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League of Arab States Update No. 3: Economic and Strategic Vulnerabilities of Oil

While the Middle East is home to some of the world's richest countries based on nominal Gross Domestic Product (GDP) per capita, it also has an underlying economic problem: much of that wealth is dependent upon oil; this is problematic because oil is a single, natural resource with finite supply and of volatile financial, economic, and geopolitical importance.¹ Recent years have shown that as technological advancement opens up new areas and reopens areas previously thought drained, prices will drop precipitously.² This is nothing new for the oil industry, which has remained extremely volatile since it was first produced on a wide scale from the fields at Baku and those in Northwestern Pennsylvania.³ Countries such as Saudi Arabia, which gets 85 percent of its export earnings from oil,⁴ are right to fear this volatility, as the history of early oil booms and rapidly fluctuating prices provides a potential glimpse into the region's future.

The town of Pithole, Pennsylvania, is an illustrative example of how an oil boom can cause extraordinarily fast growth, and equally precipitous collapse. In 1865, a piece of farmland sold for \$1.3 million (\$20.1 million in 2018 dollars); it had been "virtually worthless" a few months prior. Just a few months after the discovery of oil, however, Pithole's wells ran dry, and the town collapsed so thoroughly that when fires swept through it, not a soul was there to put them out.⁵ Though the industry is far more stable and advanced today than it was in 1865, it is still susceptible to extreme volatility, as a global crisis or new production boom can trigger a price hike or collapse. There is also the ever-present risk that the world's biggest oil consumers will either reduce their dependence on oil altogether through renewable energy or other fossil fuels, or that they will produce more of their own oil and thus no longer depend on LAS oil exports. Just as Pithole, Pennsylvania's entire economy was dependent on oil, so are the economies of several of the Middle East's wealthiest countries.⁶ As of now, any significant reduction in the consumption of oil by the rest of the world, or a boom in production, could trigger severe economic damage resulting in civil strife and possible outbreak of regional conflict.⁷ Such was the case in 2014-2015 when Saudi Arabia's fiscal deficit dramatically increased with a reported \$98 billion in lost revenue due to falling oil prices:⁸

In contrast to its action in previous periods of oil price drops, Saudi Arabia, along with the rest of OPEC, chose not to cut production in order to increase the oil price. In contrast, it aimed to maximize market share by continuing its production levels in an attempt to force other producers, especially American shale producers, out of the market. Facing a lengthy period of low oil prices, the Saudi economy struggled. As of 2016, Saudi Arabia's budget deficit was 13.5 percent of GDP, and oil still accounted for almost 90 percent of government revenues. The fall in the price

¹ Maceda, Cleofe. "Richest Countries in Middle East Revealed." Gulf News. October 19, 2015.

<https://gulfnews.com/business/economy/richest-countries-in-middle-east-revealed-1.1603124>. (Accessed September 24, 2018).

² Raval, Anjali. "Saudi Arabia's Existential Crisis Returns as US Shale Booms Anew ." Financial Times. March 19, 2018.

<https://www.ft.com/content/0a485e78-2914-11e8-b27e-cc62a39d57a0> (Accessed September 24, 2018)..; Rogoff, Kenneth, and Thomas D. Cabot. "What's behind the Drop in Oil Prices?" World Economic Forum. March 06, 2016.

<https://www.weforum.org/agenda/2016/03/what-s-behind-the-drop-in-oil-prices/>.

³ *The Prize: The Epic Quest for Oil, Money, and Power*. Daniel Yergin, Free Press Books. Pp. 14-15.

⁴ Ahmed, Irina, Josh Cohen, and Mihir Trivedi. "The Political Economy of Oil in the Middle East." Penn Wharton Public Policy Initiative. March 23, 2017. <https://publicpolicy.wharton.upenn.edu/live/news/1778-the-political-economy-of-oil-in-the-middle-east-for-students/blog/news.php>.

⁵ *The Prize: The Epic Quest for Oil, Money, and Power*. Daniel Yergin, Free Press Books. Pp. 14-15.

⁶ Al-Khatteeb, Luay. "Saudi Arabia's Economic Time Bomb." Brookings. July 28, 2016.

<https://www.brookings.edu/opinions/saudi-arabias-economic-time-bomb/>. (Accessed September 26, 2018).

