Geopolitical Developments in the Middle East 10 Years in the Future

Dr. Steven Wright
Associate Professor
Associate Dean
Qatar University

A Sustained Period of Low Oil Prices?

Back to the 1980s?

Oil Price Collapse in 1986

- It was preceded by a period of high oil prices.
- Resulted in global non-OPEC supply growing (in the North Sea, Alaska, Mexico and the Soviet Union, among others).

Lower Global Demand

- Oil Demand was 5.4 million barrels per day (mb/d) lower in 1983 than 1978.
- It is noticeable that the recent dispute between Iran and Saudi Arabia, had a limited risk/speculation impact on the price of oil.

OPEC Action

- OPEC cut production to raise prices.
- Little Impact due to Over Production

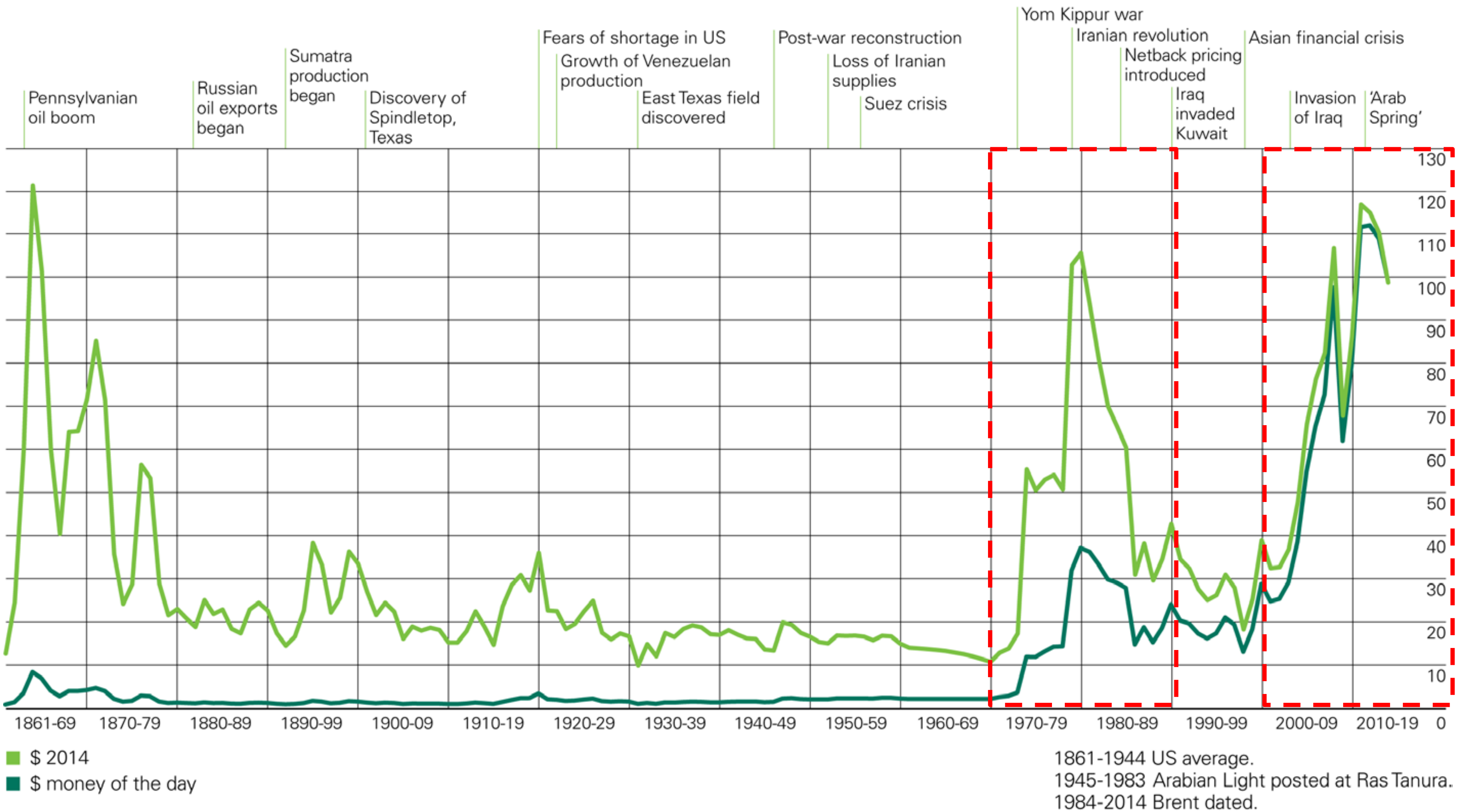
Market Share

- Saudi Arabia Changes Policy to Defend Market Share
- Policy Results in 15 Years of Low Crude Oil Prices

A New Cycle of Low Oil?

- From 1986-2000
- From 2000-2014
- 2014 - ??

