The Brave New World of Ample Oil

BY TILAK K. DOSHI

In the oil universe, the September 14th attack on Saudi Aramco's oil facilities is comparable to the 9/11 attacks on the twin towers in New York City. Yet, the taking out of half of the Kingdom's oil output led not to an oil shock but a whimper. Barely two weeks after the brazen attack, oil headlines were once again dominated by fears of over-supply and falling prices amidst a slowing global economy. Following an initial 20% intra-day price surge after the attack, the benchmark Brent crude oil price quickly retraced its steps back down to pre-attack levels.

The US oil production surge benefits Asia

The shift from a perceived world of oil scarcity to abundance has been brought about in an astonishingly short period of time by the advent of the "fracking" revolution in the US. This combines horizontal drilling and hydraulically-fracturing shale rock with high-pressure liquids to extract "unconventional" oil and gas. In the past decade, US crude oil production more than doubled. By mid-2019, US production was rated at over 12 million b/d, surpassing Russian and Saudi Arabian output as the world's largest.[1]

Academic studies suggest that global oil prices would have been higher by $10 to $50 per barrel higher if there had not been a fracking boom in the US. Given the scales involved, even with conservative estimates on the price impact, the US upsurge in unconventional oil production has probably led to the biggest transfer of wealth in history.[2] Largely at the cost of reduced oil revenues to OPEC and Russia, benefits have primarily flowed to the world's largest oil markets in the US, China, India, Japan and South Korea as well as the US unconventional oil producers.

From what was previously expected to be an inevitable growing dependence on Middle Eastern supplies, Asian oil refiners are now spoilt for choice. With Europe's long-declining oil demand trends, crude oil exports from the Russian Far East, West Africa and Latin America to Asian markets compete with the traditional large exporters of the Middle East. While the majority of Asian crude imports are still sourced in the Middle East, prices are set at the margin by competing crudes from other regions including the US.

Middle East imperatives for economic reform

While the US fracking revolution has benefited Asia's crude oil importers, it has burdened the Middle East oil producers. The Gulf states had built up extensive welfare states utilizing massive oil revenues to support social security, health, education and government employment programs. The social upheavals since the Arab Spring in 2010 led the Gulf states to further expand the social support programs to maintain their implicit social contracts with their citizens.

In 2015, the fiscal break-even oil price for Saudi Arabia – that is the oil price at which the government budget is balanced -- was estimated by the IMF to be $94.25/barrel while the reference "OPEC basket price" had plummeted to $49.50/barrel.[3] The situation since has generally been one of increased government spending, low economic growth and recurring budget deficits. [4]

The Gulf Arab states are reaching their limits of tolerance to declining oil export revenues. Low oil prices make the imperative of economic reforms and industrial diversification a central concern for the Gulf "rentier" oil states. The risks of a collapse in the social contract between the ruling regimes and their peoples in the Gulf region may be remote for now. The spectre of growing populations, unemployed youth and persistent budget deficits, however, will increasingly concentrate the minds of its planners and palace advisers.

Oil geopolitics upended

Ever since the historic meeting of Saudi Arabia's King Abdul Aziz (Ibn Saud) with US President Franklin D. Roosevelt on a warship cruiser in the Suez Canal in 1945, the quid pro quo of the strategic relations between the two nations has been clear: while the Saudis assured the Western world access to its oil exports, the US served as the security umbrella for the Kingdom. With its new-found unconventional oil and gas resources, the US is no more the energy supplicant in this relationship. 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.

In the age of US-led oil abundance, conventional notions of geopolitical risk and perceptions of energy security have been upended. By effectively making the US the "swing" producer in global oil markets, the

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See footnotes at end of text.