

APRIL 2021

Middle East Paper for Energy Spheres of Influence Project

By Fareed Mohamedi

This white paper was commissioned by the [CSIS Energy Security & Climate Change Program](#) as part of its [Energy Spheres of Influence](#) project. It informed the project's workshops and ultimately its final report, [Race to the Top](#).

This piece was written in 2019; as such, elements of this paper that were contemporaneous when written may now be dated.

Introduction

The key points this paper makes about the future control of Middle Eastern oil and gas resources in the context of the rise of Russian and Chinese regional influence are highlighted below.

Middle East oil and gas resources are controlled by their governments, who wrested control of these resources from Western companies in the 1970s.

Middle Eastern countries created national oil companies (NOCs) to manage their national patrimony. Some were never fully able to manage the resources without the continued presence of foreign companies. Some of the NOCs failed and governments had to reengage with foreign companies to restore oil and gas output.

Middle Eastern governments used existing relationships or new ones with foreign oil companies as a means to maintain, build, or adjust geopolitical relations with foreign governments. This was a fluid and evolving process and over time involved Chinese and Russian companies as they went global, and their governments gained geopolitical prominence.

While Western companies were the major players in the region's oil and gas sector, this was a product of the individual host country's geopolitical objectives, legacy positions of those companies, and their technological advantages. However, no one Western country or company was dominant across the region in the oil and gas arena. The same is likely to hold true for Russian and Chinese companies in the future. They are unlikely to dominate the playing field and will be part of the global balancing of the foreign policies of the local governments.

Some successful Middle Eastern NOCs (Saudi Aramco and Adnoc, notably) are shaping the energy relationship between their countries, China, and the rest of Asia. These relationships are still focused on gaining market access and not on giving Chinese or Russian companies access to the resources in the region. In fact, even in Iraq, where foreign companies—notably Chinese ones—have played a critical role in growing production capacity, it is quite conceivable that once the foreign investors build up capacity to a certain level, Baghdad will push to create its own NOC and reassert operational control over these assets as has been the practice elsewhere in the region.

The geopolitical importance of Russia and China in the Middle East will grow for different reasons, but the region's oil and gas resources will remain under the control of the various governments which will use them to further their own agendas. China does not have hegemonic ambitions in the region and has neither the capability nor the interest to go beyond its “development peace” policies. Russia has little to offer the region other than arms and political mediation. It will continue to be seen by the major energy players as a competitor and at times a partner in global oil market management.

The Geopolitical, Operational, and Strategic Control of Middle East Oil and Gas

Since the 1970s, the political control over the oil and gas resources of Middle East states **passed decisively** into the hands of the region's governments. Whether through negotiated nationalizations as in Saudi Arabia and other Gulf Cooperation Council (GCC) states or revolutionary takeovers in Algeria, Iran, and Iraq, Middle Eastern governments directed policymaking and set the strategic direction of the development of their oil and gas sectors. The nationalizations transferred control from Western multinational corporations working in close coordination with their own governments to national oil companies or oil ministries in these states.

The geopolitical implications of this change of control varied depending on individual states and have been the basis of petro-geopolitics for the last 50 years. The principal arena where the changed geopolitics showed up was in the global pricing of oil and more specifically in the Organization of the Petroleum Exporting Countries (OPEC) deliberations. Until the mid-1990s, there were **two camps** within the organization: the largely pro-Western OPEC doves that pushed for moderate oil prices in an effort to avoid destabilizing the Western consumer, and the OPEC hawks consisting of anti-Western revolutionary states with greater financial needs to ensure their independence from the West. Apart from the geopolitical and security dimension in pricing battles, the OPEC hawks and doves had different funding and development needs. Smaller populated GCC states could manage with lower prices while the larger countries—Iran, Iraq, and Algeria—needed high prices to meet their statist development programs.