Crude Oil Prices 1861-2014



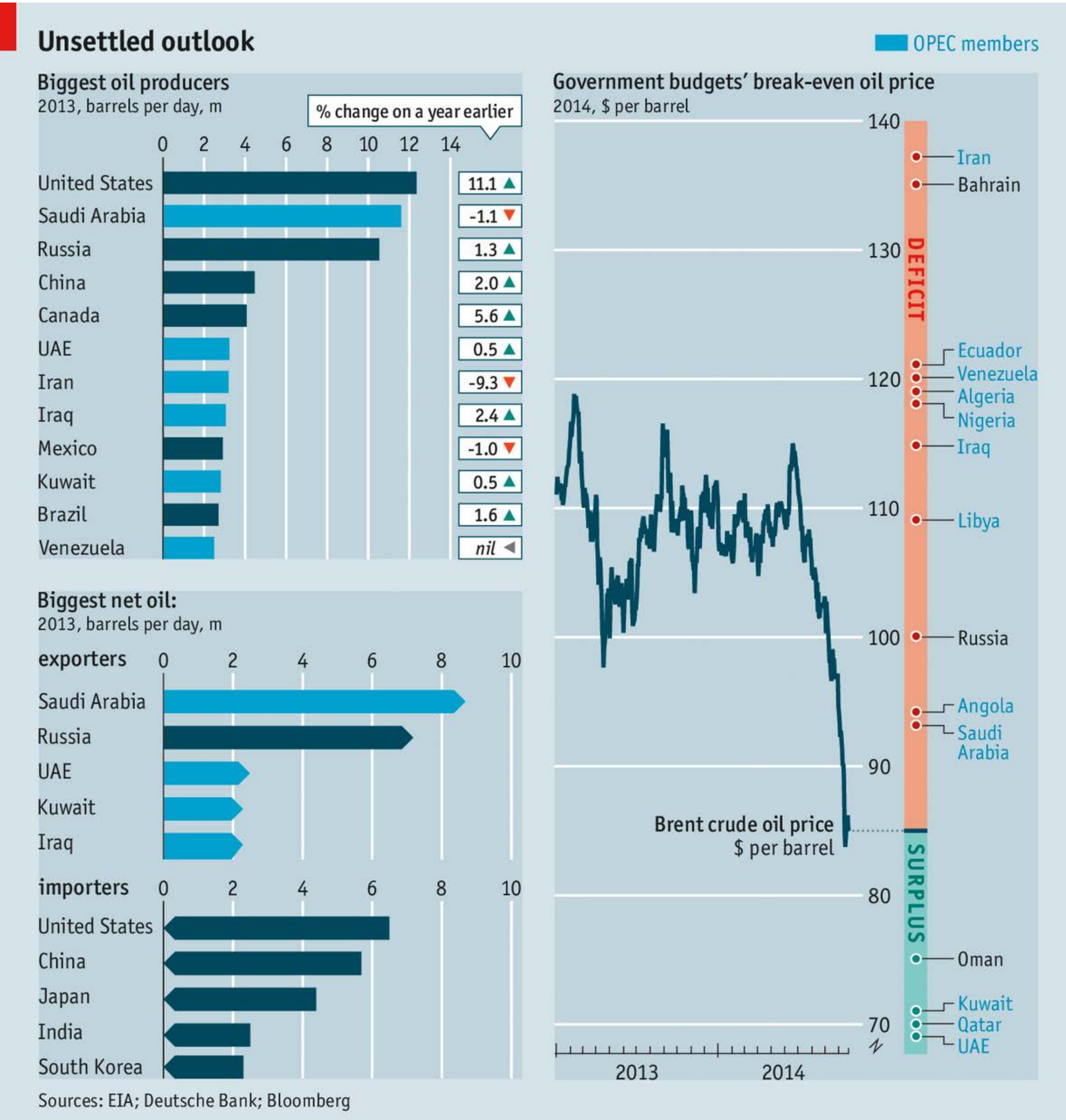
The Lifting of Iran's Containment

Factor		Distinctive features	
Energy Market	Oil Potential (4th Largest Global Reserves)	• Iran peak-oil at 4.2 million b/d in 2011 • Current domestic consumption of 1.7 million b/d	Iran has exceptional potential, but domestic demand is increasing.
	Natural Gas (2nd Largest Global Reserves)	• Production and domestic consumption of natural gas is virtually equal.	
Infrastructure	Significant investment needed in Iran's oil sector	• Ageing infrastructure means that significant infrastructure investment is needed.	Iran's oil and gas sector are require modernization: access to financing will be important indictor
	Can Iran Raise International Finance to Fund The Modernization of its Energy Sector?	• Iran's re-entry to the oil sector leads to a further downward outlook on oil price. • Mainly due to geopolitics and additional supply, but potential would have longer term impact.	

What is the Global Context?

1. Oil is expected to be the slowest-growing fuel over the next 20 years.
2. Trends in the Global Natural Gas Market suggest the future possibility of an oversupplied global market. New sources of gas such as those in the Eastern Mediterranean, East Africa and Australia, and unconventional gas production in the United States.
3. The EIA expects the United States to become a net exporter of LNG by 2016 and an overall net exporter of gas by 2018. IEA expects US natural gas production to continue rising until at least 2035.
4. The market effects of further LNG exporters coming on stream in Africa, the Levant, Russia, North America and especially Australia (expected to emerge as the world’s second-largest LNG exporter after 2015) could eventually produce a gas glut.
5. OECD consumption of oil has peaked and is expected to decline post-2015. majority of future global demand to come from China and India (*assuming their current growth trends continue*).

