Hidden Charms of Oil Swap, The Butterfly Effect : Where JCPOA, Oil Conjoin Stands OPEC+, "Oil Alliance between Saudi Arabia and Russia"

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The news that made the headline today is that the Biden Administration may have inched closer to restarting the 2015 nuclear deal with Iran. Meanwhile, it escaped attention that Iran's oil minister Javad Owji said just a day earlier in Tehran following a meeting with Igor Levitin, Russian President Vladimir Putin's senior aide, that the two countries have finalised their talks on "gas purchase and swap" and a contract is going to be signed in Moscow.

Owji disclosed that Iran and Russia are negotiating a Memorandum of Understanding (MoU) for developing another 14 Iranian oil and gas fields in addition to the seven for which contracts already exist as decided in July in an earlier MoU, according to which Russia agreed to invest $40 billion in Iran's petroleum industry. The highlights of the July MoU included the development of Iran's Kish and North Pars gas fields and six oil fields and completion of LNG projects — and, importantly, swap of gas and petroleum products, and construction of gas transfer pipelines.

Owji added that the Iran-Russia joint economic commission will meet in Moscow within the next two months to continue their discussions on the expansion of cooperation in the energy, transport, trade, amongst other areas.

A western narrative has gained ground that Russia opposes the Iran-US nuclear deal, since Iran will be replacing Russian oil in the lucrative European market and in the process drive down the high oil price too by flooding the world market with its increased up oil production, which would erode Moscow's income out of oil exports, the mainstay of its economy.

In reality, though, there is no contradiction here as far as Iran and Russia are concerned. The expert opinion uniformly is that this is far from a situation that Iran completely replaces Russian oil from the global energy market. Conceivably, Iran could add as much as 900,000 barrels a day of production within three months of sanctions being eased, and potentially pump near its full capacity of about 3.7 million barrels per day within six months.

According to Goldman Sachs, even if a deal were agreed, Iran would take around 12 months to fully ramp up its oil production. The bank also estimates Iran would increase its output to 3.7 million barrels a day, but exports would likely take several months to pick up. At best, Iran's return to the market will have a temporary effect in the near term, because a part of Iran's oil is already available in the market.

Hidden charms of oil swap

There are three key factors playing out here. First, expectations need to be tempered, considering that the understanding between Russia and Iran is at an all-time high level today and it is hard to see Tehran challenging Russia's core interests in the current geopolitical conditions — leave alone, collaborating with a western enterprise.

Iran understands that any significant improvement in its relations with Europe or the US will be a long haul, while on the other hand, the shelf life of a nuclear deal may turn out to be limited, since all bets are off in US politics beyond 2024. For European energy market too, the present time is a period of transition to green energy.

Given these parameters, Iran is rapidly stepping up its economic cooperation with Russia, with energy and transportation being two main hubs. Iran announced on Tuesday that the rial-ruble payment system has begun working and is being handled by the Russian Central Bank's Mir system. Last month, Tehran Stock Exchange launched rial-ruble trading. The strategic intention, clearly, is to bypass the US-dominant global financial system.

Secondly, there is a strong possibility that Iran could step up oil exports to Europe via a "swap" mechanism with Russia. A swap arrangement is quite viable whereby Russian oil meets the needs of Iran's northern Caspian regions while Iran exports (on Russia's behalf) the surplus oil freed from meeting its internal demands. Russian and Iranian officials have been fleshing out the idea of a "swap" arrangement.

Now, since their payment system is out of the SWIFT and dollar trade, outsiders will be left guessing about any Russian-Iranian swap deal. The EU is in no position to spurn Iranian oil. Again, Iranian oil present on the market today is almost all in the form of mixtures, which are often transported by tankers of other states.

Third, Iran has a convergence of interests with Russia (and with Saudi Arabia) as regards the prices in the global market. It is a matter of time before Iran joins the OPEC+ (the oil alliance between Saudi Arabia and Russia at its core) in some form.

Saudi Arabia, is increasingly more aligned with Russia than with the US on the global stage. And both need higher oil prices. The Saudi Oil Minister Prince Abulaziz bin Salman recently spoke of the "self-perpetuating vicious cycle of very thin liquidity and extreme price volatility" in oil markets, and how it has been "amplified by the flow of unsubstantiated stories about demand destruction, recurring news about the return of large volumes of supply, and ambiguity and uncertainty about the potential impacts of price caps, embargoes, and sanctions."

The Saudi Prince was alluding to the Biden Administration's rampant intervention in oil markets. From the Saudi perspective, President Biden's climate-first policies have thwarted upstream investment since he took office in early 2020.

The butterfly effect

The Saudi Prince's remarks were even more telling when he was asked by Bloomberg about the future of OPEC+. He stated in a written reply:

> "In OPEC+ we have experienced a much more challenging environment in the past and we have emerged stronger and more cohesive than ever. OPEC+ has the commitment, the flexibility, and the means within the existing mechanisms of the Declaration of Cooperation to deal with such challenges and provide guidance including cutting production at any time and in different forms as has been clearly and repeatedly demonstrated in 2020 and 2021.
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> "Soon we will start working on a new agreement beyond 2022 which will build on our previous experiences, achievements, and successes. We are determined to make the new agreement more effective than before. Witnessing this recent harmful volatility disturb the basic functions of the market and undermine the stability of oil markets will only strengthen our resolve."

Plainly put, Riyadh, a key regulator of the global oil market, plans to maintain or even increase the restrictions on the production and total supply of oil for the world market and to this end, will work towards a new OPEC+ agreement, which limits production in the participating countries.

The implications are: one, Russia can consider its revenues from oil exports relatively protected for the conceivable future; and, two, if a new OPEC+ agreement is worked out to make it "more effective than before," Iran in all likelihood have to be brought on board. From Iran's viewpoint also, it will be desirable to become part of the OPEC+ cartel with Russia and Saudi Arabia.

Fundamentally, Saudis understand that the ousting of Russia from the Asian markets may not take place, given the positions of China and India. That is, any increase in the presence of Gulf oil in Europe will happen by itself as Russian supplies turn to the east — and therefore, there is no reason to ruin the OPEC+ with Russia. Oil Minister Prince Abulaziz bin Salman has made this very clear.

Therefore, a significant decline in world prices due to the growth of production in Iran should not be expected. Both Saudi Arabia and Iran primarily care about the welfare of their states, therefore, their position will be formulated in such a way that the current prices are comfortable and their companies keep increasing quarterly profits.

The OPEC+ was the brainwave of President Vladimir Putin and then Saudi Deputy Crown Prince Mohammed bin Sultan on a Sunday in Hangzhou, China, six years ago. (See my article *Pay heed to the butterfly effect of Putin-Salman oil deal in Hangzhou*, Asia Times, September 7, 2016)

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