However, by the mid-1990s, the demographic explosion in the region, even in the richer GCC states, and money squandered on wars and military purchasing programs was the great equalizer between the hawks and the doves of OPEC. The need for **higher oil prices** by countries such as Saudi Arabia led to unprecedented OPEC unity and ultimately led to the higher oil prices of the 2000s. With the end of these divisions, the West's allies within OPEC were signaling a geopolitical shift away from blindly supporting lower oil prices for the sake of the Western consumer.

Higher oil prices of the 2000s were also a product of the **global demand shift from West to East**, as demand growth was coming from Asia, notably China. The newly emergent Asian industrial countries were not as concerned about oil prices because they subsidized domestic fuels to their price-sensitive consumers. More importantly, the main consumers of imported oil in their countries were their industrial sectors, which were globally competitive and could “export” the cost of oil embedded in their output. Since their main

concern was stability of supply, Middle Eastern producers began to offer capital and dedicated supplies in exchange for guaranteed market share. This was the beginning of a growing relationship between the NOCs of the consuming and producing countries.

After the nationalizations, some countries created NOCs, such as Saudi Aramco, Kuwait Petroleum Company (KPC), Northern and Southern Oil Company of Iraq, National Iranian Oil Company, and Sonatrach, which were charged with full and exclusive control over their national oil and gas assets. A notable example of a successful NOC that maintained operational control over its assets and delivered what its owner (the Saudi government) wanted was Saudi Aramco. It developed the in-house expertise and was allowed to retain sufficient capital to maintain the world's largest oil and gas sector. Managing local and international service companies in a “best practices” manner without the intrusion of local vested interests was key to the success of Saudi Aramco.

However, the majority of NOCs in the region failed to sustain domestic production, particularly during the long period of low oil prices between 1986 and 2000. As a result, many Middle Eastern governments were forced to reengage with international oil companies in order to access their capital or their technical expertise. Other countries (for example, the United Arab Emirates (UAE), Oman, and Qatar) set up NOCs, but these were operationally weak institutions. Their governments retained contracts with international oil companies that had originally developed their oil and gas sectors to continue to produce and develop their resources. Over time the countries that were either reopening their oil and gas sectors to foreign participation or expanding foreign ownership became arenas of commercial competition with a heavy dose of geopolitical maneuvering for access.

In the initial stages (the 1980s and 1990s), the private companies working in the oil and gas sectors of Middle Eastern countries were predominantly Western given their historical participation, global expertise in business development, and the strong geopolitical influence of their governments on local political elites. However, access through geopolitical pressure depended on the specific foreign relations and internal politics of each country. As a result, no foreign power had a monopoly—and certainly not the United States and its companies. The following are some interesting examples.

Algeria began [reopening its oil and gas sector in the mid-1980s](#). Given its colonial history, it favored non-French companies and engaged BP (British) and Anadarko (U.S.) to develop and expand production. Later Statoil (now Equinor—Norwegian) became an investor in the country. The Algerian government was also motivated by various reasons beyond geopolitical alliances in choosing certain foreign companies. One of the reasons was assistance in becoming a strong player in the European gas market.

Oman maintained [strong ties](#) with Shell (Anglo-Dutch), but some Omani government officials resented the dominance of one large major and pushed for diversifying the group of investors into its oil and gas sector, leading to Occidental Petroleum (a U.S. company but with an interesting past as an independent) and BP (British) developing new projects.

In the early stages, Abu Dhabi showed a preference for French (Total) and British (BP and Shell) companies in the oil and gas sector, later favoring U.S. companies (ExxonMobil and Occidental) especially after Crown Prince Mohammad bin Zayed gained control over key institutions of the state. In more recent times, [Chinese](#), [Indian](#) and Russian companies have entered the mix and the pool of upstream players has become much more diverse.

Qatar saw one of the biggest pro-U.S. shifts with [major liquefied natural gas \(LNG\) projects offered first to Mobil](#) (which later merged with Exxon) after Emir Hamad bin Khalifa Al Thani came to power. LNG and the

offer to build the largest U.S. overseas **air force base** was part of his multifaceted strategy to seek a close alliance with the United States. However, even with its close ties to the United States, further evolution of foreign company participation was expanded to Shell (Anglo-Dutch), mainly for its dominant presence and expertise in the global LNG market.

