In his commentary on part III, Abdullah bin Hamad Al-Attiyah, Qatar’s deputy prime minister and former minister of energy and industry, argues that his country’s collaborative model of hydrocarbon development will be essential as global markets respond to expected demand increases for oil and gas worldwide. He notes that producers and consumers will have to work together to ensure that natural gas and oil prices are sufficient to sustain long-term investment. He expresses more optimism than Mohamedi with regard to the ability of Egypt, Libya, and Algeria to create conditions necessary to facilitate high levels of foreign investment. Al-Attiyah also strikes a comparatively optimistic note on Iraq, saying that the country may have the capacity to overcome the immense challenges it faces and maximize its potential. Yet he shares West’s and Alkadiri’s view that the Middle East faces high levels of uncertainty and risk, concurring with them that instability in Iran and Syria has the potential to spill over into the broader region with serious consequences. Al-Attiyah concludes by positively assessing US engagement throughout all these regions, predicting that such engagement will endure and, in doing so, contribute to a safer, more secure world for producers and consumers alike.

Chapter 10

Iraq, Iran, and the Gulf Region

J. Robinson West and Raad Alkadiri

Why the Middle East Still Matters for the United States

As the largest oil-producing region on Earth, the Middle East has for decades been a central focus of US foreign and energy policy. Ensuring secure and uninterrupted flows of crude oil to the United States and its allies has been a key strategic tenet of US policy since the Second World War. It has underpinned a longstanding security doctrine involving a large-scale US military presence in the Arabian (Persian) Gulf and drawing US troops directly into two wars in the past 20 years, including the lengthy presence in Iraq. This is not to suggest that Washington’s policies toward the Middle East are or have ever been driven by oil concerns alone, as some conspiracists have argued. Nevertheless, protecting the region’s rich energy resources has been a major reason successive US administrations have dedicated so much strategic attention to the Middle East.

As the second decade of the 21st century begins, however, there are signs of a shift in US energy and foreign policy. The development of massive
unconventional oil and gas resources in North America has given rise to a sense of greater energy independence in the minds of US policy-makers and the public at large. On a geostrategic level, a combination of fiscal pressures at home and the inexorable rise of China abroad is moving the focus of US attention eastward, beyond the Middle East. The pivot of US foreign and defense strategy toward Asia has been a long time in the making, but the signs—both economic and strategic—are unmistakable. Indeed, this pivot was explicit in the early days of George W. Bush’s administration in 2001, only for US attention and resources to be diverted back to the Middle East by the tragedy of September 11.

However, although the Middle East may move down the list of Washington’s strategic priorities over the course of the coming decades, developments in the region will remain important to US energy and foreign policy-makers for some time to come for three basic reasons. First, energy independence is a chimera that makes for good political rhetoric but that will be difficult to achieve in the United States absent a major change in the country’s demand profile. Rising production from unconventional resources in North America and the eventual construction of the necessary pipeline infrastructure to transport those resources to key domestic markets will certainly lessen US reliance on foreign energy sources and will alter the map of global energy flows significantly. But even the most optimistic forecasts do not anticipate the United States being import free over the next decade. US dependence on foreign sources is anticipated to decline from 70 percent in 2007 to about 20 percent of demand by 2020, if imports from Canada are included as domestic production. Indeed, the irony of the situation at present is that the development of North American resources has led to a rise in crude oil imports from the Middle East because of refinery configurations and crude quality differences in certain parts of the United States.

Second, even though the United States will rely more on locally produced oil, crude oil is a globally priced, fungible commodity. Geography will have some effect on price, but not to the extent witnessed in the gas sector, where regional markets are more detached, resulting in a significant decline in local prices because of the upsurge of US production, even as prices elsewhere in the world remain higher. Consequently, although the United States may eventually rely less on oil from the Middle East, the US economy will remain vulnerable to any events there that disrupt supplies from the region and thereby drive global prices up. Ensuring the flow of crude oil from the Middle East may therefore be less of a direct economic imperative for Washington in the future, but the United States cannot buffer itself entirely from the impact of events there. Ensuring stability in the region is of economic importance to Washington and will necessitate continued engagement.

