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# The GCC and the Evolving Notion of Gulf Energy Security

NIKOLAY KOZHANOV

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**Abstract: The negative impact of the coronavirus pandemic on the hydrocarbon producers of the Gulf Cooperation Council (GCC) is raising serious questions about the need to change the focus of Gulf energy security from; the necessity to protect the interests of Gulf oil consumers, to the need to ensure the interests of oil producers themselves. The GCC countries have already been severely tested by; contracting economic growth, falling incomes from exports, low oil and gas prices, unpredictable hydrocarbon market fluctuations, a steep drop and sluggish growth in oil demand, as well as intense competition with other oil and gas producers. In order for the GCC hydrocarbon producers to adequately respond to emerging challenges, it is important to clearly define and understand the origins of these issues, the majority of which are deeply connected to the oil and gas market transformation which started long before the coronavirus pandemic.**

## Rethinking the Energy Security of the Gulf

The pandemic has clearly demonstrated the need to review our understanding of Gulf energy security. Since the late 1960s (if not earlier), its concept has revolved around the need to ensure the sustainability of oil consumers' access to the hydrocarbon resources in the region. The perception of oil as a unique, finite and unevenly distributed resource (the demand for which often exceeded supply) only made the world more confident that ensuring energy security in the GCC was solely limited to the stability and physical security of crude exports from the region. However, the picture is much more complex, not least because the security of consumers' interests does not mean that the interests of crude producers are automatically respected. On the contrary, producers' access to consumer markets and their ability to trade hydrocarbon resources at desired prices and in necessary volumes should be guaranteed separately. Moreover, the protection of these interests is of key importance for the existence of the GCC member states which are heavily dependent on incomes from oil and gas exports.

For decades the global oil market was dominated by oil producers, thus making the task of protecting their interests easier, despite the uneven degrees and nature of this dominance over the last 70 years. However, since the early 2010s the market balance has been gradually shifting in favor of the buyers and the coronavirus has now clearly demonstrated that the hydrocarbon producers' position is more vulnerable than before. The unprecedented sharp drop in oil demand caused by the pandemic has led to an equally unprecedented oversupply which has swung the oil market in favor of buyers and significantly weakened the position of sellers. This change has stripped the importance of hydrocarbons as a 'unique' resource, giving its consumers the right to choose between

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suppliers offering the cheapest price. Suddenly, the GCC countries are scrambling to ensure their own sustainable access to markets in order to guarantee the adequate development of their own economies, particularly the oil, gas and petrochemical sectors. In other words, the energy security focus of the GCC countries has shifted from protecting the interests of oil consumers, to protecting the interests of oil producers. And whilst the coronavirus pandemic has had a significant negative impact on the GCC countries and their oil and gas sectors, is it the sole source of their problems?

**It Never Rains but It Pours**

The coronavirus pandemic has hit the economies of the Gulf monarchies and their oil and gas sectors in several ways simultaneously:

**- Firstly**, the global oil glut has forced the GCC countries to wage a severe price war in the hydrocarbon market. Moreover, in Spring 2020, oil producers had to fight not so much for the expansion of their market presence, but rather to protect their position while being pressured by a devastating fall in demand. As one commentator observed, this turned the market competition into a bloody knife fight where anything goes.[1] Thus, in the struggle for the Chinese market, not only has Saudi Arabia increased its supplies and seriously damped on prices, but the UAE, Iraq, Russia, and oil producers in Latin America and West Africa have also joined the fight. The sharp drop in oil prices has all but erased the boundaries of suppliers' regional specializations, therefore opening up access to new markets for some players, further increasing competition. Consequently, in Spring 2020 Saudi Arabia was having to compete for the Chinese market not so much with the Russian Eastern Siberia-Pacific Ocean oil pipeline (ESPO) oil benchmark, but rather with Russia's Urals brand (which had traditionally exported to Europe not Asia).[2]

At the same time, the excessive crude reserves accumulated by some traditional consumers during the period of low prices in spring of 2020 also tempted them to temporarily become exporters when prices started to recover. This made life for

