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THE ENERGY DIMENSION IN RUSSIAN GLOBAL STRATEGY

GEOPOLITICS OF RUSSIAN SUPPLY AND U.S. FOREIGN POLICY

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Introduction

The Bush administration has recast U.S. foreign policy in a more far-ranging manner than any other administration since the onset of the Cold War in the late 1940s. Although the fate of this change of direction awaits the outcome of the U.S. elections in November, energy strategy looms large as a key element of the U.S. domestic political debate, driven in large part by renewed public concerns about American oil dependence on the Middle East. Democratic candidate John F. Kerry has identified energy as one of the four key issues of his campaign, and the politically charged Michael Moore film, *Fahrenheit 9/11*, savagely critiques the perceived link between oil and U.S. foreign policy.ⁱ

The centrality of energy issues in the run-up to the U.S. presidential election highlights the opportunity that exists for a major revamping of U.S. energy strategy. The attacks of September 11th, the subsequent “war on terror,” and the U.S. invasion of Iraq have dramatically reshaped the geopolitical landscape, fostering new alliances and straining old ones. The open-ended U.S. occupation of an Arab country in the heart of the Middle East marks a decisive break with past U.S. policy toward the region. The U.S. declaration of the doctrine of preventive war may be even more far-reaching in its consequences.ⁱⁱ These revolutionary policies could have dramatic—if still emerging—implications for the geopolitics of oil.

Yet the current debate—though lively—seems unlikely to produce a coherent energy policy if its scope is not radically broadened. Above all, the United States continues to favor an external supply-side focus rather than squarely taking responsibility for the role of rising domestic consumption.

Counterintuitively and (in many cases) counterproductively, our efforts to externalize our energy problems take us to places where our influence is significantly *weaker* than inside our own borders. Increasingly, many Americans worry about the cost—in money, lives, and U.S. credibility—of trying to secure stable oil supplies by attempting to control the Middle East. As Timothy E. Wirth, C. Boyden Gray, and John D. Podesta—officials in past Democratic and Republican administrations—have written, “If this situation remains unchanged, the United

States will find itself sending soldiers into battle again and again, adding the lives of American men and women in uniform to the already high cost of oil.”ⁱⁱⁱ

Our domestic political inability to forge rigorous compromises to achieve energy security—with liberals calling for greater conservation and conservatives for increased domestic production—has left official Washington reduced to vocal, but fruitless, hand-wringing about increasing U.S. oil imports and our continued dependence on Middle East oil.

Rhetoric about “breaking OPEC” is hollow at best. Indeed, much of the debate about U.S. energy policy, with its stress on achieving lessened dependence on foreign supplies through largely unilateral action in the foreign arena, flies directly in the face of harsh market realities. The foremost of those realities is the role of increasing consumption—especially by the United States—in driving petroleum markets. Accepting this reality is a vital first step in forging a practical medium-to-long-term strategy that will minimize the risks of severe supply disruption and skyrocketing prices. This will require stronger domestic policy and deeper energy policy coordination with fellow oil-consuming countries. It is dangerous and foolhardy even to debate military solutions to energy dilemmas before attempting, much less exhausting, less risky and expensive alternatives.

A Most Unsatisfactory Status Quo

No one is satisfied with the energy policy status quo, but few seem willing to make the hard decisions and uncomfortable compromises necessary to do anything about it. And no party has sole ownership of the status quo. It represents a continuation of the policies of successive administrations in Washington over the past quarter century—of encouraging diversity of global oil production, cooperation with major oil producers—especially Saudi Arabia—to ensure stable markets, research in alternative fuels as a hedge against long-term price increases, and reliance on a robust strategic petroleum reserve for use in cases of extreme market volatility.

The Bush administration has continued to pursue much of this agenda. Its formal energy strategy—expressed in the so-called “Cheney Report”^{iv}—was produced within months after its

assumption of office. While many domestic elements of the report were and remain controversial, most of its language devoted to the international arena could have been written under the Clinton administration, or indeed under Bush I, Reagan, or Carter.

Internationally, the centerpiece of the status quo is the “special relationship” with Saudi Arabia—a strategic quid pro quo under which the United States guarantees the security of Saudi Arabia in return for Riyadh’s cooperation in providing a reliable flow of moderately priced oil to international petroleum markets. The first pillar of the special relationship is the decisive role Saudi Arabia plays in international oil markets; Riyadh is not only the world’s largest exporter of oil, but it also possesses one-quarter of global petroleum reserves and, significantly, excess capacity for use in an emergency. The second pillar is the ability and willingness of the United States to intervene militarily should Saudi Arabia be threatened; Washington did so, most notably, in 1990-1 when it rushed troops to Saudi Arabia after Iraq had invaded Kuwait.

