



Saudi Arabia's Power Play

By John Harpole

History is marked by the unthinkable actions of nation-states or their proxies. I have often wondered why experts failed to anticipate Japan's attack on Pearl Harbor as a consequence of economic sanctions levied against that country.

The current geopolitical situation makes it a good time to ponder unthinkable scenarios. For example, I wonder whether the international community should have any growing security concerns about the new king of Saudi Arabia and the current Saudi Arabian oil power play. Could the kingdom's power play initiate a much larger conflict?

The Iranian and Russian response to Saudi Arabia may dictate the duration of this oil price trough.

A number of OPEC oil ministers claim the Saudis simply want to eradicate the U.S. short-cycle drilling efforts that have changed the face of energy. Certainly the Saudis prefer that the world interpret their action as an attack on the U.S. shale revolution, rather than as a direct attack on Iran's economy.

Is this the beginning of the end for the U.S. shale revolution?

It took three consecutive years of 1-million-barrel-per-day oil production growth in the U.S. for the OPEC ministers to get religion on the competitive threat of U.S. horizontal drilling and hydraulic fracturing.

The real target

Clearly, the Saudis understand that they can't turn off the spigot of U.S. crude oil production in three to six months. Perhaps more importantly, they now realize that they can never put the fracking genie back in the bottle. The real target of their market-share maintenance effort must be directed at the economies of Iran and perhaps even Russia.

How long do you think those two countries will believe the Saudis' claim that the real target is the U.S. shale revolution? After five months of low prices and no apparent impact on U.S. production, what will the Saudis do? After all, most experts see another year of significant U.S. oil production growth, despite a precipitous drop in the drilling rig count.

Free-market-motivated U.S. producers will simply reallocate capital to the U.S. producing basins where they still receive a 15% to 20% internal rate of return. As a result, most experts believe that U.S. production may not decline for at least two years.

Just days before that fateful Thanksgiving 2014 weekend in Vienna when the Saudis coerced their OPEC brethren to maintain production levels, the Saudis announced that they would double their security buffer zone along the kingdom's northern border

with Iraq, increasing the zone to 12 miles. Yes, 12 miles. Clearly, they anticipated a strong reaction by neighboring states to their oil power play.

"The expansion of the northern security zone aims to prevent infiltration into the kingdom from the conflicts in Iraq and Syria," said Theodore Karasik, a senior adviser with Risk Insurance Management in Dubai in a recent *Bloomberg* news article. He continued, "They also want to mitigate any instability in the north of the country, where some individuals may support radical militant groups."

Thanks to recent events in Yemen, Saudi Arabia's direct neighbor to the south, the Saudis are now "surrounded," and according to political commentator Charles Krauthammer, they are "scared to death" about additional political instability on their border. They also face an increasingly desperate and belligerent Iran and Russia.

Military cooperation

In January, Iran and Russia signed a military cooperation agreement in Tehran. Iranian Defense Minister Hossein Dehghan stated that "Iran and Russia are able to confront the expansionist intervention and greed of the United States through cooperation, synergy and activating strategic potential capacities."

Notably, the signing of the cooperation agreement marked the first time a Russian defense minister had visited Iran in 15 years.

If I were a Saudi, I would be concerned about the growing nuclear threat of Iran. Iran's Shahab-3B medium-range ballistic missile can reach the Saudi oil fields in less than 12 minutes. Those fields account for 16% of the world's oil reserves.

Is an attack on Saudi Arabia unthinkable? Where is the "line in the sand" on that issue for President Obama's administration? I hope that under our bilateral security agreement with Saudi Arabia, the U.S. is considering what our measured response might be in the wake of an "unthinkable" event. What response would send a message without collapsing world oil markets?

There are at least two other questions to consider: Does the current Brent oil price take into consideration the growing security risk that I've outlined above? And more importantly, as American consumers celebrate at the gas pump, do they understand that the Saudis are slowly dismantling U.S. energy security before Americans' very eyes? ■

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