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ENERGY, THE ECONOMY, AND GEOPOLITICS IN THE GULF ARAB STATES

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For decades, no set of countries has played a more important role on the global energy stage than the Gulf Arab states. Within the Gulf region, few periods have brought more dynamism or greater expectations of change than the one in which we currently live. The Gulf Arab states are witnessing a time of new policy departures, challenging security and political dynamics, and, some would say, fundamental reorientations. New energy relationships, new technologies, new social norms, new economic priorities, and new geopolitical influences are all making themselves felt in everyday life.

On March 1–2, 2018, the Center on Global Energy Policy hosted its third annual workshop focusing on the Gulf Arab states. A public panel discussion on the topics raised in the workshop occurred on March 1, and a video recording of this public panel discussion is available here. The workshop itself, which took place at Columbia University's New York City campus on March 2, was conducted on a nonattribution basis under the Chatham House Rule. The Center on Global Energy Policy is grateful for sponsorship support from Citi and the Kuwait Foundation for the Advancement of Science. The following summary highlights the main points that arose during the course of the workshop.

GLOBAL OIL MARKET RETURNS TO BALANCE

The workshop started with an assessment of the global oil market, a conversation that conveyed a much greater sense of optimism on the part of producers than the one seen in the last two-plus years. One person remarked that despite a number of persistent risks, the global oil market has returned to balance, and the ability of the Organization of the Petroleum Exporting Countries (OPEC) to execute and sustain production cuts is no longer a subject of doubt.

Views differed over the extent and potential longevity of the market rebalance. Some speakers expressed the sentiment that the production constraints introduced by the OPEC-plus group—especially Saudi Arabia and the Russian Federation—had fundamentally altered the psychology and reality of the market. Others noted that firmer prices were driving production growth, especially in the United States, where 2017 had resulted in an increase of well over one million barrels per day, with predictions for 2018 growth also exceeding one million barrels per day. One participant noted that practically all incremental US crude oil production—and about half of the incremental natural gas liquids volumes—is directed to the export market, which is a growing concern for the OPEC and non-OPEC producer group, as the US barrels increasingly compete with the group's exports in overseas markets, particularly in Asia. The Permian shale play has accounted for the vast majority of production growth during the latest upturn, while other areas in the Eagle Ford, Bakken, and offshore Gulf of Mexico have seen more measured growth. Moreover, beyond the shale plays there is also optimism about potential global supply growth. The cost structure and development time line of deepwater offshore projects have improved significantly, and major developers have grown more effective at squeezing incremental production from existing projects.

Not all the signals point in the direction of marked increases in global production, however. A number of countries represent risk factors with regard to global oil supply, including Venezuela, Nigeria, Libya, Iran, and Iraq, where disruptions are thought to be plausible. Within the main US shale plays, a number of factors can also be expected to constrain production growth—from a growing scarcity of high-performance rigs, fracking fleets, and experienced crews to emerging infrastructure constraints in the Permian and reduced free cash flows as a result of greater higher dividends and various share buyback schemes.

On the demand side of the equation, although everyone sees the potential for downward pressure on demand from new technologies as well as policy responses to climate change, all highlighted the robustness of recent oil demand. Growth in global trade promises to amplify this trend, but protectionist policies now emerging in a number of countries, including the United States, were viewed as posing a significant threat to global economic growth and thus to oil demand.

Despite extensive popular discussion about a coming peak in global oil consumption, most of the workshop participants see indications of persistent demand for now—and the possibility of secondary effects such as demand rebound as a result of improvements in oil efficiency, offsetting demand reductions. High-sulfur fuel oil that may be crowded out of marine transportation by impending environmental regulations could become price competitive in other uses such as power generation in the Middle East or elsewhere. "The barrels don't just disappear," one speaker noted.

CHANGING POLITICS OF THE GULF—NEW OUTSIDE RELATIONSHIPS AND TENSIONS INSIDE THE GULF REGION

Political developments within the Gulf were seen as having grown much more confrontational in the past year, with open splits separating Qatar from other members of the Gulf Cooperation Council (GCC) and heightened competition between Saudi Arabia and Iran. Another point of agreement centered around the potential for new political, economic, and even security relationships. China seeks to be friends with everyone in the Gulf, one commentator noted, and Russia is trying to strengthen its own influence, to the detriment of the United States. Also shared was the view that the new leadership of the Saudi crown prince, His Royal Highness Mohammed bin Salman (MBS), has introduced significant changes in the declared priorities, social policies, and political relationships that the Kingdom pursues with Gulf neighbors and distant partners alike.

One core topic of debate was whether the new policies of Saudi Arabia under MBS will succeed in charting a sustained new course for the Kingdom. Some highlighted the new policies as a case of the Kingdom's working to "carry its own weight" in terms of security interests, to diversify its economy, and to make its society more modern and less corrupt. Others wondered aloud where the Kingdom is headed after the arrests of influential clerics, businesspeople, and even members of the royal family.