Third, the United States remains the world’s only global superpower, and none of its long-term rivals, not even China, is showing any desire to fill that role. Washington’s influence in the Middle East may have waned over the past decade, partly because of policy missteps associated with the Iraq War and partly because of economic weakness in the wake of the Great Recession, placing greater onus on regional powers to manage stability in their midst. Nevertheless, US disengagement is not an option, nor is it one that Washington would seriously consider. For all the talk of a pivot to Asia and the realignment of forces that are accompanying it, the US determination to play a global role in shaping international politics—and the realities of its unique military might—will keep the Middle East on the agenda for a long time to come.

Indeed, the policy challenges associated with the Middle East and the risk of resource disruption may become more acute over the next decade. Longstanding problems—such as the Arab–Israeli conflict, Iran’s nuclear program, and the threat of nuclear weapons proliferation—continue to fester and will not get easier over time. More important, however, the region is in the midst of a major upheaval that began with the overthrow of a number of authoritarian regimes with the Arab Spring but could end up transforming the political and geographic boundaries of the region in a manner not seen for a century. Events in Syria will be a particularly critical factor determining the evolution of the Middle East over the next decade. Violence there is already spilling over into neighboring states, and regional powers, including Turkey, Iran, and Saudi Arabia, are looking warily at what the fall of the Bashar Al-Assad regime in Damascus could mean for the regional balance of power. Thus, the Syrian civil war is bound to be disruptive. It will shape not just stability in the Middle East but also the region’s oil and gas production potential in the medium term by bringing regional rivals into conflict and possibly even forcing a redrawing of regional borders. These factors raise the possibility of significant disruptions to energy flows, with all the concomitant price and economic implications.

The Iranian Wild Card

The most immediate potential threat to stability in the Middle East is the impasse between Tehran and the international community over Iran’s nu-
clear program. The refusal of the Islamic Republic to accept United Nations Security Council–mandated restrictions on the program and its failure to disclose the extent of its activities to the satisfaction of international inspectors have led to growing fears of military action against Iran, spearheaded by either Israel or the United States, to destroy Iran’s nuclear weapons capacity. In reality, the immediate prospect of an attack against Iran is exaggerated, despite persistent rhetoric: Israel cannot do it on its own, and the United States has no appetite for preemptive action that risks catastrophic escalation in the region unless there is no other option. Entering its second term, the Obama administration in Washington has signaled that, although its patience with Iran is not limitless, it prefers to continue with its carrot-and-stick approach—ratcheting up sanctions while seeking to reach a grand negotiated bargain that would severely limit Iran’s nuclear program for the future.

This strategy has adopted a significant economic tool that can be used not just on Iran but also, indirectly, on the global economy. In Iran, sanctions and restrictions on financial flows have driven up inflation and undermined growth in the nonoil sector. The rapid collapse in the value of the rial in the autumn of 2012, although prompted by a planned devaluation of the currency, illustrates the difficulty of managing an even more isolated economy and eroding consumer confidence. But it also suggests that Iranian leaders are preparing contingencies for the long haul: they are seeking to reduce imports and extend the cover provided by what are still relatively healthy foreign reserves. This approach will undoubtedly contribute to popular dissatisfaction with the regime, but it is a policy that has worked in the past.

Sanctions on Iran have also had an impact on the global economy, although it has been nowhere near as deleterious as the domestic consequences. The fear of possible military action has introduced a war premium on oil prices that will persist in the market as long as the crisis remains unresolved and will certainly rise much higher—at least temporarily—if an attack on Iran does take place. More important in the longer term, steadily tougher international sanctions, especially the European Union’s embargo on crude imports from Iran and ever-tightening financial restrictions, have blocked investment in the country’s oil and gas industry and significantly reduced Iranian oil exports to around 1.0 million barrels per day (mb/d) from a preembargo level of 2.2 mb/d. These losses have not been disastrous so far: global demand growth remains relatively muted, and rising production from Saudi Arabia and key Gulf states, as well from sources outside the Organization of the Petroleum Exporting Countries (OPEC), have made up for the shortfall in Iranian exports. But these losses have put clear upward pressure on oil prices, as well as tightening the supply–demand picture globally as OPEC spare capacity (especially in Saudi Arabia) has declined.

