

# New Alignments? The Geopolitics of Gas and Oil Cartels and the Changing Middle East

Songying Fang,<sup>1</sup> Amy Myers Jaffe<sup>2</sup> and Ted Loch-Temzelides<sup>3</sup>

## Executive Summary

Two recent political and economic developments in the Middle East and the United States are likely to bring significant changes to energy markets. On one hand, the ongoing democratic movements and civil wars in the Middle East have challenged the stability of regimes across the region, including Saudi Arabia. On the other hand, the United States is set to commercially exploit its own large reserves of unconventional oil and gas. How will these developments influence the configuration of the energy markets in general, and Saudi Arabia's energy policy in particular? Will the long-standing U.S.-Saudi alliance remain the cornerstone of the kingdom's relationship with the outside world?

Until recently the scholarship on Middle East politics tends to predict continuity in U.S.-Saudi relations. Two assumptions are implicit in the prediction. First, it is assumed that the oil-for-security aspect of the relationship will not change. This is

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<sup>1</sup> Department of Political Science, Rice University (sfang@rice.edu)

<sup>2</sup> Graduate School of Management, UC Davis (abmjaffe@ucdavis.edu)

<sup>3</sup> Department of Economics, Rice University (tedt@rice.edu). Corresponding author.

unlikely to be true following the commercial exploitation of large reserves of unconventional oil and gas in the United States. Second, there will continue to be a great deal of regime stability for Saudi Arabia. The Arab Spring challenged the assumption. The sudden collapse of Mubarak's government, the ensuing turmoil in the region, and most recently, the Syrian civil war, have put tremendous pressure on all regimes in the Middle East, including Saudi Arabia, to make adjustments in order to maintain monarchical order.

In light of the changes in the geopolitical environment in the Middle East and energy markets, we believe that it is important to investigate whether Saudi Arabia's self-interest will lead it to seek new external alignments. The democratic movement has forced the Saudi regime to spread its wealth more generously within its population. A downturn in oil prices, which may be the result of the anticipated increased supply in the United States, might render this strategy ineffective. Thus, the endurance of the Saudi regime might necessitate new energy coalitions.

Specifically, we investigate whether the new political and economic trends may warm the Saudi regime to a workable energy cartel with Russia. We evaluate the potential with a simple cooperative game, considering both economic and geopolitical payoffs for the countries we study: Saudi Arabia, Qatar, and Russia. The actions of these producers generate much of the dynamics in energy markets. Moreover, we analyze potential coalition formations in oil and gas markets simultaneously. Over the past two decades, natural gas has made strong gains as a substitute for oil, and the substitutability of natural gas for oil is expected to grow in the coming years. We consider all possible coalitions for the three major resource producers in the world.

There are two main findings. First, we find that the status quo configuration is stable, to the extent that Saudi Arabia and Qatar continue to assign great value to their alliances with the United States. However, the Arab Spring might have brought significant changes to Saudi domestic conditions and its regional relationships, leading to a reevaluation of the country's economic and security needs. As Saudi leaders take popular sentiments into account, it will likely become more difficult for them to disregard the reactions of domestic audiences on important economic and security issues in order to satisfy the policy demands of the United States. Therefore, changes in domestic and regional conditions are likely to reduce the benefits that Saudi Arabia derives from its alliance with the United States.

Second, Saudi Arabia's concern for its regime stability will elevate the importance of its revenue from oil. In the short run, the ability of the Saudi monarchy to hold onto the reins of power seems assured, as economic handouts, targeted repression, and the promise of reform have so far kept the vast majority of Saudis off the streets. In the long run, however, as expectations of the population increasingly need to be met with broadly distributed benefits, higher oil prices will likely become a top policy concern for Saudi Arabia. Under these circumstances, cooperating with Russia to sell oil and gas at higher prices may become a much more attractive option than it has been in the past. These changes can result in weakened ties between the United States and Saudi Arabia, and lead to an increased attractiveness of a Saudi-Russian coalition in energy markets. This would be especially true if Russia were to be more effective than the United States in helping contain Iranian nuclear ambitions and other regional threats in a manner that is less costly to Saudi internal stability. Thus, while a strong coalition between Saudi Arabia

and Russia may not be imminent, a scenario under which such a coalition may become more compelling in the future appears to be plausible.

How should the United States respond to such a potential realignment in energy markets? The new domestic discovery of shale oil and natural gas is making the United States less dependent on foreign oil imports. At the same time, the U.S. preference for democracy promotion in the Middle East may increasingly come into conflict with the interests of the Saudi ruling class. Despite these, the relationship should not be significantly downgraded. Saudi Arabia remains a major oil producer, and therefore, Saudi energy policy will affect world energy prices even as the United States becomes a major producer itself. U.S. allies in Europe and Asia will still be dependent on Saudi exports. The two countries also have common interests in preventing Iran from becoming a nuclear power and to fighting terrorism. Therefore, more rigorous U.S.-led conflict resolution initiatives in the Middle East would, in addition to avoiding military escalations that drive up oil prices, reduce the opportunities for Russia to leverage regional conflicts to bargain for energy coalitions.