The Oil of Iran: Past and Present in Perspective

https://www.e-ir.info/2016/01/19/the-oil-of-iran-past-and-present-in-perspective/

GREGORY BREW, JAN 19 2016

The end of 2015 saw a new low in the international oil market, as the price of a barrel of oil dropped below $34 for the first time in more than a decade. The past year has been one of retreat and retrenchment in the energy industry as exploration is cut back, jobs are lost, wells are shut down and investment in new production comes to a halt.

Rising tensions in the Middle East have added to the sense of uncertainty. The long-simmering rivalry between Saudi Arabia and Iran escalated in December 2015 following the execution of a Shi'ite dissident by the Saudi government, the burning of the Saudi embassy in Tehran and the immediate cessation of relations between Riyadh and the Islamic Republic. And yet: the price of oil, which normally spikes when OPEC members quarrel, kept falling. Low prices, in part the result of rising production from the US shale boom and the decision of OPEC to continue producing at high levels in order to retain market share and squeeze out new producers from the US, have placed all major oil producers in serious financial situations, with state budgets slashed as oil revenues dry up while social programs are cut and borrowing increases.

It is therefore with some surprise, and even quite a bit of skepticism, that industry analysts greet declarations from Iran that the country's oil industry, restrained for years by sanctions and crumbling infrastructure, is about to experience a renaissance. The country's Minister for Energy Bijan Zanganeh expects Iran to increase its oil production by 1.5 million barrels a day by 2018. Only the United States, Russia and Saudi Arabia produce as much. Iran could thereby become the world's fourth-largest oil producer, and President Hassan Rouhani has pinned his hopes of bringing economic relief and new prosperity on a resurgent energy sector.

This article seeks to place the current state of Iran and the international oil economy in a historical and global perspective. The deal struck between Iran and the Western powers in July 2015 has presented the country's regime with the opportunity to revitalize its energy industry once economic sanctions are lifted. Iran's history indicates its tremendous potential as an oil producer, and with vast reserves to draw upon it is possible that Iran could make good on its claims and transform itself into an energy superpower.

But there are huge challenges to be surmounted if Zanganeh's and Rouhani's hopes are to be realized. The country's energy infrastructure is crumbling and badly needs fresh capital. Consumption and domestic demand have been supported for years by wasteful oil subsidies, and will have to be brought under control if oil exports are to increase. Western investment may be difficult to acquire amid Iran's on-going internal political divisions and factional in-fighting, which pits moderates like Rouhani against hard-liners in the Revolutionary Guard Corps and the country's ruling religious hierarchy. These challenges are in no small part exacerbated by the crisis within the oil industry itself: if Iran does succeed in dramatically increasing its production, it will find its oil lost amid a world-wide energy glut, sending the price down even farther and deepening a crisis of over-production that currently affects the world's energy industry.

The Gifts of the Nuclear Deal: Iran's Oil Hopes Resurge

Amid all the news emerging from the Middle East, including the expansion of the West's campaign against the Islamic State, the on-going quagmire of Syria's civil war and the expanding threat posed by terrorism, an event of profound importance passed almost without notice.

In late November, representatives from hundreds of businesses, from Europe and Asia, flocked to the Iranian capital of Tehran. Some of them came with dossiers from the world's largest energy firms; BP, Total, Shell, Statoil and Sinopec were all in attendance. The reason: to hear presentations from Iran's Minister of Energy, Bijan Zanganeh, and the CEO of the National Iranian Oil Company (NIOC), Roknoddin Javadi, and the announcement of new contracts in Iran's energy industry. Worth $30 billion, these contracts would be offered for the first time to Western companies and provide more flexibility, less risk and considerably more profit for companies working with NIOC and Iran's government. Over 150 companies attended the Tehran conference, and Iran hopes to attract $150 billion in new investment over the next five years.

None of this would be possible without the recent thaw in Iran's relations with the West. The successful implementation of the Joint Comprehensive Plan of Action (JCPOA), better known as the Iran nuclear deal, agreed upon between Iran and the Western powers in July, has the potential to dramatically change Iran's economic capabilities in the near future. Sanctions relief, the un-freezing of overseas Iranian financial assets and the loosening of other restrictions on Iran's economy may improve the country's short-term economic outlook.