This picture is unlikely to change any time soon. Absent regime change in Iran, Tehran is likely to remain defiant. This defiance is not simply a matter of national pride, although Iranian leaders insist that the nuclear program is civilian and, therefore, legitimate; it also reflects Iran’s own security fears and the conviction of Iranian leaders that the real goal of the United States and US allies is to remove the current regime. Under these circumstances, reaching a compromise on the substance and sequencing of any deal will be very difficult, even assuming that achieving nuclear breakout capability is not Tehran’s real objective. Bridging the gap between the international community’s and Tehran’s perceptions and introducing mutually acceptable confidence-building measures that provide a pathway to a long-term agreement have proved impossible so far, and there is little to suggest that such efforts will get any easier.

That does not mean, at least at this writing, that war is imminent. For all the rhetoric, Western intelligence agencies do not seem convinced that Iran is about to build its first nuclear bomb. But as time passes and the status quo prevails, the threat of military action will inevitably rise, with all the risks associated for energy supplies. Not merely will strikes threaten Iran’s own production, but also Iranian retaliation will reduce exports from other regional producers: 17.0 mb/d of crude and product pass through the Strait of Hormuz,7 which Tehran has threatened to block in the event of an attack. Its ability to do so will be limited by the international community’s determination to open the strait within days, but even a temporary blockade would cause a massive spike in oil prices. Over the longer term, Tehran may respond through asymmetric warfare, targeting production on the Arab side of the Gulf. The failed terrorist attack against Saudi facilities at Abqaiq in February 2006 and the cyber attack against Saudi Aramco in 2012 are sobering reminders of the potential vulnerability of oil and gas infrastructure in the region.

But at the same time, factors that could reduce the risk of confrontation may alter the status quo—notably political change in Iran. The regime’s response to postelection demonstrations in 2009 illustrated Tehran’s still significant capacity to quash domestic dissent, and the Arab Spring offers reminders of the cost of failure. Nevertheless, time may do what the protec-
tors could not and alter the character of the regime in a material way. The biggest wild card in Iran is not the nuclear program, but rather the longevity of its leader, Ayatollah Ali Khamenei, and the implications his eventual death will have on the sustainability of the current regime. Undoubtedly, a host of players have a vested interest in perpetuating the current system, but Khamenei and his allies have through their repression undermined the legitimacy of the regime and narrowed its base. And in taking sides so clearly in the domestic unrest, Khamenei debase the authority of the Office of the Supreme Leader and with it the credibility of the vilayat-e faqih (or rule of the jurisprudent) system of government that was established by his predecessor, Ayatollah Ruhollah Khomeini, who led the 1979 revolution. The Iranian regime managed to avoid a crisis of legitimacy on Khomeini’s death in 1989, but Khamenei’s passing is likely to bring no such reprieve. What follows will look significantly different from the regime that exists today. It will usher in a period of uncertain—and probably violent—transition, given the hold of the Revolutionary Guard and other security forces, but the prospects for a Persian Spring will rise significantly in the medium term.

Although this transition might reduce tensions in the Gulf and ease pressure on oil prices, whether it will automatically bolster energy supplies from Iran is not clear. Any successor regime will have to deal with the consequences of years of sanctions on the oil and gas sector. Foreign investment may flow again, but the damage has already been inflicted on the resource base through a mixture of mismanagement and the forced shut-in of production that will not easily be recovered. PFC Energy estimates that Iran’s production capacity has declined by around 0.5 mmbpd as a result of sanctions, and that decline will only grow as the embargo on the Iranian oil and gas sector tightens. Iran may well recover some of this capacity through investment and new technology, but such improvements will take time. Consequently, hopes that a political resolution will lead to the rapid restoration of Iran’s output potential appear fanciful at best.

Iraq: Between Potential and Reality

Indeed, a pertinent example of the potential gap between hopes and reality in the midst of political transition lies immediately to Iran’s west. The overthrow of Saddam Hussein’s regime in Iraq in 2003 prompted optimistic forecasts of the speed and scale at which the country’s oil produc-

tion would increase. Immediate postwar estimates imagined rapid output expansion, delivered in part by foreign investment in the sector; 6 mmbpd within six years was regarded as an achievable target.

The reality has been much more disappointing. Iraqi production did not consistently reach prewar highs until January 2011. The sector was not opened up to foreign investment until 2009, and even then on only a very limited basis. Moreover, it has quickly become apparent that the production forecasts associated with this investment (almost 12 mmbpd by the end of 2017) are entirely unachievable. If Iraq is able to reach half that figure, it will be a major achievement, especially in light of waning investor appetite.