There is, of course, more to the special relationship than this quid pro quo. During the Cold War, a shared opposition to communism led to U.S.-Saudi cooperation in such far-flung arenas as joint support for the anti-Soviet resistance in Afghanistan. But with the demise of the communist threat, such ideological common ground disappeared. The special relationship has come under increasing stress, with rising Saudi public disenchantment with the continuing U.S. military presence in the Persian Gulf region and growing criticism, particularly in U.S. neoconservative circles, of Saudi Arabia’s support for anti-Israel terrorist groups and Islamist movements in Central Asia and elsewhere. To an important extent, U.S.-Saudi cooperation in the Gulf War of 1990-1 and the subsequent efforts to contain Iraq camouflaged the dwindling ideological basis of the bilateral relationship. With the demise of Saddam Hussein’s regime and the U.S. occupation of Iraq, differences between Riyadh and Washington are emerging more clearly.

The September 11, 2001, attacks on New York City and Washington, D.C., gave new impetus to reassessment of the special U.S. relationship with Saudi Arabia. The fact that Osama bin Laden and fifteen of nineteen suicide bombers were Saudi nationals lent the long-standing neoconservative critique of Saudi Arabia great public salience; so did subsequent reports of less-than-wholehearted Saudi support in the war on terror. In the wake of September 11th,

neoconservative journals stepped up their attacks on Saudi Arabia, openly branding it an “enemy.”^v In the lead-up to the invasion of Iraq, neoconservative commentators routinely included Riyadh in the list of Middle East capitals—along with Tehran and Damascus—where “regime change” would be desirable, despite Saudi Arabia’s quiet support in oil markets. The summer 2004 publication of *The 9/11 Commission Report* also kept Saudi Arabia in the news with its call for Washington and Riyadh to confront their problems openly.^{vi}

Increasingly harsh judgments of Saudi Arabia have not been limited to neoconservatives; indeed, one very mainstream foreign policy expert has recommended putting Saudi oil fields under United Nations supervision—a policy that would, in practical terms, mean the U.S. invasion and seizure of the eastern third of Saudi Arabia.^{vii} The American Left—as witness Moore’s film—has also joined the anti-Saudi bandwagon.

Despite this firestorm of criticism, the formal U.S. relationship with Saudi Arabia has not changed in the wake of September 11th. Saudi Arabia has diligently—albeit more quietly—continued to raise its oil production in times of war and in market emergencies. And senior officials in both Riyadh and Washington have downplayed their differences and reaffirmed the special nature of the U.S.-Saudi partnership. Energy Secretary Spencer Abraham followed the lead of his predecessors in cultivating Saudi Arabia, even going so far as to suggest tacit U.S. approval of OPEC (Organization of Petroleum Exporting Countries) price bands and financially supporting the establishment of a secretariat for a new international energy forum in Riyadh. Before leaving office, U.S. Treasury Secretary Paul H. O’Neill actually endorsed OPEC’s efforts to keep oil within its targeted band. This was the first time in history that the senior U.S. economic policy official has voiced public approval of nonmarket price mechanisms.

The rise of oil prices this fall to historic levels above \$50 a barrel and Saudi Arabia’s apparent inability to restabilize markets through active intervention has prompted a new wave of questioning of the value of the U.S.-Saudi oil alliance. At the center of the debate are two issues. The first is Saudi Arabia’s ability or willingness to develop new oil production capacity as quickly as needed. The second is the risk associated with relying on a supplier whose facilities may be subject to terrorist attacks.

As today's so-called "terror premium" on oil prices suggests, a major attack on Saudi oil production facilities would be very hard to countermand. As noted in the *Economist*, "Saudi Arabia remains the indispensable nation of oil."^{viii} Saudi Arabia not only exports more oil than any other producer, but it also maintains the quickest salvo-to-swing capacity that can be brought on hand for emergencies, and in relatively short order.

Saudi oil export infrastructure has important, substantial built-in redundancies on both east and west coasts that will make it extremely difficult for terrorists to knock out Saudi export capacity for any significant period. The same applies to military attacks by air. Saudi Arabia's export capacity is over 14 million barrels per day (b/d), almost twice as much as current export levels, and many facilities would have to be attacked simultaneously before oil exports would have to be curtailed.

But a major attack on core Saudi oil production facilities that significantly affected production and handling operations, such as those at Abqaiq (the world's largest oil gathering center), would prove far more difficult to offset quickly.

