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Power Shifts and the Risk of a "Crisis Within the Crisis": COVID, Oil and the MENA Region

by Luca Franza

COVID-19 triggered a collapse in oil prices from approximately 60 to 20 dollars per barrel between January and April 2020. Signs of a rebound are visible but prices remain well below the breakeven for many producers. If prices stay this low for long, or if they fall again after a partial rally in a relapse scenario,[1] the world may witness a crisis within the crisis, with even further adverse effects on the world economy.

Small and midsize oil companies could go bankrupt in the US and drag down their creditors, with potential repercussions on the global financial system. Some "zombie" production has continued[2] as operators have been drilling at a loss, but this is unsustainable in the long term.[3] Hundreds of thousands of people would then lose their job further reducing consumer spending. Even in producing countries with low extraction costs, state budgets would shrink with additional backlashes on the economy, particularly where this is very much state-driven.

The bottom line is that the oil crisis threatens every country's economy. As a result, consuming and producing countries share an interest in at least a partial rebound in oil prices. This is confirmed by the fact that the International Energy Agency (IEA) – traditionally seen as an importers' club – supported the OPEC+ production cut deal of 9 April, albeit from the backstage.

[1] A scenario in which infections rise again after lockdowns are lifted, leading to new lockdowns and limitations to local mobility and air travel.

[2] Derek Brower and Anjli Raval, "Coronavirus, Opec and Shale: FT Energy Reporters Answer Your Questions on the Oil Industry", in *Financial Times*, 16 April 2020, https://www.ft.com/content/82ef0eeb-eadf-4bff-959d-eaab16846796.

[3] Megan Greene, "Bailing Out the Oil Industry Brings a Fate Worse Than Death", in *Financial Times*, 19 April 2020, https://www.ft.com/content/4a6494e2-7fbe-11ea-b0fb-13524ae1056b.

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While some countries have buffers that can allow them to weather a longer crisis, others do not. In this phase, the ability to rely on financial buffers – but also on other types of safeguards, including social and political stability – will make all the difference. Talking about socio-political resilience, it is important to realise that the crisis did not take place in a void. Even before COVID-19, social unrest was mounting in many countries and deep (geo)political transformations were unfolding.

The Middle East and North Africa (MENA) is particularly exposed to the dynamics described above. The region hosts some of the world's most oil-dependent countries; countries with deep pockets looking to diversify risks; countries with critically limited socio-political resilience; and some of the world's most financially constrained countries.[4]

Depending on its duration, the crisis might trigger shifts in the regional balance of power. Countries with large financial resources could seize the opportunity to purchase cheap assets, reaping the benefits once there is a true recovery. Conversely, those with financial constraints might suffer irreversible damage and sell cheap assets, becoming more politically dependent on countries that aquire them.

All MENA countries are suffering at the moment. The halving of oil prices is expected to lead to a decline of 230 billion US dollars in annual revenues for MENA oil exporting countries this year. The IMF expects GDP in MENA oil exporting countries to shrink by 4.2 per cent in 2020,[5] worse than the 2020 world average and also worse than the region's decline in 2008–2009 and 2014–2015.

GDP is expected to shrink by 2.7 per cent across the Gulf Cooperation Council (GCC) and by as much as 6 per cent in non-GCC countries. Kuwait is expected to be hit the least (-1 per cent), while Algeria and Iraq (-5 per cent) as well as Iran (-6 per cent) the most. Libya's GDP is expected to shrink by a whopping 58 per cent, also as a result of the ongoing civil war.

The IMF officially forecasts a V-shaped rebound for the region in 2021[6] but this is highly doubtful as it is becoming increasingly clear that the global economic recession will have a long tail. Lockdowns may be temporary but their effect is likely to be structural in at least some cases, as they involve bankruptcies and lingering risk aversity that limits spending.

Non-oil GDP is expected to fall even more than oil-related GDP.[7] Services, retail and tourism, and to a lesser extent manufacturing, are being hit hard. Small and medium enteprises (SMEs)

[4] Stefanie Dekker, "Is Lebanon on the Brink of Bankruptcy?", in *Al Jazeera*, 10 November 2019, https://www.aljazeera.com/news/2019/11/lebanon-brink-bankruptcy-191110074708847.html.

[5] International Monetary Fund (IMF), *Regional Economic Outlook: Middle East and Central Asia*, April 2020, p. 1, https://www.imf.org/en/Publications/REO/MECA/Issues/2020/04/15/regional-economic-outlook-middle-east-central-asia-report.

[6] Ibid., p. 5.

[7] Ibid., p. 9.

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are those suffering the most because they have less buffers.[8] Supporting them is key for MENA oil producing countries because they represent the linchpin of economic diversification strategies.

MENA oil importing countries are also under pressure. It is true that low oil prices reduce their energy bill but this benefit is only marginal. In Morocco, Lebanon and Jordan, the halving of the oil price relative to pre-crisis levels is only expected to boost national income by 3-4 per cent.[9]

Beyond trade balances, the oil price collapse negatively affects oil importing countries due to their high dependence on GCC economic performance via workers' remittances, tourism and foreign direct investment. For the moment, GCC countries are focussing on their own economies.

Also, the price of all commodities – and not just that of oil – is down. This is affecting countries that rely on the export of food[10] and commodities other than oil, such as Jordan, Mauritania, Morocco and Tunisia. Some MENA net oil importers were already on the brink of bankruptcy and ravaged by social unrest before COVID-19, namely Lebanon.