Ultimately, four factors will determine just how much oil Iraq produces in the next decade. The first is whether sufficient onshore infrastructure (including water injection facilities) can be built to ensure the production and transport of rising volumes of crude. Significant pipeline, storage, and pumping capacity bottlenecks still exist in the south of the country that will limit output potential unless addressed quickly, not just because of immediate transport constraints but also because international companies will be even more reticent to invest the necessary sums to ensure that their projects reach maximum potential.

Whether this situation is reversed is linked to the second factor—namely, whether the Iraqi government improves its decision-making processes, bringing them in line with the terms of the technical service agreements it has signed. Thus far, Baghdad has struggled to meet its responsibilities, not just on the infrastructure side but also through the facilitation of procurement and remuneration. Moreover, its planning assumptions, in terms of both cost and time, have been out of touch with reality, leading to additional delays. These factors, combined with payment delinquency and endless bureaucratic red tape, have undermined the economics of the contracts signed and have been instrumental in convincing companies such as Statoil to divest their stakes in southern projects, while others have slowed down their intended pace of investment.

This situation is unlikely to improve unless the third factor can be addressed—namely, the human resource constraints faced by Baghdad. Years of war and sanctions have led to a toxic mix of isolation and brain drain, robbing Iraq of actual and potential expertise. Reversing this situation will take as much as a generation, thus making the schedule that Baghdad set in 2009 appear even more unrealistic. Irrespective of recent gains in production, which have taken output to historic highs, if Iraq is to keep increasing its
output over the next decade, it will have to find a way to compensate for its weak human resources. That effort will almost certainly require the government to alter its investment model to reduce the state’s role in the program.

This change does not look feasible because of the fourth and arguably the most overriding factor: the fractious and divisive political situation in the country. Political polarization has risen steadily as critical disputes, particularly over federalism and power sharing, remain unresolved. The resulting turmoil has paralyzed effective decision-making, thus keeping the government from introducing major new initiatives or reforming existing institutions and procedures. Political power and survival is the name of the game, with all factions viewing issues through a damaging and very short-term zero-sum lens.

In this context, the government will find altering the investment framework for the oil and gas sector very difficult. Not only does resource nationalist sentiment remain strong, but also senior government officials fear that their rivals will use any revamp of the investment framework against them, even if it contributes to increased production in the longer term. Moreover, the gradual politicization of ministries over the past decade—turning them into what amounts to political fiefdoms—makes the process of intergovernmental coordination, which is necessary to improve the investment environment, more difficult. The most determined opponents of Prime Minister Nouri al Maliki are also his partners in coalition government, and none of them has any interest in making his policies succeed. Absent the overwhelming victory of one faction in future elections or acknowledgment that broad coalition government is not effective, this situation will persist irrespective of who leads Iraq.

Under these circumstances, the dangers to Iraq’s oil production prospects are not merely operational or investment related. Instead, the viability of the state in its present form is increasingly coming into question as inter-factional tensions rise and the government fails to deliver basic services. The most dangerous immediate schism is between the federal government in Baghdad and the Kurdistan Regional Government (KRG) in Irbil. Relations between the two sides have witnessed a dangerous deterioration as personal antipathy has added fuel to the fire of disputes over their rival interpretations of federalism. For the Kurds, anything more than a weak confederal system composed of multiple regional administrations (rather than just an Arab and a Kurdish one) is anathema; any alternative—other than outright independence—is seen as an eventual existential threat. For most Arab parties, this division is regarded as a threat to the territorial in-

tegrity of Iraq, which they suspect is Irbil’s long-term goal. Maliki may be more vociferous than others in insisting that Baghdad’s sovereignty must be preserved, but his Arab rivals—both Shia and Sunni—share his opinion. For some Sunnis, greater decentralization of power from Baghdad is seen as an attractive but temporary option until they can find a way of restoring their authority over the central government.

As this seemingly intractable dispute becomes more intertwined with factional and personal rivalries, the risk that it will prompt renewed inter-communal conflict is increasing. Recent spikes in violence have prompted fears that Iraq is returning to the type of civil war that raged between 2005 and 2008. This is still a possibility, but a more likely scenario in the medium term is that localized conflagrations, provoked by disputes over territory, spark intercommunal tensions. Repeated standoffs between the Iraqi Army and Kurdish Peshmerga forces in disputed territories have so far been resolved peacefully, but the risk of a violent clash keeps rising, especially in the absence of the calming presence of US forces as a buffer between the two. Similarly, tension has risen along fault lines between Sunni and Shia communities in Iraq. Meanwhile, regional events—especially the civil war in Syria—are altering the calculations of different Iraqi factions, prompting greater rigidity as a result of either perceived risk or perceived opportunity.

