

ENERGY GEOPOLITICS IN THE MIDDLE EAST AFTER THE OPEC SUMMIT

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Overview of the OPEC Summit's Implications

The Middle East is home to 65% of OPEC's oil reserves and, with 32 million b/d, provides just over a third of the global oil supplies. Since 2014, the group of GCC (Gulf Cooperation Council) countries, lead by Saudi Arabia, had seen a worldwide oversupply send prices lower and reduce revenues to government budgets.¹ Defending and expanding market share had been the primary goal of the low-cost Middle Eastern states with the aim to squeeze potential rivals in Russia and the Americas out of the game. However, in a classic case of prisoner's dilemma, price wars resulted in loss-making for all producers.² Aside from deep budget deficits, low prices induced demand surge for motor vehicles around the globe that undermined efforts for resource diversification. Persistent global warming due to human-induced greenhouse gas (GHG) emissions created a much gloomier issue with long-term repercussions than merely regional political dynamics, necessitating cooperation and immediate action.

The global economic slowdown and the accompanying slump in oil prices dragged down growth in oil exporting countries of the Gulf. Faced with fast depleting sovereign reserves, which were saved as cushion to weather turbulent times, lead oil producers of the Gulf announced new measures such as abandonment of capital-intensive infrastructure projects, cost-cutting, introduction of the VAT, and far-reaching reforms such as privatization, diversification and removal of subsidies to fight fiscal deficits. Of special concern was Saudi Arabia's exposure to persistent low oil prices creating an ever growing burden on the kingdom's finances that are spread thin over efforts to sustain foreign aid and proxy warfare in as far afield as Syria, Iraq, Yemen, and Libya. On top, Iran's nuclear accord with the P5+1 and the subsequent prospect to grow, expand and dominate the Gulf monarchies forced policymakers of the region to rethink their strategy and consolidate their positions against a rising rival power. Pragmatism has prevailed and paved the way towards a well-coordinated effort to provide breathing space to oil producers of the Gulf at an international summit in 2016.

In accordance with market expectations, the November 2016 OPEC summit in Vienna concluded with a cornerstone deal at the last minute that reversed the cartel's long-held

policy of defending market share over oil prices. The agreement to curb output by 1.2 million b/d within six months, the first since 2008, took effect in January 2017 with crucial non-OPEC producers such as Russia and Mexico joining to shoulder an additional output cut of 600,000 b/d, reaching a total of 1.8 million b/d. Iran has been permitted a symbolic increase on its quota forecasted for growth in 2017, thus giving a signal that OPEC is still credible and relevant,³ surging oil prices above the \$50 pb level. Reports have confirmed that most member parties reliably comply by their commitment⁴ to clear the enormous supply overhang accumulated over years, although doubts remain about the contribution of non-members, crucially of Russia. EIA's short-term energy outlook for 2017 projects \$53-\$55 oil price for Brent and WTI crude,⁵ which are yet lower than the fiscal break-even price of the Gulf countries.

Geopolitics of Oil in the Gulf Region and Beyond

The road to the OPEC deal coincided with Donald Trump's victory at the US presidential elections. The US administration's promises of pulling out of the Paris climate accord, extending full support for increasing shale oil production, lifting restrictions on drilling in the Gulf of Mexico and the Arctic, and building up American energy independence and energy exports are expected to result in more hydrocarbons flowing to the international markets. This will only add to the global oil glut and will potentially depress oil prices in the long term,⁶ effectively undermining OPEC's efforts. In addition, any move to cut oil production sends a signal to shale producers to boost activity. American producers, whose break-even oil price is below \$30 thanks to improvements in efficiency, are quick to seize the opportunity and ramp up production as the market recovers. Supported by 1.3% oil demand growth in 2017 to reach 97.4m b/d⁷ according to IEA's estimates, oil price within \$50-\$55 band is sufficient for US shale production to be profitable.