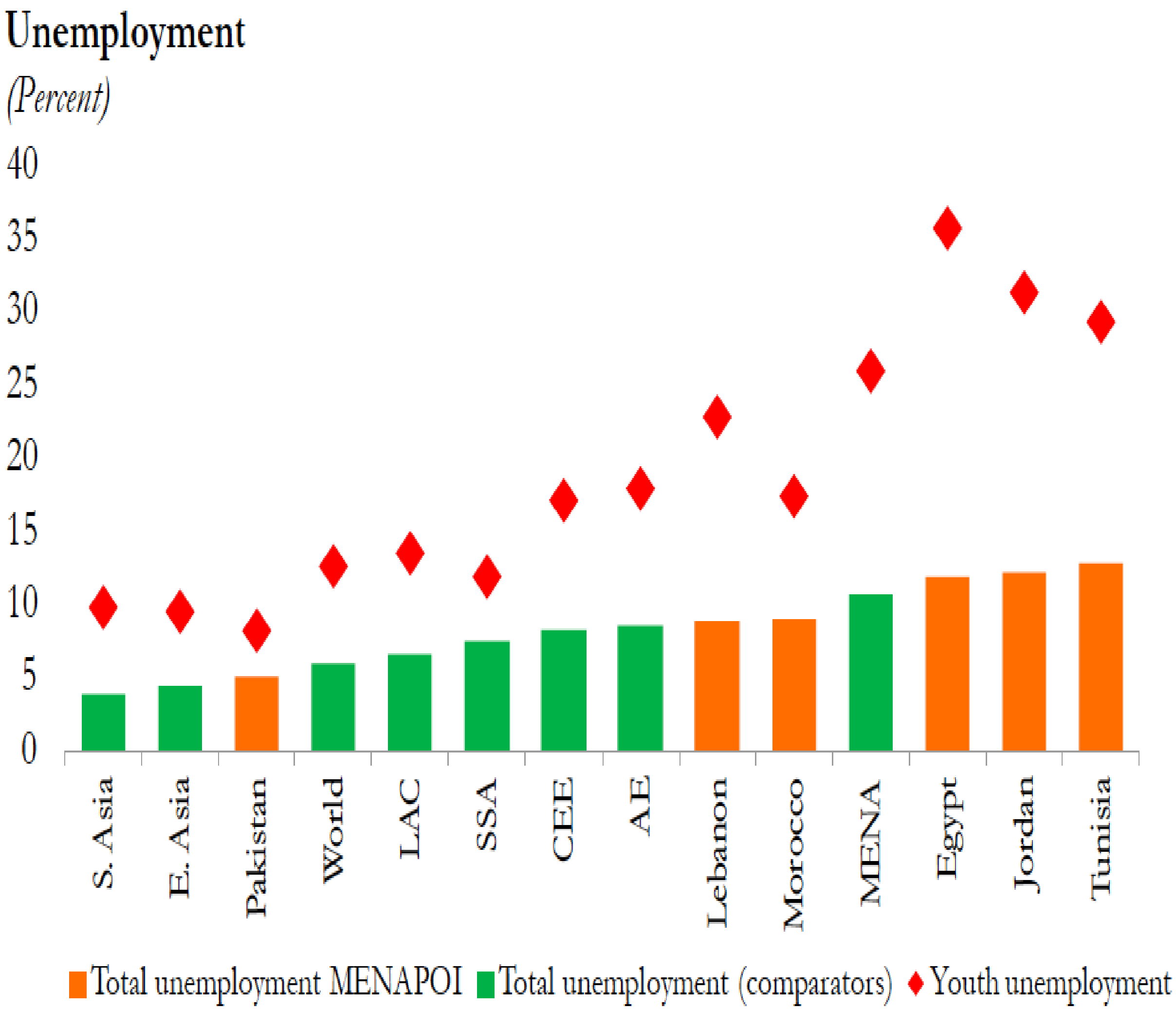
A Future of Low Oil on the Middle East



Negative Outlook

1. Even wealthy countries in the Middle East will inevitably face rising economic problems and liquidity problems.
2. Diversification has failed. The focus is on what reforms can be implemented, and will they result in instability?
3. Less Foreign Aid and Regional Investment.

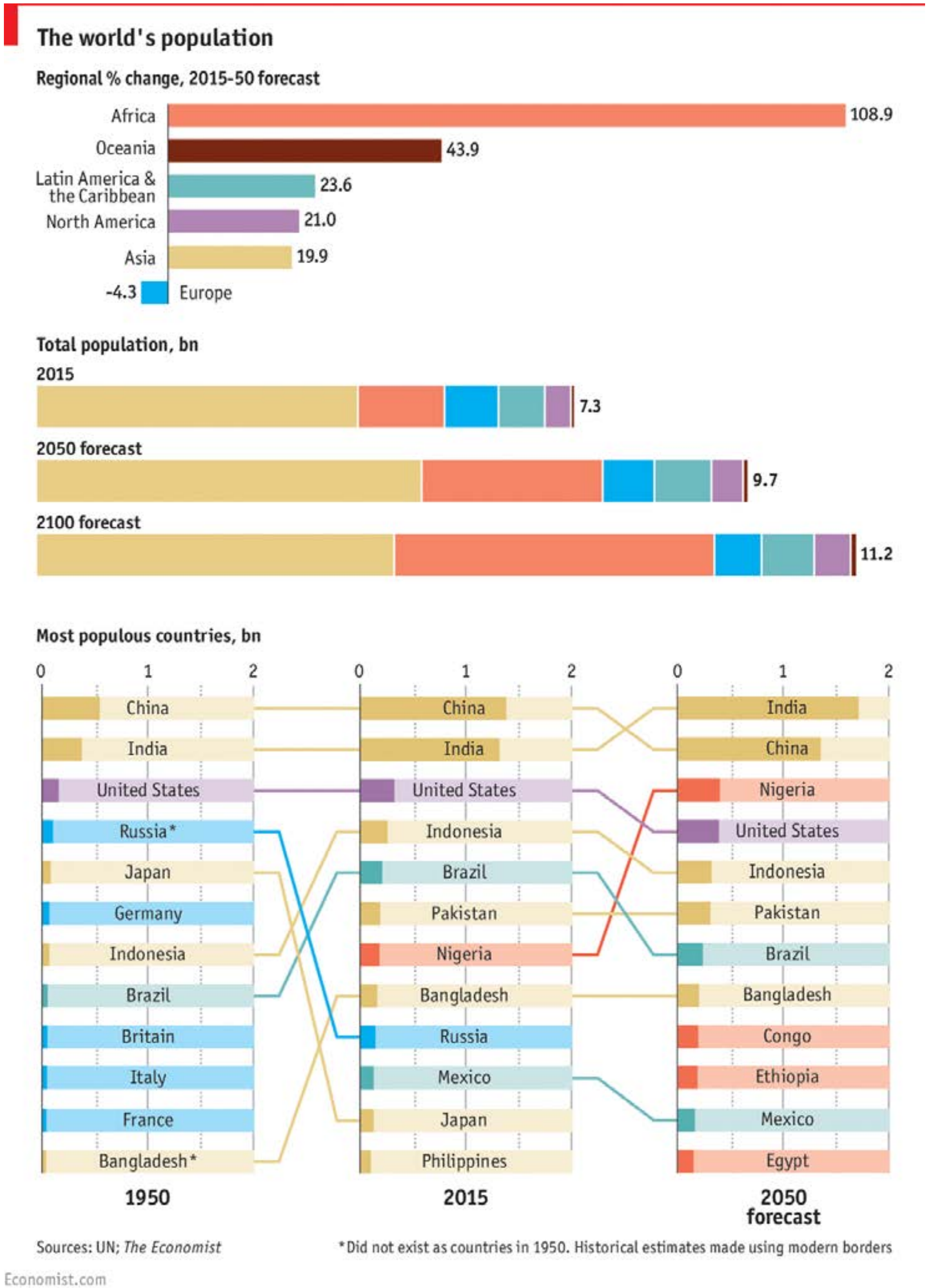
Adding to Existing Economic Problems?



Negative Employment Outlook

1. Unemployment is a rising problem in the Middle East and is expected to rise in the context of weak economic growth.
2. Unemployment can lead to people being disillusioned or turn to religious extremism.
3. Countries such as Egypt face an acute problem, and for the GCC countries, the problem is a bloated public sector.

Adding to Existing Economic Problems?