The Neoconservative Challenge

So, are there alternatives to the unsatisfactory status quo? The one offered by neoconservatives—a radical shift of policy that would see Washington play an altogether more assertive role in the oil arena—has fallen flat on its face. Neoconservative diatribe argued that diversity of supply would not be just an economic end but a strategic means. The United States would attempt to drive down the price of oil, break the ability of OPEC to set prices, and deprive unfriendly states—including Saudi Arabia—of revenue. The neoconservative approach bears more than a passing resemblance to U.S. oil strategy during the Cold War, when the Reagan administration encouraged Saudi Arabia to suppress prices to cause economic damage to the Soviet Union. The resemblance is more than coincidental. Most of the neoconservatives in the current administration served under Presidents Reagan and Bush senior; all were staunch advocates of an uncompromising stance against the Soviet Union. They view today's threat—

whether described as terrorism, in particular, or Islamic fundamentalism, in general—as similar in severity and scope to the challenge posed by the Soviet Union and international communism in the decades after World War II.^{ix}

Neoconservative concerns transcend the direct economic impact of high oil prices and oil-price volatility on the U.S. economy. They center on a belief that oil revenues permit countries such as Iran and Saudi Arabia to sustain authoritarian regimes and promote anti-American policies. Under this analysis, state-owned oil companies in major Middle East producing countries serve as government agents to collect economic rents that would, under a privatized system, flow to the people of the countries, themselves. Collusion on production levels through OPEC, in turn, sustains those rents at a high level. Saudi Arabia, though nominally an ally of the United States, plays a particularly pernicious role, according to this neoconservative analysis, by using its immense oil revenues and leadership in OPEC to promote its own brand of fundamentalist Islam—Wahhabism—in the Middle East and Central Asia.

At one level, the neoconservative argument possesses a powerful, if primitive, logic: low oil prices—in addition to providing substantial economic benefits for the U.S. and global economies—will reduce the revenue available to oil states that sponsor terrorism or seek weapons of mass destruction. But the neoconservative analysis both overestimates the ability of the United States to sustain low international oil prices and underestimates the consequences of a general decline in oil prices for oil-producing allies of the United States. It assumes that the United States will be able to persuade major oil producers such as Russia and a post-occupation Iraq to pursue policies against their own economic interests. And, not least, the neoconservative alternative neglects the huge risk that its approach might actually succeed and prompt sufficient hardship in Saudi Arabia to cause “regime change” in Riyadh. There is no guarantee that a new Saudi government would in fact be more “pro-American” than the current one; even if a regime more aligned with U.S. interests were to arise, disruptions associated with a change in government could lead to declining Saudi production and an even larger rise in prices than were seen this summer. Indeed, historic evidence suggests that any radical domestic political change in oil-producing countries leads to suppressed output, whether that change is in an “anti-

American” direction (the Islamic revolution in Iran) or a pro-American one (the collapse of communism in the Soviet Union).

Russia to the Rescue? Maybe, Maybe Not...

Less radical than the neoconservative alternative is what could be called the “status quo plus.” It seeks to reduce—if not end—our reliance on Saudi Arabia by cooperation with other major producers. Russia leads the list. Indeed, the reassessment of the “special relationship” has occurred against the backdrop of a major recovery in Russian oil production. That recovery has been nothing less than spectacular. While still far from matching peak production attained during the Soviet era, when the Russian Federation produced more than 11 million b/d, Russian oil output has recovered sharply from its lows of 6 million b/d in the mid-1990s. It reached 9 million b/d by mid-2004. Exports show an equally dramatic increase, now making Russia the largest non-OPEC exporter in the world, second only to Saudi Arabia in total exports.

There are a number of reasons for the spectacular recovery of Russia’s oil sector over the past several years. They included greater political stability, an improved legal environment, lower domestic costs because of the ruble devaluation of 1998, and higher world oil prices since 1999.

But the rise of private Russian oil companies—notably Lukoil, Yukos, Sibneft and BP-TNK—has clearly been a powerful impetus for expansion. The ongoing conflict between Yukos and the Kremlin is, however, now casting a shadow over Russia’s production success, with fears that planned investments by BP-TNK in East Siberia and by the Western majors in Sakhalin and in other important greenfield projects are also coming under attack. The Kremlin’s proclivity to back statist-oriented companies such as Gazprom and Lukoil is telling. These companies, liked specifically because they are willing to put the Kremlin’s noncommercial interests first, have produced little, if any, production gains over the last several years. This leaves open the possibility that predictions that Russian oil production will continue to gain by 2 million b/d by 2010 will be overly optimistic.

U.S. interest—both official and private—in the Russian oil sector is not new. Indeed, in the immediate aftermath of the fall of the Soviet Union there were high hopes that U.S. and other foreign investment could play a critical role in rehabilitating and expanding the Russian oil sector. For a while it appeared that the reopening of the Russian oil sector would make available more acreage for international oil company exploitation than had ever occurred in any single decade since oil became a commercial commodity 150 years ago. Such hopes were quickly dashed. Far from expanding, Russian oil production collapsed. The commercial opportunities sought by U.S. and other foreign oil companies proved to be chimerical. Russia—beset by political instability, economic chaos, and complete inexperience with even the rudiments of capitalism—was simply not ready for major foreign investment in its oil sector. It wasn't even ready for domestic investment. Moreover, Moscow—fearing competition from its new neighbors to the southeast—proved to be an obstacle to the Clinton administration's efforts to bring the sizeable oil reserves of the former Soviet republics, Azerbaijan and Kazakhstan, to international markets.

