Director of
Central
Intelligence

Top Secret
[redacted]

NOFORN-NOCONTRACT-
ORCON
[redacted]

CIA|CPAS---|NID-88-203JX---

National Intelligence Daily

Tuesday
30 August 1988

RELEASE IN PART
EXEMPTIONS: (b)(1)
(b)(3)
DATE: SEP 2001

Top Secret
CPAS NID 88-203JX
[redacted]
30 August 1988

19

[redacted]

Special Analysis

IRAN-IRAQ: **Cease-Fire Portends Lower Oil Prices**

If the cease-fire in the Iran-Iraq war holds, increased exports from Persian Gulf oil producers—especially Iraq—might drive prices down by as much as $3 to $12-16 per barrel over the next year or two. [redacted]

Although a peace settlement might improve the environment for cooperation in OPEC to support prices, divergent interests among its Persian Gulf member states will continue to complicate efforts to negotiate a workable production allocation scheme. [redacted]

Iraq's efforts to build an extensive export pipeline system and to maintain an aggressive oilfield development program have put it in a good position to increase oil output. If the cease-fire holds, Iraq would be able to increase oil exports by 1 million barrels per day within six months by using two single-point mooring buoys in the Gulf. Even without these buoys, Iraq will expand its export capacity another 1 million b/d by late next year with the completion of its pipeline through Saudi Arabia. [redacted]

Non-Communist oil consumption, however, is expected to grow by only about 500,000 b/d next year, and nonmembers will supply as much as 200,000 b/d of that increment. Demand for OPEC oil—at current prices—will increase by only 300,000 b/d next year. [redacted]

Should Iraq opt to use all its additional export capacity, oil prices would collapse. Statements by Iraqi oil officials suggest that Iraq will try to export as much oil as possible after the war without triggering such a price decline. [redacted]

Given the relative strength of Iraq's oil sector, Baghdad is likely to demand a quota from OPEC that is much higher than that of Iran. Baghdad may decide to deal with the rest of OPEC, including Tehran, in the market rather than at the bargaining table. This would pose a challenge to other Gulf producers also looking for higher quotas and exports. [redacted]

The war's end probably will have little effect on Iranian oil production and export capacity over the next several years. Iran has allowed its oil production capacity to deteriorate from 6 million to 3 million b/d during the war, and it does not have much potential for an aggressive increase in oil exports. With current production about 2.3 million b/d, Iran can increase its oil output over the near term by no more than 700,000 b/d. [redacted]

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Tehran is likely to be more sensitive than Iraq to the impact of higher output on oil prices. Throughout the war, Iran produced well under its productive capacity, preferring higher prices to volumes, a policy that probably will continue. [redacted]

As usual, the Saudis will play the key role in determining the shape of the postwar market, but the divergent interests among Gulf producers will make it difficult for Riyadh to encourage greater price support. Moreover, the Saudis have little oil policy leverage over other Gulf producers. Although Riyadh has the ability to limit Iraqi exports through the pipeline that transits Saudi Arabia, it is not likely to do so for fear of antagonizing its powerful neighbor [redacted]