

The Middle East and Energy Geopolitics in An Age of Oil Abundance

By **Tilak Doshi**

Series Introduction

The Covid-19 pandemic capped a series of events that made 2020 one of the most disruptive years in the annals of the energy industry, affecting markets, prices and livelihoods. The “Middle East, Asia and Energy Security in the Age of Covid-19” series of *Insights* looks at some of these developments and their impacts, including the astonishingly rapid emergence of the United States as the world’s leading oil and gas producer, the increasingly dire outlook for the member countries of the Gulf Cooperation Council, the role of Asia in resuscitating global oil and gas demand and the increasingly important role of China, among the world’s largest importers of oil and gas, in Middle East affairs.

Abstract

By effectively making the United States the “swing” producer in global oil markets, the shale revolution has weakened the ability of the Organization of the Petroleum Exporting Countries and Russia to support crude oil prices through output restraints. In this age of US-led oil abundance, conventional notions of energy security and geopolitical risk have been upended. Asia’s oil importers have been enjoying the benefits of falling oil prices at the expense of their supplier nations in the Middle East. Furthermore, America’s reduced dependence on imported crude has made it less vulnerable to upheavals in the Middle East. However, new energy shocks could arise if a Joe Biden presidency pushes through its proposed policies against fossil fuels or seeks to rehabilitate oil-producing Iran by easing sanctions against it. Nonetheless, it would be a fallacy to assume that America’s strategic interests in the Middle East might wane with reduced US energy dependence on the Middle East. The United States is likely to continue its involvement in the Middle East with considerable leverage over its regional rival and allies, but much depends on how this leverage is utilised by the new incoming US administration.

By late 2018, the shale revolution had allowed the United States to surpass Russia and Saudi Arabia to become the world’s largest crude oil producer for the first time since 1973.¹ The surge in oil production over the past decade has reduced America’s dependence on imported crude and in fact even enabled the country to replace oil supplies disrupted by political instability in the Sudan, Syria, Libya and elsewhere. Consequently, prior to the global economic slowdown and fall in energy demand arising from the lockdowns imposed since the Covid-19 pandemic, projected growth in US exports had been expected to absorb the bulk of the increased global demand for energy into the middle of the

¹ US Energy Information Administration, “The United States is now the largest global crude oil producer”, 12 September 2018, <https://www.eia.gov/todayinenergy/detail.php?id=37053>.

decade at least.² Other non-Opec producers such as Brazil, Norway and new producer Guyana also would have added to global oil supplies.

Much has been written about “import independence” as a target for US energy policy, but it is important to avoid a superficial understanding of “dependence” on oil imports from the Middle East. Oil is sold in fungible global markets, and its price is linked to oil prices everywhere else. Ultimately it does not matter how much of the oil consumed comes from the Middle East; the price of oil depends on global demand and supply, and the disruption of oil trade flows anywhere affects consumers everywhere. Thus America’s strategic interests now lie less with its own imports, which are marginal, than with overall price and stability in oil supplies on which the global economy and its allies depend. By effectively making the United States the “swing” producer in global oil markets, the shale revolution has weakened the ability of the Organisation of the Petroleum Exporting Countries (Opec) and Russia to support crude oil prices by restraining output.

In the age of US-led oil abundance, conventional notions of geopolitical risk and perceptions of energy security have been upended. America’s reduced dependence on imported crude has increased its leverage in achieving its geopolitical objectives: it has given the country greater latitude to support allies and sanction rivals and made it less vulnerable to political and social upheavals in the Middle East. For instance, it has been able to impose export sanctions on oil-producing adversaries such as Iran, and without the risk of pushing up global and domestic oil and gas prices.

The Shale Revolution and its Impact on the Middle East

The impact of the US shale revolution has been transformational on the Middle East. Owing to decades of increased consumption and reduced crude output in the United States, the conventional wisdom in the 2000s was that the country would be increasingly dependent on the Middle East for its oil supplies. The opposite has occurred, as the country’s oil imports from the Middle East fell, along with those from Africa and Latin America. The United States now imports only a small fraction of its crude oil needs from the Middle East. Saudi Arabia and other Middle East oil producers still constitute the world’s major source of low-cost conventional oil reserves. However, their overwhelming dominance is no longer a defining feature of global oil markets.