Another topic that elicited vigorous debate was whether the United States has withdrawn or reduced its attention to the Gulf Arab states. Many asserted that such a change has occurred, although one speaker noted that with 65,000 US military service members stationed in the region, few Americans could be persuaded that the United States has withdrawn.

Another topic that elicited a range of views was the extent to which the new tensions in the Gulf were a recent phenomenon or just the latest manifestation of antipathies that date back to the 1990s or even to the 19th century. Some speakers termed Iran an existential threat to Saudi Arabia, which meant that changed policies on the part of Qatar toward Iran are an unavoidable prerequisite for a reduction in tensions. Others said that Tehran has simply taken opportunistic advantage of missteps in the Gulf by others, including the United States.

Opinions also differed significantly on whether there is a useful future for the GCC, whose members currently see the politics of the Gulf in divergent forms. Some suggested that what lies ahead is a cold war among the GCC countries. Others regarded this as an exaggerated scenario; instead, as often happened in the past, economics would prevail over politics. Just as the Dolphin natural gas pipeline connecting Qatar and the United Arab Emirates has operated in spite of the recent political tensions, so too would GCC economic collaboration regain momentum and facilitate political rapprochement.

ECONOMIC REFORMS BRING AMBITION AND UNCERTAINTY TO THE GULF

The period from 2015 to 2016 were years characterized by low oil prices and extremely difficult deficit spending for the Gulf Arab states. Now, after a gradual price recovery through much of 2017 and the first quarter of 2018, those states are addressing the economic aftermath. Some of the Gulf states face particular challenges to restore fiscal surpluses, especially Oman, Bahrain, and Saudi Arabia. To many decision makers in the Gulf, it has become clear that old economic growth models are inadequate—too dependent on oil sector profits, government-dominated employment, subsidized services, and top-down economic opportunity.

As a result of the oil market downturn, the aggregate fiscal position of the Gulf Arab states had swung from a 10 percent surplus in 2014 to a 12 percent deficit or more at present. This massive worsening of the region's macroeconomy made clear that possible economic reforms, which have long been debated in the region, needed to be put in motion. Consequently, value-added taxes (VATs) have been introduced in Saudi Arabia and the United Arab Emirates; other Gulf states may institute taxes in the coming period. Reductions in energy subsidies have been implemented with relatively little controversy.

Not everything has gone smoothly, of course. In the case of Saudi Arabia, for example, many noted that implementation of the very ambitious National Transformation Plan is complicated by the relative weakness of institutional capacity and a lack of delivery mechanisms. Other challenges arise from difficulties surrounding internal coordination inside the Saudi government and external communication of priorities and time lines. In particular, these challenges were having the effect of slowing growth in the Saudi non-oil economy, a stated target for the new economy. On the other hand, a new sense of accountability is starting to be seen in Saudi government ministries, where technocratic leadership and transparency are being emphasized.

In Saudi Arabia's energy sector, a great deal of change is underway. The Kingdom has reengaged in oil diplomacy with the goal of fostering greater stability of oil prices. Wasteful domestic energy use is under attack through a broad-gauged energy efficiency program that is already achieving savings of 140,000 barrels per day. Utility prices have been adjusted, with special assistance being provided to households least able to pay higher prices and to certain industrial consumers. Renewable energy sources are being developed in order to maximize oil exports. Energy policy formulation in the Kingdom is also being restructured to be more unified and system oriented rather than fractured among oil, natural gas, electricity, and other subsectors.

NEW STRATEGIES FOR NATIONAL OIL COMPANIES AND SOVEREIGN WEALTH FUNDS

The year 2018 started with what one participant dubbed “the return of OPEC.” But this fact does not equate to a return to traditional standard operating procedures in the Gulf Arab states’ national oil companies (NOCs) and sovereign wealth funds (SWFs). Instead, the NOCs are focusing on streamlining their operations, selecting priorities with care, and making strategic investments for an uncertain future. Meanwhile, SWFs are building partnerships around the globe, especially in industries where sustained growth can be expected.

Many commentators noted that Saudi Aramco, the Abu Dhabi National Oil Company (ADNOC), the Kuwait Petroleum Company, and other NOCs are focusing carefully on the need to invest wisely. Corporate transformation is a top priority in some of the companies, with new approaches being employed with regard to their investment portfolios, business systems, technology, and local content. Capital expenditure programs are extremely strong in the case of some NOCs, while other companies have elected to privatize certain downstream functions in order to redeploy cash to higher value-added opportunities.

SWFs are looking for partnerships around the globe, with Asian destinations providing natural areas for growth. Top-tier SWFs are investing in energy, but they are also pursuing diversified opportunities in sectors such as health care, chemicals, and technology. A challenge for many in the Gulf Arab states is the question of whether downstream diversification along the oil value chain represents “the old economy” and whether peak oil demand is real or illusory. Several participants stressed the importance of investing in natural gas development, LNG capacity, and downstream industries, including refining and petrochemicals. A unifying point that resonated throughout the final session of the workshop was the importance of careful strategies for the NOCs and SWFs across the Gulf Arab states.

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