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King Abdullah Petroleum Studies and Research Center

Instant Insight

What Could Happen to the Oil Market if Iran's and Venezuela's Sanctions Are Lifted?

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Discrepancies in short-term oil outlooks have emerged because of concerns about economic slowdowns (Golubkova and Xu 2023), the slow revitalization of the Chinese economy (Reuters 2023), and current geopolitical incidents. These disparities in expectations of future oil demand have consequences for the strategic planning of both suppliers and consumers. While producers are concerned about market stability resulting in actions such as the Organization of Petroleum Exporting Countries and its allies' (OPEC+) extension of its oil production adjustments by the end of 2024 (OPEC 2023a), consumers' attention is drawn to actions to maintain oil prices at low levels in the near future, with some rushing to refill their oil inventories (Egan 2023). These factors, combined with the consequences of the geopolitical crisis in Europe, have reawakened discussions about easing sanctions in Venezuela (Laya 2023) and Iran (Hunnicutt and Hafezi 2023) as alternatives to offset the lack of Russian oil exports to Western countries.

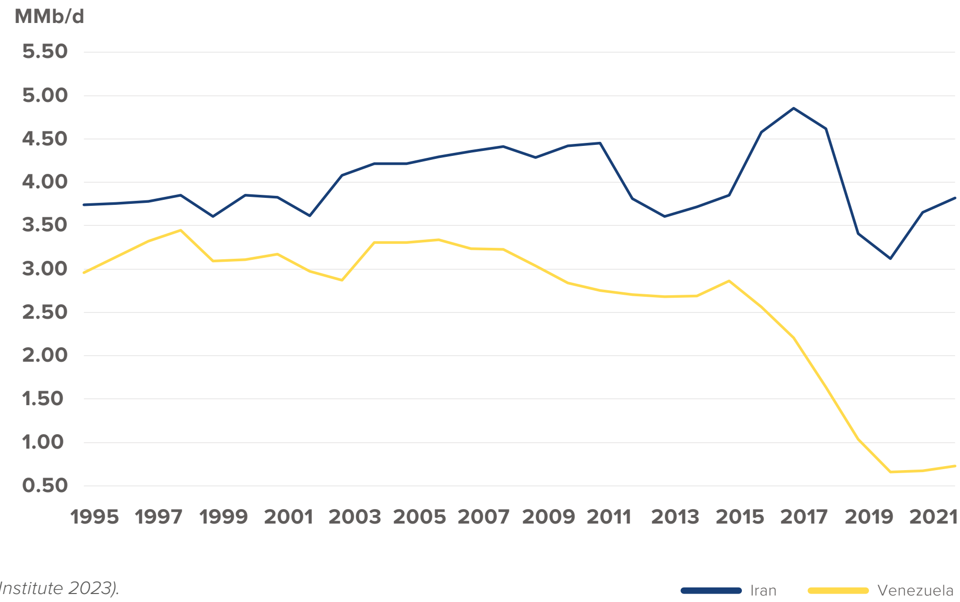
Venezuela holds the largest proven oil reserves worldwide, with 303.2 billion barrels as of the end of 2022, while Iran holds the fourth position with 208.6 billion barrels (OPEC 2023b). Both countries have significant potential to produce oil at much higher rates than those currently registered. Venezuelan oil production in 2022 was 723,000 barrels per day (b/d), significantly down from the record reached in 1997 of 3.52 million barrels per day (MMb/d), just a few years before the start of the Chavez regime (Figure 1). Iran's situation is less extreme, with oil production at 3.82 MMb/d in 2022, 1.03 MMb/d lower than the 4.85 MMb/d produced in 2017, the highest production level since the 1970s, and not even comparable with the 6.06 MMb/d peak production reached in 1974 (Energy Institute 2023).

The drop in oil production in both nations is a result of, among other reasons, the sanctions imposed by the United States, European Union, and their allies. In Venezuela, sanctions have been linked to anti-democratic actions and human rights violations, with intensified restrictions since 2014 (Seelke 2022). In 2019, the Trump Administration imposed additional sanctions, worsening the oil industry's operational abilities.

Iran's sanctions are linked to the Joint Comprehensive Plan of Action (JCPOA) on nuclear weapon development. In 2015, the P5+1 (China, France, Germany, Russia, the United States, and the European Union) reached an agreement with Iran to ensure that its nuclear program was exclusively peaceful. However, in 2018, the United States withdrew from the JCPOA (The White House 2018) and started a set of new sanctions against Iran, including restrictions on oil exports.

In 2022, the geopolitical conflict between Russia and Ukraine resulted in sanctions against Russia, which, combined with inflation and a faster-than-expected post-COVID-19 oil demand recovery, increased fuel prices (Patton 2022). This market tightening led to discussions about softening sanctions on Venezuela and Iran. However, the U.S. government was reluctant to revisit the issue, as Congressional approval was required (Toosi 2022). In the first half of 2023, low oil prices have mitigated public pressure, reducing the likelihood of lifting sanctions on Iran and Venezuela. However, this idea persists because higher prices could be on the horizon.

Figure 1. Historical yearly oil production in Venezuela and Iran.



Source: (Energy Institute 2023).

What are the Consequences of Bringing Venezuela and Iran Back into the Oil Market?

First, let us discuss some of the challenges that must be addressed before this occurs.

1. For the United States, lifting sanctions either requires Congressional approval (Toosi 2022) or sufficient support in Congress for a presidential decision to rescind sanctions. Given the complexity of the topic and differentiated interests of the parties, this is a challenging task.

2. The United States would need to obtain a buy-in from the other countries imposing sanctions on Iran. The Persian nation would then have to hold challenging negotiations with each member of the P5+1 group before the sanctions are lifted.

