

Energy and U.S. Middle East Policy in an Era of Plentiful Oil

by [Patrick Clawson \(/experts/patrick-clawson\)](/experts/patrick-clawson), [Simon Henderson \(/experts/simon-henderson\)](/experts/simon-henderson), [Helima Croft \(/experts/helima-croft\)](/experts/helima-croft)

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ABOUT THE AUTHORS



[Patrick Clawson \(/experts/patrick-clawson\)](/experts/patrick-clawson)

Patrick Clawson is Morningstar senior fellow and director of research at the Washington Institute for Near East Policy.



[Simon Henderson \(/experts/simon-henderson\)](/experts/simon-henderson)

Simon Henderson is the Baker fellow and director of the Bernstein Program on Gulf and Energy Policy at The Washington Institute, specializing in energy matters and the conservative Arab states of the Persian Gulf.



[Helima Croft \(/experts/helima-croft\)](/experts/helima-croft)

Helima Croft is the global head of commodity strategy at RBC Capital Markets.



Brief Analysis

Three experts discuss U.S. priorities in the Middle East, the potential upsides and downsides of increased American energy independence, and the consequences of low prices for various oil-producing states.

On August 1, Patrick Clawson, Simon Henderson, and Helima Croft addressed a Washington Institute Policy Forum to promote the recent publication of [Energizing Policy: America and the Middle East in an Era of Plentiful Oil](http://www.washingtoninstitute.org/policy-analysis/view/energizing-policy-america-and-the-middle-east-in-an-era-of-plentiful-oil) (<http://www.washingtoninstitute.org/policy-analysis/view/energizing-policy-america-and-the-middle-east-in-an-era-of-plentiful-oil>), by Patrick Clawson and Simon Henderson. Clawson is the Morningstar Senior Fellow and director of research at The Washington Institute. Henderson is the Baker Fellow and director of the Gulf and Energy Policy Program at the Institute, and served as moderator of the event. Croft is the global head of commodity strategy at RBC Capital Markets. The following is a rapporteur's summary of their remarks.

PATRICK CLAWSON

The project *Energizing Policy* arose from policymakers' surprise regarding recent trends in energy markets and concerns about a potentially diminished U.S. role in the Middle East, given increasing domestic oil production. Indeed, rising domestic production, along with a lingering sense that the 2003 Iraq war was driven largely by the need for Middle East oil, has led some to conclude that the United States will, and should, turn its political and military focus away from the region.

Assumptions of an oil-driven U.S. focus on the Middle East, however, are ill informed. Rather, the principal reason the United States is involved in the Middle East is to combat insecurity by actors whose violent ideologies have dangerous repercussions not only for the Middle East but also for U.S. interests on American soil and abroad.

Meanwhile, increased U.S. reliance on domestic oil production has a number of advantages -- as well as disadvantages. In terms of advantages, the United States will be less vulnerable to price hikes and boycotts, such as that in 1973, when producers refused to sell oil to America. Moreover, increased self-reliance enhances Washington's ability to pressure Middle East producers on issues related to terrorism and weapons of mass destruction. When energy markets were tight, the United States wielded less leverage on such matters.

As the United States becomes increasingly reliant on its own oil production, however, suspicion may rise among Middle East states that America will no longer be a guarantor against regional aggression. And as countries worry that the United States will no longer be a major security actor in the region, they may use methods or tactics of which the United States does not approve to ensure their security. Furthermore, as America reduces its reliance on Middle East oil, future administrations may have greater difficulty generating domestic support for intervention in the Middle East. Overall, low oil prices could exacerbate the region's instability unless oil-producing states pursue reforms.

To maximize opportunities and minimize disadvantages, the U.S. population needs to hear that the United States is involved in the Middle East for reasons related to security rather than oil. Furthermore, Americans need to hear how committed the United States is to the Middle East. Finally, U.S. officials must assure the international community that involvement in other regions, such as East Asia and Europe, does not come at the expense of policy interest toward the Middle East.