⁷ Even, Shmuel, and Yoel Guzansky. "Saudi Arabia's Vision 2030: Reducing the Dependency on Oil." The Institute for National Security Studies. May 06, 2016. (Accessed September 26, 2018). <http://www.inss.org.il/publication/saudi-arabias-vision-2030-reducing-the-dependency-on-oil/>.

⁸ Brinded, Lianna. "Here's Proof That Saudi Arabia Doesn't Care about Killing Oil Prices - Only the Competition." Business Insider. August 11, 2016. <https://www.businessinsider.com/saudi-arabia-july-oil-production-and-oil-price-impact-2016-8>.

of oil has also led to a sharp reduction in Saudi currency reserves and increased government borrowing to make up for the budget shortfalls.⁹

As a result, the Saudi government has reevaluated its economic and foreign policy plans to weather any turmoil caused by oil-price change.

The Oil Weapon, and the Western Drive for Energy Independence

In the 21st Century, domestic calls in Western nations for an end to dependence on oil from the Middle East are nothing new; indeed, it appears nearly obligatory, at this point, for each United States of America (USA) presidential candidate to assert the desire for “energy independence.” Yet this attitude has roots in the previous century, specifically, during the 1973 war with Israel, in which Organization of the Petroleum Exporting Countries (OPEC) members deployed what is known as “The Oil Weapon” in an attempt to dissuade Western interference in the conflict on the side of Israel.¹⁰ This ‘weapon’, really the restriction of exports to the United States, had the unintended consequence of creating what could now be described as a permanent feeling of insecurity about the source of America’s oil among its citizens, previously unaware of such realities before the domestic energy crisis that was instigated during the 1970s.

Along with its allies and in coordination with its multinational oil companies, the USA began leading an effort to reduce the amount of oil it imports from League of Arab States (LAS) Member States. This effort has been long-term and slow-moving, but highly successful in generating new sources of oil and thus reducing the hold that Member States have on the global oil market. Exploration in the North Sea and Alaska, for example, have led to the discovery of massive oil reserves.¹¹ The USA has begun tapping what are now known to be the largest singular reserves of oil-shale on Earth, at 3.7 trillion barrels (of which approximately 900 billion barrels is estimated to be recoverable with current technology).¹² The United States is projected to become the largest producer of oil in the world next year,¹³ a significant change from the very recent past in which Saudi Arabia was the world leader in oil production.

In the 21st Century, the drive by Western states to reduce their consumption of Middle Eastern oil also includes sources of renewable energy with emphasis often placed on clean energy. France, for example, relies on nuclear generating stations to produce some 80 percent of its electric power, a policy directly attributable to the use of the “Oil Weapon” in the early 1970s.¹⁴ Growth in wind and solar-power technologies will continue as their creators find ways to make them more efficient at generating electricity, both at macro, grid-level power production, and for micro-level home power production.¹⁵

Oil and War

Oil has been a vital strategic resource for modern economies, and often sees its importance increased exponentially during wartime. World War I brought about some of the earliest fighting for oil, as land warfare became increasingly mechanized, and the world’s navies began switching from coal to oil, with enormous dreadnoughts becoming the preeminent symbol of naval power.¹⁶ The importance of oil would continue to increase as nations’ economies and militaries would grow ever more dependent on it. It is often said that most of the conflicts that have

⁹ Ahmed, Irina, Josh Cohen, and Mihir Trivedi. “The Political Economy of Oil in the Middle East.” Penn Wharton Public Policy Initiative. March 23, 2017. <https://publicpolicy.wharton.upenn.edu/live/news/1778-the-political-economy-of-oil-in-the-middle-east-for-students/blog/news.php>.

¹⁰ *The Prize: The Epic Quest for Oil, Money, and Power*. Daniel Yergin, Free Press Books, pp. 570-594.

¹¹ *The Prize: The Epic Quest for Oil, Money, and Power*. Daniel Yergin, Free Press Books, pp. 647-652.

¹² “2010 Survey of World Energy Resources.” pp. 110-122. World Energy Council.

https://web.archive.org/web/20141108215623/http://www.worldenergy.org/wp-content/uploads/2012/09/ser_2010_report_1.pdf

¹³ “Short Term Energy Outlook.” U.S. Energy Information Administration (EIA). September 10, 2018.

<https://www.eia.gov/outlooks/steo/?src=home-b1>. (Accessed September 26, 2018).