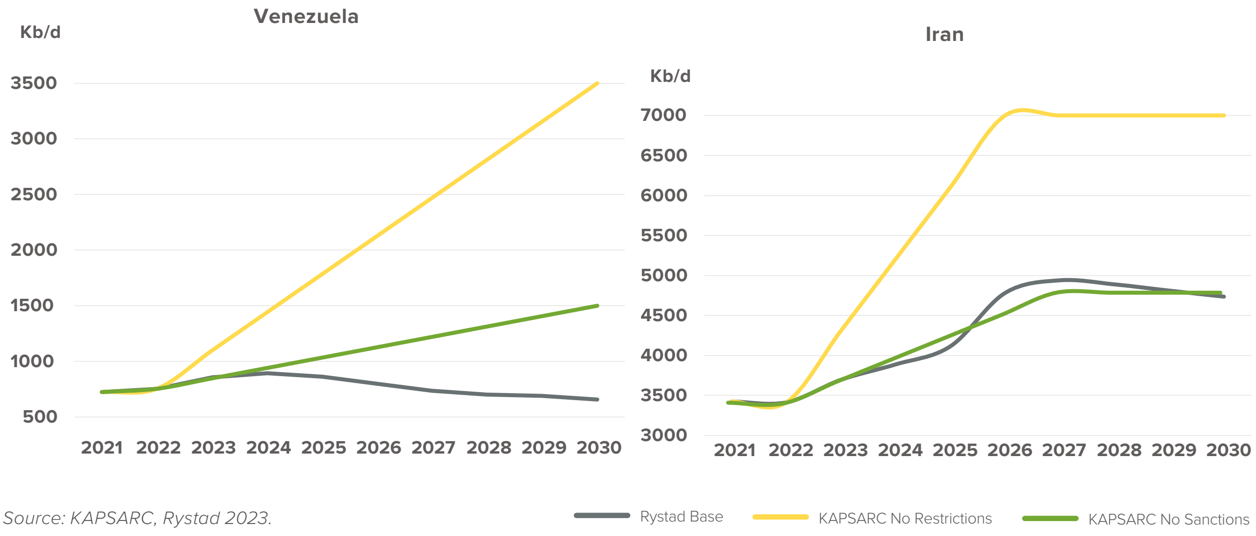
3. After lifting the sanctions, rebuilding production capacity will require time and investment:
   - **Venezuela would require at least seven or eight years and an investment of USD 250 billion to return to 1997 levels, or 3.5 MMb/d,** according to Toro Hardy, a prominent Venezuelan economist (Abreu 2022).
   - **Iran has the technical potential to increase from 3.5 MMb/d to 7 MMb/d in two to three years if provided with suitable investment** (Shokri 2022).

4. United States–Iran tensions are showing no signs of progress. Iran's close relationship with Russia has diminished the possibility of reaching agreement on the JCPOA (Rome 2022).

5. Iran's position in the OPEC+ is another point to consider. Even under sanctions, some OPEC+ members may expect Iran to accept the production quota. Iran has made it clear that no production limits on the country's output will be accepted until it returns to pre-sanction levels and recoups the losses from the sanction period. Therefore, Iran is unlikely to accept a quota readily (Shokri 2022).

The time factor for rebuilding maximum technical capacity (Iran at 7 MMb/d and Venezuela at 3.5 MMb/d) is significant, as illustrated in the no-restrictions scenarios in Figure 2. This is the best-case scenario and additional factors are likely to limit the speed of development and attainable volumes.

Figure 2. Oil production outlook for Venezuela and Iran.



Source: KAPSARC, Rystad 2023.

** The no-restrictions and no-sanctions scenarios are based on the average numbers circulated in the media.*

These limitations are not linked to current sanctions and would limit the capacity of oil production if sanctions are lifted. A more realistic production scenario that accounts for these limitations is presented in the no-sanctions case. The limitations imposed are as follows:

- Investments: According to the Iranian Ministry of Energy, the Persian nation has invested USD 28.8 billion in its oil industry over the past two years. Still, it needs close to USD 250 billion to remain productive (Iran International 2023). Venezuela's investment needs are similar, requiring eight years (Abreu 2022).

- Technology transfers: Sanctions have pushed international oil companies and operators out of these countries, causing a technology lag in local industries. Consequently, the marginal cost of crude production has grown. In 2015, Venezuela's marginal cost was among the highest globally and it has worsened since (Dotti et al. 2021). Iran's marginal cost also increased more than fivefold between 2016 and 2020 (Knoema 2022).

- Relationships: Agreements, competition, and responsibilities to stakeholders such as OPEC+ limit production growth. Iran and Venezuela's oil production could affect oil prices and the market for other suppliers. The unrestrained growth of these two players could then flood the market.

Iran and Venezuela fared differently under sanctions. Iran managed to largely maintain its production at a stable level, with oil exports going to 'new' consumers despite the sanctions. However, Venezuela has experienced much more damage to its infrastructure and will face a slower production recovery curve.

Conclusion

Iran's oil production outlook (Figure 2) shows that oil output will likely grow to 5 MMb/d with or without sanctions. On the contrary, Venezuelan oil production is unlikely to reach 1 MMb/d under sanctions, whereas eliminating sanctions could raise production to 1.5 MMb/d by 2030.

In other words, the short-term impact of lifting sanctions on Iran and Venezuela will not shake global oil markets. Iran is already expanding its production and exports under sanctions and lifting them would accelerate this process. However, lifting sanctions on Iran may be slowed by production limitations under the OPEC+ Declaration of Cooperation. Venezuela, with or without sanctions, has a limited upside. Lifting sanctions would help the country stabilize its market with a slow reverse in its production trend. It is estimated that the country could see a total increase of up to 500,000 b/d over the next seven years.

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