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traditional oil producers even harder; for instance, in July 2020, the Chinese oil traders suddenly announced their intention to resell about 1 million barrels of oil from their reserves to Asian consumers at a price lower than those set by Saudi Arabi and the UAE (as the GCC member countries included transportation costs which were higher than those of Chinese traders whose stocks were already located in the region).[3]

As the rate of oil consumption in Europe and Asia has started to gradually recover, the situation has somewhat improved and the competition between producers become less aggressive, but it is still far from normal.[4] Albeit with a time lag, the global gas market is currently repeating some of the same negative patterns seen in the oil trade. However, whilst the oil producers have OPEC+, which could at least play the limited role of a market regulator, gas exporters have no equivalent which makes the price war even more aggressive. Thus, during the first six months of 2020, Qatar and Oman failed to offer competitive prices for their liquified natural gas (LNG) supplies to the shrinking South Korean market. As a result, the volume of their exports in comparison with the same period of 2019 fell by 24% and 10.5% respectively. At the same time, in spite of the negative market conditions, Australia, the USA, Indonesia, Malaysia and Russia managed to increase their LNG supplies to South Korea,[5] whilst Doha played differently by offering the most appealing prices to local consumers in Taiwan and increasing its export volume. Doha's main competitors (Russia, the USA and Indonesia) also managed to increase their exports at the expense of others, thus making the gap between them and Qatar smaller.[6]

At the same time, the internal struggles of the GCC have also escalated: Under the current circumstances, Qatar's plans to increase the volume of LNG supplies and engage in a price war for gas sales with the USA, Australia and Russia has forced Oman considering whether there is a place for its products in the foreign markets. Furthermore, the excess supply of light oil from the Gulf has forced Bahrain to question its previous plans to increase oil exports, with Manama instead considering using oil which can be additionally produced in future for the needs of its own refinery.[7]

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**- Secondly,** the macroeconomic indicators of GCC members have deteriorated significantly amid lower revenues caused by the fall in oil prices and the all-out war for market shares. The resulting fall in oil incomes, accompanied by the need to support non-oil sectors hit by the global lockdown, have triggered significant budget deficits in the GCC countries. These deficits have, for example, put Kuwait at risk of running out of foreign exchange reserves, and Oman on the verge of a debt crisis.[8] Given the dominant role of government institutions in financing GCC economic development, any reduction in oil revenues inevitably slows down the implementation of key development programs. Together with the downturn in economic activity, this will lead to negative GDP growth rates for the Arab monarchies in 2020 with impacts on social indicators (See Table 1).

**- Thirdly,** the pandemic is threatening to slow down the development of the GCC oil and gas sector itself. On the one hand, national oil companies (NOC) will have to revise and, probably, cut their expenditures for 2020/2021, something which Saudi Aramco and Qatar Petroleum have already stated their intention to do.[9] Indeed Saudi Aramco is already questioning the necessity of implementing some gas projects. In late May 2020, it cancelled its participation in Indonesia's Cilacap Refining Project. In July 2020, it also stated that it needed to temporarily delay the USD15 billion purchase of a 20% share in the petrochemical and refining business Indian Reliance, a deal which is of key importance for Saudi expansion plans in Asia (moreover, it was argued by some analysts that the Cilacap purchase was cancelled to re-allocate necessary funds for the Indian Reliance purchase).[10]

The NOCs will need to reconsider their development plans not only due to declining revenues but also their own governments attempts to squeeze extra funds from the NOCs for the needs of socio-economic recovery, thus, deliberately depriving the national holders of assets which could be spent on development. To a certain extent, this is already happening with Saudi Aramco promising not to cut 2020 dividend payments,[11] with this money going to the Saudi government, the main company shareholder. Additionally, Saudi Aramco will pay the tax on company income (20% for downstream activities and 50% for other operations)[12] and

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royalties (15% of income from oil exports before taxes).[13] It has also decided not to delay the purchase of shares of the SABIC petrochemical Corporation, funds from which will de-facto be spent on keeping the Saudi economy afloat as they are to be allocated to the Saudi Public Investment Fund (PIF). Despite these measures, some experts believe the Saudi behemoth will need to raid its reserves to fulfill its financial obligations as the 2020 incomes might not be enough.[14]

On the other hand, during the protracted hydrocarbon market imbalance and very vague prospects for a rise in hydrocarbon prices, it is hard to expect foreign investors to be active in the GCC oil and gas sector. The expected increase in government control over Gulf economies and changes in tax regimes (such as a three-fold increase in VAT in Saudi Arabia) as a result of GCC austerity measures and recovery plans, will also have a negative impact on foreign investors interest in the Gulf oil, gas and petrochemicals sector.

