

Saudi Arabia: No Longer a Swing Oil Producer

by Hilal Khashan - July 13, 2022

Last May, the Saudi minister of energy warned that “the world is running out of energy capacity at all levels.” More recently, in a chat with U.S. President Joe Biden, French President Emmanuel Macron reportedly said UAE President Mohamed bin Zayed told him that the United Arab Emirates had reached its maximum oil production capacity. MBZ also said the Saudis could raise their production levels by only 150,000 barrels per day and that increasing production any more would require an additional six months. The news surprised U.S. officials who thought the Saudis and Emiratis were refusing to ramp up output in retaliation against Biden’s decision to suspend the UAE’s acquisition of F-35 fighter jets and unwillingness to communicate with Saudi Crown Prince Mohammad bin Salman. While Saudi Arabia and the UAE have their grievances with Biden, their unwillingness to increase supplies is really due to the fact that they do not have spare capacity.

Saudi Reputation

Since the 1970s, the Saudi royals have consistently exaggerated their hydrocarbon reserves and spare production capacity, winning Saudi Arabia a reputation as a swing producer. The country’s geopolitical importance rested on its presumed and undisputed capacity to produce as much oil as needed to stabilize production in line with market fundamentals, namely supply and demand balance and crude oil price determinants. Saudi oil experts have always sounded confident about the kingdom’s capacity to meet surging demand and address market uncertainties. A long-time energy adviser urged the global market to trust “Saudi Arabia’s ability to hike output to meet growing demand.”

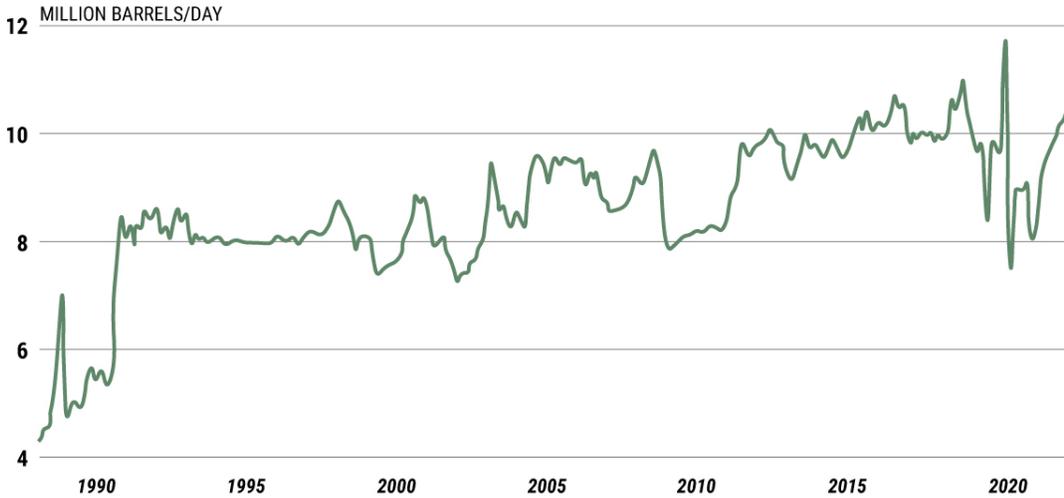
In 2008, when the price of oil peaked at \$147 per barrel, it was sufficient for Saudi officials to say they would immediately boost production by 1.3 million bpd, a claim that the International Energy Agency and oil experts readily accepted. Until Russia's war in Ukraine, Saudi Arabia assured the oil market that its short-order spare production capacity stood at 1.2 million bpd and longer-term capacity at 2.5 million bpd, sustainable for at least 90 days. Conventional wisdom held that OPEC+ countries had 6.9 million bpd spare capacity, half of which came from Saudi Arabia and the UAE. In 2020, the CEO of Abu Dhabi National Oil Company claimed that his firm could produce 4 million bpd at short notice. Neither Saudi Arabia nor the UAE told the truth about their production capacity, and their claims were never put to the test.

Saudi Reality

In 1989, state-owned oil giant Saudi Aramco estimated that Saudi Arabia's oil reserves totaled 170 billion barrels. Over the 33 years since, no significant new oil discoveries have been reported. Still, in 2017, Aramco revised its estimated oil reserves to 268 billion barrels, even though it extracted 96 billion barrels over that period. Assuming the 1989 figure is more accurate than the revised 2017 figure, it seems Saudi Arabia has already depleted 57 percent of its proven reserves.

Despite the public relations campaign carried out by Saudi officials and their advisers, independent observers predicted as early as 2011 that Aramco would soon lose spare production capacity. In 2013, oil field technicians started using carbon dioxide to increase the depleting output of Ghawar, the world's largest oil field discovered in 1948, which accounted for 25 percent of total Saudi production. In 2017, some financial analysts slashed Aramco's controversial valuation from \$2 trillion to \$1.1 trillion.