A Rising Population in a Weak Economic Outlook

1. **Saudi Arabia**:-
   31.5 Million (2015)
   36.8 Million (2025) (16.8%)

2. **Yemen**:-
   26.8 Million (2015)
   33.1 Million (2025) (23.5%)

3. **Egypt**:-
   91.5 Million (2015)
   108.9 Million (2025) (19%)

4. **Iraq**:-
   36.4 Million (2015)
   47.7. Million (2025) (31%)

5. **Iran**:-
   79.1 Million (2015)
   86.5 Million (2025) (9.4%)

The Food and Water Problem

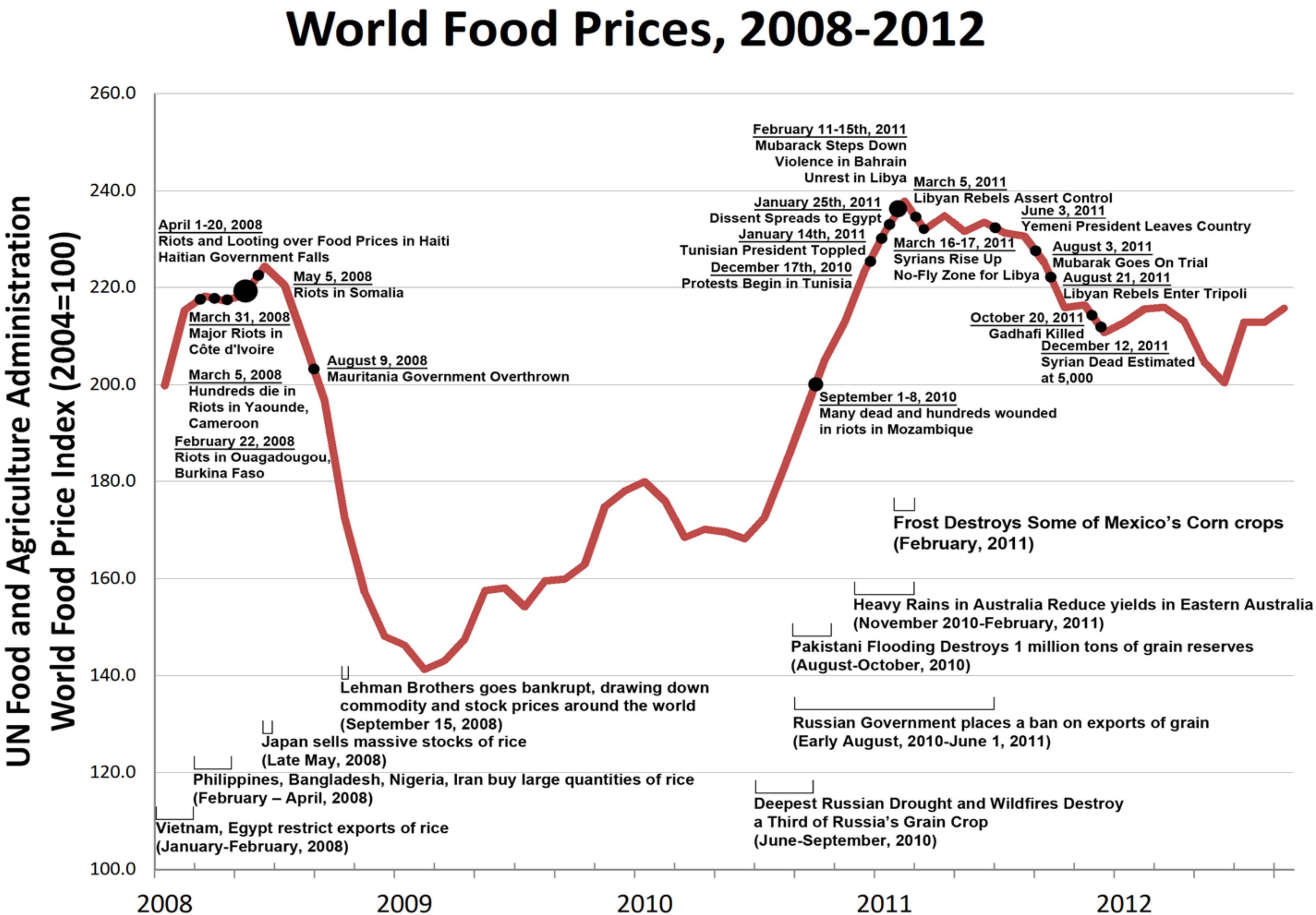
Percent of income spent on food and average age per-capita of the top wheat-importing countries

2010 Wheat imports per capita			Per capita		Age
Rank	Country	Metric tons (in '000s)	Income (in U.S. dollars)	Food - percent of income	Percent under 25 years
1	UAE	370.659	47,400	8.7	31.1
2	Libya	242.803	12,062	37.2	47.4
3	Israel	238.968	27,085	17.6	43
4	Jordan	173.611	4,435	40.7	54.4
5	Algeria	101.439	4,477	43.7	47.5
6	Tunisia	89.330	4,160	35.6	43.2
7	Yemen	86.843	1,230	45	65.5
8	Egypt	81.284	2,771	38.8	52.4
9	Iraq	76.701	2,625	35	60.6
10	Cuba	70.503	5,000	n/a	34.6

Source: Troy Sternberg, "Chinese drought, bread and the Arab Spring," Applied Geography 34 (2012): 519–524.

1. A key explanation for the timing of the Arab Spring in 2011, was the rise in food prices caused by climate change.
2. In Egypt, food prices rose by 20%, and 40 million persons were on food rations.
3. Rising population trends place further pressure on food prices, which are made worse by a weak economic situation.
4. This raises the risk of spontaneous popular uprisings by the population: It is more about social-economic factors than the political system.