For major players such as Saudi Aramco and Qatar Petroleum, this situation will not be as problematic as for smaller producers. The oil and gas producing sectors of Saudi Arabia, the UAE and Qatar are likely to face a slowdown in implementation of their development plans. Yet, for smaller states and their hydrocarbon sectors the situation might be critical. For example, experts are currently doubtful about the positive prospects of Bahrain's plans to increase oil and gas production through the development of new fields in the near future.[15]

- **Fourthly,** the pandemic has also demonstrated the declining role of OPEC+ as a market regulator which in turn, negatively affects Saudi abilities to influence oil prices. OPEC+ lacks sufficient capabilities to bring about instant market stabilization. The recovery in demand for hydrocarbons, as well as oil market rebalancing will be slow regardless of how the coronavirus pandemic develops. It is expected that the average annual drop in 2020 oil demand will be at least 8.1 million barrels per day, while OPEC+ and other factors will remove a further 7.2 million barrels per day due to oversupply.[16] In addition to the slow recovery in demand, the global economy will still 'burn' additional barrels of oil accumulated in reserves during the peak of

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oversupply in the first half of 2020, ensuring a period of relatively low and unstable oil prices in to 2021. A second wave of coronavirus infections threatens to worsen the situation, making the recovery in global oil consumption even less predictable.

**- Finally,** the availability of a wide range of alternative energy resources has made the threat of the physical disruptions of oil supplies from the Gulf less critical. Previously, only Iranian rhetoric about its readiness to block the Strait of Hormuz was enough to make the situation on world markets fluctuate. After a brief pause due to the coronavirus, the USA and Iran's game of muscles around the Gulf has now resumed but is of less concern to the market. The same can also be said for the continuing threat to the region's oil infrastructure from the Houthis. This, in turn, clearly demonstrates that political blackmail in the form of interrupting oil supplies from the region has somewhat lost its importance. In the age of a declining role for oil producers the security of the region's oil and gas infrastructure is becoming a headache primarily for the GCC itself, rather than for non-regional players. This also provokes the GCC's opponents to potentially act more aggressively (especially when Iran has made progress in building infrastructure to export its own oil, bypassing the Strait of Hormuz).

**Is this all about the coronavirus?**

As it becomes clearer that the end of the pandemic will not mean the return to the pre- coronavirus normality, it is also apparent that the coronavirus itself is not the source of the GCC's problems, but rather a catalyst. The roots of the majority of the above-mentioned issues go back to 2012-2015 and are linked to two factors: the impact of the US shale revolution on the global hydrocarbon market and the beginning of the global energy transition to non-carbon fuels. Thanks to the shale revolution (de-facto, new technological revolution) the USA not only became the largest producer and exporter of hydrocarbons, but also stimulated the emergence of new market players in other countries. Driven by these factors, the growth rates in global oil supply have been steadily surpassing growth in oil demand since 2011 causing the markets' oversupply in recent years. Due to the specifics of shale oil production, neither the 2014-2016 price war waged by Saudi Arabia in an attempt to bankrupt its global rivals, nor OPEC+'s subsequent efforts to regulate the market through the reduction of oil output could remove or eliminate this oversupply. Unsurprisingly, by the beginning of the pandemic the global oil market was already oversupplied and even without factoring in the coronavirus the volume of market supply was set to surpass demand by 2million barrels per day, making the fall in oil prices inevitable (although not that drastic).

In other words, the market oversupply which created alternatives to the Gulf suppliers and rendered any theories about the 'uniqueness' of hydrocarbons irrelevant to the oil price formation, emerged long before the coronavirus. Under these circumstances, it is not a coincidence that the new round of GCC economic troubles began almost simultaneously with the rise of the US shale oil production. The Arab monarchies have never fully recovered from the 2014-2016 fall in oil prices, which were caused, for the first time in history, by the rise in shale oil output. After 2014, their GDP growth rates significantly dropped, sometimes even recording negative values, and the oil incomes of the key players never returned to previous levels (see Table 1, Table 2).

