balance their federal budget).

In order to buttress their regime, Saudi rulers have maintained ties with the U.S., despite the entrenched divisions between the House of Saud and the United States. These divisions are rooted in the U.S. support of Israel, and the U.S. overthrow of Saddam Hussein, which resulted in the installation of the first Shia government in Iraq.

On the other side of the coin, access to oil is why the U.S. has supported, and continues to support, the Saudi rulers and similar regimes in the MENA region despite known links to al Qaeda and other extremist groups. Preserving the power relations that secure the flow of oil further explains why in October of last year, the U.S. penned an arms deal worth $60 billion (the largest single deal ever) with Saudi Arabia and have been training an elite Saudi military force tasked with protecting vital oil infrastructure. Perhaps more importantly, the rising threat to the House of Saud has, in fact, granted the Saudis an important bargaining chip in the debate over the establishment of an internationally recognized Palestinian state. Riyadh has threatened ‘disasterous consequences’ should the U.S. veto the UN recognition of a Palestinian state. Such a recognition, however, would significantly weaken U.S.-Israeli relations, and one might go so far as to interpret this as a divide-and-conquer strategy. At any rate, for these and other reasons, the Saudi-U.S. relationship remains tenuous at best.

To bring this back to point, regime preservation explains why Mr. Naimi left the June Opec meeting visibly frustrated, proclaiming it to be the worst meeting ever, and why Saudi Arabia announced that they were going to break with the Opec quota system.

Though the decline in oil prices brought about by the Saudi announcment hit their own bottom line, it also hit Iran’s bottom line. This is a small price to pay, however, given that Mr. Al Naimi’s words and actions buttressed the U.S.-Saudi relationship while at the same time driving the wedge between the U.S. and Iran ever deeper. But don’t take my word for it, consider instead the reaction of Congressman Edward Markey (D) who proclaimed, “Opec, led by Iran and Venezuela, has snubbed its nose at the United States and the rest of the western nations.”

Of course the situation in Syria highlights the fact that Iran faces a similar threat to the one faced by Saudi Arabia. In both countries, domestic discontent and a yearning for democracy threatens to topple the ruling regimes. Consequently the U.S. finds itself confronted with competing objectives and mired in the complexities of Middle East geopolitics. We feel compelled to support the pro-democracy movements, but require the unperturbed flow of oil out of the region. We need look no further than to Libya to see that regime change – be it to a functioning democracy or from one authoritarian regime to another – threatens the flow of oil. Hence, reconciling these competing objectives requires finesse and more than a bit of luck.

Bringing this argument full circle, while the most recent Opec meeting had little lasting impact on oil prices, the real story is found in the analysis above. A troubling truth is revealed by considering Mr. Al Naimi's words and actions in the context of the ongoing MENA crisis. As an x-ray reveals asymptomatic osteoporosis, Mr. Naimi's words and actions reveal just how fractured and fragile the Middle East has become, and by extension just how perilous our economic recovery remains.