After its liberation from Iraq, the Kuwaiti ruling family wanted **to open up the oil sector to Western oil companies** (a development called Project Kuwait)—partly because KPC could not carry out the new investment program and partly because the ruling family thought that the West would continue to provide protection to Kuwait from its northern neighbor if Western companies were present in its oil and gas sector. However, the ruling family did not get its way as the resurgent post-liberation Kuwaiti parliament blocked this move on the grounds of potential corruption by well-connected local agents.

In the run-up to the U.S. invasion of Iraq, critics of the invasion argued that the United States and its companies coveted its massive oil and gas reserves. As it turned out, **only one U.S. company remains** in southern Iraq's major oil and gas fields, alongside more numerous European, Chinese and other Asian companies as well as smaller Middle Eastern companies. The large number of foreign companies is not in itself the critical factor, but rather each individual or group of companies' participatory share in projects (and therefore their capital contribution), their operatorship of the project, and their project's contribution to new Iraqi oil supplies. Given these factors, Chinese companies have a prominent position in the Iraqi oil sector. However, that was more a result of most international oil companies, especially the Western ones, eschewing the **onerous contractual terms** set by the government and the greater tolerance for these terms by Chinese and other NOCs from Asia.

In Iran, high levels of indebtedness in the mid-1990s and the need to rebuild its war-ravaged oil and gas sector and economy led the government to **reopen its oil and gas sector to foreign companies**, even those from the United States. U.S. government attempts to block foreign oil companies led to some complicated geopolitical and commercial maneuvering by international companies to avoid legal challenges. Conoco attempted to participate in a gas development and export project, but the **Clinton administration blocked the deal**. After the U.S. Congress passed the Iran and Libya Sanctions Act, Total moved in and cobbled together a deal with Gazprom and Malaysian NOC Petronas in **defiance of U.S. secondary sanctions**. Iran has in the last decade sought Chinese and Russian company investment, but their participation in the Iranian oil and gas sector has been subdued due to UN sanctions during the Obama administration and then to renewed **sanctions pursued by the Trump administration**.

Middle Eastern governments also controlled the contractual terms under which foreign companies were allowed to engage with them. The terms varied by country and were shaped by local politics, geopolitical, commercial, and competitive considerations. They were also shaped by the relative power and prowess of the local NOC. A notable example of this was the influence of Saudi Aramco to stave off attempts by some royals to reopen the oil and gas sector to foreign companies.

Frustrated by Saudi Aramco's inability to produce sufficient quantities of natural gas for power generation and to feed the country's burgeoning petrochemical sector, prominent members of the Saudi ruling family created the **National Gas Initiative** in the late 1990s, inviting foreign companies to explore and develop domestic natural gas assets. Saudi Aramco expertly maneuvered to restrict foreign company participation by fencing off certain geographical areas and created a bidding formula so restrictive and uneconomic that most foreign commercial companies declined the invitation. Saudi Aramco management's main concern was maintaining its monopoly over its oil assets because it suspected foreign companies would use the gas opening as a backdoor means to enter the oil sector. They also worried that foreign companies would recruit local agents with undue influence and corrupt operations in the sector.

NOCs in the region have also pursued proactive plans for commercial reasons and to support their country's strategic priorities. An early pioneer of this was the National Iranian Oil Company (NIOC), which during the Shah's era developed a [crude pipeline](#) in Israel (the Trans-Israel Pipeline) and began a program to invest in refineries in foreign countries that would become "captive" buyers of its crude oil. The 1979 revolution ended these plans. Similarly, with the Kuwait Petroleum Company subsidiary, the Kuwait Foreign Petroleum Exploration Company (KUFPEC), [had plans](#) to invest in upstream assets overseas sufficient to offset domestic production in case of an invasion. These plans were never realized.