Table 1. Real GDP Growth of GCC Member Countries 2012–2020 (%)

| | **2012** | **2013** | **2014** | **2015** | **2016** | **2017** | **2018** | **2019** | **2020**[17] |
|---|---|---|---|---|---|---|---|---|---|
| **Saudi Arabia** | 5.4 | 2.7 | 3.7 | 4.1 | 1.7 | -0.7 | 2.4 | 0.3 | -6.8 |
| **UAE** | 4.5 | 5.1 | 4.3 | 5.1 | 3.1 | 0.5 | 1.7 | 1.3 | -3.5 |
| **Qatar** | 4.7 | 4.4 | 4 | 3.7 | 2.1 | 1.6 | 1.5 | 0.1 | -4.3 |
| **Oman** | 9.1 | 5.1 | 1.4 | 4.7 | 4.9 | 0.3 | 1.8 | 0.5 | -2.8 |
| **Kuwait** | 6.6 | 1.2 | 0.5 | 0.6 | 2.9 | -4.7 | 1.2 | 0.7 | -1.1 |
| **Bahrain** | 3.7 | 5.4 | 4.4 | 2.9 | 3.5 | 3.8 | 2 | 1.8 | -3.6 |

Source: International Monetary Fund (IMF)

Table 2. Oil Export Revenues of Kuwait, UAE and Saudi Arabia 2012-2019 (in billions of USD)

| | **2012** | **2013** | **2014** | **2015** | **2016** | **2017** | **2018** | **2019** |
|---|---|---|---|---|---|---|---|---|
| **Kuwait** | 108.5 | 107.5 | 98.6 | 47.4 | 40.6 | 48.9 | 64.6 | 52.4 |
| **UAE** | 86 | 85.6 | 88.9 | 53.8 | 40.4 | 50.6 | 57.9 | 49.6 |
| **Saudi Arabia** | 337.5 | 321.9 | 284.6 | 152.9 | 136.2 | 170.2 | 231.6 | 202.4 |

Source: www.MEES.com

The increased competition of the GCC producers with other market players was also a result of the shale revolution which changed the hydrocarbon trade patterns. The USA has ceased to be an important market, instead becoming another exporter and diverting a significant

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portion of global hydrocarbon exports to Asia, thus, increasing competition in the main consumer market for GCC oil and gas producers. At the same time, the high sensitivity of shale oil production to oil prices subsequently shortened the duration of global oil price cycles and changed their amplitude. Given the ability of shale oil producers to quickly increase output if encouraged by positive market dynamics, oil prices are unable to rise too high and/or for too long, forcing GCC countries to say goodbye to the era of ultra-high incomes. Consequently, it was not the coronavirus, but shale oil which undermined the role of OPEC+ as a market regulator. The organization is only able to influence the price dynamics to a limited extent as any reduction in production volumes inevitably raises prices, therefore creating favorable conditions not only for the OPEC+ members, but also for other players to increase output and subsequently bring prices back down again.

In addition, more frequent swings between periods of high and low oil prices increases the chances of a 'perfect storm'. A natural decline in production under the pressure of falling oil prices caused by oversupply may more frequently coincide with a force majeure. This further suppresses demand and causes market instability due to unprecedented volumes of available extra barrels. And this was exactly what happened when the Coronavirus pandemic began.

Changing perceptions of the issue of physical security of hydrocarbon exports from the GCC countries were also a factor long before the coronavirus. The growing oil (over) supply and the oil consumers' understanding of the diminishing significance of the Gulf as a source of oil supplies also changed the situation considerably. By 2018, consumers no longer panicked when hearing about production shocks caused by political threats in the Persian Gulf, Middle East and even beyond. It is notable that, in 2018-2019, neither the instability of oil production in Libya, nor the practical disappearance of Iran and Venezuela from the market had long-lasting effect on prices (at best, only preventing them from further sharp decline). Even the allegedly Iranian-inspired attack on Saudi Arabia's oil production and refining infrastructure in September