Meanwhile, regional rivals Riyadh and Tehran find opportunities to improve their standing across the Middle East, often in zero sum ways.⁸ Despite having reached a compromise deal at OPEC, their economic profiles are in stark contrast with each other. Saudi Arabia's crude reserves of 266.5 bb are seen to last for only 70 years⁹ due to which the kingdom plans to enact radical reforms by reducing overreliance on oil, sell off state-owned assets, and harness the power of markets.¹⁰ The effects of measures are already visible with the 14% drop in Riyadh's fiscal break-even price of oil from \$92.90 pb to \$79.70 pb,¹¹ albeit much lower than what the IMF had forecasted in 2015. Iran, by contrast, thanks to its more diversified economy, exceeded IMF's expectation with a break-even price of \$55.30 pb.¹² As an exceptional case, the mutually hurting stalemate of low oil prices made possible a financial deal in the OPEC despite huge political differences in Riyadh against Tehran and Moscow. Iran, at the time, certainly appeared to be better equipped to weather oil-price shocks.

Nevertheless, Donald Trump's protectionist trade policies and fiscal stimulus package at home are expected to reduce demand for foreign goods and slow down the global recovery, stimulate FED interest rate hike and support US dollar's appreciation, effectively capping further rise in the oil price. This deals a major blow to Iran's plans to revive its economy, attract foreign investment to its fast-aging fields let alone to dig new wells at

a time of heightened insecurity, instability, and risk. Stagnant oil price and rising interest rates reduce windfalls and squeezes liquidity also in the Gulf states that are all the more dependent on the US for political, economical, and military support. Amid budget deficits, Saudi Arabia is preparing for a pro-longed period of low oil prices by hedging its risks through economic diversification, leaner public administration, reduced military spending, and stronger regional alliances to share the increasingly unsustainable burden.

The US administration clearly stated its aim to counter Iran's rising regional influence and court Israel's security by reversing the tide from Barack Obama's liberal internationalist policies and instead hand-picking its friends of convenience. Israel joined the coir by recently going as far as to say "the real division is not Jews, Muslims... but moderate people versus radical people,"¹³ pointing squarely at Iran's extremist policies. Saudi Arabia and Israel formed a de facto united front, joined by Turkey, for a new push against Iran, signaling a growing alignment in their interests, while US lawmakers promised to seek new sanctions on the Shi'ite Muslim power.¹⁴ In stark contrast with the higher perceptual positioning that Iran leveraged following the nuclear-accord, it now seems to be cornered out not only as the major source of destabilization but also as a potential spoiler in any political deal over the fate of the region.

Perhaps the most interesting case was Turkey's turbulent political course since the end of 2015. Amid growing rift with the Western alliance, Turkey was largely isolated over the Syrian front after downing of the Russian jet in November 2015, raising its risk profile to an unsustainable level. Hit hard by economic slow-down, loss of influence, prestige, and leverage it did not take long for Turkey to re-evaluate its regional policy and realize the benefits that would accrue through realignment with crucial powers in the neighborhood. Reconciliation process with Russia and Israel demonstrated Turkey's strategic maneuverability and interest to consolidate its influence as a power-house in as wide a geography as Europe, Middle East, and the Eastern Mediterranean. The failed coup attempt in July 2015 drew the rift with US wider upon allegations of involvement, since when Turkey has declared state of emergency to recover from a drastic year of 2016 economically, politically, and militarily. Donald Trump's victory in December 2016 started a new chapter in Turkey's Transatlantic relations, restoring cautious optimism in Ankara to form a more amicable partnership with the US and overcome common, regional challenges.

Turkey's long-standing alliance with the Sunni Arab Gulf states, confronted by Iran's Shi'ite crescent, experienced hurdles through the flow of the past turbulent six years. The front of GCC states categorically rejects cooperation with Iran until it ceases to prop up the Syrian government, ballistic missile tests, funding Shi'ite insurgents throughout the region, and meddling in its neighbor's affairs. The change of course in US foreign policy entails detachment from idealistic democracy-building experiments, limitation to subsidizing alliances, and adoption of a more antagonistic stance towards Iran, which, as a by-product, seems to have strengthened bonds in the Sunni Muslim camp including Turkey. However, although Turkey and Iran have been regional rivals for decades and aim to restrain each another's hegemonic ambitions, both have shared interests in herding stability, economic cooperation, and preventing formation of a belligerent Kurdish state at their door step. In an increasingly multi-polar world, Turkey indeed threads a thin line of balance in this shifting power-play of partnerships for benefit maximization, power, and leadership.