Asia's economic rise after the 1980s—and particularly China's entry onto the world stage post-1990s— attracted the attention of Middle East producers. For energy security reasons, Chinese buyers of crude oil attempted to source oil from Middle Eastern states such as Iran and Iraq, as well as Africa, Latin America, and the states of the former Soviet Union. Maintaining market share for large producers like Saudi Aramco has been a challenge. The desire to hold on to a sizable share of this rapidly growing market also dovetailed with Saudi Aramco's objective of increasing its yield from the entire crude oil value chain. Therefore, with the aim of becoming the world's largest energy company through its Accelerated Transformation Program, Saudi Aramco has been the most aggressive in building commercial relations with China and other Asian crude oil buyers.

Starting with investments in South Korea and Japan (as well as the United States and the Philippines), Saudi Aramco set its sights on building up significant assets in China following its initial investment in Fujian province. Its success has been limited due to Chinese NOCs' desire to maintain control over their own downstream sector. The Chinese NOCs have been forced to give up some control over their market to [the "teapot refiners" and the new rising independents](#) (the super large refiner/petchem companies) which has given Saudi Aramco a new entry point into this rapidly growing market. But an important factor in Saudi Aramco's limited success in China has been its reluctance to offer upstream access to Chinese NOCs in the oil area ([Sinopec was given acreage for gas exploration](#) and they failed to find any resources)—something they have sought but have been rebuffed. Given the recent aloofness of Chinese NOCs, Saudi Aramco has spent equal time in the last five years seeking to develop commercial [refining and petrochemical projects in other Asian countries](#) like Indonesia, Malaysia, Pakistan, and India.

Chinese and Russian Participation in the Middle East Oil and Gas Sector

Chinese NOCs' investments in the Middle East are important but do not point to a trend toward dominance or even prominence. In Iraq, China National Offshore Oil Corporation (CNOOC) has a technical services contract in the Missan oil fields while China National Petroleum Corporation (CNPC) plays an important role as low-cost supplier in partnership with BP in the Rumaila oil field.

CNPC partners with Total and Petronas in the Halfaya oil field and took a 25 percent stake in Iraq's West Qurna-1 field from ExxonMobil. Chinese NOC production in Iraq is material but it is not an indication of rising prominence in the region. In fact, in Iran, Chinese NOCs—which have access to large oil and gas fields and could have taken a strategic position in the sanctioned country—have pushed to suspend their operations due to U.S. pressure and fear of operational disruptions in North America and elsewhere. Chinese NOCs have also [reduced their purchases of Iranian crude oil](#) in compliance with U.S. sanctions.

Chinese and other Asian companies have also become important service providers for the oil and gas industries of the Middle East. Japanese and Korean companies paved the way for breaking the monopolies of the Western service providers, and in more recent times, Chinese and Indian firms have received [contracts from Middle Eastern NOCs and governments](#). Restrictions on U.S. service providers in Iran

allowed Chinese service companies to enter that country's oil and gas sector largely in tandem with Chinese NOCs becoming project developers. Chinese investment and financing have also played an important role in support of its service companies.

As for Russia, there are few commercial ties between Middle Eastern oil producers and its oil and gas companies. Middle Eastern producers, in general, viewed Russia as a competitor and were unfamiliar with the quality and prowess of the Russian NOCs. Nonetheless, Russian companies have achieved limited forays into the region's oil and gas sector. Lukoil was **one of the few** investors in the Saudi National Gas Initiative despite the difficult terms, but it failed to find serious quantities of gas in the kingdom. Lukoil also **took a position in Iraq** in West Qurna-2, and Rosneft, through its acquisition of Bashneft, came into Block 12 in Iraq. **Gazprom Neft is a partner in the development of the Badra field** in Iraq. In Iran, Gazprom and Lukoil have limited investments and have not taken advantage of the absence of Western firms.

More recently, Russian and Saudi Arabian cooperation in the OPEC arena has attracted much attention as a sign of growing strategic ties. Their cooperation in the OPEC-plus framework since late 2016 has endured perpetual skepticism over **Russia's compliance**, as well as an outright **price war** in spring 2020 that sent the oil market into a tailspin.

