

Kaboom!

The rock that will remake global politics.

Steve LeVine April 21, 2010 | 2:06 pm



The words most often used by the heads of oil companies to describe the boom are “revolution” and “game changer.” Industry historian Daniel Yergin calls it “the shale gale.” Admittedly, serious questions remain as to whether shale gas will pass the ecological test—critics say it can’t be extracted safely in proximity to groundwater, and the EPA is engaged in a two-year study of extraction techniques. But, if producers can develop it on a global scale, we may be looking at a geopolitical disturbance as great as the 1970s Arab oil embargoes.

As it stands, the projected growth in global oil demand over the coming decades—and, therefore, the fiscal wherewithal of Venezuela, Iran, and the rest of the Middle East—relies largely on Asia’s roaring economy, because U.S. and European consumption is dropping as Western consumers react to higher prices by conserving more. Specifically, the increase rests on an anticipated surge in Chinese and Indian demand for cars. But, if their oil demand does not materialize as expected—if, for example, those future Chinese and Indian motorists drive

fewer gasoline-fueled cars and more plug-in hybrids and electric vehicles recharged by natural-gas-fired power plants—that increase will be much smaller, or could even evaporate.

A surge in gas supplies would facilitate that switch, and experts say signs of such a shift are already under way. Beijing has said that it intends to satisfy more of its swelling electricity needs with natural-gas-fired plants and that its consumers will become the world’s largest group of buyers of electric cars and hybrids. Meanwhile, liquid natural gas (LNG) from Australia and Qatar—and possibly Alaska—that has been largely locked out of the United States by the domestic shale-gas glut is being aimed at the Chinese market. In addition, China itself has indigenous shale gas estimated at as much as 7.5 billion barrels of oil.

Lower Chinese oil demand would add to a challenge already posed by a surge of six million barrels per day of new crude-oil supplies expected from Iraq in the next seven or so years, which PFC Energy, a Washington-based consulting firm, forecasts will contribute to a long-term surplus of global oil. Oil surpluses mean lower prices, which could lead the petrostates—never a harmonious bunch—into a debilitating price war. “If they really start fighting in a diminishing-demand environment, prices could go straight down to twenty to thirty dollars a barrel,” says Fareed Mohamedi, PFC Energy’s head of country strategies. Oil is currently selling above \$80 per barrel.

The results of the last energy-driven disruptions—the 1973 Arab oil embargo and the 1979 Iranian revolution—were a shift of much economic wealth to the Middle East and the bankrolling of the oil-rich Soviet Union for an additional decade, forestalling its eventual 1991 collapse. In this century, an oil-price spiral fueled the rise of Vladimir Putin’s full-throated Russia.

The gas age could well reverse those geopolitical shifts; \$35-per-barrel or even \$50-per-barrel oil would change the landscape for Russia, as well as Saudi Arabia, Kuwait, and other members of the Organization of the Petroleum Exporting Countries (OPEC), stripping away the disposable income to which they have become accustomed and subjecting them to political instability.

For example, low oil prices could finally force Putin's Russia to address its considerable internal economic problems and diversify its economy. (There is evidence of such a shift in the Kremlin's recent announcement of a \$200 million plan to build its own Silicon Valley—a tech-savvy city outside Moscow for cutting-edge innovation.) And the increased gas supply could reduce Russia's strategic leverage abroad. Already, because of the new American gas glut, Qatari LNG originally meant for the United States is being diverted to Europe at discount prices. That has undermined Gazprom, which controls a quarter of the European gas market and, in recent years, has terrified countries—such as Bulgaria, Hungary, Lithuania, Poland, and Slovakia—by temporarily shutting off pipelines that supply them. The threat to Gazprom's European gas demand, in turn, has cast doubt on Russia's state-dominated economic model, which is largely dependent on Gazprom revenue, and also on the company's continued ability to serve as a spear point of Russian foreign policy. Over the last four years, Russia has cut Ukraine's gas supply three times in what's perceived locally as an attempt to demonstrate continued power over the former Soviet bloc.

For its part, the Saudi royal family depends on cash payments to ultra-fundamentalist local and regional Islamic groups, in some measure, for political survival. The Saudis also make such payments to outside militant groups as part of a policy of spreading the Kingdom's influence throughout the Muslim world—a strategy that may no longer be possible in an era of rock-bottom oil prices. The Saudis “would have to think about where their interests really are long term,” says Charles K. Ebinger, director of the Energy Security Initiative at the Brookings Institution.

Other OPEC countries would be in even bigger trouble. Venezuela and Iran, for instance, are already stretched economically. With sub-\$50-per-barrel oil, both could face a “devastating” financial squeeze, said Kenneth B. Medlock, who runs the natural-gas program at Rice University's James A. Baker III Institute. The world's most belligerent petrostates tend to speak more softly on the international stage when oil prices drop, and “Iran would change its posture toward the rest of the world,” becoming more conciliatory, Medlock says. Venezuela's Hugo Chavez is already decidedly more friendly toward Western firms—in early April, he agreed to new terms in a gas extraction contract with Chevron, for instance.

Of course, there are factors that could undercut the drama wrought by shale gas: A meaningful shift in U.S. or Chinese electrification will take not years, but decades; and, in the same way that shale gas arrived without warning, another wholly unexpected discovery or event could shake up everything anew. Still, the current trend points to a time dominated by natural gas.

Washington has only begun to consider the economic impact of shale gas, and policy circles appear not to have registered the geopolitical ramifications at all. Yet, at once, some of the country's most intractable problems may become much less so. If federal policy encourages the wholesale shift from coal- to natural gas-fired power plants, the United States could rapidly cut global greenhouse-gas emissions. Abroad, the United States could face a fundamentally different landscape in the Middle East, in which there is far less cash to foment mischief, and a weakened or even reformed Russia. But this change will be destabilizing in its own ways. The gas age could help unravel many maddeningly problematic knots, but Washington needs to grasp what's coming and anticipate the landscape it will encounter.

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