Syria and the Threat of Regional Conflict

Indeed, spillover from the collapse of the regime in Syria—and the way it shapes the perceptions of both Iraqi factions and the governments of neighboring states—may be the single most important influence on stability in Iraq over the next decade. It is shaping the energy picture along with everything else—particularly in the case of the Kurdistan region of Iraq. The civil war to Iraq’s west has convinced some factions—notably the Kurdistan Democratic Party (KDP), which dominates the KRG—that their aspirations for greater autonomy (and eventual independence) are increasingly achievable. The emergence of a Kurdish enclave in Syria not only is an opportunity to extend the Irbil government’s regional influence but also heralds the possibility that the KRG will not be the only autonomous Kurdish entity in the Middle East. For KDP leaders, including Masoud Barzani, president of the KRG, the establishment of another statelet modeled on the Irbil administration would provide a useful ally. More important, it would further enshrine the concept of ethnic identity as the basis for quasi-state
formation in the Middle East, which Barzani and the KRG are likely to interpret as a major steppingstone to eventual Kurdish independence.

Whether Barzani and the KRG can achieve this age-old dream will be closely linked to oil and gas developments in Kurdistan—critically whether the regional government is able to develop export routes independent of the federal administration in Baghdad. Optimism about Kurdistan’s production potential is high (local authorities estimate output in 2015 to be as much as 1 mbpd), and the contractual terms are attracting the world’s largest oil and gas companies despite punitive threats from Baghdad. But absent independent export routes, Irbil will remain reliant on Iraqi government-controlled pipelines through Turkey to get its oil and gas to market, leaving the KRG—and its investors—at Baghdad’s mercy fiscally. The federal government has already demonstrated that it is willing to use its control over revenue to limit Kurdish autonomy, and as long as underlying political disputes between Irbil and Baghdad remain unresolved, the Iraqi government has little reason to change course. Only when new pipelines to international markets are built will the Kurds have fiscal autonomy and the ability to guarantee full remuneration and cost recovery to its investors. And at that point, the allure of independence is likely to be too tempting to pass up.

Ultimately, the most critical factor determining Irbil’s future options will be Turkish policy and whether the government in Turkey will allow independent export routes. Ankara’s tilt toward Irbil—and away from Baghdad—was an important factor encouraging the KRG to challenge the Iraqi government’s authority, particularly on the oil and gas front. Indeed, Irbil and the companies that have invested in Kurdistan appear convinced that Turkey would acquiesce to an independent export route across its territory. Until recently, Ankara has done little to belie this belief, regarding Kurdistan not only as a lucrative market for investment, but also as a source of cheap hydrocarbons in the future.

But Turkish leaders, though more sympathetic to Irbil than were their predecessors, are nonetheless wary of creating the basis for an independent Kurdistan. Ankara’s preference is for a hydrocarbon- and revenue-sharing deal between the KRG and Baghdad that would reinforce the territorial integrity of Iraq while also promoting Turkish investment across the country. Ankara will see a landlocked Kurdistan that is reliant on Baghdad-controlled infrastructure as far more controllable, no matter how much Irbil protests that independence is not the KRG’s goal. If Iraq does begin to split up, Turkey may review its position on independent pipelines, but only to ensure that Ankara maintain maximum leverage on any future Kurdish entity.

Not just the KRG sees the Syrian civil war as a source of long-term political opportunity. A variety of Iraqi Sunnis and nationalist groups also believe that regime change to the west—particularly if it brings with it a Sunni-led government—will be to their advantage by altering the regional balance of power in their favor and isolating the Shia-led government in Iraq. At a minimum, these Iraqi opposition groups (something of a misnomer given that many are actually represented in the Maliki coalition government) hope that change in Syria will force Shia parties in Baghdad to be more accommodating of Sunni and nationalist demands. But the gradual collapse of the Assad regime in Damascus has led some Iraqi opposition groups to dream of restoring a version of the old, pre-2003 order in Iraq.