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2019 only had a short-term impact on the market, even though the volume of oil this removed from the market in a single hit had not been seen since 1973. Under these circumstances, it is not surprising that in the context of the much larger excess of oil supply in 2020 caused by coronavirus lockdowns and restrictions, the world has almost ceased to respond to the Iranian-American tensions in the Gulf. In particular, the resumption of the USA and Iran confrontation in the spring of 2020, or new attempts by the Houthis to shell the territory of Saudi Arabia have provoked little reaction.[18]

**The Coronavirus Test**

In conclusion, taking the GCC countries should not blame only the coronavirus for their misfortunes as it has in fact only amplified the negative impact of processes which began a long time ago. Under these conditions, it is impossible to expect that the end of the pandemic crisis will lead to a gradual return to the pre-coronavirus situation, when the problem of Gulf energy security was solely related to the stability of consumers' access to regional hydrocarbons. The world has entered an era of relatively low oil prices, frequent market fluctuations, limited potential for growth in oil demand, and intense competition. Under these circumstances, the old rules do not work effectively, and any resolutions to the problems currently experienced by the GCC countries should be focused not so much on fighting the consequences of the coronavirus itself, but on curbing the negative consequences of deeper processes, whose damaging impact on the Arab monarchies was only worsened by the pandemic.

To a certain extent, the set of measures in response to market changes have already been drawn up and implementation started long before the coronavirus crisis. Some elements include (but not limited to):

- Economic diversification (with special focus on the development of the petrochemical industry as part of the so-called 'vertical diversification')
- Improved effectiveness of NOC business model
- Active interaction with traditional consumers in Asia in order to ensure

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their long-term loyalty as Gulf oil and gas consumers (both through active political contact and investment in their petrochemical production)

- Active overseas investment in upstream and downstream sectors, including investment in GCC rivals (such as US shale industry)
- Preservation of OPEC+'s role as market regulator with periodic attempts to actively monetize existing hydrocarbon resources (to the extent one strategy allows the implementation of the other)
- Investments in renewables and green energy
- Promotion of the role of natural gas as a transition type of fuel (from hydrocarbon to non-carbon fuels)

Under these circumstances, the coronavirus will not lead to the emergence of a new strategy, but rather provide motivation for the Gulf players to intensify the implementation of measures designed before the coronavirus pandemic began. It is notable that even whilst under heavy financial pressure the GCC member countries are not attempting to back away from the strategy they chose to deal with the market's evolution. Thus, Saudi Aramco is undergoing structural reorganization of its downstream business to increase its capacities as a petrochemical producer and is trying to preserve its ambitious foreign investment plans, starting off in Asia. The purchase of SABIC shares was also partially driven by the need to respond to the ongoing market transformation.[19] And as other NOCs also strive to continue with their pre-coronavirus' plans, it is clear that the coronavirus has not been an all-out game changer, but rather a deterrent and catalyst at the same time. The pandemic has clearly had a significant negative impact on the GCC countries and their oil and gas sectors. However, it would be a mistake to see it as the sole source of their problems.

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## About the Authors

**Nikolay Kozhanov is a Research Associate Professor at the Gulf Studies Center of Qatar University. He is also a Consulting Fellow at the Russia and Eurasia Programme of Chatham House. His research interests are focused on the geopolitics of the Gulf energy, Russian foreign policy in the Middle East as well as Iran's economy and international relations. Nikolay holds his PhD in economics from St.Petersburg State University (2010). He also has an MA degree in Oriental Studies (2006, St.Petersburg State University) and MA degree in Middle Eastern Studies (2012, University of Exeter). Dr. Kozhanov has been a visiting fellow at a number of leading international think tanks including Chatham House and the Carnegie Moscow Center. His recent publications include Russia and the Syrian Conflict: Moscow's Domestic, Regional and Strategic Interests (Gerlach Press 2016); Iran's Strategic Thinking: The Evolution of Iran's Foreign Policy 2017-1979. (London, Berlin: Gerlach Press, 2018) and Russian Policy across the Middle East: Motivations and Methods (Chatham House 2018).**

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**Address**: Istanbul Vizyon Park A1 Plaza Floor:6
No:68 Postal Code: 34197
Bahçelievler/ Istanbul / Turkey
**Telephone:** +902126031815
**Fax:** +902126031665
**Email:** info@sharqforum.org

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