The JCPOA has the potential to turn Iran into a new energy superpower. That, at least, is the hope of some within the Islamic Republic. In August 2015, Iran's energy minister Zanganeh declared Iran's intention to increase oil production by 1 million barrels per day (bpd) within a few months of the deal's passage. In early November, Zanganeh moderated his position somewhat, announcing that Iran would increase its production by 500,000 bpd once sanctions are lifted, with another 500,000 bpd coming on line within six months. Yet his language was still bullish and a little confrontational. "We don't seek permission from anyone to use our rights," stated Zanganeh. Iran would not, in other words, work with the Organization of Petroleum Exporting Countries (OPEC) and stick to a firm quota. Iran had the right, Zanganeh said, to pump as much crude as it wished.

With the fourth largest oil reserves and second highest gas reserves of any nation on earth, it only seems natural that Iran should take advantage of the coming economic windfall to expand its oil and gas production, which has stagnated since sanctions went into effect in 2012. While Iran's minister of tourism has predicted a "tsunami" of foreign tourists once relations between the West and Iran improve, more hopes are pinned on a tidal wave of oil to carry the country into a new future of prosperity and power.

A Struggling Behemoth: Iran's Oil History

To understand the significance of these high expectations, it is necessary to understand Iran's long, fraught history with petroleum. Oil was first discovered in Iran in 1908, in the southwestern province of Khuzestan. By the 1920s, the national oil industry had matured, an enormous refinery had been built in Abadan on the Persian Gulf, and Iran was among the top five oil producers in the world, accounting for 5-6% of world production (Ferrier, 1982).

Yet the industry was owned and operated by a British firm, the Anglo-Iranian Oil Company, and the bulk of the oi revenues were shared between the British government and oil company, with only a small percentage paid to Iran as a royalty. This situation came to a head during the 1951-53 oil nationalization crisis, when Iranian prime minister Mohammed Mossadegh nationalized the country's oil industry, ejecting the British technicians from Abadan and setting off a world-wide oil crisis. Some historians, including prominent Iranian scholar Ervand Abrahamian, have argued that control over oil was the primary reason the United States and Great Britain plotted to overthrow Mossadegh in the infamous coup of August 1953. (Abrahamian, 2013)

The regime of the Shah, Mohammed Reza Pahlavi, that succeeded Mossadegh made energy production a major focus of Iran's economy. After the 1973 oil crisis and the quadrupling of the oil price, Iran began to earn enormous revenues from its oil production, much of it funneled into modernization, industrialization and militarization programs. Production peaked in 1974 at 6 million bpd (Karshenas, 1990). Yet the massive influx of oil-based wealth de-stabilized the Iranian economy, accelerating inflation and exacerbating a mid-1970s downturn that provided part of the impetus for the ousting of the Shah in 1979 and the rise of the Islamic Republic (Abrahamian, 1982). The Islamic Revolution, as well as strikes within Iran's oil fields, caused Iranian oil production to plummet to 2 million bpd (Bill, 1988).

Today, Iran produces roughly 3.6 million bpd, down from a pre-2012 peak of 4.3 million in 2011 (BP, 2014). Sanctions in place since 2012 have cut Iran's oil production in half. It exports a much smaller percentage of its production due to the rise of domestic demand: in 2014, Iran exported only 1.1 million bpd according to OPEC figures. Natural gas, which Iran has in abundance in part due to its shared ownership with Qatar of the enormous South Pars field in the Persian Gulf, forms the second component of Iran's energy industry. Iran produces around 8 trillion cubic feet (tcf) each year (Wright, 2010).

There are lofty ambitions within Iran's current government to leverage the benefits of the JCPOA and rebuild Iran's oil and natural gas infrastructure. A revitalized energy sector could kick-start Iran's economy, stagnant since the last major oil boom in the mid-2000s. In a sense, it could see the return of the heady days of the 1970s, when the country was flush with oil riches and the state benefited from high oil prices and ever-expanding revenues. Yet those days carry with them the memories of the Shah's regime, which the current rulers of Iran – even today – continue to resent as repressive, corrupt and overly Westernized. Beyond these historical lessons, however, there remain immense challenges facing Iranian plans to ramp up oil production.

Challenges: Infrastructure, Consumption and Politics

The three problems facing Iran's ambitions to increase oil exports are aging infrastructure, domestic demand and internal political disunity.