Ever since the historic 1945 meeting between Saudi Arabia’s King Abdul Aziz and US President Franklin D Roosevelt on a US warship in the Suez Canal, the *quid pro quo* involved in the strategic relationship between the two nations was clear: while the Saudis assured the Western world of access to their oil exports, the United States served as the security umbrella for the kingdom. But, today, with abundant unconventional oil and gas resources, the United States is no more the energy supplicant in this relationship.

The extent to which the US–Saudi Arabia security relationship has been transformed is illustrated by the sequence of events following the collapse of talks to shore up oil prices through production cuts and the Saudi–Russian price war that began on 9 March 2020. In the ensuing tumultuous month, Brent crude fell below US\$20 a barrel, its lowest in nearly two decades. Through intensive diplomacy and negotiations involving the leading oil producers and the G20 countries during the Easter weekend in April, Opec and a group of non-Opec producers led by Russia finally agreed to cut output by a record 9.7 million barrels per day (b/d) in May and June.

The United States played a critical brokering role between Saudi Arabia and Russia for the new OPEC+ accord. Reportedly, in a phone call with Crown Prince Mohammed bin Salman, the de facto

² International Energy Agency (IEA), “United States to lead global oil supply growth, while no peak in oil demand in sight”, 11 March 2019, <https://www.iea.org/news/united-states-to-lead-global-oil-supply-growth-while-no-peak-in-oil-demand-in-sight>.

leader of Saudi Arabia, US President Donald Trump threatened to pull out US troops and missile batteries protecting key oil facilities in the kingdom if Riyadh did not cut oil production.³ President Trump's efforts were motivated by his desire to protect the US oil industry — an important political constituency in Texas, New Mexico and other states — from a disastrous price collapse while the country was still struggling to contain the pandemic and recover from what is expected to be the deepest recession since the Great Depression.

The shock of low oil and gas prices that the Gulf Cooperation Council (GCC) members now face has been compounded by the drastic pandemic-driven lockdowns and global economic slowdown, which has in turn reduced energy demand. This has occurred at a time when promoting economic diversification, expanding employment opportunities for their youthful populations and attaining fiscal sustainability had already become an urgent policy concern in the GCC countries.

For fragile and conflict-ridden states such as Iraq, Syria, Yemen and Libya, already on the brink of social and economic collapse with battered infrastructure, massive youth unemployment and civil unrest, the pandemic and its collateral economic damage might prove to be catastrophic. Increasing instability in an already volatile region could spike rivalry in the wider Middle East region and geopolitical risks for energy importers.

Implications for Asia

Perhaps the most profound impact on Asia since the steep fall in oil prices in the second half of 2014, followed by the price collapse with the twin shocks of the global pandemic and the oil price war in March 2020, has been the lowering of the cost of oil imports.

Cheaper and more diverse oil supplies

One study suggests that global oil prices would have been higher by up to US\$50 per barrel if there had not been a fracking boom in the United States.⁴ Given the scales involved, even with conservative estimates on the price impact, the upsurge in unconventional oil production in the United States has arguably led to the biggest transfer of wealth in economic history. Assuming conservatively that the US-led oil supply shock brought prices down by US\$25 per barrel, this amounts to a savings of almost US\$320 billion dollars per year for Asia, where, according to BP, total oil consumption in 2019 was over 36 million b/d (out of a global total of 98 million b/d).⁵ If one begins the low price year from 2015, the total savings for Asia amount to over US\$1.2 trillion.

China, India, Japan and South Korea constitute four of the world's five largest oil importing markets. Given that over 60 per cent of Asia's total oil imports are sourced from the Middle East, low oil prices have led to a massive foreign exchange transfer in favour of Asia's current account balances at the expense of the Middle East oil exporters.

The fall in oil prices spurs economic growth by lowering costs. According to one estimate, a US\$10 per barrel decrease in oil prices leads to a 0.15 per cent increase in GDP for China, and 0.25 per cent increase in GDP for India.⁶ Low oil prices helped countries such as India and Indonesia to cut energy

³ T Gardner, et al, "Special Report: Trump told Saudi: Cut oil supply or lose U.S. military support — sources", Reuters, 30 April 2020.

