# The Impact of an "American First" Policy on Stability in the Middle East: The Impact on Oil Markets

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## Introduction

A major problem with this opinion paper is the presence of "Trumpian Uncertainty". This refers to the fact that it is virtually impossible to determine what President Trump's policies are and how they may develop in the future. The only basis for determining his policy is a series of random and uncoordinated tweets around a mantra of "America First". In particular, his policies on the Middle East and North Africa (MENA) are totally unclear with the White House and Trump's immediate entourage producing very different views from those of the State Department or indeed the Pentagon. This is despite the fact that he has been in Office for almost seven months. Therefore what follows can only be purely speculative. The starting point for analysis is the current state of the oil market

## The Current State of the Oil Market: Lower for Longer?

The current oil market remains seriously over supplied despite the OPEC agreement of December 2016 with Non-OPEC producers to cut 1.8 million barrels per day (mbd) – 1.2 mbd from OPEC.

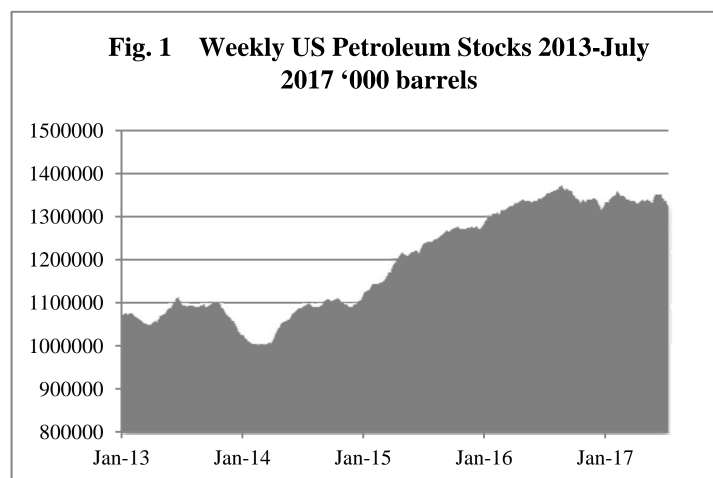


**Fig. 1 Weekly US Petroleum Stocks 2013-July 2017 '000 barrels**

Source: EIA Website

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The OPEC target set at the Algiers Agreement in September was for a production of 29.8 mbd by January 2017. By March, even accounting for the 1.2 mbd cut, OPEC was producing 31.8 mbd. Thus the cuts needed to be 2 mbd more. Nigeria, Libya and Iran were excluded from the deal and United States tight oil production began to increase again. Thus despite extending the December agreement until March 2018 the record level of inventories shown in Fig. 1 shows little sign of reducing[1].

On balance the prospects for higher oil prices above $50 per barrel are not good. The continuing over supply has been translating into a downward pressure on prices. At the same time, there is effectively a price ceiling. This has been created by the shale technology revolution in the United States. There exists a “fracklog” of wells[2] that have been drilled but not completed. They were drilled because the terms of the lease forced the drilling but were not completed (i.e. fracked) because the crude price was too low. At the same time the shale technology revolution has significantly increased the price elasticity of supply. Conventional oil projects have lead times of 5 to 15 years while tight oil projects have lead times of a few months. Thus increased prices will produce a much faster supply response to choke of further price increase. There is already evidence to this effect. Between January and March 2017, the EIA increased its projection of production by 0.5 mbd reflecting the higher prices seen since the December 2016 agreement. This tendency to produce a supply response to higher prices is likely to be reinforced by an “America First” policy which is likely to encourage domestic oil production most obviously by tax breaks and by opening up Federal land to exploration and development.