¹⁴ *The Prize: The Epic Quest for Oil, Money, and Power*. Daniel Yergin, Free Press Books., p. 637.; Bollaert, Baudouin. “French Nuclear Power and Its Alternatives.” Brookings. July 28, 2016. <https://www.brookings.edu/articles/french-nuclear-power-and-its-alternatives/>. (Accessed September 24, 2018).

¹⁵ “Tesla Solar Roof.” Tesla, Inc. <https://www.tesla.com/solarroof>. (Accessed September 26, 2018).

¹⁶ “Of Blood and Oil – How the Fight for Petroleum in WWI Changed Warfare Forever,” Military History Now, November 9, 2016, <https://militaryhistorynow.com/2016/11/09/of-blood-and-oil-how-the-fight-for-petroleum-in-wwi-changed-warfare-forever/>

erupted in the Middle East, especially in modern times, have been related to oil.¹⁷ Saddam Hussein's invasion of Kuwait was directly tied to the profits of the Kuwaiti oil fields. This of course led to a US response by way of invasion and intense air strikes.¹⁸ More concerning than the motivations of past wars is the way oil has impacted more recent conflicts, such as the Syrian Civil War.

The Islamic State of Iraq and the Levant (ISIL) has seen its territory and power drastically reduced in recent years, however at the height of its rule, ISIL was taking full advantage of the rich oil fields of Syria and Northern Iraq. Even as an internationally recognized terrorist organization, ISIL was finding immense success in financing the operations of its caliphate through the sale of oil from the many fields it had captured. Every day an estimated 1.5 million USD was filling ISIL coffers by way of oil sales to a variety of buyers.¹⁹ By now, much of ISIL's oil production has been cut off as fields and facilities continue to fall to the various factions opposing them.²⁰ Although the issue of ISIL funding is being resolved as the terrorist organization is steadily defeated, the ability of nefarious organizations to utilize oil for their own financial gain has been proven and must be accounted for when considering future security vulnerabilities of oil. Even as the economic power of oil falls into question, as long as money can be pumped out of the ground, it will remain a resource that is the focal point of conflict.

Visions for the Future

Given these realities, it is clear that LAS Member States must proceed into the future with an eye toward economic diversification. Dependence on a singular resource so susceptible to even minor political crises and wild boom/bust cycles is not a model for healthy economic development. Member States are beginning to realize this, as evidenced by Saudi Arabia's "Vision 2030" plan, announced in 2016 by Crown Prince Mohammad bin Salman.²¹ The plan is designed to build new sectors for the Saudi economy, including finance, healthcare, and heavy industry, and defense, while in the short-term seeking to finance the plan by increasing the country's oil revenues. Though a possibly overly-ambitious plan, Vision 2030 represents a starting point for Saudi Arabia's movement toward a stable economy and can serve as a useful jumping off point for this committee's members to discuss the future of oil in the Middle East. The strategic vulnerabilities of oil only compound the economic issues of LAS Member States' reliance on the resource. In a time of conflict, all aspects of oil production and exportation become more difficult, or potentially impossible. This leaves consumers and investors reluctant to engage with LAS Member States involved in such conflicts, which then translates to negative economic consequences. If LAS Member States wish to avoid such situations, economic diversification is of paramount importance. A cooperative effort of the body is crucial to ensuring such a transition is possible for all Member States.

¹⁷ "Middle Eastern Wars Have Always Been About Oil." Global Research. February 26, 2016. Accessed November 01, 2018. <https://www.globalresearch.ca/middle-eastern-wars-have-always-been-about-oil/5510640>.

¹⁸ "The Gulf War, 1991," US Department of State, <https://history.state.gov/milestones/1989-1992/gulf-war>

¹⁹ Solomon, Ericka, et al, "Inside Isis Inc: The journey of a barrel of oil," Financial Times, February 29, 2016, <https://ig.ft.com/sites/2015/isis-oil/>

²⁰ "US-allied Forces Take Syria's Largest Oil Field from ISIS," New York Post, October 22, 2017, <https://nypost.com/2017/10/22/us-allied-force-takes-syrias-largest-oil-field-from-isis/>

²¹ Even, Shmuel, and Yoel Guzansky. "Saudi Arabia's Vision 2030: Reducing the Dependency on Oil." The Institute for National Security Studies. May 06, 2016. <http://www.inss.org.il/publication/saudi-arabias-vision-2030-reducing-the-dependency-on-oil/>. (Accessed September 26, 2018).