Global powers, meanwhile, can work with the United States to offset some of the problems arising from the low-oil-price environment. One example of cooperation is the international agreement among advanced industrial countries to maintain strategic petroleum reserves. While the International Atomic Energy Agency (IAEA) charter governing the agreement currently only allows participation by countries in the Organisation for Economic Co-operation and Development (OECD), a proposed expansion would include India and China. Indeed, having already begun developing its own strategic petroleum reserve, China may be more open to joining the Saudi-led International Energy Forum rather than the IAEA, which is dominated by the advanced industrial countries. Furthermore, global powers have pursued cooperative efforts such as the Joint Organisations Data Initiative (JODI) -- which aims to improve the transparency of production, consumption, and reserve numbers -- and protection of the sea lines of communication.

Energizing Policy considers two potential futures for U.S. oil production: one in which the United States continues to import about one-third of its oil, and another in which the United States becomes a net oil exporter on the order of several million barrels per day. Relatedly, both output and demand are unknown variables in industrialized and industrializing countries. Over the past twenty years, oil output has repeatedly fallen outside ranges predicted in the five- to ten-year forecasts of numerous governmental, international, and private organizations. Although the prevailing assumption is that low oil prices lead to less investment and more demand such that prices rise, and high

oil prices lead to more investment and less demand such that prices fall, a number of forecasts have suggested that changes in the oil industry are driven as much by technological advancement as they are by price.

HELIMA CROFT

As the U.S. government gains more confidence that world oil markets will be well supplied, Washington can more vigorously press its agenda with oil-producing countries. Consider the example of Nigeria. Around 2003, the U.S. government became very interested in non-Middle East sources of oil, notably from the Gulf of Guinea. In Nigeria in particular, U.S. criticisms of the country's 2003 vote were far more muted than what they would be of the 2015 vote, not only because of strategic security cooperation but also because of interest in Nigerian oil production. Whereas in 2003 the United States imported about 10 percent of its oil from Nigeria, today it imports almost none from the country. In the remarkable shift already noted, following the 2015 Nigerian elections, the United States and allied powers exerted more pressure on the Nigerian government, threatening travel bans, asset freezes, and other measures in response to rigging. Previous debates within the policy community have weighed the merits of managing relations with oil-producing countries against pressuring their governments for reform. In light of recent growth in domestic production, these debates may be replaced by more significant efforts to push reform.

The recent drop in oil prices has led to consequences for both oil-producing countries and OPEC's decisionmaking capabilities. Many states that increased spending in the wake of the Arab Spring are now running significant debts, and even wealthy oil-producing countries in the Gulf have been forced to deal with low prices through renewed debt issuance. Although the Gulf countries have substantial sovereign wealth funds and safety nets to deal with a low price environment, they may need to consider prospects for refinancing, structural reforms, and reductions in sovereign-wealth-fund investment in areas such as real estate and European equity markets.

How long the world will be well supplied with oil is unclear. For poorer oil producers such as Iraq, which is struggling with the Islamic State, low oil prices, and political problems in Baghdad, few options are available except to borrow from the International Monetary Fund to meet payrolls. Furthermore, despite the North American energy revolution and the current large inventory, North American producers cannot provide all needed barrels in the absence of growth from other producers. Countries such as Iraq, Venezuela, and Nigeria have struggled to fund the development of energy infrastructure and experienced significant reductions in rigging in recent years.

Low oil prices, as well as increased global interest in renewable energy sources, have likely heightened concern among long-range planning departments in Middle East national oil companies. Currently, the biggest factor keeping oil prices low is very large global stockpiles, currently at five-year highs. Over the next year, those stockpiles are expected to decrease; even if U.S. oil production rises, it may be difficult to keep prices from reaching \$70-75 per barrel over the next two to four years if no production growth occurs outside North America.

That said, the short-term outlook suggests that oil markets have more than ample oil. At the OPEC meeting in June 2015, it seemed as though a demand-driven recovery -- with demand at a five-year high -- was leading to an upswing in oil prices. Despite such optimism on prices, disparities between the Gulf Cooperation Council and poorer OPEC countries over fair oil pricing thwarted a decision on a collective price ceiling. Likewise, the June 2016 meeting was reflective of the meeting a year prior. Although many of the larger producers expressed consensus on the need for higher prices to incentivize investment, tremendous disparities remain between the GCC and the so-called "fragile five": Libya, Iraq, Nigeria, Venezuela, and Algeria.

This summary was prepared by Emily Burlinghaus. ❖

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