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Bombing Saudi Oilfields: The Risk to Collective Action on Climate Change from State-Owned Oil Interests

There is a certain bloodless attitude that is required to stay current with the thrust and parry of events in the world that oil and gas producers have wrought.

This week, the events leading up to and now trailing away from the attack on Saudi Arabia's oilfields[1] have implications not only for a reported 5 percent of the world's oil supply, but also the direction of climate change policy.

The upshot for the climate: the control of large segments of the world's oil supply by cash-strapped, politically fragile and increasingly desperate regimes represents a risk to collective action on climate change that is distinctly different from that posed by large, private oil and gas interests beholden to shareholders.

There are three immediate takeaways from last week's events and the market reaction:

1. Current markets are oversupplied and likely to remain so for the foreseeable future. This depresses revenues and heightens pressure within governments and oil companies.

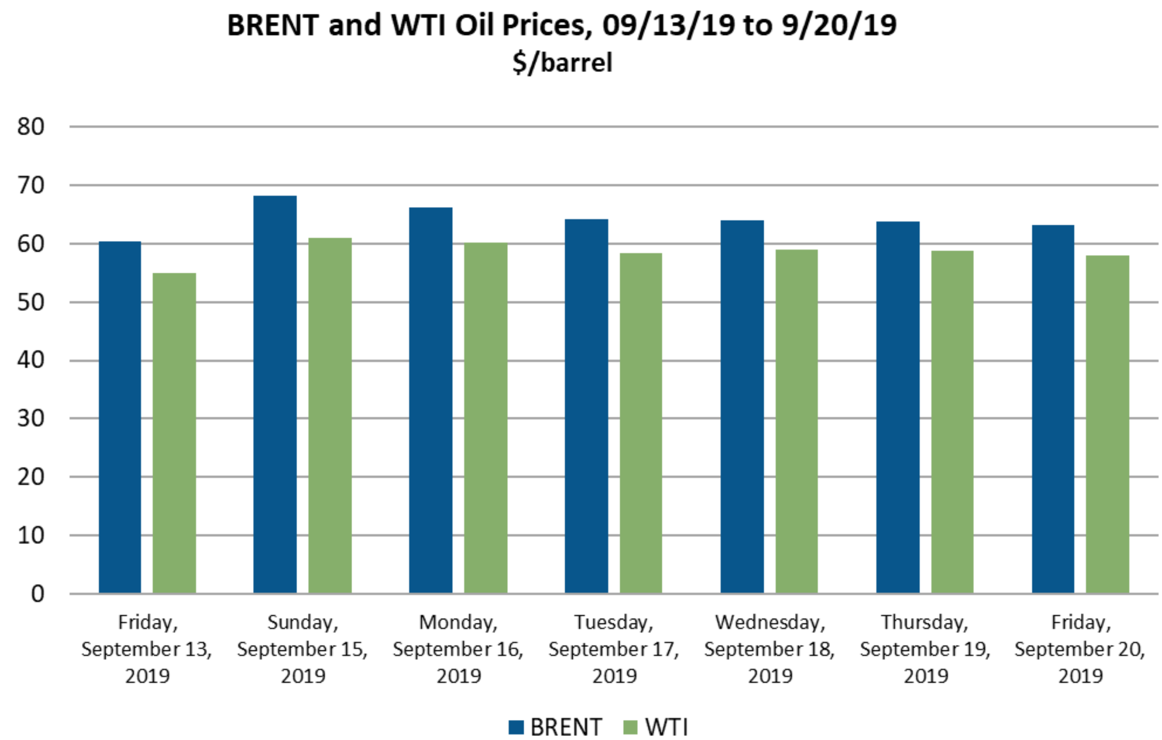
2. For now, the flow of oil and cash to governments is more important to political leaders than the flow of blood that often punctuates conflicts over energy.

3. Oil producers will not combat climate change. The events showcased the heightened need for collective action. But any consensus among oil producers to participate meaningfully in climate action is weak, at best.

1 Annahar. Yemen's Houthi rebels launch drones on 2 big Saudi oil sites. September 14, 2019.

Markets

Current Markets Are Oversupplied and Likely to Remain so for the Foreseeable Future



An oil price increase in the wake of the bombings was predictable.[2] Its size[3], duration and implications,[4] however, underscored a fundamental market reality: Oil markets are oversupplied.