Among oil exporting countries with buffers and deep pockets one can certainly mention Saudi Arabia, Kuwait, Qatar and the United Arab Emirates (UAE). On the other hand, the most constrained countries are Algeria, Oman, Iraq, Bahrein and to an extent Egypt.

Iran is in a fairly unique position. While it has been hit very hard by COVID-19 (also economically), the country developed resilience over decades of isolation and tends to be sheltered from global market shocks. US sanctions had already hit Iranian oil revenues before COVID-19 and its gas export potential was also largely untapped.

Low oil prices after the 2014 downturn had the effcect of gradually "normalising" rich countries in the Gulf – making them a little less unique. Manifestations of this journey towards "normalcy" were steps such as the introduction of a value added tax (VAT) and the cutting of some handouts, privileges and wasteful spending. Net debt in rich Gulf countries has become positive in recent years, as in the majority of countries around the world. Tax increases and the kind of cuts started over the last years are not viable in the midst of a crisis, but the trend is likely to resume afterwards.

In response to the current crisis, substantial liquidity injection and fiscal measures[11] in MENA countries with significant financial resources have taken place. There have been

[8] Massoud Hedeshi and Frank Hartwich, "Coronavirus in the Arab World: Can Survival Turn to Recovery?", in *Middle East Eye*, 4 May 2020, https://www.middleeasteye.net/node/169311.

[9] IMF, *Regional Economic Outlook: Middle East and Central Asia*, cit., p. 1.

[10] Food and Agriculture Organization (FAO), *Global Food Commodity Prices Drop Further in April*, 7 May 2020, http://www.fao.org/news/story/en/item/1273914.

[11] The Arab Gulf States Institute in Washington (ACSIW), *Gulf Economic Barometer*, updated 10 May 2020, https://agsiw.org/gulf-economic-barometer.

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cash transfers and salary support, suspensions of rent and utility payments, modifications of loan conditions, government guarantees for SMEs, interest rate cuts (which encourage spending, by making it cheaper to borrow), and reserve requirement reductions (which lower the amount of cash that banks are required to hold, allowing them to make more loans and thus stimulate the economy). Fiscal deficits will increase, but this is not dramatic *per se*.

Conversely, if the current situation is prolonged, countries like Algeria, Oman, Iraq, Bahrein, Egypt and oil importers such as Lebanon, Morocco, Jordan and Tunisia might suffer even more serious macro-economic and financial trouble. They might become even more heavily indebted and exposed to the influence of more financially solid Gulf countries (as well as of external actors, like China). Bahrein already received financial aid from neighbours in the Gulf.

The crisis has increased Saudi Arabia's interest in infrastructure projects in the broader MENA region and in the Mediterranean. Assets have become cheaper. Recently, Qatari sovereign wealth funds have eyed sectors such as health and high-tech.[12] But Gulf money is likely to also flow to cheap energy assets, including shale oil and gas in the US, further cementing US–Gulf interdependence. Investment needs in oil and gas will remain high if we look at demand projections.[13]

Even if uncertainty reigns, a number of conclusions can be made. Firstly, Gulf countries have an interest in avoiding a "crisis within the crisis" threatened by oil. Their role in oil markets empowers them and encourages them to act responsibly. The current crisis is likely to (further) strengthen bonds of interdependence between the US and the Gulf.

It has become clear that US shale needs Saudi Arabia's balancing role on global markets. Saudi Arabia also holds a significant share of US debt.[14] In turn, it needs the US as an ally in the Middle East. Interdependence might reach a whole new level if Gulf countries start buying depreciated US upstream assets, also motivated by geopolitical considerations.

Secondly, the narrative put forward by those who focus on fiscal breakevens[15] in Saudi Arabia, Kuwait, Qatar and the UAE should be softened. While it is true that deficits and debt will increase and that foreign exchange reserves and other buffers have already been used since 2014, these countries still enjoy relatively ample room for manoeuvre.

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12 Andrew England, "Qatar Sovereign Wealth Fund Seeks Health and Tech Deals", in *Financial Times*, 26 April 2020, https://www.ft.com/content/418da0bb-c9eb-4575-b61f-48b329f02d0a.

13 International Energy Agency (IEA), *World Energy Outlook 2019*, November 2019, https://www.iea.org/reports/world-energy-outlook-2019.

14 Liz McCormick, "Saudi Buying of US Treasuries is Soaring Under Trump", in *Bloomberg*, 1 July 2019, https://www.bloomberg.com/news/articles/2019-06-30/saudi-buying-of-treasuries-is-soaring-under-trump.

15 Davide Barbuscia, "Saudi Arabia Would Need Oil at $80-$85 a Barrel to Balance Budget: IMF Official", in *Reuters*, 11 February 2019, https://reut.rs/2URtsco.

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This will make all the difference going forward.

Other countries in the MENA are much more vulnerable and financially constrained. This could accelerate shifts in the regional balance of power as financially solid countries hunt for cheap assets around the region, including strategic ones such as infrastructure. Long-term challenges and threats remain, as COVID-19 did not emerge in a void, but the pandemic may further solidify relationships of dependance on rich Gulf states in the Arabian Peninsula.

For countries affected by social unrest and financial instability before COVID-19, the challenge is to limit the multidimensional impact of the pandemic. For Saudi Arabia and other Gulf countries the challenge is to promote economic diversification while also allocating investment to counter oil production declines in preparation for future demand recoveries. As these countries "normalise" in a number of ways – by accumulating debt and introducing taxes – pressures to adapt their "social contracts" might very well increase, potentially leading to calls for political reforms to increase representation.

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