

## SUMMARY - GULF ROUNDTABLE SERIES



## PARTICIPATING SCHOLARS

**Edward L. Morse** is the global head of commodities research at Citi Group. He is also a member of the international advisory board of the National Bank of Kuwait S.A.K. Morse has held similar positions in the past at several other companies. Morse also served as the head of energy at the U.S. Department of State and as a senior adviser to other government agencies on issues related to oil, natural gas, and the impact of financial flows on energy prices. He holds a Ph.D. in politics from Princeton University. ■

**David F. Gordon** is head of research and director of global macro analysis at Eurasia Group. Before joining Eurasia Group, Gordon had a long career in government including as the director of policy planning under Secretary of State Condoleezza Rice and in senior positions at the National Intelligence Council, the CIA's Office of Transitional Issues, the Overseas Development Council, the House Foreign Affairs Committee, and USAID. Gordon earned his Ph.D. in political science and economics from the University of Michigan. ■

## Unconventional Energy and the Future of the Gulf

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The geopolitics of oil in the Middle East is undergoing a transformation as significant as the aftermath of the 1970s oil embargo due to the rise of U.S. unconventional oil and gas. Edward L. Morse, global head of commodities research at Citi Group, argued that the growth of energy production in North America known as the “unconventionals revolution” is turning Middle Eastern oil producers away from a zero-sum mentality toward one that recognizes that their leverage in the future will be more limited. He spoke with David Gordon, head of research and director of global macro analysis at the Eurasia Group, at a CSIS Gulf Roundtable entitled “Unconventional Energy and the Future of the Gulf” on September 25, 2013. Gordon noted that the unconventional revolution has already had political effects in the region, but he also warned that it may not be long before new surprises in technical innovation upset current predictions.

Morse and Gordon both argued that the supply of energy will be robust in the coming decade and will likely outpace demand. Morse explained that U.S. and Canadian oil production has increased by more than 2 million barrels per day (bpd) since early 2011. The United States became a net exporter of petroleum products for the first time since 1949 in 2011. If current projects go through, the United States could become a major net exporter of LNG within the decade. Other oil- and gas-producing countries have spare capacity and prospects for new development as well.

Increasing production will help lower the risk of shocks, argued Morse, though Gordon cautioned that the context of Middle Eastern instability will counter some supply-side optimism and will stand in the way of downward pressure on prices. This effect is already at work: after turmoil began in Libya in 2011, prices went up about \$20 per barrel but have stayed relatively stable since then. Viewed from a different lens, one political effect of the unconventional revolution is that it has offset the potentially destabilizing effects of dramatic production drops on global markets and prices. Iran's production and exports have declined significantly over the past two years due to sanctions, Gordon noted, yet market prices have not increased dramatically, in part because of additional supplies that entered the market and in part due to lower demand than expected. This price stability helped sustain broader international political will to impose

## THE GULF ROUNDTABLE SERIES

The CSIS Middle East Program launched the Gulf Roundtable in April 2007 to examine the strategic importance of a broad range of social, political, and economic trends in the Gulf region and to identify opportunities for constructive U.S. engagement. The roundtable defines the Gulf as the United Arab Emirates, Saudi Arabia, Oman, Qatar, Bahrain, Kuwait, Iraq, and Iran. The roundtable convenes monthly, assembling a diverse group of regional experts, policymakers, academics, and business leaders seeking to build a greater understanding of the complexities of the region. Topics for discussion include the role of Islamist movements in politics, the war on terror, democratization and the limits of civil society, the strategic importance of Gulf energy, media trends, trade liberalization, and prospects for greater regional integration. The Gulf Roundtable series is made possible in part through the generous support of the Embassy of the United Arab Emirates. ■

sanctions and maintain them. Unconventionals have also helped maintain price stability during Libya's continued production decline.

Growing non-OPEC production will weaken OPEC's ability to act as a cartel, Gordon argued. It will also change power dynamics between international oil companies (IOCs) and oil-producing countries' governments: there will be competition to see who can bring new sources to the market most quickly, and with far more geographies in play, the owners of capital and technology will have more leverage over the sovereigns with whom they sign contracts. Energy in the ground that had assumed value before, Gordon noted, now loses value because the future demand for oil is so uncertain.

Despite regional tensions, Morse and Gordon agreed that the GCC countries in particular are more stable than many give them credit for. A good predictor of stability is optimism about the future, and that optimism is still relatively high in these countries, according to Gordon. The biggest looming challenge is the fiscal environment, as the oil prices required for government budgets to break even have risen. Morse stated that he had more optimism about small Gulf states' ability to restructure themselves than about larger ones, such as Saudi Arabia. But even Saudi Arabia can stem the growth of its domestic energy demand by raising prices, and it can address labor issues by reducing the size of its expatriate population and instituting a minimum wage, building on recent labor reform efforts.

In contrast, Iraq is a less rosy case. With rising energy production globally, energy markets need Iraq less than expected. The IOCs that chose to go into Iraq a few years ago under uncertain conditions have fewer incentives to accept Iraq's high-risk environment and now have more options for where they could invest and produce. This dynamic creates a self-fulfilling trajectory: because global markets are not dependent on higher Iraqi production, external actors are less likely to invest in boosting Iraqi production and help Iraq achieve broader political stability.

Energy is not the only driver of U.S. engagement in the Gulf, but the unconventional revolution reinforces other trends in U.S. foreign policy that might lead to different engagement in the region, Gordon argued. The United States is willing to live with greater instability in the Middle East than it would have tolerated in the past because its booming production makes it less reliant on energy from the Gulf. Energy self-sufficiency amplifies the increasing skepticism toward using military force in the Middle East and percep-

tions of the need to shift orientation to the Asia-Pacific. The United States will not pull back dramatically, because it must guarantee the security and stability of global energy markets. Nonetheless, it is likely that U.S. forces will focus more on guarding against catastrophic risk than on seeking to shape the security environment in the Gulf moving forward. The Middle East is likely to remain a region dominated by conflict, particularly between Shi'ite and Sunni powers—especially Iran and the Arab Gulf states.

The unconventional revolution creates some ambiguities for China, which seeks to diversify its sources of energy through access to North American unconventional oil and gas. The strategic priority of importing North American unconventional supersedes China's interest in broadening its influence in Central Asia and the Middle East, where China perceives more threats and instability. Rising U.S. energy exports create the potential for U.S. leverage over China on a broader set of bilateral issues. A positive outcome would be greater Chinese engagement with the United States and with U.S. companies, along with an informal deal linking assurances of Chinese restraint in Asia to assurances of the security of China's energy imports from the Gulf and North America. ■

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