But the Russian oil promise, if deferred, began to materialize after devaluation of the ruble in 1998. And Washington was paying attention. U.S.-Russian cooperation on energy in general and oil in particular was high on the agenda of Bush-Putin summits, beginning in the summer of 2001 and culminating with the creation of a U.S.-Russian energy dialogue after the two presidents met in May 2002.

Most importantly, after September 11th Washington could look to Moscow as an ally in the war on terror; in particular, Russia proved surprisingly accommodating when the United States used the countries of Central Asia—Russia's traditional “near abroad”—as staging areas for the attack on the Taliban regime in Afghanistan. Moscow, for its part, could expect more muted criticism from Washington of its efforts to suppress the revolt by its own Chechen Muslim minority. Unsurprisingly, there was talk of a new “axis of oil” between Moscow and Washington, with Russia supplementing, if not displacing, Saudi Arabia as a partner in U.S. efforts to provide a stable supply of moderately priced oil to world markets.

But Russia faces serious obstacles in its quest to equal, much less surpass, Saudi Arabia, in international oil markets. Despite significant strides in recent years, the Russian business climate remains marked by inadequate rule of law. Standards of transparency, accountability, and protection of minority shareholder rights are honored more in the breach than in the observance. Despite years of pressure from the United States government, Moscow remains adamantly opposed to production-sharing agreements (PSAs), a traditional means of attracting foreign participation in high-risk oil development. In fact, Washington insiders are starting to say that the U.S.-Russia oil dialogue that emphasized the need for legal reform in the energy sector isn't just dormant; it may be dead beyond resuscitation.

Russia clearly wishes to give preference to its own companies, and most recently, the Kremlin is favoring state-controlled firms loyal to its politics. International joint ventures such as the union of British Petroleum and TNK remain fraught with peril in an environment where legal determinations might be even harder to achieve and even then not stand as the definitive answer. In short, Russia may find it difficult to attract the tens of billions of dollars in private investment necessary to make its ambitious oil expansion plans a reality.

So far, recent increases in Russia's oil production has come from the giant oil fields in Western Siberia. But future resource development will need to include new, more remote areas such as the Timon-Pichora, Eastern Siberia, the north Caspian Sea, and the Russian Far East. Development of these distant resources will be critical to sustained high levels of Russia output but face technical, economic, and bureaucratic barriers. The geographic terrain extremely challenging, and Russia's uncertain tax and legal regimes have also created disincentives to foreign and even domestic investment in these ambitious new greenfield projects. It is also unclear whether or under what incentives private companies will be able to invest in the pipeline infrastructure needed to service these remote, but prolific, regions. The United States has pressed Russia to reform the state oil pipeline monopoly Transneft and its pipeline sector, not only in Russia but also in its links to the Caspian, but reform is slow in coming.

Even more profoundly, the Russian oil sector lacks three characteristics that permit Saudi Arabia to play its unique role in world oil markets. First and most importantly, Russia possesses next to

no unutilized capacity, nor is Russia likely to develop such capacity in the future. This stands in stark contrast to Saudi Arabia, with excess capacity—in the 1.4–1.9 million b/d range in 2003—sufficient to stabilize world oil markets, should a major disruption occur. The importance of the Kingdom’s excess capacity was proved again in 2003, when it increased production by more than 1 million b/d in the run-up to the war in Iraq; without such Saudi intervention, prices might have risen well above \$40 per barrel.

Second, Russian oil is relatively expensive, with much of the planned expansion in production slated for geographically remote and geologically challenging fields. This makes Russia’s continued production expansion far more vulnerable to a sharp and sustained decline in oil prices than the Persian Gulf production. Saudi Arabian oil, by contrast, is among the cheapest in the world to produce—allowing the Saudis, at least potentially, to weather price declines with less pain. (It should be noted, however, that in one important respect Russia is better equipped to adjust to falling prices than Saudi Arabia. Oil and gas provide proportionately less government revenues for Russia than for Saudi Arabia. And, unlike the Saudi economy, the highly diversified Russian economy has winners as well as losers when energy prices fall.)

Third, Russia is not, or at least is not yet, a global player. Saudi Arabia has managed to be a base-load supplier of oil to the Western Hemisphere, East Asia, and Europe, with the first two of these markets representing areas of high growth. Russia, on the other hand, is basically a European supplier, with virtually no commercial ties to East Asia or North America to bolster and reinforce its political ties.