However, any oil price forecasts need a warning that they can easily be de-railed by geo-political events and it is here we need to consider the consequences of “Trumpian Uncertainty”, his “America First” policy and the stability of the MENA region. Three areas are of concern: Saudi Arabia’s oil policy, United States’ relations with Iran and President Trump’s threat to move the Embassy to Jerusalem

## The Impact of President Trump on the Middle East?

The first area of concern is how the impact may affect Saudi Arabia’s oil policy. 2016 saw Saudi Arabia change the market share strategy it had adopted in mid-2014 to one of trying to restore an administered market. Several reasons explain the change. Saudi Arabia was coming under huge pressure for other oil producers who were suffering for the lower prices. Fig. 2 illustrates the budget break-even price for OPEC members in Summer 2014.

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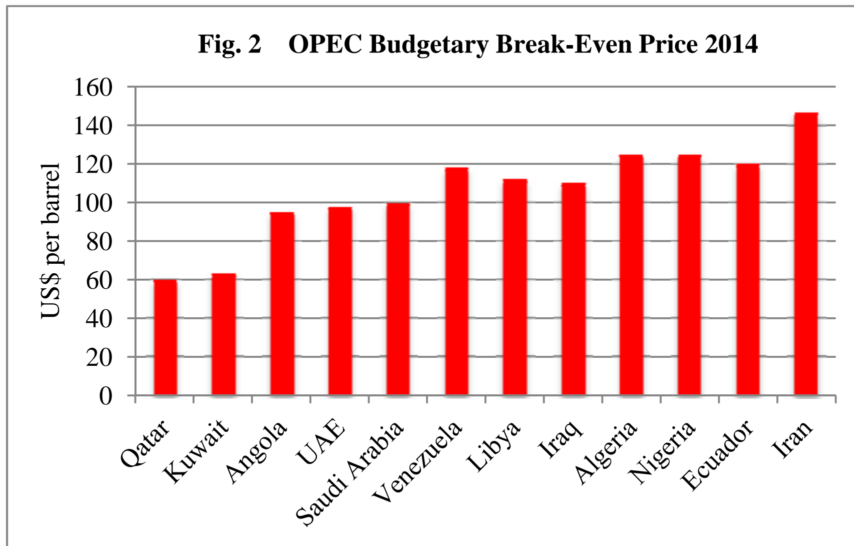
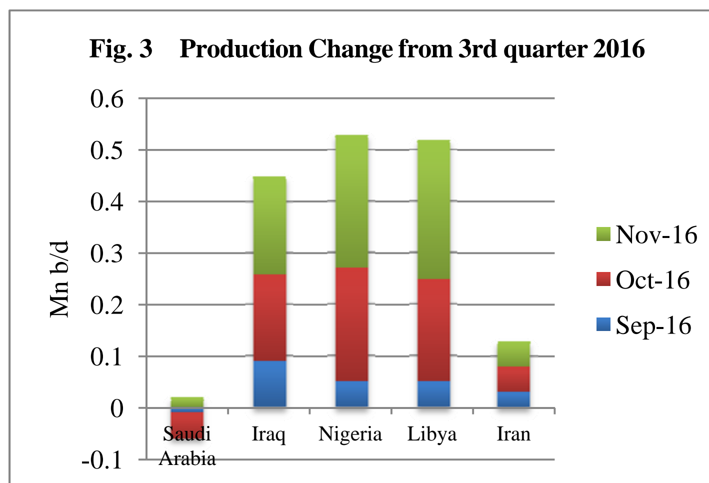
[1] Inventory data for the oil industry is notoriously unreliable and is subject to considerable lags. The data from the United States Energy Information Agency simply acts as a reasonable proxy to illustrate the existing over-hang.

[2] Also referred to as drilled but uncompleted wells (DUCs)




Source: Ali Aissaoui, 2014

The weighted average barrel price was $102 with only Kuwait and Qatar able to survive at $60. The Kingdom was also facing its own financial problems with their financial reserves falling much faster than had been expected. In Summer 2014, they had $750 billion, by mid 2017 this had fallen below $50 billion. Finally, Saudi Aramco was struggling to provide the barrels needed for a market share strategy. In October 2017, they discovered they could not produce above 10.9 mbd despite the conventional view that their sustainable capacity was 12-12.5 mbd. The author has this information from what he regards as a reliable source and it appears to be confirmed by the production figures in Fig. 3.