⁴ Manuel Frondel, et al, "The US Fracking Boom: Impacts on Global Oil Prices and OPEC", IAEE Energy Forum, 2nd Quarter 2018.

⁵ BP "Statistical Review of World Energy 2020", <https://www.bp.com/en/global/corporate/energy-economics/statistical-review-of-world-energy.html>.

⁶ Bank of America estimate cited in Thomas E Donilon, "Remarks" at Center of Global Energy Policy, Columbia University, 21 January 2015.

subsidies without imposing undue burdens on poorer consumers. As Asian countries struggle to recover from the economic recessions brought about by the pandemic-led lockdowns, low oil prices will be an advantage to the region's net oil importers.

Equally important, Asian importers now are spoiled for choice as they have access to a wider range of competitive crude oils from different regions, such as West Africa, Central Asia, Latin America, Russia and, now, the United States. This includes access to spot crudes from the United States, which allows importers greater flexibility than the annually renewable, long-term contracts that most Middle East crude oils come with and serves Asian government objectives for diversification of crude oil imports to avoid over-dependence on Middle East producers. The increase in diversity of oil producers, as well as the relative political stability of the United States, improves energy security for Asian oil importers and has enhanced the stability of oil markets in general. Asian crude importers also benefit from diversification of price exposure, as new US Gulf Coast free on board (FOB) price assessments emerge as a competing pricing basis, along with the long-standing Brent and Dubai crude oil benchmarks.

On the flip side, the dire security outlook for fragile and conflict-ridden states such as Iraq, Syria, Yemen and Libya portends intensified risks for those Asian oil and gas importers who still depend on the Middle East for their baseload oil and gas supplies.

Slowdown in oil refining and petrochemical investments

The rapid and massive US shale gas production increases substantially bolstered America's comparative advantage in energy-intensive manufacturing. International natural gas markets are far less integrated than other commodity markets (such as oil) largely because the costs of liquefaction and transport of liquefied natural gas (LNG) constrain its tradability. This means that the rest of the world has not been able to enjoy the price advantage that US consumers enjoy as a result of the US shale gas revolution. Consequently, the United States has seen a "manufacturing renaissance", with energy-intensive industries in which natural gas is the critical intermediate input registering increases in output and exports.⁷

The emergence of the US Gulf Coast as the most competitive region for global investments in petrochemicals manufacturing has had a significant impact on Middle East national oil companies (NOCs) planning to integrate oil refining with downstream petrochemicals. Spurred by low oil prices post-2014, the Gulf NOCs such as Saudi Aramco and Abu Dhabi National Oil Company (ADNOC) dramatically scaled up plans to increase the complexity and capacity of oil refineries and petrochemical manufacturing as part of their governments' long-term economic diversification strategy.⁸

With the oil price collapse since March 2020, the major plans by GCC NOCs such as Saudi Aramco, Qatar Petroleum and ADNOC for investments in the downstream oil refining and petrochemical sectors, both domestically and via international joint ventures, will be either much delayed or cancelled as the Gulf countries grapple with stalled economies and tightened fiscal constraints. If such delays or cancellations occur, the pressures on oil refining and petrochemical margins experienced by incumbent players in Asia and other regions will be alleviated. But, in the medium term, as the markets

⁷ Using data covering the period- 1997–2012, one study econometrically estimated an increase of 3.3 per cent in capital investment in US-based energy-intensive industries for every US\$1 increase in the gap between natural gas price in the United States and that in the rest of the world. This translates into an increase of US\$10 billion in investment in energy-intensive manufacturing for 2012 alone. See Rabah Arezkie, Thiemo Fetzerb and Frank Pischc, "On the Comparative Advantage of US Manufacturing: Evidence from the Shale Gas Revolution", *Journal of International Economics* 107 (2017) 34–59.