Iraq Is No Picnic, Either

With the removal of the regime of Saddam Hussein, Iraq has joined Russia as a possible alternative to Saudi Arabia in international oil markets. Iraq’s potential as an oil producer is unquestionably huge. It possesses 11% of world’s proven oil reserves, second only to Saudi Arabia and probably about the same size as Russia’s share, once recent upgrades in Russian reserves are taken into account. While Iraq’s oil sector never fully recovered from the disruption associated with the war with Iran and chronic underinvestment during the 1980s and 1990s, it

nonetheless achieved production as high as 3.5 million b/d before the Gulf War of 1991. Under optimal circumstances, Iraq could be very attractive to foreign investors, not least because of its low production costs and proximity to both the Persian Gulf and Mediterranean Sea, giving it access to major European and Asian markets.

Some estimate that Iraqi oil production could reach 6–7 million b/d by the end of the decade, making it the world's third-largest exporter after Saudi Arabia and Russia. And early plans, after the U.S. intervention, were to reach 3.5 million b/d by 2005 and 5–6 million b/d by 2010. But these estimates—while geologically possible—may, for any number of political reasons, prove to be wildly optimistic.

U.S. hopes that Western assistance would bring Iraq's oil production quickly back to pre-sanctions levels have not panned out. Instead, efforts to resume production since the war have been hindered by widespread sabotage or—no less debilitating—general lawlessness. Even holding production at 2.5 million b/d will represent a significant achievement, given recent attacks on oil production and transportation facilities in both the north and south of the country.

A major expansion of Iraqi output will face additional hurdles. The cost will be vast, running into the tens of billions of dollars and requiring either substantial foreign investment or high levels of foreign aid. In the best of times, Iraqi oil revenues only topped \$10 billion—to-\$12 billion dollars in recent years, with humanitarian assistance taking up 70% of those funds.

Moreover, Iraq is far from offering the physical security, political stability, and legal environment that will make it attractive for major foreign investors. Talk of privatizing the state-owned Iraqi oil industry to accelerate investment—a favorite theme of neoconservatives—is particularly premature. The list of obstacles to privatizing the Iraqi oil industry is daunting. It will require, among other things, the reorganization of the Iraqi oil industry, enactment of a new body of business law, creation of a regulatory regime, settlement of contentious issues of regional revenue-sharing, rescheduling of Iraq's foreign debt, adjudication of outstanding disputes over concessions granted by the regime of Saddam Hussein, and, not least, some level of democratic legitimacy. Even a plausible model of partial privatization will face most of these

obstacles. In this model, the state structure of the oil industry would be left intact and would eventually reach some 3.5 million b/d of production, while new oilfield developments and greenfield projects would be given to the private sector (both domestic and international) for investment.

Legitimacy will be key to any reorganization of the Iraqi oil industry. An effort by the United States or an interim government to “shove through” privatization of Iraq’s oil industry before a new constitution is in place and free elections are held is fraught with moral controversy, as well as the economic danger of a future renationalization to undo a nonlegitimized deed. Insofar as major U.S. and British oil firms will stand to benefit, privatization will be perceived by a suspicious world—rightly or wrongly—as conclusive evidence that Washington and London did in fact invade Iraq for its oil. Perhaps more seriously, privatization could prompt a nationalist backlash in Iraq itself, with accusations that the United States and its local allies were selling Iraq’s patrimony to foreigners. Even under the best of circumstances, major privatizations in less-developed countries have often been poorly managed and politically divisive, leading to the transfer of state-held assets to a few corrupted wealthy entrepreneurs or members of the local mafia. Common sense would suggest an extremely measured approach to any possible privatization, full or partial, of the Iraqi oil industry.

The same holds true of Iraqi membership in OPEC. Baghdad has been an inactive member of the cartel since the Gulf War of 1990-1. It is still unclear whether Iraq will resume full participation in OPEC under a transitional regime. In the short run, at least, there is little evidence that OPEC would press Iraq to reduce production. Once Iraqi production began to rise toward the 4 million b/d mark, however, strains could appear in the cartel as it debated how to handle rising Iraqi exports.

The idea that a grateful Iraqi citizenry would relinquish its rights to high oil prices out of gratitude to the United States for their liberation seems—to put it gently—far-fetched. It should be noted here that formal OPEC membership is not necessary for such cooperation to occur; U.S. friends Russia, Mexico, and Norway—all non-OPEC producers—cut output in concert with

OPEC in 1999-2000 following the price collapse of the late 1990s and could do so again down the road.