The nationalist perceptions of Iraqi Sunnis are shaped to a large part by the sense of victimization and marginalization they have felt at the hands of successive, Shia-led postwar governments in Baghdad. The absence of real political reconciliation in the country has convinced these groups—and the constituencies they represent—that the new order offers little hope for genuine political inclusion or power sharing. The danger is, however, that these groups will misjudge the effect of the changes that are taking place in Syria and overreach, either by pressing their case too hard with Baghdad or by seeking greater autonomy with the hope of getting political, logistical, and possibly military support from a new regime in Syria. At best, their overreach is bound to increase tension and political polarization in Iraq, further paralyzing the Iraqi government; at worst, it could pull apart the fabric of the existing Iraqi state.

Indeed, both the Iraqi Kurdish and Sunni nationalist responses to the Syrian civil war illustrate how destabilizing the crisis is. Moreover, hopes that the regime in Damascus will fall quickly and that violence will abate look fanciful. Syria is in the process of state collapse, with power diffusing in an unmanaged fashion to local groups. This situation, in turn, has exacerbated the weakness of neighbor states, not just in Iraq but also in Lebanon and Jordan. Hopes of restoring powerful state structures in any of these countries are dim; instead, what is in store is likely to be an extended—and often violent—period of political instability that could, at worst, threaten to redraw the boundaries of the Middle East from western Iran to the Mediterranean Sea.

How Secure Are Saudi Arabia and the Gulf States?

If a period of regional instability persists, its ripple effects will extend to the Gulf states to the south, adding to the pressures—political and fis-
cal—already created by the Arab Spring. Indeed, unrest in Syria—perhaps more than any other single factor besides the situation in Iran—will shape the regional policy of the Gulf states and, by extension, their domestic stability and energy policy for the next few years. Saudi Arabia and Qatar have adopted particularly active regional foreign policies over the past two years, with Qatar parlaying the huge financial strength that its gas investments have delivered into real political influence as it has sought to mediate domestic crises in a number of Arab states. But for all its success, Qatar faces the same challenges that Saudi Arabia and the other regional hegemons (Iran, Turkey, and Israel) do in pursuing intervention in Syria—namely, balancing its efforts to shape the outcome there with the need to limit the spillover effect of the Syrian civil war into the wider region.

Backing proxies in Syria, as both Qatar and Saudi Arabia are doing, will be key to this balancing effort. But this policy risks heightening the violence and accelerating the collapse of the Syrian state, not only pulling the two Gulf states further into the maelstrom, but also making the violence more difficult to quell. Moreover, in the absence of any regional security framework, such a policy will likely heighten regional competition between rival hegemons (Saudi Arabia and Iran are already at loggerheads, and early signs of tension exist between the Gulf states and Turkey). Syria, therefore, could very quickly resemble Lebanon during its civil war in the 1970s and 1980s, when regional states fought their battles indirectly through allies on the ground. But given Syria’s strategic location and proximity to a host of weak states, including Lebanon itself, the destabilizing impact is likely to be much greater.

By virtue of size, distance, political homogeneity, and financial strength, Qatar will be able to protect itself somewhat from the immediate consequences of the escalation of the Syrian conflict and the spillover of violence there. But it cannot hope to remain completely immune from instability elsewhere in the Gulf or any conflict that encourages a more aggressive policy by Iran. Saudi Arabia faces a much more difficult task managing its future, with the risks posed by regional instability compounded by the challenge of its own domestic transition. The deaths of Crown Princes Sultan bin Abdulaziz and his brother Nayef in rapid succession were a reminder—as if any were needed—that the apex of power in the Kingdom is geriatric. The ascension of Salman bin Abdulaziz—who at 76 is comparatively young by the standard of senior princes—to the post of Crown Prince may offer some temporary respite after the passing of King Abdullah bin Abdulaziz, but a shift to the next generation of princes (the grandsons of the Kingdom’s modern founder, Abdulaziz al Saud) is only a matter of time. And the likely jostling for power among contenders from the different kingly lines will force a much clearer division of power between rival factions.

Ultimately, the government of Saudi Arabia is likely to prevail in its current form; the ruling family has shown itself to be more robust and cohesive in times of crisis than many analysts have anticipated. Nevertheless, succession issues are bound to divert the attention of senior Saudi princes inward at a time when delicate management of regional crises will be vital. With the region facing what is potentially a once-in-a-century political upheaval, not to mention the ever-present threat of military action against Iran, the risk of Saudi miscalculation will be heightened as long as Saudi Arabia’s own house is not fully in order. Domestic competition will exacerbate the risk that rival agendas will cloud policy-making and lead to missteps.