Saudi Arabia's Crude Oil Production



Source: Trading Economics

Graphic redesign by Geopolitical Futures

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In September 2019, the Saudis cut production by 5.7 million bpd after Iranian-backed militants in southern Iraq launched missile and drone attacks on vital Saudi oil facilities. Saudi Arabia's Energy Ministry assured consumers that Aramco would restore its 12 million bpd by the end of the year. The announcement ignored the fact that it would take several weeks to assess the damage, let alone repair it. To honor its export commitments, Aramco bought Iraqi oil that had similar specifications to its own. But these supplies likely came from Iran, which smuggles its oil to the Basra region and rebrands it as Iraqi oil – meaning the Saudis likely rewarded Tehran for ordering its Shiite proxies to target Saudi oil installations.

In the second quarter of 2020, Aramco increased its production to 12.1 million bpd and nearly exhausted its oil storage tanks. More than two years ago, it announced that it would boost its maximum production capacity from 12 million bpd to 13 million bpd without specifying a target date – though it's unlikely to happen before 2027. The problem is that Aramco's current sustainable output is well below 12 million bpd, probably under 10 million bpd, because its spare capacity virtually disappeared even before Crown Prince Mohammed bin Salman launched his Vision 2030 initiative in 2016. The project seeks to diversify the Saudi economy, making it multi-sectoral with an emphasis on services and manufacturing. The National Renewable Energy Program strives to transform Saudi Arabia into a post-oil country by ensuring that renewable energy sources account for at least 50 percent of domestic consumption.

The formation of OPEC+ in 2016 ended the rivalry between producers and halted the oil glut – which had caused a 57 percent drop in prices between 2014 and 2016 – leading to a rally in prices that began in 2017. It also allowed Saudi Arabia to replenish its storage ranks. Still, the Saudis pumped 10.42 million bpd last month, representing an increase of just 60,000 barrels from May, despite mounting U.S. pressure to increase production capacity. And over the next six months, Saudi production will rise to 11 million bpd, a minor surge that represents the most Riyadh can do to stabilize the market and comes at the cost of draining its strategic reserves at home and abroad.

Given the uncertainties in the oil market, Saudi Arabia isn't keen to increase its production beyond 12.5 million bpd. It wants to strike a middle ground between spending heavily on increasing capacity, which could be squandered if oil loses its strategic value, and reducing production, which could compromise its geostrategic significance. Aramco is investing more financial resources on infrastructure maintenance and adding more lateral wellbores than the expensive drilling of new wells. The UAE, which is rapidly diversifying its economy, plans on raising its maximum oil production capacity to 5 million bpd by 2030, contingent on investing \$30 billion on infrastructure.

Saudi Arabia didn't turn down Biden's demands to hike production because he was critical of the kingdom during the presidential election campaign and refused to communicate with the crown prince over Saudi journalist Jamal Khashoggi's murder. The reason it refused these calls is that Riyadh cannot increase production without draining its own stockpiles. Even if Saudi Arabia possesses significant spare production capacity, as it claims, it is bound to comply with the OPEC+ Declaration of Cooperation, which regulates members' oil output and gives Riyadh more significant advantages than it would receive by complying with U.S. demands.

Biden's Visit

On July 15, Biden will arrive in Jeddah from Israel. He hopes his visit will achieve a breakthrough in Middle Eastern relations by expediting Israel's full integration in regional affairs, establishing a collective defense alliance, and increasing oil shipments from the Gulf Cooperation Council countries, namely Saudi Arabia and the UAE. But these expectations face a grim reality.

The 1945 historic meeting between U.S. President Franklin Roosevelt and Saudi King Abdulaziz aboard the USS Quincy in the Suez Canal established a unique partnership built on oil exports. The 1973 Arab oil embargo championed by King Faisal shocked the U.S. and led to a surge in oil prices. Since then, all U.S. presidents keen on keeping Saudi oil flowing have visited Saudi Arabia to maintain this precarious relationship, especially after Sept. 11 and the rise of Iranian expansionism. But Biden's visit is unlikely to substantially change the current realities of the oil market or Middle East relations.

A few months ago, Salman responded to a question about whether Biden misunderstood him by saying it was "up to him [Biden] to think about the interests of America." Observers thought he was referring to the U.S.' reliance on Saudi oil output. More likely, he was referencing economic ties, military cooperation and arms purchases between the two countries, since Riyadh doesn't have much more oil to offer than it's already producing anyway. Biden understands this, but he's still hoping Saudi Arabia and the UAE can help relieve the pressure on the oil market, since the sanctions on Russia will continue for the foreseeable future. He could expect to get a pledge of increased oil shipments starting in January, by which time OPEC+ countries will have met their commitments to the organization and can start rebuilding their production capacity.

Author: Hilal Khashan

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