At a minimum, continued Iraqi membership in the short-to-medium term would appear to hold little downside risk for a new regime in Baghdad. Should Iraqi production increase dramatically, oil revenue on a per capita basis could rise even if prices fell considerably. If Iraq becomes a democracy, therefore, a future government could conceivably find it in its interests for domestic political reasons to leave OPEC, but that will remain an open question for some time. Full privatization of the Iraqi oil sector, however, would make Iraqi participation in OPEC extremely problematic. With production and transportation facilities in private hands, it would be very difficult—though, under some export-licensing regimes, not quite impossible—for Baghdad to constrain production and exports. This is surely one of the great appeals of privatization from the neoconservative point of view.^x

However the questions of privatization and OPEC membership are decided, Iraq could—barring a collapse into chaos—become a more important producer during the years ahead. In the short run, however, the unstable situation in Iraq may, ironically, make the United States more dependent on Saudi oil, not less, depending on how well other countries do in increasing world oil supply.

Other Sources, Other Problems

Of course, Russia and Iraq are not the only oil producers that could post significant gains in output. But will these increases, if they come, be sufficient to meet rising global (and U.S.) demand? Relatively poor global economic performance in recent years has led to a slowdown in the growth in world oil demand. As a result, oil forecasters are predicting that world oil use will rise to 89 million b/d by 2010, up from the current 77 million b/d. This projection is down from earlier estimates of 100 million b/d by the end of the decade. But producing an additional 12 million b/d of oil—particularly in light of the constraints that Iraq and, to a lesser extent, Russia, face—will be no mean task.

A quick *tour d'horizon* of oil-producing regions reveals just how daunting that challenge will be. In Central Asia and the Caucasus, political instability, corruption, unstable customs, inadequate tax and legal regimes, and complex transportation issues (including problems created by Moscow) continue to impede efforts to bring major amounts of oil to market. Major increases in Latin American oil output are similarly blocked by regulatory, political, and environmental barriers. There is no question but that the resurgence of populism in South America will slow the pace of expansion in petroleum production. The recent recall election victory of President Hugo Chavez, whose first-term policies have led to a decline in Venezuela's oil-production capacity, offers little hope for dramatically increased Venezuelan production. Faced with this reality and a slowing pace of energy-sector reform in important countries such as Brazil and Mexico, the United States will be forced to look elsewhere, not just for increased oil imports, but also to maintain the levels of oil we have been receiving from our southern neighbors. Elsewhere, production in the North Sea is rapidly approaching its geological peak. And most of Asia remains very disappointing in terms of easily accessible, low-cost fields.

That means that, besides Russia, whose industry's future is currently in question, the United States can expect to be most dependent on Africa to satisfy its increased need for oil imports. By some estimates, Africa, including North African producers such as Libya, could double output to 10 million b/d by 2010, alleviating some dependence on the Middle East.^{xi} But political turmoil in West Africa, most notably Nigeria and Angola, raises real questions about the reliability of already-established African production. And the United States is not the only customer for African oil; East Asia frequently pulls one million b/d from West Africa to feed its growing appetite for high-quality West African crude.

African oil is not without a global competitor, as China holds an active place in Sudan's oil sector and is pursuing opportunities elsewhere on the continent. Chinese participation in Africa has been accompanied in some cases by Chinese military delegations selling arms, a situation of some concern, given the proclivity towards ethnic and political strife in some key oil-producing countries in the region. China's role in the current crisis in the Darfur region of Sudan has been less than constructive, boding ill for future diplomatic cooperation between the United States and China on stabilizing oil supply in difficult regions.

Unfortunately, the one supplier that the United States might truly benefit from encouraging—Canada, with its 175-billion barrels of tar-sand resources—is not being actively pursued.^{xii} If anything, U.S. politicians have gone out of their way to slight our northern neighbors, backing a natural gas pipeline route that ignores the location of Canadian resources in favor of political featherbedding for the city of Anchorage and, to compound the problem, fanning disputes over other Canadian imports such as beef, softwood, wheat, potatoes, and, potentially, salmon, all without any regard for the energy consequences of these actions. Oil sands projects could be a key alternative for the American consumer, with production, which has already reached 800,000 b/d, expected to rise by 1.5 million b/d by 2010 if currently proposed projects can meet their targets, possibly higher if proposed new projects are added. But even these promising resources face environmental barriers, since the process of mining the sands emits carbon and requires large quantities of water.

Approved Canadian Oil Sands Projects

Project	2001	2002	2005	2010
Syncrude	225	250	350	465
Suncor	130	220	260	400
Shell/Chevron	-	155	155	155
Albian/Koch/T.N.			95	190
Canadian Natural Resources				300
Gulf Resources				100*

Source: Petroleum Argus

*proposed for 2013

The Myth of Controlling the Other Guy

The status quo plus approach clearly has its advantages. Diversity of supply is an important object of any U.S. energy strategy, both as a measure to increase overall supply and a hedge against regional disruption. And it certainly avoids the high risks associated with the

neoconservative alternative. But today's rise in prices above \$50 highlights the difficulties and failures of this limited and basically passive approach.