Iran has one of the world's most mature oil industries. Most Iranian fields have been in production for decades, and 80% of its reserves were discovered before 1965 (Wright, 2010). New fields have been discovered and are in development, particularly the Yadavaran and North Azadegan areas; due to Western sanctions only Chinese and Russian companies are engaged. Yet overall the Iranian oil industry suffers from aging and crumbling infrastructure, facilities that have been in use for decades and a lack of sufficient capital to improve efficiency or increase throughput (EIA, 2015). A recent test of whether existing infrastructure could handle the planned increase found "a number of leaking pipelines."

The second problem is domestic demand. Iran is the Middle East's second-largest oil consumer, after Saudi Arabia, and currently consumes 1.8 million bpd. Consumer demand grew during the 1990s for two reasons: population growth and Iran's energy policies. A baby boom after the Islamic Revolution saw Iran's population double, from 37.5 million in 1979 to 81 million today (CIA, 2014). Since 1980, the Islamic Republic has used public subsidies to offset the cost of living. Energy subsidies in place since the 1980s kept the price of gasoline exceptionally low, encouraging easy consumption and creating an enormous demand for automobiles, which in turn provided a boost for Iran's automotive industry (EIA, 2015).

Yet this rapid rise in consumption put enormous pressure on Iran's oil industry, and particularly its refinery capacity, to keep up. A massive project to increase Iran's refinery infrastructure was launched in the 1990s, and today Iran can refine 2 million bpd in order to meet its demand for refined petroleum products (OPEC, 2015). Much of that capacity is in low-value products, which means that Iran, the hopeful energy superpower, must import as much as 61,000 bpd to keep up with domestic gasoline demand (EIA, 2015). The public thirst for gasoline will continue to increase as the Iranian automobile industry, one of the country's most important economic sectors, continues to churn out "zero cars", which are expensive, low-quality gas guzzlers (Clawson, 2015). If Iranian oil production increased in the near future, as regime officials hope, it must work to control domestic demand for gasoline and other petroleum products, which will eat into exports.

Regarding the country's monopolistic, wasteful auto-industry, native Iranians have taken matters into their own hands. In September, "No Zero Cars" became a trending topic on social media, as thousands of Iranians vowed to boycott the domestic auto industry until safety and fuel standards were improved. Closer attention to waste and runaway consumption should help to restrict domestic demand for oil in the coming years, freeing up more oil for export.

But to really turn oil production around and upgrade refining capacity, Iran will need large infusions of outside capital.

In the 1990s Iran offered “buy-back” contracts to foreign companies (partnerships between the National Iranian Oil Company and foreign firms are illegal) in order to develop new production and repair infrastructure (EIA, 2015). The new contracts announced at the November conference offer more incentive for foreign investment: ownership of reserves discovered, lower risk and a greater return for initial investment, along with the vocal cooperation of the Iranian government.

The third barrier to Iran’s oil revolution is the present political climate in Iran itself. Noticeably absent from the November gathering in Tehran: every major US oil and energy company, including ExxonMobil, Chevron and ConocoPhillips. Despite Zanganeh’s enthusiasm for Western investment, many hardliners and conservatives are concerned that such investment will undermine the Islamic Republic’s integrity. Doing business with the Islamic Republic remains a difficult prospect for US businesses, despite the working relationship forged between American and Iranian diplomats in July over the JCPOA.

Supreme Leader Ali Khamenei and the Iranian Revolutionary Guard Corps (IRGC) remain resistant to the idea of closer economic ties to the West. Their reasoning is not entirely ideological. Economic changes and increased foreign investment would undermine the control the IRGC exercises over much of Iran’s economy. Increased partnership with Western oil companies would pull NIOC away from the handful of elites who control and largely benefit from its operations. The pragmatic Khamenei acquiesced to the JCPOA in July but came down hard against further “fraternizing” with the US several months later.

Today, the political climate in Iran appears unstable, with moderates and hard-liners competing with one another throughout the nation’s complex, at times contradictory civil society. Indicators that moderates may be gaining the upper hand are countered by the continued vitality displayed by the country’s hard-liners, clerics and arch-conservatives. While crowds of jubilant young Tehranis celebrated the July nuclear agreement, the deal sparked an intense debate within Iran’s political community, which has become increasingly split between hard-liners wary of Western intentions and reformers eager to open the country’s economy to outside investment.