⁸ See for instance, *Middle East Economic Digest*, "Aramco to spend \$100bn on refining and chemicals projects", 28 November 2018, <https://www.meed.com/aramco-spend-100bn-refining-chemicals-projects/>; Kate Dourian, "ADNOC repositions itself to challenge international oil majors", The Arab Gulf States Institute in Washington, 15 March 2019, <https://agsiaw.org/adnoc-repositions-itself-to-challenge-international-oil-majors/>.

for refined oil products and petrochemicals rebalance, and as the GCC economies recover, some of the more viable downstream projects planned by the Gulf national oil companies may be resuscitated.

Increased competition in oil refining and the petrochemicals industry from US and GCC-based companies was expected to put increased pressure on profit margins in the sectors, particularly in Europe. In Asia, the most disadvantaged regional players in this new competitive environment will be poorly capitalised, mainly government-owned Asian oil refiners and petrochemical producers like those in India and China, who are dependent on protected domestic markets and operate older plants.

Marginalisation of Singapore?

Prior to the pandemic, it had been argued that, as NOCs from the GCC increasingly shift into downstream activities, "... intermediaries like Singapore hold less leverage than in the past. The GCC countries in particular will project more international power in the downstream sector in the coming years than in the past".⁹ The assumption was that Singapore's role as Asia's leading "entrepot" refining centre — one with no domestic crude oil reserves and only a small domestic market — will be increasingly marginalised as the Middle East oil producers add value to their crude by investing in oil refineries and petrochemicals.

But this view seems simplistic. Clearly, the GCC countries' new oil refining and petrochemical investments, both domestically as well as via their several joint ventures in Asia, will provide competition to Singapore's existing plants. But Singapore's oil refiners and petrochemical producers are highly efficient and have access to various regional markets through the international affiliates of Exxon, Shell and Chevron (which is a shareholder in the Singapore Refining Company). Furthermore, in a world of fungible oil and gas markets, access to domestic oil and gas resources does not necessarily confer substantive competitive advantages. Singapore's strategic location also provides freight advantages to the large East Asian markets that its GCC-based counterparts are not able to offer.

The Middle East and Asia in Global Energy Geopolitics

As 2019 drew to a close, it was apparent that the US shale revolution had served the Trump administration's geopolitical and foreign policy objectives, allowing it to effectively pursue its "America First" and "Energy Dominance" approaches, especially in Europe and Asia. But the onset of the pandemic-driven lockdowns and industrial shuttering worldwide has complicated the picture. Nonetheless, there is no reason to believe that as more and more countries emerge from strict lockdowns and recover economically, the United States will lose its advantages as one of the world's leading oil and gas exporters. The current low oil and gas prices have no doubt already begun to lead to a significant slowdown in production in the US shale sector and bankruptcies of smaller firms or their acquisition by larger companies with stronger balance sheets.¹⁰ But, "rocks don't go bankrupt", as the energy expert Daniel Yergin puts it.¹¹ In other words, the country's oil and gas resource endowments remain, and as the oil market rebalances with supply cuts and when demand picks up as countries emerge from their lockdowns, US shale production will once again ramp up if oil prices increase beyond the US\$55–60 per barrel range. The United States — with the requisite deep capital markets, technology and skilled labour — will remain the world's leading oil and gas producer.

⁹ Juergen Braunstein, "Singapore in the Global Energy Transition", *Insights*, Middle East Institute, NUS, No. 219, 3 December 2019.

¹⁰ Collin Eaton and Rebecca Elliott, "US shale drillers could be casualties of oil-price war", *Wall Street Journal*, 9 March 2020.

¹¹ Joe Carroll, "Rocks don't go bankrupt: Experts say shale will rise again", *Bloomberg News*, 27 March 2020.

As the Asian economies recover from the global pandemic in the months and years ahead, low oil and gas prices will be an added factor in their favour. In their trade negotiations with the United States, the large Asian economies will be able to turn to imports of US oil and gas as a means of reducing their trade surpluses with the United States. In the longer term, as the global economy regains momentum, the developing countries of Asia will once again emerge as the largest growth market for fossil fuels so necessary to drive industrialisation, urbanisation and higher standards of living.