Its main shortcoming is that it focuses on what other countries can do to address our energy concerns rather than on actions we can take domestically to reduce our dependence. By continually seeking to externalize solutions to our internal problems, we have left ourselves vulnerable to overestimating our ability to shape oil developments beyond our borders. This policy has left us squarely where we are today, with rapidly rising oil prices and no immediate solution. We are, to coin a phrase, "up the creek without a paddle."

Our ability to shape production policies in Saudi Arabia, Russia, and—in time—even Iraq is hugely constrained. And the widening turmoil in the Middle East and Southeast Asia has left the U.S. Coast Guard and Navy with the daunting task of protecting overseas oil from the long-term threat of sabotage. As reported in the *Wall Street Journal*, the U.S. military is bracing for an era of continuing attacks by insurgents bent on blocking oil flows vital to the world economy.^{xiii} U.S. ships and soldiers are already engaged in protecting oil facilities in the Persian Gulf. In coming years, their services will increasingly be demanded in places such as Colombia, Yemen, Central Asia, the Caucasus, and Asian sea lanes. About thirty warships now patrol the Persian Gulf and surrounding waters, about twice the level of the 1980s when U.S. military operations to protect oil cost the U.S. taxpayer about \$4–to–\$5 a barrel.

Can We Rein in Demand?

Missing from the neoconservative or status quo plus approaches are any serious measures to address the demand side of our reliance on Middle East oil. As noted, even under conservative estimates global oil demand will rise by 12 million b/d between now and the end of the decade. Analysts have tended to focus, rightly, on a growing Chinese appetite for oil—which could increase by 3 million b/d by 2010—as a decisive element in the growth of world demand.^{xiv} But it is crucial to remember the dominant role the United States plays in international oil markets.

Indeed, the consistent growth in U.S. oil imports is an overwhelming factor in global oil markets—one that official Washington refuses to recognize, despite criticism from allies in Europe and Japan. U.S. net imports rose from 6.79 million b/d in 1991 to 10.2 million b/d in 2000. Global oil trade—that is, the amount of oil exported from one country to another—rose to 42.6 million b/d from 33.3 million b/d over that same period. This means that America’s rising oil imports alone have represented over *one-third* of the increase in oil traded worldwide over the past ten years. In terms of OPEC, the U.S. import market was even more significant—over 50% of OPEC’s 1991–2000 output gains wound up in the United States. Current U.S. oil demand is about 20 million b/d, of which only 40% is produced domestically. In light of this reality, talk about “breaking OPEC” or even finding a less dramatic alternative to the U.S.-Saudi “special relationship” through shaky geopolitical alliances—rather than through permanent, domestic political policies well within our control—seems dubious at best.

The United States has been so busy managing the diplomacy of its relationships with oil suppliers that we have failed to give highest priority to the international relationships where common interests may be strongest—with other major oil-consuming nations. Reliance on coordinated policy responses through the International Energy Agency (IEA) in Paris needs to be remolded to meet changing market conditions. When the IEA was founded as an offshoot of OECD (the Organization for Economic Cooperation and Development), its members were responsible for more than 75% of global oil trade.

But with the emergence of China, India, and other growing non-OECD markets, the IEA’s membership has become increasingly isolated from the real operation of the international market and new sources of oil demand growth. The ideas behind the IEA remain valid; it is critical for oil-importing countries to bind themselves collectively to meet pending disruptions. But the membership and scope of the organization have become too narrow. It is time to rethink ways to include critical emerging markets within the consuming countries’ emergency response mechanism. One can imagine, for example, that a coordinated IEA stock release during a market disruption would be less effective if China were to respond by buying up oil in a panic and hoarding it than if China, itself, had strategic stocks to contribute to the market.

True, the Bush administration has initiated dialogue with the EU on hydrogen fuel research and other alternative energy sources. But joint research in energy technologies, like the purview of the IEA, must extend as broadly as possible to include the largest future oil consumers. Still, before the United States can truly show leadership in forging links with fellow oil consumers, it must gain some credibility by demonstrating a willingness to curb its own unrestrained oil addiction. America would then be in a better position to initiate a truly global effort to encourage conservation policies, to conduct multilateral research and development programs, and to disseminate promising energy technologies.

On the domestic front, any politically plausible mix of conservation policies or increases in domestic production will leave the American oil-guzzling position largely unchanged. While the idea of a grand compromise—which might include opening up, not just wildlife refuges in Alaska, but also vast tracts of politically sensitive U.S. coastal shelf, to production, while imposing stringent new automotive standards—may be theoretically appealing, it stands little chance of passage. Certainly, there is nothing in the campaign literature of President Bush or Senator Kerry to suggest that either is prepared to support such a far-reaching, but politically painful, compromise.