Ramifications of the New Regional Equation for the Syrian War

It is not a coincidence that the US administration singles out Iran as its arch-enemy in the region by using a tough rhetoric to accuse it of offensive acts. The offshore balancing strategy adopted by Donald Trump enables the US to concentrate on preventing the rise of a rival hegemon of China in the Asia-Pacific and of Iran in the Middle East, while preserving its dominance in the Western Hemisphere.¹⁵ The US officials calculate that Russia is a reactive, declining power and does not pose a major long-term threat as would a rising China in the Pacific or would a resurgent, nuclear Iran against Israel. As evidenced in Donald Trump's statements on NATO and the US contribution to the Gulf's defense, the US prudently prefers to let allied states take more ownership and responsibility for burden-sharing in regional security.

In Syria, a key arena for Iran's power projection, each party to the conflict has their own vision for a desired end-state to the conflict.¹⁶ In 2016, the regime of Bashar Al-Assad re-gained control over a significant part of the main population centers with the help of the Iranian Quds Force, its allied militias, and the Russian air power. The US attempted to reap apart the Russian-Iranian alliance while continuing to provide air support and heavy armory to the Kurdish-dominated SDF in the north, courting Turkey's co-operation against ISIS, and consolidating its influence over Iraq. From this perspective, Turkey's rapprochement with the Russian-Iranian axis and successful incursion into northern Syria under the operation code-named "Euphrates Shield" has worried the US administration. If nothing else, the Turkish offensive prevented SDF from joining the cantons of Afrin and Kobane to form a continuous Kurdish belt along northern Syria.

Seeing an opportunity to fill the void before the new US administration has fully taken on the helm, the three guarantors agreed on a plan to support Syrian truce¹⁷ at the Astana peace process amid America's declining regional assertiveness. The US then quickly resumed relations with a rifting Turkey to map out a joint plan of action to capture Raqqa, the defacto capital of ISIS, and contain Russian-Iranian influence. This recent development took place as Russia warmed relations with the Kurdish YPG and Iran traded accusations with Turkey over their role in Syria.¹⁸ In this power struggle, Turkey on one hand joined forces with Russia to consolidate its gains in northern Syria and on the other hand offered to cooperate with the US to take out ISIS, with the role given to SDF, if any, still to be decided. As the war reaches a critical juncture, if the US and Russian policymakers strike a grand bargain over the future of Syria, as the two may do in their own interest at the expense of regional powers, it will be appealing to see the impact on the regional equilibrium.

Conclusion

Oil's role as the most important commodity in the world is evident in its impact on political developments around the world. As the epicenter of the global economy and the demand for oil shifts from the West to fast-growing Asian markets, the Middle East has gained competitive advantage and heightened in importance by its crucial geostrategic location, both as a rich supplier and as a conduit. The fiscal break-even price of oil in producers of the Gulf, Russia, and Iran has been above market prices since 2014, putting pressure on their export revenues, government spending, and welfare, thus enabling an

agreement at the OPEC summit in November 2016. The interplay between geopolitics of oil, economic reforms, and security requires vigilance to shifting regional dynamics and raises sensitivities to realities of the multipolar world order. Great power politics occupies an important place in world affairs, albeit to a smaller extent in comparison to a unipolar or bipolar order. Regional alliances are formed with greater flexibility, creating micro spheres of influence, and raising uncertainty. The US assumes an offshore balancer role with focus on Asia-Pacific while the Middle East appears ever-more divided along ethnic, religious, and sectarian lines. Iran and Saudi Arabia, the two arch-rivals of the Gulf, aim to improve their standing while Turkey and Israel play pivotal roles to sustain their influence over developments in the region. The ultimate arena of this power politics is Syria, the fate of which depends on negotiation skills of intervening parties to create a framework agreement where there are no winners or losers.

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