Low Oil Prices Mean Greater U.S. Involvement Is Needed in the Gulf

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Brief Analysis

During the first half of 2020, global markets saw a significant decline in crude oil prices as a result of the coronavirus pandemic. Though the price of crude oil has since stabilized at a little less than $40 a barrel, crude oil remains at just 40 percent of what it was at the beginning of 2020. Policies of containment and closure implemented in most countries worldwide have led to a decrease in global oil demand. A corresponding increase in supply suggests that this decline in demand will likely have a lasting impact on those countries whose revenues rely on oil.

This is a striking concern for the Middle East and for the Gulf region in particular, due to its reliance on the oil revenue to cover their expenditures. Several Gulf states either remain beholden or have just begun to diversify their economies away from a reliance on oil. And while the future of the U.S. role in the Middle East has been increasingly a subject of debate within the United States, U.S. policy makers should understand the twin economic dangers of an enduring pandemic and low oil prices are potentially deeply destabilizing. As such, stepping away from diplomacy around the oil market, and especially in the region, should be understood as dangerous to U.S. interests and addressed accordingly.

For American allies in the region, the decline in oil prices has had two main results. For gulf countries such as Saudi Arabia, the effects of the decline in crude oil prices have been cushioned by the country's strategic financial reserves of around 700 billion dollars. Gulf countries like Saudi Arabia and the Emirates had already been seeking to diversify their economies in the understanding that there will likely be a global decline in crude oil demand as more countries shift towards renewable energy. Yet Saudi Arabia's second quarter spelled a **decline for its oil and non-oil economies alike (https://www.bloomberg.com/news/articles/2020-09-30/saudi-economy-shrank-7-in-second-quarter-as-virus-oil-hit-hard?sref=FVpgSLg0)** , contracting 5.3 percent and 8.2 percent respectively. Unemployment also rose to 15.4 percent, demonstrating the potential ongoing impact of these low oil prices and reduced demand.

The situation in Iraq, where the United States and Iran have been navigating their competing interests, is much worse. The fall of crude oil prices has had a disastrous impact on the country's rentier economy, which is 93 percent dependent on oil revenues. This drop in oil rents has led to a major crisis, bringing Iraq towards an economic meltdown acknowledged in the country's recent white paper. Combined with the country's ongoing political challenges, the Iraqi government has had to resort to obtaining domestic and foreign loans to cover state expenditures—a dangerous sign for any government. Though Iraq's current government has been actively working with the United States to reset their economic and security bilateral relations, the country is quite vulnerable to prominent anti-American forces.

While all agree that the fall in oil prices suggests challenges for a number of Middle Eastern states, the impact on U.S. policy is less clear. Some contend that the fall in oil prices and newly achieved levels of oil production in the United States will inevitably lead to a smaller U.S. role in the region. President Trump himself has suggested on several occasions that the Middle East is no longer a strategic priority for U.S. foreign policy—linking it explicitly to the United States' rise as a major oil producer in its own right. Yet this argument ignores the ongoing importance of the region to the United States, both from an energy and national security perspective.

From the angle of international oil markets, greater U.S. oil production does not mean U.S. independence from the global market and its connections with Middle Eastern producers. The price war between Saudi Arabia and Russia earlier this year demonstrated this, bearing a direct effect on the United States. When Saudi Arabia flooded the international crude oil markets with cheap oil after Russia refused to reduce its own production and help stabilize falling prices, the spat had a significant negative impact on U.S. shale oil companies, many of which were on the verge of declaring bankruptcy and terminating hundreds of employees as a result of the falling oil prices.

The resulting U.S. intervention also demonstrated the importance of an ongoing U.S. involvement in the region. Through U.S. mediation, Russia and Saudi Arabia came to the table and worked their way out of the crisis, settling on the "**OPEC-plus (https://aawsat.com/home/article/2341841/)** " agreement. This required oil production to be cut by 9.7 million barrels per day in May and June, with continued reductions until the end of the 2020 calendar year. Such American mediation came as a result of the United States' conviction that the continued collapse of oil prices is not in its interest, but it will rather affect the American interior as well. In other words, the continuation of this collapse does not works for anyone's interest. Both Saudi Arabia and Russia had suffered the economic consequences of their production war, and the deal was meant to buoy oil prices and restore some degree of normalcy. In the end, the deal was necessary for all three actors, the United States, Russia, and Saudi Arabia, if they were going to avoid catastrophe in their energy sectors.

In addition, while Middle Eastern oil production is important to U.S. interests for economic reasons, the security implications of maintaining stability are critical as well. Falling oil prices will pose a major challenge for countries that largely depend on oil revenues to support their state budgets and government spending. This deterioration in government spending could undermine regime stability in multiple Middle Eastern countries, particularly those that depend primarily on oil revenues, and stir up domestic unrest, as occurred in the Algerian Civil War in the 1990s.

Furthermore, the United States has friends and allies in the region who are looking for U.S. support in exchange for cooperation in looking after U.S. interests. It was only because of U.S. pressure that Saudi Arabia cut crude oil production, led negotiations with Russia to reach an agreement, and stopped flooding the market with cheap oil, restoring equilibrium to the market and saving U.S. shale oil companies. This incident demonstrates the power of the United States in managing the global economy generally and the importance of maintaining loyal allies in the region who remain willing to work with and listen to the United States. Stepping back further from this role will leave the United States less prepared to serve as a mediator in vital circumstances such as these, hurting both U.S. and regional ability to navigate the ongoing conflict around oil pricing and production cuts.

As U.S. policy makers continue to examine the country's role in the Middle East, and with elections just around the corner, they should not forget the problems that regional instability have repeatedly caused for the United States. Especially in areas of weak governance, there are plenty of agents who see the United States as an enemy and are looking to exploit any instability. The United States should take this opportunity of political challenge to increase its regional involvement and continue to rethink its priorities, which could pave the way for the promotion of democracy and human rights in the region. Policymakers must realize that a decreased U.S. presence in the region could have dire consequences, which could directly impact the United States through a deadly combination of terrorism and shocks to the global oil market. ❖

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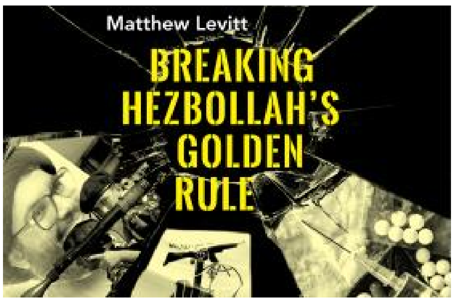

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