Source: IEA data for the Monthly Oil Market Report

Such a production pattern in fig. 3 is not that of a producer trying to secure market share. What the Saudi strategy in the future is likely to be remains to be seen. It appears that Saud Aramco is trying to restore its spare capacity, which has been a pillar of its oil policy since 1985. It also appears that President Trump is encouraging Mohammad bin Salman, who is currently the de facto rule, to be aggressive to Iran and indeed to Qatar. As will be discussed below, this could be extremely destabilizing in the MENA region. However, Saudi Arabia faces a fundamental problem. If it decides to go back to an administered market to fix prices at some desired level, this will only be possible if it eventually is willing to resume its swing role. The history of the sort of agreements reached in December 2016 within OPEC and with Non-OPEC does not bode well for a collectively managed market. There is already growing evidence that compliance with the agreement is weakening. Resuming a swing role will simply lead to a re-run of 1980-85 and that would be unsustainable.

A second potential threat to oil markets concerns Iran. The Joint Comprehensive Plan of Action (JCPOA) agreement has de jure removes many sanctions on Iran. However, President Trump was extremely negative towards the agreement and indeed threatened to "rip it up". Fortunately the "grown-ups"[3] in Washington have persuaded him against this. However, it is clear that he intends to target Iran. Most worrying is the report that he has created a small task force within his immediate White House circle to consider action against Iran and bypass the CIA and the Pentagon in terms of "intelligence". Those with long memories will remember a similar tactic by G W Bush in 2002 in the context of Iraq followed by the United States' invasion in 2003. The danger is that Iran is in a position to further destabilize the MENA region. It is necessary to go back to 1918, the end of World War I and the collapse of the Ottoman Empire, to find a period when the region was so unstable. Iran is in a very strong position to worsen that instability. This would inevitably cause problem for the global oil markets re-instating a geo-political premium on oil prices.

The final immediate threat to the political stability of MENA and to the oil market concerns President Trump's election promise to move the United States' Embassy in Israel to Jerusalem from Tel Aviv where virtually all other countries have their embassies located. This would be a de facto and a de jure acceptance of the Israeli frontier created by the 1967 Six Day War. Such a diplomatic move would trigger a major and seriously destabilizing uprising in the region comparable to the Arab Uprisings and the various Intifadas. Fortunately, again the "grown-ups" in Washington have persuaded President Trump not to pursue this promise but it remains on the table and, as with his threats over Iran, could seriously destabilize oil markets.

[3] This refers to the few people in the Trump Administration who have any idea how the real world outside of New York real estate actually works.

## Conclusions?

The most obvious conclusion is that in the short to medium term “Trumpian Uncertainty” presents very serious challenges to predicting what may happen in global oil markets. Absent a geo-political upheaval, oil prices are likely to stay lower for longer. Certainly they will remain below $60-70 for the next few years as the increased elasticity of supply acts as an effective ceiling. Longer term, for the reasons outlined, a major upheaval in the MENA region is increasingly possible. Coupled with the move against hydrocarbons triggered by COP 21 and the Paris Agreement, this is likely to sound the death knell of oil as a major energy source as consuming governments decide ‘enough is enough’ and seek to use policy to move away from what will become seen to be an increasingly unstable and unreliable source of primary energy.

Writer’s Profile
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Educated as an economist and as a specialist on the Middle East at Cambridge and SOAS; 1973-1979 teaching at the American University of Beirut in Lebanon; 1979-93 at the University of Surrey. Between 1993 and 2008, he was Professor of Petroleum Policy and Economics at the University of Dundee, Scotland, a chair created by BP. He is an expert in the international petroleum industry, economic development in the Gulf and energy economics.


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