The Food and Water Problem



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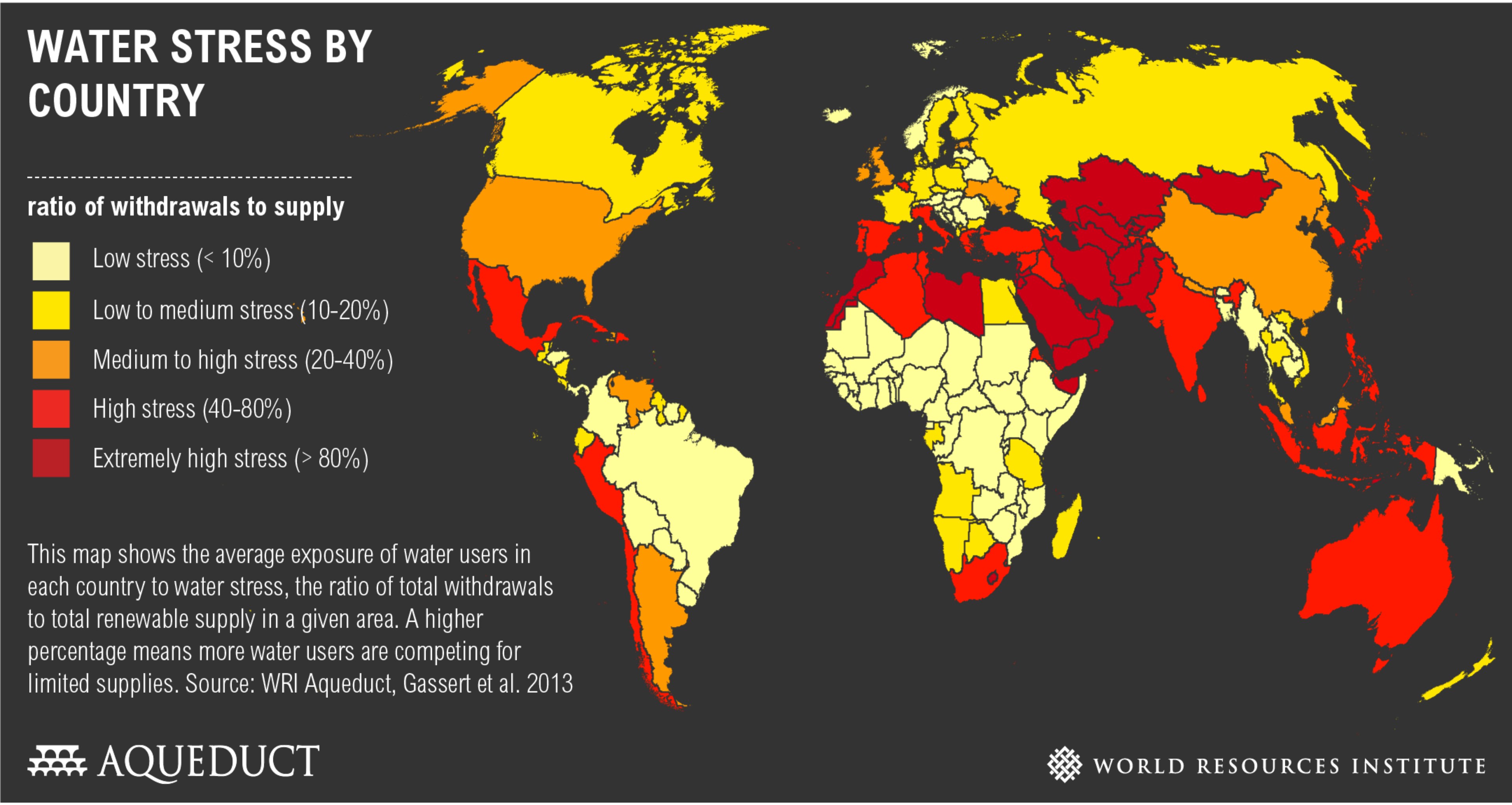
The Food and Water Problem



1. Extremely high water stress exists: this makes agriculture more problematic; it inhibits development; and is an increasing problem due to population growth and climate change.
2. Migration is likely to be a key theme for the future. Those who are more educated, are likely to be the ones who will migrate, which inhibits development.

Key Observations:

Currently Three Broad Groupings

1 **The GCC: (Bahrain, Kuwait, Oman, Qatar, Saudi Arabia, and the UAE)**
Majority are Dominant Players in the Energy Market; Greater Political Cooperation as a Bloc; Less Affected by the Arab Spring; More Acute Economic Imbalance with New Global Economic Climate.

2 **Non-GCC Oil Exporters: (Algeria, Iran, Iraq, and Libya)**
All affected by the political environment; Very High Public Debt; Fragile and insecure states in the case of Libya and Iraq; Algeria weak economic outlook; Iran has potential but is dependent on sanctions remaining lifted post-Obama.

3 **Post-Arab Spring Countries: (Egypt, Jordan, Lebanon, Morocco, and Tunisia)**
Uncertain and fragile politics; risk of insurgency.

Fiscal Breakeven Brent Oil Prices

	2009	2010	2011	2012	2013	2014	2015
Kuwait	29.4	31.6	36.4	45.5	51.6	56.4	62.8
Qatar	29.4	44.6	43.8	44.9	54.2	58.5	65.3
UAE	66.2	69.5	65.9	63.7	68.2	74.5	78.2
Saudi Arabia	65.2	66.8	83.4	77.7	92.8	98.9	104.6
Oman	65.8	71.4	92.7	97.2	103.8	107.5	113.2
Bahrain	82.9	101.3	112.3	121.4	119.4	126.4	130.2
Libya	43.6	62.5	160.3	87.9	110.5	185.6	165.0
Iraq	78.3	97.6	102.5	103.4	117.2	108.3	97.7
Algeria	81.3	83.6	108.4	124.2	109.2	128.5	132.6
Iran	66.8	73.5	85.7	120.4	128.3	136.3	137.2

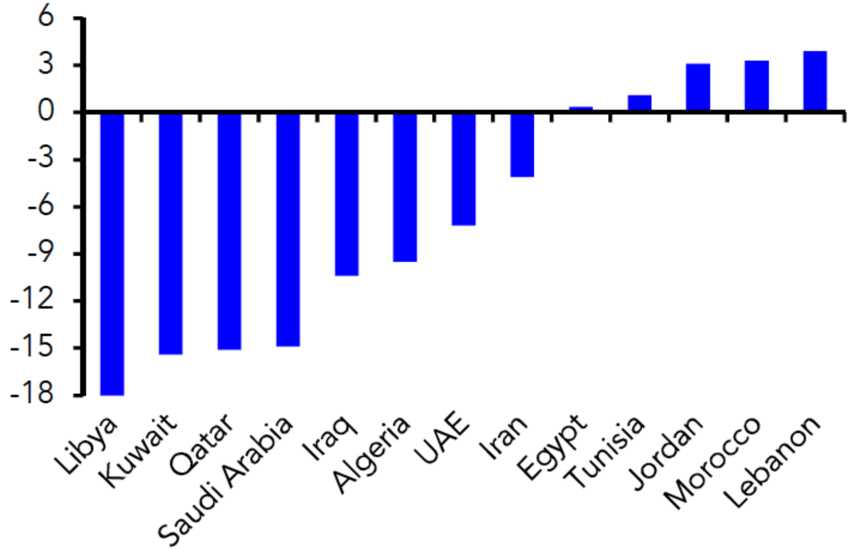
Source: IIF.