Looking forward, Russian relations in the Middle East may come under strain. President Vladimir Putin has attempted to broaden the relationship beyond narrow oil market management, leveraging Russia's growing geopolitical role in the Middle East's complicated politics. A number of oil-related **memorandums of understanding (MOUs) were signed** with Saudi Arabia and the UAE following Putin's visit there in October 2019. In Abu Dhabi, **Lukoil acquired** a 5 percent stake in the strategically important Ghasha offshore concession and signed a strategic framework agreement with Gazprom Neft on upstream, downstream, and technology cooperation. Beyond oil and gas, **Rosatom signed an MOU with the UAE Atomic Energy Corporation**. The Saudi Public Investment Fund (PIF) agreed to **acquire a stake in the Russian services company Novonet** from Rosnano, which was the first joint investment by RDIF, Saudi Aramco, and the PIF established in 2017. There were other investments agreed upon in the petrochemicals area. All in all, these are early days for Russian-Middle Eastern economic cooperation and vastly overshadowed by Russia's geopolitical stature in the region.

Chinese and Russian Policies Toward the Middle East and Objectives beyond the Oil and Gas Sector

Chinese foreign policy has three important components:

- Gaining and maintaining access to natural resource inputs for its huge industrial sector.
- Developing and diversifying global markets for its exports in a secure manner that discourages interference by other powers.
- Maintaining China's territorial integrity. Toward this end, it has aggressively readjusted borders (with India or in the South China Seas) or lobbied other countries since the 1970s to recognize mainland China over Taiwan as the rightful government of greater China.

Noninterference in its supply chain and territorial integrity is the closest thing to an "ideology" that underpins China's foreign policy. Even the Belt and Road Initiative (BRI), President Xi Jinping's signature global relations program that promotes the "Chinese development model" as an ideal over Western liberal democracy and human rights, is largely an economic program and conforms to China's strong belief in the noninterference in the affairs of sovereign states. **Top priorities** of the BRI—political coordination, facilities

connectivity, unimpeded trade, financial integration, and people-to-people bonds—are more about economic cooperation and support than political domination.

As for gaining security in various regions around the world, China largely depends on other powers. Notably, China is completely [dependent on the United States to secure safe passage of oil](#) through the Straits of Hormuz. The anti-piracy presence it maintains in the Arabian Sea is a [minor foray into maritime security](#) in relative terms to other countries, particularly the United States. The United States may call China a “free rider” in terms of security of supply in the region, but it is unlikely to invite it into some sort of joint policing mission. In fact, China has shown no interest or capacity to become a regional hegemon or a prop for local governments anywhere, even in the proximate states of Central Asia where it has increased security assistance. A good example of this is Venezuela. Chinese state institutions and oil companies have [provided \\$60 billion in loans](#) and are completely helpless if the government of President Nicolás Maduro fails. China would be dependent on the Russians for help in the event of a collapse in the government.

China does not have a grand plan for the Middle East even though its energy and economic dependence will grow over time. In its [Arab Policy Paper of 2016](#), it recognized that energy was the basis for interest in the region but also talked of developing infrastructure, trade, and other investments as well as assisting the region with alternative energy development. There was no mention of a political plan to support these economic objectives. While it regularly denounces the chaotic and disruptive U.S. policy in the region, it does not have a viable alternative other than calls for “collective security” initiatives.

China’s modus operandi is to stay as disengaged from regional politics as possible and carefully balance its relations and interests with all parties, or to remain on friendly terms with everyone and dodge all difficult subjects.

The partial withdrawal of the United States from the Middle East is a problem for China. Beijing understands that the Middle East is unlikely to magically return to harmony in the absence of the United States. Rather than trying to fill the void (for which it lacks the military and diplomatic capacity), it will try not to provoke the United States (note the Chinese companies’ compliance with the end to the waiver of oil sanctions) and then likely look to Putin for help and hope that his Middle East strategy will at least somewhat protect China’s interests. Beijing knows full well that these services will not come for free.