A shift to fuel cell technology and hydrogen-based technology, proposed by the Bush administration and concretely pursued, may eventually reduce U.S. petroleum imports, but the time-frame involved runs to the decades, not years. Moreover, this hydrogen economy is dependent on scientific breakthroughs that are in no way guaranteed and on plentiful local natural gas supplies that are iffy at best. Indeed, the Bush administration's decision to focus on the "hydrogen economy" is viewed by many as an effort to deflect a more politically painful, but immediately plausible policy, to make a here-and-now effort to switch to hybrid automotive technologies that could immediately reduce consumption through increased efficiency. General Motors' commitment to produce 1 million hydrogen fuel cell cars a year by 2012 seems modest when compared with an estimated 100-million-vehicle growth in the American transportation fleet over the same period. Clearly, a bigger, bolder policy with greater short-to-intermediate-term impact is needed.

Still, realistically, no matter what happens on the demand side in the United States, there is no escaping the need for increased overall world output to keep prices reasonable despite rising world (and U.S.) demand. But the United States will do itself a disservice by indulging in the fantasy that it can create this supply by diplomatic pressure or military action.

Like it or not, there seem to be few short-term alternatives to the maintenance of Saudi Arabia as a supplier of last resort and necessary hedge against short-to-medium-term disruptions. Over the last two years, such disruptions have occurred in both Venezuela and Nigeria. Far from replacing the U.S.-Saudi Arabian “special relationship” with an “axis of oil” between Moscow and Washington, any new approach can at best create an “oil triangle” with its points in Washington, Riyadh, and Moscow, perhaps eventually adding Iraq or Canada to the mix. But even this realistic view is fraught with uncertainties as internal political stability inside Saudi Arabia deteriorates, calling into question what the United States would do if an internal upset there restricted oil exports.

In short, there is no easy solution to our pressing energy dilemma, short of an unlikely (and unpleasant) worldwide recession that would reduce demand for oil. Any post-9/11 reassessment of our energy strategy must accept this reality and focus on measures that will allow us to achieve slow and practical progress over a sustainable period, not on risky, expensive alternatives that continue to ignore the demand side of our energy quandary. All that is lacking is the political will—and leadership—necessary to move beyond what could be called, without exaggeration, a policy of emotional denial.

Notes

- ⁱ Moore's film has grossed over \$100 million, making it easily the most commercially successful documentary in U.S. history.
- ⁱⁱ "The National Security Strategy of the United States of America," available online at whitehouse.gov
- ⁱⁱⁱ "The Future of Energy Policy," by Timothy E. Wirth, C. Boyden Gray, and John D. Podesta, *Foreign Affairs*, July-August 2003.
- ^{iv} "Reliable, Affordable, and Environmentally Sound Energy for America's Future," Report of the National Energy Policy Development Group, May 2001, available online at whitehouse.gov.
- ^v See, for example, "Our Enemies, the Saudis," by Victor Davis Hanson in *Commentary*, July-August 2002.
- ^{vi} *The 9/11 Commission Report*, pp. 371-5, available online at www.gpoaccess.gov/911.
- ^{vii} "Then There Were Two," by Michael Mandelbaum, *Newsday*, June 26, 2003.
- ^{viii} "What if?" *The Economist*, May 29, 2004, pp. 69-70.
- ^{ix} One of the most outspoken neoconservatives, former CIA Director R. James Woolsey, has declared that, for the United States, World War IV (World War III being the Cold War) has already begun. See text of his speech of November 16, 2002 (published November 22, 2002), at www.frontpagemag.com/articles. Frequent contributor, Norman Podhoretz, has also referenced the same themes in *Commentary*.
- ^x "The Road to Economic Prosperity for a Post-Saddam Iraq," by Ariel Cohen and Gerald P. O'Driscoll, Jr., Heritage Foundation Backgrounder No. 1633, March 5, 2003, available online at www.heritage.org/Research/MiddleEast/bg1633es.cfm.
- ^{xi} Jaffe, Amy Myers, "The Geopolitics of Energy," *Encyclopedia of Energy*, ed. Cutler Cleveland, Elsevier Science, Oxford, U.K. 2004.
- ^{xii} See "Will Calgary Be the Next Kuwait," by Manik Talwani, *The New York Times*, August 14, 2003.
- ^{xiii} Chip Cummins, "As Threats to Oil Facilities Rise, U.S. Military Becomes Protector," *The Wall Street Journal*, June 30, 2004, p A1.
- ^{xiv} Jaffe, op cit.