In the midst of this domestic and regional instability, however, one thing is clear: Riyadh will want oil prices to remain at their recent high levels, although not so high as to disrupt foreign markets or weaken demand. Higher spending will continue to be used to buffer the Kingdom from the impact of regional unrest, just as it has during the Arab Spring. Meanwhile, financial power can be translated into wider regional influence, especially with governments whose coffers are relatively bare. But that situation creates an imperative for Saudi Arabia to keep oil prices—and therefore oil revenues—at current high levels, allowing it to balance its domestic and external accounts despite higher spending while continuing to build financial reserves to provide funds in case of an emergency.³

This scenario does not mean, however, that Riyadh is likely to drive prices up further in the medium term. Oil policy-makers in the Kingdom recognize the fine balance between prices and demand, especially at a time when the global economy remains fragile. As the only holder of significant spare capacity in OPEC, Riyadh has used its production prowess and the need to protect both price and demand to bolster its financial strength and its strategic relevance—a factor that adds a further element of insurance for the Kingdom. For the foreseeable future, Saudi Arabia will not be replaced in this pivotal role.

This fact has two important implications. First, it puts an onus on Saudi Arabia to keep developing its hydrocarbon resources, both oil and gas. Although both Kuwait and Abu Dhabi have ambitious plans to expand capacity, the Kingdom remains the linchpin of OPEC efforts to maintain spare capacity. Indeed, this role is core to Saudi Arabia’s strategic raison d’être.
The government in Riyadh is spending hundreds of billions of dollars to maintain capacity at 12.5 mmbpd, and officials have talked in the past of increasing production capacity to 15.5 mmbpd, although this goal has been mostly shelved since 2008. Meanwhile, Saudi Aramco and the new King Abdullah City for Atomic and Renewable Energy (known as KA-CARE) are focusing considerable efforts to develop natural gas, solar energy, and nuclear energy, which will be critical to substituting oil in local power generation, thereby allowing additional crude to be exported. The importance of these challenges has been recognized at the very highest levels of the Saudi oil and gas industry, with calls for a clear and effective strategy to be introduced over the next decade, including greater energy conservation.10

The second implication is that this balancing role will perpetuate the close relationship between the Kingdom and Washington. US officials and the public at large may sometimes question the value of the relationship, but its contribution to the global energy supply and economic stability remains crystal clear. Disruption of these supplies, whether from domestic upheaval in Saudi Arabia or regional events spiraling out of control, would be disastrous for the world economy and, by extension, for the United States as long as the world’s only superpower, as well as its allies, remains dependent on hydrocarbons to power its economy.

A Region in Need of Continued US Attention

Turmoil is nothing new in the Middle East. But the current changes sweeping the region are particularly disruptive and could conceivably bring about political transformations not seen since the 1920s. The instability associated with this upheaval will be significant and will shake many of the assumptions about oil and gas supply from the region over the next decade. Some countries—particularly Iraq—will face even more obstacles to increasing output significantly. Certainly, the most optimistic output estimates for the end of the current decade now look out of the question, and a risk remains that regional events will lead to a fragmentation of the country, which would further depress production growth and could reverse recent gains.

This risk reinforces the importance of Saudi Arabia as the central bank of oil for the foreseeable future. It also illustrates the continued centrality of the Middle East to US economic, energy, and foreign policy. For all the determination and strategic imperative for Washington to pivot its focus eastward, its attention will continue to be dragged back to the Middle East and the need to ensure stability there.

Notes

2. According to the US Energy Information Administration (EIA), US crude imports from the Gulf have increased from 1,500 barrels per day in January 2010 to 2,500 barrels per day in May 2012. See the table “US Imports from Persian Gulf Countries of Crude Oil” at EIA’s website, http://www.eia.gov/dnav/pet/hist/LeafHandler.ashx?n=PET&s=MCRIMUSPG2&f=M.
4. These figures are PFC Energy Market Intelligence Service internal estimates.
6. These figures are PFC Energy Market Intelligence Service internal estimates.
7. This point has been made repeatedly to the authors in meetings with senior Kurdish leaders over the past six years.
9. According to PFC Energy internal estimates, in 2012 Saudi Arabia needed a crude oil price of around $70 per barrel to balance its current account.