Brent prices were at $60 per barrel on Friday, September 13 before the bombing, rose to $68 by Monday, and, if one were using a stopwatch, hit $71 per barrel for a very short time.[5] By Friday[6] September 20, one week later, Brent prices had settled back down to the $64 per barrel range. Not a bad week for oil prices.[7] Prices traded above $60 per barrel, and, in the stock market, the sector moved from last place, to next to last place.

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[2] CNBC.com. Saudi stock market dives, crude futures to jump after drone attack on oil plants. September 15, 2019.
[3]CNN.com. US oil prices had their biggest spike in a decade after Saudi attack disrupts global supply. September 15, 2019.
[4] OilPrice.com. Oil Price Explosion – Brent Crude Jumps 20%. September 15, 2019.
[5] Straitstimes.com. Oil prices soar by most on record after attack on Saudi facilities cuts global supply. September 16, 2019.
[6] Aljazeera.com. Oil prices dip as questions linger over Saudi production. September 17, 2019.
[7] Marketwatch. Oil posts biggest weekly gain in months after attacks on Saudi facilities . September 20, 2019.

During a time of lower-for-longer prices, the price pop was significant in that it was short-lived and quite modest.[8] The settling out leaves the industry pretty much unchanged – cash-challenged, racing to cut costs and subject to volatility. It tells investors the energy sector is likely to remain at or near the bottom of the stock market for some time to come.[9]

The industry news at the end of the week was business as usual – rig counts down,[10] production rising,[11] troubles in the Permian,[12] oil field services hoping for new contracts,[13] U.S. consumers expected to be hit by predatory gasoline price increases,[14] and oil traders looking at the bombing in the past tense.[15]

Political Response

The bombing was a political event. And, it was a political event in the Middle East, a place in perennial turmoil where most petro-states have a history rife with internecine conflict.

The response from industry leaders was quick. There were no casualties.[16] Saudi Arabia production was back up and running quickly[17]. And, as Russian energy leaders put it, the world's oil producers were well-positioned to fill the gaps in supply if needed.[18]

The first two points could be true. The last point has a clearer evidentiary basis. Excess capacity is the order of the day and is of such magnitude that it can be mobilized to fill even a gap as large as 5 percent of the world's oil. OPEC producers have been cutting production for the last few years in search of a price boost.[19] Russia has supported the cuts.[20] Private investment in the United States has driven production levels of both oil and gas to record levels but smothered profits.[21] To

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[8] CNBC.com. Oil prices rise slightly as Saudi supply risks come into focus. September 21, 2019.
[9] Yardeni Research. Performance 2019 S&P 500 Sectors & Industries. September 16, 2019. P.1.
[10] Oilprice.com. U.S. Oil Rig Count Takes Sharp Turn Downward. September20, 2019.
[11] Washington Post. Saudi Arabia's oil troubles don't rattle the U.S. as they used to. September 19, 2019.
[12] OilPrice.com. The World's Top Oil Basin Is Running Out Of Space. September 20, 2019.
[13] Chron.com. Weatherford lands five-year equipment deal with Saudi Aramco. September 18, 2019.
[14] The Detroit Bureau.com. Gas Prices Expected to Rise in Wake of Attack on Saudi Oil Facilities. September 20, 2019.
[15] OilPrice.com. Are Oil Traders Already Looking Beyond The Saudi Oil Crisis?. September 20, 2019.
[16] New York Times. Two Major Saudi Oil Installations Hit by Drone Strike, and U.S. Blames Iran. September 14, 2019.
[17] Market Realist. What Stopped Crude Prices' Upside Today. September 2019.
[18] OilPrice.com. Russia's Energy Minister: Global Oil Stocks Can Cover Saudi Supply Gap. September 16, 2019.
[19] Bloomberg. OPEC Gets Its Price Spike in the Worst Way. September 16, 2019.
[20] CNBC.com. OPEC allies agree to extend supply cuts in a bid to support oil prices. July 2, 2019.
[21] U.S. Energy Information Administration. U.S. crude oil production surpassed 12 million barrels per day in April. July 8, 2019.

take a step back, Canada's untapped oil sands reserves, once a leading light in the industry, have become all but economically unextractable as the high production costs have bled billions, led to capital flight and proven the lack of urgency for massive new production of oil and gas.[22] In addition, Canada's political leadership is engaged in a series of desperate moves to prop up the industry.

