The Oil Game Has Changed

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Theme: Global Economy, Oil and Energy

Global Research, December 26, 2018

The Players Have Changed

US oil production is rapidly growing and has reached 11.2 million barrels per day in Nov 2018, is expected to reach 12.05 m/bpd next April and 12.29 m/bpd by yearend 2019. The pipelines bottleneck will be resolved by the end of 2019 including pipelines to the export ports enabling the US to substantially increase its oil exports and compete with everybody else. And, with $60 – 80 prices being profitable for the US shale producers, this becomes the ceiling for oil prices, and woe to those needing higher prices to breakeven or balance their budgets.

With the dramatic rise of US oil production (its 2018 increase is greater than Nigeria's total production), the oil market is now dominated by three players: The USA, Russia and Saudi Arabia who jointly represent 30 – 40% of total world production, giving them control of oil prices and hence, the fate of the world.

At the same time, OPEC's power to influence oil market and prices seems to be declining. The evident discord among its members regarding increasing and lowering production levels and quotas is becoming more vocal, which further weakens the cartel and hastens its possible demise, inviting more confusion, lower prices, higher costs and weaker economies.

While there are many outcomes, we examine here a scenario where the goals and objectives of the three big producers are contradictory. Additionally, the assumption that the small producers will tamely submit to the big producers, despite representing above 60% of production, unjustly ignores their rights as well as capabilities.

The Goals of the Players

The likely goals of the players may be assumed as:

The US Goals: One of its primary goals is to shrink its balance of trade deficit and turn it into a surplus. One method is to cease importing oil and become a major exporter. This is evident in the US policy in support of shale oil extraction through Fracking despite the consensus on its damaging effects on the environment. The US has supported and funded the research in Fracking and continues to support Frackers financially, politically and taxwise.

As for increasing its oil exports, it has shrewdly increased the supply of its product, is marketing it aggressively and is systematically undermining the competition. Some examples are:

– Its attempts to weaken the Russian economy through economic sanctions and to block Russian gas sales to Europe, thus opening the European market to US liquid Gas LNG despite it being much more expensive.

– This particular goal is important because of the large gas content of the US shale oil wells, which if not sold is burnt as waste. It also hampers the producers' ability to increase production, which in turn delays the plan to increase exports. The US has been exerting huge efforts to sell its LNG to everybody; friends, allies and even foes and its gas exports have quadrupled in 2017 and is expected to become the third largest gas exporter by 2020!

– Its attempts to reduce competitors' supplies. The choking of the Venezuelan oil industry and economy is a prime example as well as the sanctions on Iran, the destruction of Libya, etc.

Russia's Goals: For centuries, Russia has been faced by conspiracies and wars designed to weaken it regardless of the nature of its government; be it Imperial Czarist, Soviet Communist, or a Capitalistic Republic. Its sheer size and natural wealth and resources have always made it an attractive target for the West. And despite the economic and social destruction it witnessed after the collapse of communism, it has been able to rebuild itself to levels way better than ever before.

But rebuilding is a difficult and costly exercise and requires huge capital investments and the support of friends. It soon discovered that its friends were few and many held ill will towards it. It is also hampered by Western economic sanctions and threatened by a NATO military cordon. It had to rely on oil and gas revenues in rebuilding itself until the oil price crash of 2014 when it quickly redirected its efforts towards the agriculture and armaments sectors and soon succeeded in becoming the world's largest wheat producer and the second largest seller of sophisticated weapons.

On this basis, one would expect Russia to be extremely wary of entering any oil alliance with the US, and is expected to continue its goal of developing and expanding its oil & gas production and exports.

Saudi Arabia: It is different to its two large producer colleagues (USA and Russia). It doesn't have well a developed multi-sector economy to shield it from the disasters of oil price declines and, since 2014, has been suffering from persistent budget deficits. This has now been addressed by the ambitious 'Vision 2030' plan to transform the economy into multi sectors, industries and revenues. However, until that occurs, oil prices could remain below $60 – 80 and the ensuing budget deficits could erode the country's financial reserves. Nor is borrowing likely to be a viable solution.

Based on the negative outlook for oil prices, Saudi may opt to increase its production and exports to halt or reduce its budgetary bleeding. Such a goal is implied in its determination to introduce alternative energy sources (Solar, wind, hydraulic and nuclear) to reduce local oil consumption freeing more for export. It is also rapidly increasing its investments in developing new and existing oil fields.

The Other Oil Producers: In view of their relatively small individual size, they have little say and are at the mercy of the big boys. However, they have been suffering for several years from reduced revenues and rising expenses. Their initial reflex-reaction may be to jack-up oil production, but that could trigger a 2014-like crash and with a worse financial outcome. They need a different solution that increases their collective power. An alliance similar to OPEC may be their best option, subject to it being much more cohesive and mutually supportive. Something that would pool their oil as a single unit with a centralized management of all technical, production and marketing operations, and, most importantly, stand ready to financially support any member that stumbles. Of course, this would require a lot of wisdom and forward thinking and, only time will tell.

The Consumers: Their eternal goal is lower oil prices, and they may get it. Producer disagreements and disputes are a god-send and it is in the consumers' interest to play them off against each other.

Conclusion

Nothing remains constant. The present weak oil demand coupled with the rise in production have lowered prices at a time when the world is racing towards alternative energy sources. At the same time, the oil producers (including the big boys) are suffering from economic hardships that are threatening to become catastrophes, and they all see their salvation in increasing their oil production and sales.

The big producers are powerful, but their individual goals are contradictory and unlikely to be reconciled – except, maybe, through arm twisting, conspiracies or wars. However, they seem fully united against the small producers.

In return, the smaller producers may initially react individually, but are unlikely to succeed. They will eventually realize their need for collective action to defend themselves, especially as they represent over 60% of world oil production. However, any such move will be resisted by the big boys and could, in the, worse case, lead to military interventions and/or false flags. Therefore, the sooner they act collectively to counter the negative odds facing them, the better are their chances of survival.

The above is a description of one hypothetical scenario, which may or may not come to be. However, wisdom dictates that all concerned parties consider it carefully, study its possible outcomes and prepare a plan "B".

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