In the energy sphere, the entire focal point for China will be maintaining Middle East petroleum and market access with minimal provocation or disruption. Building [strategic stocks at home](#) has been accelerated to overcome short-term disruptions. Over the longer term, Beijing hopes that its BRI programs will have a material impact on the region and bring peace and stability through economic development. Also, it is likely that China will accelerate domestic energy policies to diversify away from oil and its dependency on the Middle East as much as it can—as difficult as that may be.

Russia’s overall foreign policy goals are to rebuild the international stature it lost after the collapse of the Soviet Union. It has had a hard time joining the global economic system other than as an important commodity producer. Putin’s attempts to restore order in the Russian oil and gas sector was instrumental in that regard. Since the Ukraine crisis and annexation of Crimea, Putin has been intent on reversing Western sanctions and using Russia’s leverage in various regions as a means to that end. The United States’ gradual withdrawal from the Middle East and its inability to oust the Maduro government in Venezuela has given Putin a number of opportunities. However, his aims are limited in line with his means.

Nonetheless, Russia’s regional power and political broker status have grown exponentially with a calculated policy of becoming both the preserver of the status quo and regime stability and a promoter of new

regional arrangements. This seemingly contradictory role came about as Russia became the lead figure in the critical triumvirate (along with Turkey and Iran) that controls the political future of the Assad regime in Syria. Russia's judicious and strategic use of force to save the regime has greatly revived Russia's regional geopolitical stature.

By saving the Assad regime, **it has made Iran totally dependent on it for military assistance**. Even Israel, a potent military player and regional power, has come to **“appreciate” Russia's role in Syria as a stabilizing force** and more importantly as a restraint on Iran. In fact, to a certain extent, **Russia “permits” Israel's attacks on Iranian forces in Syria** as a means to check a potentially overambitious Iran and the militias it controls. Russia has also **restrained Turkey from using unbridled force** to destroy Kurdish forces in Syria and brokered deals to **reintegrate parts of Syria under Kurdish control back under government control** and bring those Kurdish militias into the formal Syrian army.

Russia has leveraged its newfound political influence in the Middle East to demonstrate its strategic relevance to Europe with the aim of rolling back European diplomatic isolation and economic sanctions following its annexation of Crimea and dismemberment of Ukraine. Russia's success in crafting a political settlement in Syria is critically important for Europe because it could lead to the repatriation of sizable numbers of Syrian refugees—a phenomenon that harmed Europe's most powerful leader, Chancellor Angela Merkel, and bolstered anti-immigrant right-wing parties across the continent. As noted above, China also looks on Russia to protect its interests in the region through regime stability and brokering interstate rivalries.

Despite fiercely opposing the Assad regime, Saudi Arabia and other OPEC members in the region have seen the “reality on the ground” and acquiesced to Moscow's moves in the region. Yet while there have been some “oil deals” in the region for Russian companies, these do not point to the Russian oil companies gaining a strategic advantage over any other companies of any particular nationality. Middle East governments, particularly Saudi Arabia, will see Russia as a serious competitor in Asian markets and will likely deemphasize energy cooperation and access for other areas, such as military procurement or technology collaboration. Russia has certainly gained a place at the geopolitical table through its maneuverings in the region, but its companies have not gained access in any material way to the region's oil and gas resources. They will not become strategic players, and as we have seen since the 1970s, Russian companies will be treated like all the other companies of various nationalities—commercial, technical, or geopolitical tools to further the host government's objectives and priorities. ■

Fareed Mohamedi is managing director of SIA-Energy International.

This report is made possible by support from the Smith Richardson Foundation.

This report is produced by the Center for Strategic and International Studies (CSIS), a private, tax-exempt institution focusing on international public policy issues. Its research is nonpartisan and nonproprietary. CSIS does not take specific policy positions. Accordingly, all views, positions, and conclusions expressed in this publication should be understood to be solely those of the author(s).

© 2021 by the Center for Strategic and International Studies. All rights reserved.