The divisions over the country’s political direction are appearing more and more frequently. A national newspaper went so far as to flout official censorship, publishing the name of former-prime minister and prominent reformer Mohammed Khatami in open defiance of the laws banning his name from all publications. Elections in February for Iran’s Council of Experts and the parliament are highly anticipated and may indicate a hardening of Iran’s political community or, as some experts expect, a further bolstering of Rouhani’s moderate agenda. The January attack on the Saudi Arabian embassy in Tehran, which has led to the severing of diplomatic ties between Iran and its regional rival, was not sanctioned by the Rouhani regime, which has long hoped that Iran be accepted as a legitimate actor on the international stage. The attack has brought condemnation from hard-liners, even as Iranian moderates accuse them of taking advantage of the violence to weaken Rouhani. The political mood in Iran remains tense, chaotic and unstable.

Conclusion

Amid Iran’s worsening relations with Saudi Arabia, its internal political disunity and the region’s overall atmosphere of crisis, work to overhaul the energy infrastructure continues. In early January several deals were made between Iranian firms and Russian ship-builders which could see the country construct a series of new off-shore drilling rigs. An Iranian official announced that the North Yaran field, a new development in the country’s southwestern oil fields, is set to come on-line three months early, with production beginning in March 2016. Iran remains committed to increasing oil production by 500,000 bpd in early 2016, with an ultimate goal of producing 5.7 million bpd by 2018.

But there remains a great deal of doubt that Iran will be able to deliver on this new promise. The enthusiasm present at the Tehran conference in November dissipated in the weeks after, with some questioning whether Iran was entering a flooded market. The rising tensions with Saudi Arabia have industry analysts on edge, a feeling compounded further by concerns that the period of low prices may continue well into 2016. Ongoing hostility among hard-liners towards outsiders, the deepening political divisions within Iranian society, and confusion within the business community as to who, exactly, calls the shots in Rouhani’s government will make Western investment challenging.

Even Zanganeh's modest 500,000 bpd increase will likely be difficult to accomplish, with oil prices plunging in early 2016 to less than $40 per barrel, and likely to remain in the $50-60 per barrel range for some months. Faced with low energy prices, domestic political resistance and likely competition with a firmly-entrenched Saudi Arabia, Iran is unlikely to see its position as an oil exporter change enormously in the near future.

Yet big things have small beginnings. After so dramatic a year, it remains to be seen how 2016 will change things in the Islamic Republic, and how those changes will fit into the new global energy economy.

References

Ervand Abrahamian. *Iran Between Two Revolutions.* Princeton, NJ: Princeton University Press, 1982.

Ervand Abrahamian, *The Coup: 1953, the CIA, and the Roots of Modern U.S.-Iranian Relations.* New York: The New Press, 2013.

CIA World Factbook. Iran. 2015 https://www.cia.gov/library/publications/the-world factbook/geos/print/country/countrypdf_ir.pdf

James A. Bill. *The Eagle and the Lion: the Tragedy of American-Iranian Relations.* New Haven, CT: Yale University Press, 1988.

Clawson, Patrick. "Iran's Post-Deal Economic Stagnation Challenges Rouhani." Washington Institute, PolicyWatch. 8 October 2015 http://www.washingtoninstitute.org/policy-analysis/view/irans-post-deal-economic-stagnation-challenges-rouhani

U.S. Energy Information Administration. "Iran: International Energy Data and Analysis." July 2015.

Facts Global Energy, "Iran's Oil and Gas Annual Report 2014." December 19, 2014.

BP Statistical Review of World Energy. Excel Workbook of Historical Data, 2014.

R.W. Ferrier. *The History of the British Petroleum Company, Vol. I.* Cambridge, UK: Cambridge University Press, 1982.

Massoud Karshenas. *Oil, State and Industrialization in Iran* (Cambridge, UK: Cambridge University Press, 1990.

Organization of Petroleum Exporting Countries (OPEC). Annual Statistical Bulletin.2015. http://www.opec.org/opec_web/static_files_project/media/downloads/publications/ASB2015.pdf

Wright, Robin ed. *The Iran Primer: Power, Politics and U.S. Policy.* United States Institute for Peace Press: Washington DC, 2010.

About the author:

Gregory Brew is a PhD candidate at Georgetown University. He studies the modern history of US-Iranian relations, oil history and the political economy of the global oil industry. His work has appeared in Modern Diplomacy, Foreign Policy News and Mediterranean Quarterly.