1. The Middle East is an insecure and highly complex geopolitical arena.
2. All states will be affected by the foreseeable forces.
3. The distinction between these grouping may slowly erode as all face similar problems in the next 10 years

Key Observations:

Impact of Lower Oil Prices on Current Accounts

percent of GDP



Source: IIF. 2015 prices.

1. In the context of the Arab Spring, increased subsidies were undertaken by GCC governments which raised their breakeven prices.
2. Example: Saudi Arabia's February 2011 subsidy of $37bn which included a 16% increase of public-sector salaries. This is equivalent to an additional $14/b on the price of Saudi exports for 2010.
3. Qatar has its own debt refinancing risks which limit liquidity based on GRE Borrowing. IMF estimates show that total external debt (excluding banks) has more than doubled since 2008 to $89.2bn (52% of GDP) in 2011.
4. Based on the above, Qatar's breakeven is estimated to be over $80/b by 2017.

Key Observations:

What Does This Indicate for the Next 10 Years?

1. The economic context created by a long-term low oil scenario has serious regional implications.
2. A low oil price impacts region-wide on financial liquidity.
3. A weak economic outlook adds to the existing region-wide structural problems of unemployment, food and water security, in the context of a rising population base
4. Diversification has been a failure in the GCC states in particular; therefore for the next 10 years the focus will be on managing the decline.
5. Middle Eastern oil states, will have less liquidity at their disposal to ease what are expected to be rising social tensions.

General Observations

The Middle East Region has a Highly Complex Social, Political and Security Order. The trends indicate less stability over the next decade.

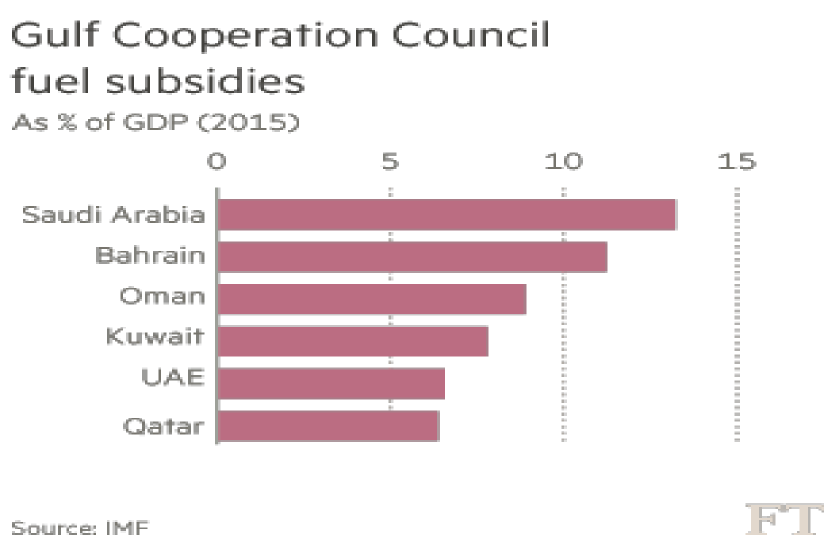
The Key Question is:
How will states ensure liquidity and balance their budget, whilst balancing this against the risk of a social breakdown.

How will the Economic Decline be Managed? Policy 1 – Cut Spending (Austerity)

What Is the Trend?

Subsidy Reform and Restructuring

- Government Spending will Decline
- Reduction of Subsidies.
- Government Organizations to be Restructured and Cost Cut.
- Budget Linked to Planning.
- **Risk of social response in a reduction in benefits context.**



Subsidies

- Fuel
- Water
- Electricity
- Food

Government Budgets

- Current Budgets have experienced significant cuts.
- This is problematic in context of a rising populations.

Restructure

- Opportunity for Budget Based Planning
- Focus on Core Business
- Will Add to Unemployment

How will the Economic Decline be Managed? Policy 2 – Taxation

What Is the Trend?

Developing a Stronger Tax System

- All Middle Eastern Governments will seek to strengthen revenue generation mechanisms.
- The oil economies of the GCC will see the most activity and changes.
- The Six GCC Countries, decided in Q4 2015 to implement a Consumption Tax This will take around of 18-24 months if planned correctly.
- Corporate Taxes can be expected to rise.
- Greater indirect taxation will be implemented, which will be socially resented.

Consumption Tax

- GCC States have agreed to adopt it.
- Exemption of essential goods as per international standard.

Income and Corporate Taxes

- Saudi Arabia had income tax from 1950-1975.
- Policy on Nationals changed in 6 months, expatriates stopped paying tax in 1975.