Quelling fears of a longer conflagration was also a priority and reflects the low-price environment. Countries with large state-owned holdings and private companies[23] are learning to live with a lower price environment and lower revenues but can ill afford prolonged periods of oil supply disruptions. Large oil majors are telling skittish investors that lower prices will not hurt rising dividend levels.[24] Russia made it a point in its fiscal deliberations that it can live with oil prices at $40 per barrel.[25] Saudi Arabia is looking to sell its assets in the stock market to raise cash.[26] Norway made it plain that the long-term outlook on oil and gas will significantly depress government revenues, permanently. The government is now seeking a broad public dialogue on how to prosper in a post-fossil fuel world.[27]

Today, lower prices are the only way to maintain demand for oil and gas. The choice for cash-poor, oil-rich countries: better to maintain demand at low prices than risk reduced consumption and political hostility from price hikes. High prices are a market signal to consumers to find cheaper alternatives – an option that is more realistic now than in prior periods of elevated prices. Large price spikes for long periods are unacceptable.

Implications for Climate Change

There are several observations to be made regarding the impact of these events on collective global action to combat climate change. Overall, the market forces and political reaction of the last week weakens the consensus-building needed to intensify collective action, while also underscoring the growing urgency for such consensus-building.

1. OPEC's cohesion is weakened. The bombing heightens tensions between Saudi Arabia and Iran. Despite the relatively benign impact on price and supply, the incident in the short-term indicates to consumer nations and private companies that they should further diversify supply. This suggests an almost permanent state of drilling and oversupply, weakened growth projections in any given oil-producing nation and company, and a more precarious revenue picture all around.

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[22] Theenergymix.com. Koch Brothers Abandon Alberta Tar Sands/Oil Sands. August 18, 2019.
[23] Fortune.com. Inside Oil Giant Shell's Race to Remake Itself For a Low-Price World. January 4, 2018.
[24] Yahoo Finance. StockBeat: Oil Majors' Dividends Stand out as Brent Settles Above $60. September 17, 2019.
[25] Standard and Poor's Global Ratings. Hooked On Oil: Is Russia Breaking Free?. March 16, 2019
[26] Financial Times. Saudi Arabia 'bullies' wealthy families to pump cash into oil IPO. September 21, 2019.
[27] Europeanceo.com. Norway threatened by GDP decline. May 15, 2019.

2. Industry oversupply is substantial. The lesson of the week: for war and its sundry skirmishes to have a substantial impact on supply and price, a conflagration would have to occur over a long period of time. And it would have to involve collective action by several oil-producing nations acting in concert on both sides of any adversarial exchange. Oil-producing nations have preferred proxy skirmishes to avoid broad market disruptions.

3. The current long-term low-price environment will be fraught with ongoing regional conflicts as smaller and smaller amounts of market share will lead to greater offense being taken over slighter provocations. Iran's message is clear: if it cannot secure the benefits of a stable part of the global oil and gas trade, then it will disrupt it.

4. The political stability of dependent oil producer countries is far more fragile than the bellicose tone that dominates their public pronouncements. The drive to stay committed to fossil fuels and opposed to collective action on climate change is tied to the political legitimacy of many ruling regimes. *Dependency by state owners of fossil fuels poses a material risk to collective action to combat climate change that is distinctly different from that of private companies acting at the behest of their shareholders.*

The challenges to forging a constructive environment for climate solutions with producer nations have been laid bare by the events of the last week. Oil is and will continue to be their economic life blood. Norway's attempt to have a dialogue with its citizenry about its economic future is an important, if lonely, step forward.

To advance effective climate policies and initiatives, the future is complicated. Popular opposition to what is an increasingly reckless disregard for the planet, its people, economy and energy supply is likely only to grow in intensity.

For investors looking at the energy sector and its leadership the message should be clear – run, don't walk away.

About IEEFA

The Institute for Energy Economics and Financial Analysis conducts research and analyses on financial and economic issues related to energy and the environment. The Institute's mission is to accelerate the transition to a diverse, sustainable and profitable energy economy. www.ieefa.org

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