Fall in Oil Prices Poses a Problem for Russia, Iraq and Others

By DAVID M. HERSZENHORN  OCT. 15, 2014

MOSCOW — A steep decline in oil prices is straining the budgets of major petroleum-exporting countries around the globe, raising a specter of spending cuts in Russia, where the economy is under pressure from Western sanctions, and posing a potentially grave security challenge for Iraq, which is already struggling to finance its fight against the Islamic State.

From Moscow to Caracas, Riyadh to Baghdad, in Tehran, Algiers, Kuwait City and Lagos, political leaders, finance ministers and central bankers have been scrambling to confront the plunge in prices — roughly 25 percent since a peak in June — driven by increased production in the United States and by projections of sustained cuts in demand in many developed countries, as well as decelerating growth in China.

The price drop is mostly welcome news in the developed world, and particularly in Washington. Countries like Russia, Iran and Venezuela that in recent years have sought to thwart America’s influence could begin to moderate their behavior, as they come under growing financial pressure.

While Russia maintains reserves of hundreds of billions of dollars as a cushion for precisely this sort of price drop, there are already signs of tensions here.

At a meeting in Moscow this week with a government human rights council, President Vladimir V. Putin pointedly rebuffed a request for increased financing, citing the pinch from declining oil revenues.

““You know that energy prices have fallen as well as for some of our
other traditional products,” Mr. Putin said. “Due to that, would we not, on the contrary, reconsider the budget toward reducing some spending?”

It was a notable departure from the bravado that Mr. Putin has shown in responding to Western economic sanctions over Ukraine, dismissing them as little more than an annoyance.

In another sign of mounting pressure, a spokesman for the Russian state-controlled oil company, Rosneft, accused Saudi Arabia of secretly manipulating prices — an echo of conspiracy theories about American and Saudi collusion against the Soviet Union during the Cold War.

Last week, Venezuela, which depends on oil for 95 percent of its export revenues, called for an emergency meeting of the Organization of Petroleum Exporting Countries to address the steep slide in prices, a move that other members rebuffed in favor of a regular meeting next month.

The price of a barrel of Brent crude, a global benchmark, was $83.78 on Wednesday, down from about $115 per barrel since its high in June.

Experts on energy policy say that prices are nearly certain to rebound in response to normal market forces and continued strong demand, particularly in the developing world.

And some of the surplus that is dragging down oil markets is a result of production increases in Iraq and Libya, both struggling with instability that could shut down their oil fields at any time and send prices soaring.

But in the near term, the big producers will probably face budget problems in varying degrees of severity, with an array of economic, strategic and political ramifications.

“It depends how long and how sharp the decline, but if oil prices stay around 20 percent lower, that is going to be very challenging for countries that depend heavily on oil to meet their budget requirements,” said Jason Bordoff, the director of the Center on Global Energy Policy at Columbia University in New York. “Many of these countries have implicitly high break-even numbers.”

Professor Bordoff said that Russia and Iraq faced particularly difficult circumstances, partly because of broader geopolitical tensions in each region. Russia, already squeezed by inflation and a drastic decline in
the ruble, has found its ability to borrow money severely constrained by the sanctions. Iraq is facing a costly, and potentially open-ended, military conflict against the Islamic State.

“If oil prices were to stay in the range they are in now, we’ll see the Russian budget fall into deficit next year; that’s on top of the economic challenges they are already facing from sanctions and the decline in the value of their currency,” Professor Bordoff said. “Iraq has its own set of challenges with skyrocketing public expenditure requirements, large public payroll, food and energy subsidies. They need to rebuild a dilapidated armed forces.”

Some major oil producers are already experiencing substantially more budgetary pain from the decline in prices, particularly Venezuela, because of underlying economic problems, and Iran, which has faced years of Western economic sanctions over its nuclear energy program. Nigeria faces particular political uncertainty because it has a presidential election coming up early next year.

Venezuela has limited options in responding to the price decline, which leaves less money for social spending, government payrolls and subsidized imports of vital goods. The government could scale back on subsidized oil that it supplies to allies in South America and the Caribbean, including Nicaragua, Bolivia and Cuba. There is also some talk of raising the domestic price of gasoline, which is the cheapest in the world.

In demanding urgent action by the Organization of Petroleum Exporting Countries, Venezuela’s foreign minister, Rafael Ramírez, has also thrown around conspiracy allegations. According to a government news release, Mr. Ramírez demanded “some kind of action to stop the fall in the price of oil, especially since we are convinced that it does not result from fundamental market conditions but that there is price manipulation to create economic problems for the large oil-producing countries.”

The major question now looming is if OPEC, led by Saudi Arabia, will cut production and stabilize prices at a meeting next month.

Some analysts say that is a logical step, while others suggest that Saudi Arabia may allow lower prices to persist, in part to squeeze its main
rivals — Iran and Russia — and in part to put pressure on shale oil producers in the United States, whose higher production costs make it harder for them to compete when prices are lower abroad.

Saudi Arabia’s relatively low production costs and its domestic spending program allow for a balanced budget at a price of roughly $95 a barrel, compared with $100 or more for Russia and even more for Iran. Saudi Arabia also has huge cash reserves to prop up its budget while prices remain low.

“The question is how much are you willing to eat into your cash reserves and for how long until you adjust your production down,” said Gal Luft, co-director of the Institute for the Analysis of Global Security, a Washington research organization focused on energy issues. “In the November meeting of OPEC you are going to see some of their members saying, ‘We cannot live with those kind of prices; we are going bankrupt; we want to cut down production.’

“Then you will have others, mainly Saudi Arabia, who might say, ‘Well, we don’t want to overreact.’ In the short run, I think most of the players can survive,” Mr. Luft said. “In the long run, beyond a year, I don’t think they have the means.”

For the United States and most of the developed world, a decline in oil prices is generally regarded as a macroeconomic plus, reducing costs for consumers and businesses and often lifting stock markets.

That classical view has begun to change, however, as the United States has increased its own oil production, particularly in states like Texas and North Dakota.

In Russia, the Kremlin and the Central Bank have insisted that there is no cause for panic. Official projections show oil prices rebounding to about $100 a barrel over the next three years, and government officials are adamant that the country’s cash reserves are sufficient to weather temporarily low prices.

In testimony before the lower house of Parliament on Monday, the head of Russia’s Central Bank, Elvira S. Nabiullina, said that despite the government’s confidence, the bank was assessing the risks of a severe and prolonged decline in oil prices, to $60 per barrel.
“The central bank is currently working on a so-called stress scenario, emergency scenario so to say, which includes an abrupt, more noticeable oil price fall in a forecasted time span,” Ms. Nabiullina said. “Nevertheless, I think there are low chances of this.”

Mr. Luft, the Washington-based analyst, said it was hard to say whether the Saudis would eventually tighten the spigots in an effort to prop up prices, as they have in the past, or pursue a strategy of preserving market share, which means keeping prices relatively low.

“From them, what matters is how much money goes through the door,” he said. “They don’t care how many barrels they sold or pumped, but how much money in billions goes through the door. In the end, that’s what it is all about. It’s about staying alive, staying in power, making sure you don’t end up like Mubarak.”

William Neuman contributed reporting from Caracas, Venezuela.

A version of this article appears in print on October 16, 2014, on page A6 of the New York edition with the headline: Fall in Oil Prices Poses a Problem for Russia, Iraq and Others.