Indirect Taxation

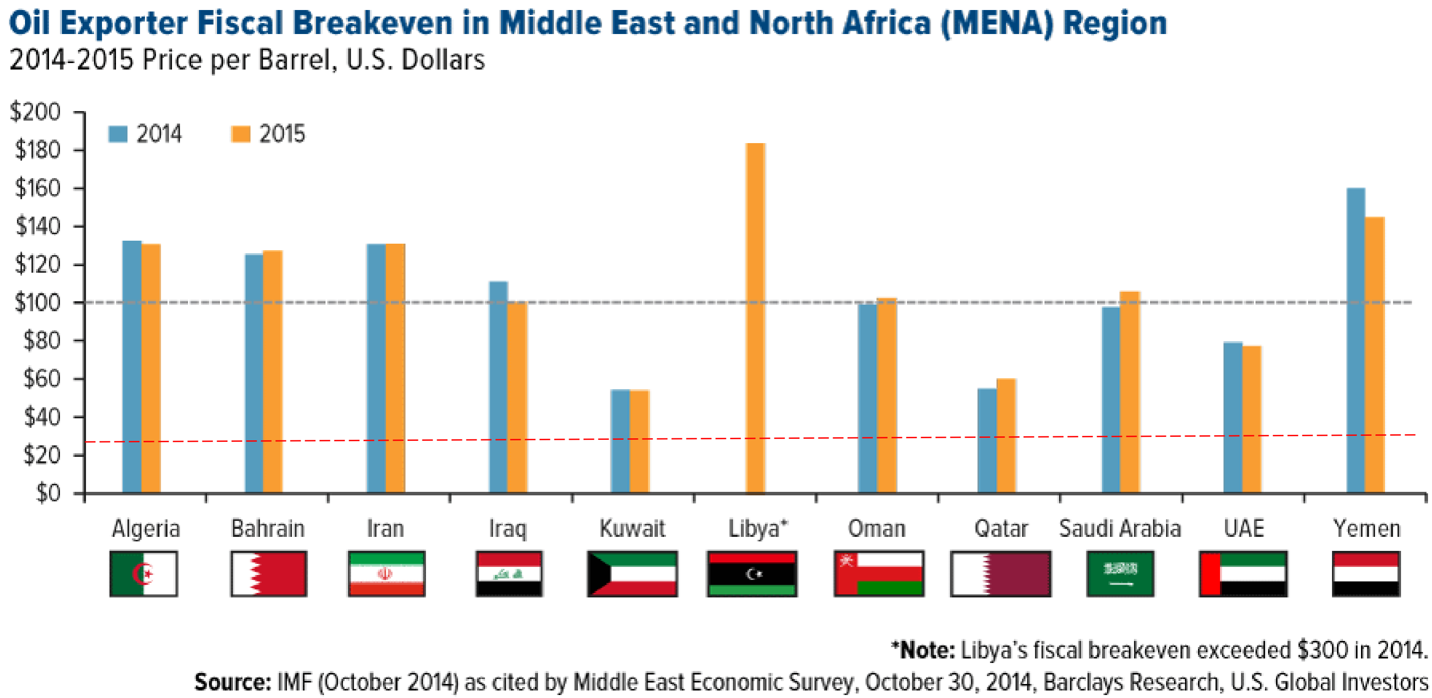
- Government services
- Property taxation
- Many examples to choose from….

Current Revenue Structure in the GCC

	2012	2013	2014	2012-14
	In percent of GDP			
Total Revenue	48.9	47.6	44.0	46.8
Non-Oil Revenue 1/	8.6	9.6	9.9	9.4
o/w Tax Revenue	1.6	1.5	1.7	1.6
Oil Revenue	40.3	38.0	34.1	37.5
	In percent of non-oil GDP			
Total Revenue	106.1	96.8	83.2	95.3
Non-Oil Revenue 1/	17.9	18.8	18.2	18.3
o/w Tax Revenue	3.3	2.9	3.0	3.1
Oil Revenue	88.2	77.9	65.0	77.0
	In percent of total revenue			
Non-Oil Revenue 1/	17.5	20.2	22.5	20.1
o/w Tax Revenue	3.3	3.2	3.8	3.4
Oil Revenue	82.4	79.8	77.5	79.9

1/ includes investment income

How will the Economic Decline be Managed? Policy 3 – Print Money (QE)



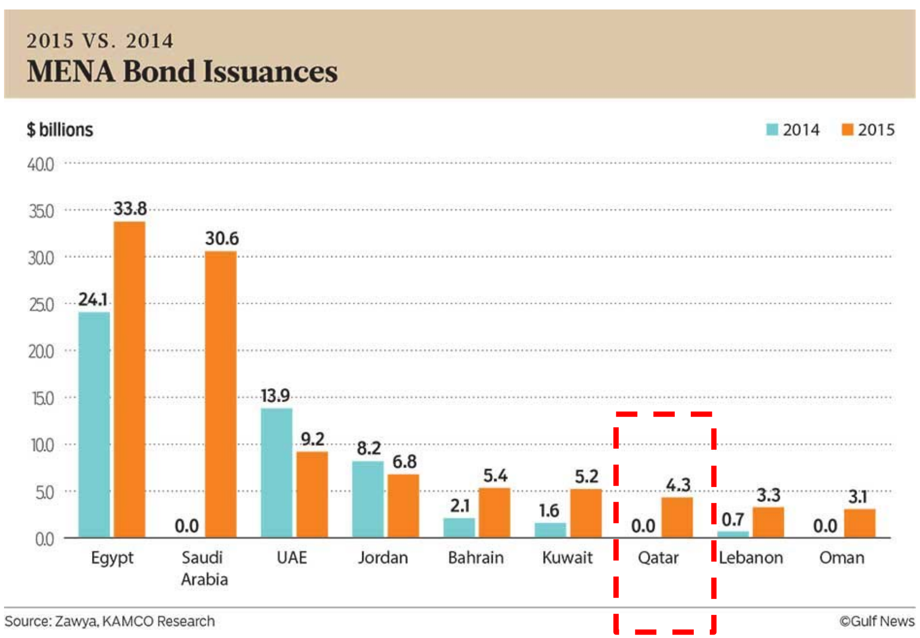
- For the GCC States who have a peg to the dollar, they are unable to engage in monetary easing.
- The challenge will be to maintain the peg given deficits and speculative trading.
- There is a risk the peg cannot be maintained (Oman, Bahrain and Saudi Arabia), a marginal benefit is that the governments can engage in monetary easing, but a major disadvantage is that will lead to inflation on food and other imports which all GCC states rely on.
- Middle Eastern states without the peg, are expected to engage in quantitative easing. This will impact on food imports.

How will the Economic Decline be Managed? Policy 4 – The Bond Market

What Is the Trend?

Borrowing to Provide Liquidity

- Promoting Economic Growth means regional liquidity must be promoted.
- For the non-oil Middle East countries (especially Egypt), bond issuances is a key public policy tool.



The Rise of Regional Debt

- Saudi Arabia is facing an acute problem, and is raising liquidity both internally and externally.
- A distinction needs to be made between countries in the GCC – Qatar, Bahrain and Oman had already had a trend of borrowing.
- Qatar's rate is higher (over 80%) if all inclusive of types of debt - external debt, public debt and banks' net external position.

	GDP ($ bn)	Gov't Debt (% GDP)	Public Foreign Assets (% GDP)
	2014	2014	2014
GCC	1651	12	143
Bahrain	34	47	17
Kuwait	170	7	256
Oman	78	6	94
Qatar	207	25	175
Saudi Arabia	753	2	116
UAE	408	20	150

Trends in Saudi Arabia: A Cause for Concern?

1. Saudi Arabia's energy consumption is unsustainable: it should be a serious international cause for concern. Far-reaching reforms in energy subsidies towards reducing consumption and its level of dependence on oil revenues are needed beyond what has been announced by December 2015.

