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From Scarcity to Plenty: The Geopolitics of a World Awash in Oil

By Barry Desker

Synopsis

More sources of supply mean energy prices are likely to stabilise at lower prices than in the last decade. The decline in US dependence on Middle Eastern oil is likely to make the US see instability in the MENA region increasingly as a European problem.

Commentary

A decade ago, there were fears that the United States would be increasingly dependent on an unstable Middle East and a hostile Venezuela for oil imports. There were worries that US natural gas prices would be determined by the price of imported LNG. Today, there is growing attention to the prospects of the United States as a LNG exporter influencing prices in Asia and Europe. The shift occurred because of the unexpected emergence of unconventional oil and gas production in North America, especially as Saudi Arabia did not reduce its oil production to stabilise prices at relatively high levels.

This development, together with renewed supply from Iraq and Libya which had previously declined because of domestic political instability as well as reduced demand arising from the economic slowdown in China and the recession in Europe and the US following the global financial crisis of 2008, resulted in a sharp fall in the oil price. Earlier projections of continued increases in demand were based on continued healthy economic growth and tighter supply. The assumption was that a lack of new sources of production would lead to rising prices for oil and natural gas and a growing emphasis on energy security as consumers tried to lock-in supplies even as alternative sources of energy were promoted. It is now recognised that the majority of these alternative sources are not commercially viable unless subsidies are provided.

Impact on global markets and power balance

For oil and natural gas importers like Singapore, the cost of domestic utilities and transportation will be reduced while lower fuel costs for the important maritime and air services sectors will have a positive impact on their financial performance. Shipyards building offshore platforms and offshore supply vessels will have a dwindling order book. The building of LNG terminals in Singapore will enable Singapore to benefit from price differentials in the Asian, European and North American gas

markets. When the first LNG terminal began operations in 2013, Singapore was no longer dependent only on piped natural gas from Indonesia and Malaysia.

Two major uncertainties affect global markets. First, whether the three natural gas regional markets will merge into a single market. Currently, the natural gas price is US\$2.7 per million British Thermal Units (MMBTU) in North America, \$7.4 per MMBTU in Europe and \$7.8 per MMBTU for re-gasified LNG sold in Northeast Asia. Secondly, whether the price differential between oil and gas continues in international markets. From a thermal energy value perspective, one barrel of oil is approximately equivalent to 6 MMBTU. With oil currently at around \$65 per barrel, the oil equivalent price of gas should be approximately \$11 per MMBTU. However, in all the major markets, gas is trading at a discount to its oil equivalent price.

The effect of the downturn in oil prices is that the power balance has shifted from the holders of resources to consumers. It will be a period of belt tightening for oil producers, although most of them have accumulated significant dollar reserves. This explains the rise in opposition to the Maduro administration in Venezuela which cannot dispense the largesse offered under previous president Hugo Chavez. It has made Iran more ready to talk to the West to remove the effect of crippling sanctions resulting from its development of indigenous nuclear technology, including enrichment, and limited Saudi Arabia's capacity to buy off domestic opposition through larger social welfare hand-outs.

United action by OPEC to increase oil prices by restricting supply is unlikely. Saudi Arabia has a greater motive in maintaining the current price to squeeze Iran, its political rival in the Middle East, as the Saudis are concerned about the ongoing turmoil in the region and the risk of unfriendly political realignments in neighbours such as Yemen. Nearer to Singapore, Malaysia faces increasing pressure to meet the income shortfall through cutting oil and gas subsidies as a budget deficit looms. Declining oil prices offer Indonesia an opportunity to cut back on oil subsidies now that it is a net oil importer. Importers like South Korea and Japan will also benefit from lower oil prices.

Changes in trade patterns and perspectives

Significant changes in trade patterns are likely. Russia will export more to China and East Asia, with Europe now more wary of increasing dependence on Russian oil and gas after the turmoil in Ukraine. Global markets will be affected by the declining US reliance on imported oil and the expectation that the US Congress will adopt legislation allowing an export of the American surplus. If this occurs, the US oil and gas markets will become increasingly integrated and the global integration of gas markets is likely to occur. However, it is uncertain whether the US will allow oil and gas exports.

The decline in US dependence on Middle Eastern oil is likely to make the United States see instability in the Middle East and North Africa increasingly as a European problem. After the long and inconclusive wars in Afghanistan and Iraq, there will be a reluctance to expend American manpower and resources on the rising threat of the Islamic State and unstable regimes in the Middle East. While policy rhetoric about a re-balancing to Asia will be heard, US defence budgets cuts will occur and there is unlikely to be a significant increase in US military deployments in Asia. Although there will be wariness about rising Chinese economic and military capabilities, the United States will remain the paramount global military power in the decade ahead.

While attention has been focused on the shale gas revolution in the United States, future potential unconventional oil and gas producers include Argentina, China and Ukraine. Governments of these energy importers will want to exploit their resources but will be constrained by their infrastructure, water access and industry expertise. A key difference is that in the United States, underground resources are owned by the owners of the surface land. Elsewhere, the state owns these resources, giving individual land owners no incentive to exploit the reserves. They are likely to emerge as opponents of hydraulic fracking because of the perceived risks of stimulating earthquakes, the negative impact of methane leakage and concern with water management issues.

Nevertheless, the critical point is that the presence of increasing sources of supply is likely to result in energy prices stabilising at lower levels for the next decade compared to the last ten years, provided there is no major political upheaval which disrupts energy markets.

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