



The US Tight Oil Revolution and Its Impact on the Gulf Cooperation Council Countries:

Beyond the Supply Shock

Executive Summary

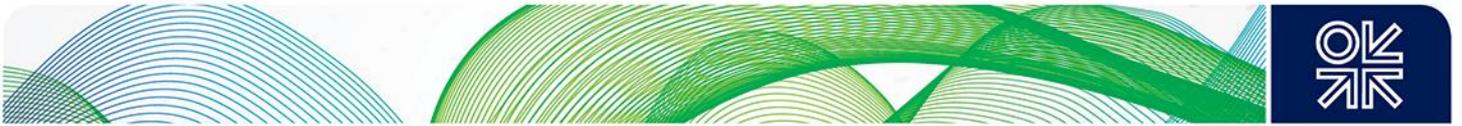
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While the impact of the increase in US production on prices and on oil market dynamics is yet to be fully felt, as some of the underlying forces still need time to unfold and need to be fully understood, it is important to provide a general framework to help us analyse the US shale revolution and its potential impacts on oil markets and key Middle East producers. In this paper, we propose a broad framework based on three main aspects:

- (i) the US tight oil revolution as a positive oil supply shock – with the potential to transform into a global supply shock if hydraulic fracturing technology successfully diffuses to other parts of the world;
- (ii) the US tight oil revolution as a force disrupting the existing trade flow patterns of crude oil, petroleum products, condensates, and NGLs;
- (iii) the development of US shale as a powerful force behind the shift in market perceptions, not only from a position of oil scarcity to one of oil abundance, but also as a shift in terms of the USA's aspiration to achieve energy independence and how this would impact US foreign policy and its relations with other players, including key Middle East oil exporters.

This paper analyses each of these aspects in depth. It argues that despite the transformations in the global oil scene, the paper argues that the Middle East more generally – and the GCC more specifically – will remain a central feature of the oil market. With the share of oil in global primary energy demand expected to hold at close to 30 per cent through until 2035, the call on Middle East and GCC oil will continue to increase. Therefore, the investment policies in these countries will remain key to future oil balances. In the shorter term, many of the supply shocks and their offsets originate from the region. The US supply shock has helped put a ceiling on the oil price and under some circumstances could result in a softer market. But the view that the US oil shock could erode the revenue base of the GCC, and consequently destabilize it, is rather simplistic. The supply shock from the USA on its own is unable to move the market to a persistently low oil price environment. But, more importantly, it is in these softer markets that the output policies of some GCC producers would have the most significance.

Nevertheless, the growth in US tight oil output has resulted in significant shifts in the trade flows of crude oil, petroleum products, LPG, and condensates. These shifts are resulting in greater competition, which would only intensify as US net imports continue to fall. In crude oil markets, the competition will be reflected mostly in more competitive discounts, while in LPG, naphtha, and condensates markets, shipping costs and rising domestic demand (which would limit export availability) can continue to provide support for prices of these products. It is important to stress that these more competitive pressures are taking place at a time when the GCC countries are continuing their efforts to capture more value added through vertical integration into refining and petrochemicals. Petroleum products and specialty product markets are intrinsically more competitive than crude oil



markets; GCC producers going down the vertical integration path have yet to come to terms with the necessity of developing new marketing tactics and pricing strategies in this rapidly changing environment.

The paper concludes that rather than external factors, some of the internal dynamics could prove capable of playing a much bigger role in the future position of the GCC within the global energy order. One of the disturbing trends in the region over the last two decades has been the faster growth of regional oil consumption in comparison to its production. While factors such as robust economic and population growth, improvements in living standards, and energy intensive industrialization have all contributed to growth in energy demand, a big part of the demand growth can be attributed to wasteful consumer behaviour and inefficiency in the use of energy due to low energy prices. Political turmoil and fear of regional spillovers have reinforced pre-existing barriers to reforming the region's domestic energy markets (including energy prices), and such reform is needed to put a dent in domestic energy demand growth. On the supply side, low domestic prices, unattractive fiscal terms, erosion of the technological and human capability of NOCs, and a deteriorating investment environment in some parts of the region imply that supply growth is likely to be constrained in many parts of the region. This is happening at a time when countries, including those unaffected by the immediate repercussions of the Arab Uprisings, have responded to the upsurge in political turmoil across the region by increasing their social spending, which means that Middle East oil exporters have become even more dependent on high oil prices and hydrocarbon revenues, increasing their vulnerability to cyclical movements in the oil price. Rather than changes in the US energy scene, domestic factors in the shape of oil producers' lack of success in diversifying their economies and their revenue base, together with inefficient energy policies, could prove to be the region's biggest threat.