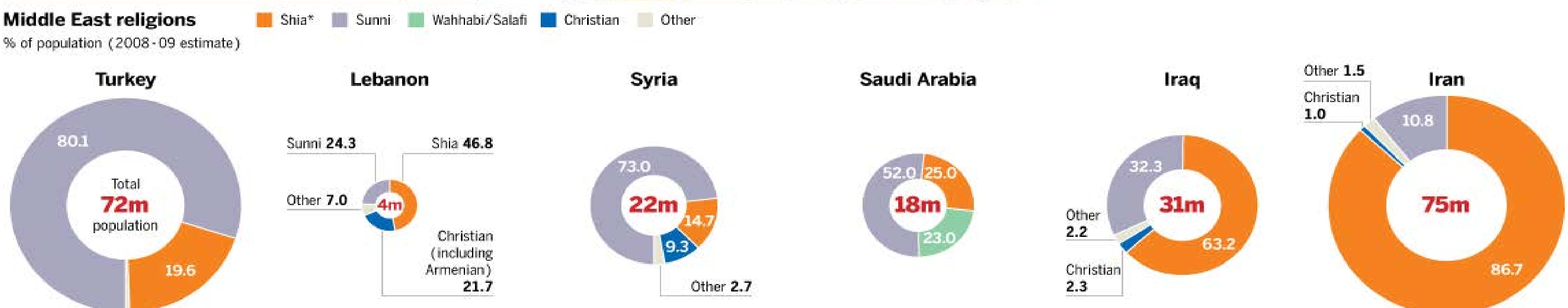
2. At current oil prices (2016), Saudi Arabia will run through its reserves by early 2020s. This will place greater pressure on its peg to the dollar.

3. Instability in Saudi Arabia poses the greatest single challenge to the Middle Eastern system. Instability in the Kingdom would have a domino effect. As of 2016, it is facing serious internal economic challenges, in addition to security threats.

Sectarian divisions

Middle East religions

% of population (2008-09 estimate)



* Includes gnostic Alawites and Alevis

Expatriate workers are not included in these figures

Source: Based on work by Dr Michael Izady at gulf2000.columbia.edu

FT graphic

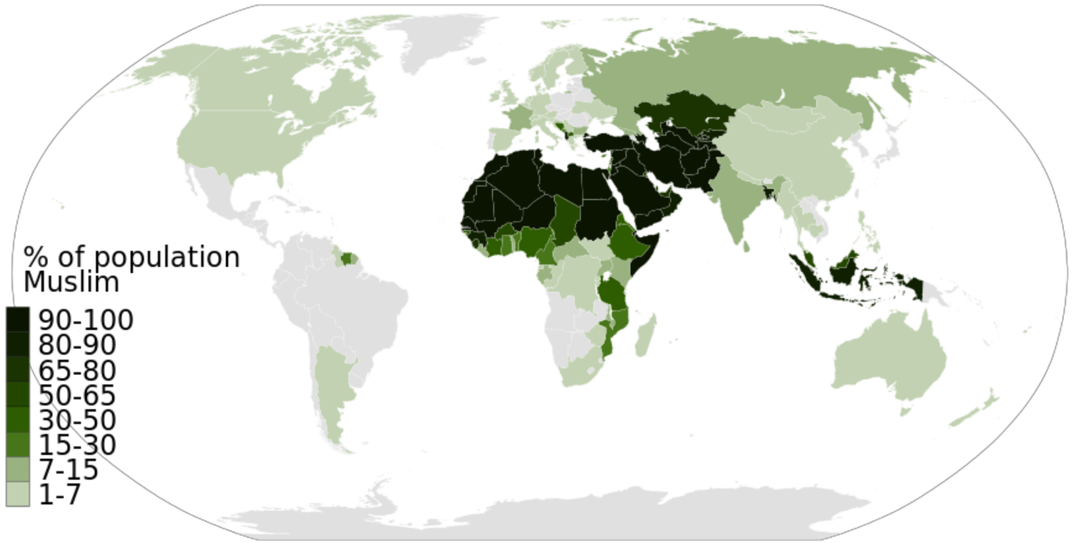
The Risk of Rising Sectarianism

What Does This Indicate for the Next 10 Years?

1. Saudi Arabia sees Iran as a threat and incompatible with its conception of a Islamic Ummayiah (Pan Islamic Community).

2. There is an inherent incompatibility with an Islamic Ummayiah and the Nation State. The Nation state has actually proved to be a destabilizing force as it has narrowed the definition of citizenship to encompass religious identity. This narrowing of identity has proved detrimental in the Middle East.

3. The next decade is expected to see, in the context of growing socio-economic challenges, an intensification of identity along religious lines. This leads to proxy warfare as is happening in: Yemen; Lebanon, Syria, Iraq, Bahrain. This is in addition to creating fault lines within Saudi Arabia itself given 25% Shia population.



The Context of Religious Extremism

Currently Three Broad Groupings

1

The Emergence of Daesh (Islamic State) stems from:

1. (2000) - Jam'at al-Tawhid wa al-Jihad – Al Zarqawi
2. (2004) - Al-Qaeda in Iraq (Al Zarqawi pledge to Bin Laden)
3. (2007) - Islamic State of Iraq
4. (2013) - The Islamic State of Iraq & Levant (Daesh)
5. (2014) - The Islamic State (Daesh)

2

Takfirism:

- Argues its followers should not cooperate with Shias and apostates.
- Justifying killing Muslims (Shias & Sunnis).
- Goal is to reestablish the caliphate.
- All Middle Eastern States are under threat.

3

Key Point:

- Even with the military defeat of the Islamic State, the ideology which it grew from, will remain and a new offshoot group will emerge.

1. **The risk caused by government instability is that (in the absence of a democratic culture or separation of religion from the state) it is an ideal breeding ground for extremist groups.**
2. **The risk of terrorism will likely rise progressively.**

Concluding Observations

1. The 10-Year Outlook for Middle Eastern region is negative. A complex arrangement of problems exist which have been progressively growing.

2. Tensions within states; and amongst states; and also against radical Islamic Ideology is expected to grow. This will likely lead to increased migration flows from the region.

3. The three broad regional categories of states that exists in 2016 will start to gradually erode, even the GCC states will see an economic decline and a need to reconstruct the social and economic system. The greatest challenge remains an unstable Saudi Arabia given the regional implications it would have.