The region most adversely affected is undoubtedly the Middle East. The GCC countries cannot depend on high oil and gas prices to rescue them from fiscal unsustainability in the medium term. Much will depend on how they re-negotiate the social contracts they had with their citizens in an era of ample oil and gas supplies and how successful these “rentier” states are in their efforts to adopt more sustainable models of economic growth. The economic and political transformations that are needed in this process will be made even more difficult by the political and economic instability faced by their poorer, conflict-ridden oil-importing neighbours in the Middle East and North Africa. In this context, the Asian powers — such as China, India, Japan and South Korea — who still depend heavily on the Middle East for their oil and gas supplies will continue to face energy security risks.

The most portentous impact of the global pandemic and its aftermath for the GCC countries is the state of US–China relations. Already contentious over the past few years, these ties are at their lowest ebb at least since the 1989 Tiananmen Square crackdown. How China pursues its strategic energy relations with Russia and Iran and how it utilises its position as a major economic partner to the GCC energy exporters and its so-called Belt-and-Road strategy to play an active role in the broader Middle East region is one of the key questions in energy geopolitics today. Arguably, the radically weakened economic condition of the GCC countries will yield China added trade, investment and diplomatic clout in the region.

It may be argued that America’s strategic interests in the Middle East might wane along with the decline in its energy imports from that region. But it would be a mistake to make too much of America’s reduced dependence on Middle Eastern oil. Containing Islamist terrorism, mitigating the threat of nuclear proliferation and supporting Israel’s defence needs in a volatile region remain strategic foreign policy imperatives. More significantly, as the unclassified version of the US national defence strategy report of 2018 made clear, the United States is not prepared to see the Middle East “dominated by any power hostile to the United States”.¹²

Much depends now on how the new US administration wields its strategic advantages arising from its military and diplomatic assets in the region, its vast energy resource endowments and its innovative and free market economy. There is a view suggesting that with Joe Biden having (most likely) won the US presidential election, a modicum of pragmatism will prevail as the Democrats’ excessive campaign promises face the cold light of day and the real costs of policy decisions become apparent. The US Senate looks likely to remain Republican and hence would provide a check to the more extreme pledges made in the name of “net zero” emissions in the power sector by 2035 and in the entire economy by 2050.

Nevertheless, despite the potential veto a Republican Senate might provide against some of the more radical policies of the Biden plan for clean energy,¹³ a Biden presidency will still have wide powers via executive orders for re-introducing onerous regulations that the Trump administration had dumped and via working through politicised administrative agencies such as the Environmental Protection Agency (EPA).¹⁴ By constraining US oil and gas production, a Biden–Harris administration intent on renewable

¹² US Department of Defence, “Summary of the 2018 National Defence Strategy of the United States”, 9, <https://dod.defense.gov/Portals/1/Documents/pubs/2018-National-Defense-Strategy-Summary.pdf>.

¹³ “The Biden plan for a clean energy revolution and environmental justice”, <https://joebiden.com/climate-plan/>.

¹⁴ Steven F Hayward, “The EPA is politicized — so make it official”, *Wall Street Journal*, 8 January 2013, <https://www.wsj.com/articles/SB10001424127887323320404578216034024416590>.

energy and climate change priorities would achieve, at a stroke, the long-sought and common objectives of Russia, Saudi Arabia and other Opec oil and gas producers suffering under low oil prices.

But Biden is no unalloyed blessing for the Middle East and Russia. While unintentionally assisting Russia, Saudi Arabia and the rest of the Opec+ group by hobbling US oil and gas production, a Biden administration will also consider easing President Trump's "maximum pressure" sanctions on Iran. Biden has stated that he would return to the 2015 nuclear deal if Tehran "resumes compliance". A potential resumption of Iranian exports of over 2.5 million b/d (its peak export level in 2018 before President Trump's oil sanctions were imposed) would make it impossible for the OPEC+ group to balance supply and demand. The OPEC+ cutback agreement of 9.7 million b/d would be at risk of collapse, along with oil prices from their already low sub-US\$40 per barrel levels.

Whether the energy shock emanates from the eclipse of the United States as the world's leading oil and gas producer (leading to high oil and gas prices) or from the collapse of the Opec+ production cut agreement brought about by the re-emergence of unconstrained Iranian exports (leading to very low oil and gas prices), a Biden presidency presents highly disruptive scenarios in energy geopolitics, scenarios no less disruptive than those that occurred under Trump's watch.

About the Author

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