

Market Solutions: Why Militarization is Unlikely

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The Global Energy Market:
Comprehensive Strategies to Meet Geopolitical and Financial Risks
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Resource Wars?

- **Thesis: countries are scrambling to secure increasingly scarce oil supplies (whether due to “peak oil” or geopolitical factors) and will resort to military means, if necessary, to secure them.**
- **“No highly industrialized society can survive at present without substantial supplies of oil, and so any significant threat to the continued availability of this resource will prove a cause of crisis, and, in extreme cases, provoke the use of military force” [Michael Klare, *Resource Wars* (2001)]**
- **This view focuses on importing countries and oil.**

Durability of Markets

- US policy has been to maintain an open global market for energy resources- and has used its military power to do so. Oil and other energy resources are allocated by price.
- Markets have demonstrated their ability to deal with short term price volatility and can deal with a rising price trend. Due in part to:
 - ◆ Energy is a decreasing share of GDP
 - ◆ Oil is increasingly a transportation fuel - easier to adjust to price disruptions.
- But appreciation (and belief) in markets is learned and must constantly be reinforced by experience. Statist ideas are still popular - fear that some countries may not always “play by the rules”.
 - ◆ Creation of consumer country NOC reflects ideology and distrust of markets. Countries feel more secure if they “control” supplies. (China, India etc as well as experience of 1970s - although market was less well developed in the 70s).
 - ◆ However, even exclusive state to state supply contracts are tied to market prices. (Markets perform price discovery function)

Disincentives to Defection

- Without coercion foreign NOCs will have to pay “the going price”. Oil exporting countries want to maximize benefits whether economic or political/strategic. Price still allocates oil.
- Oil from distant countries needs to be transported. The US controls the sea lanes.
- Can oil markets fail without endangering other market relationships?
(Costs of defection would be high)

Historical Record

No clear-cut cases where war was the result of conflict over energy supplies - as distinct from cases where conflict over energy was the result of conflict over other issues.

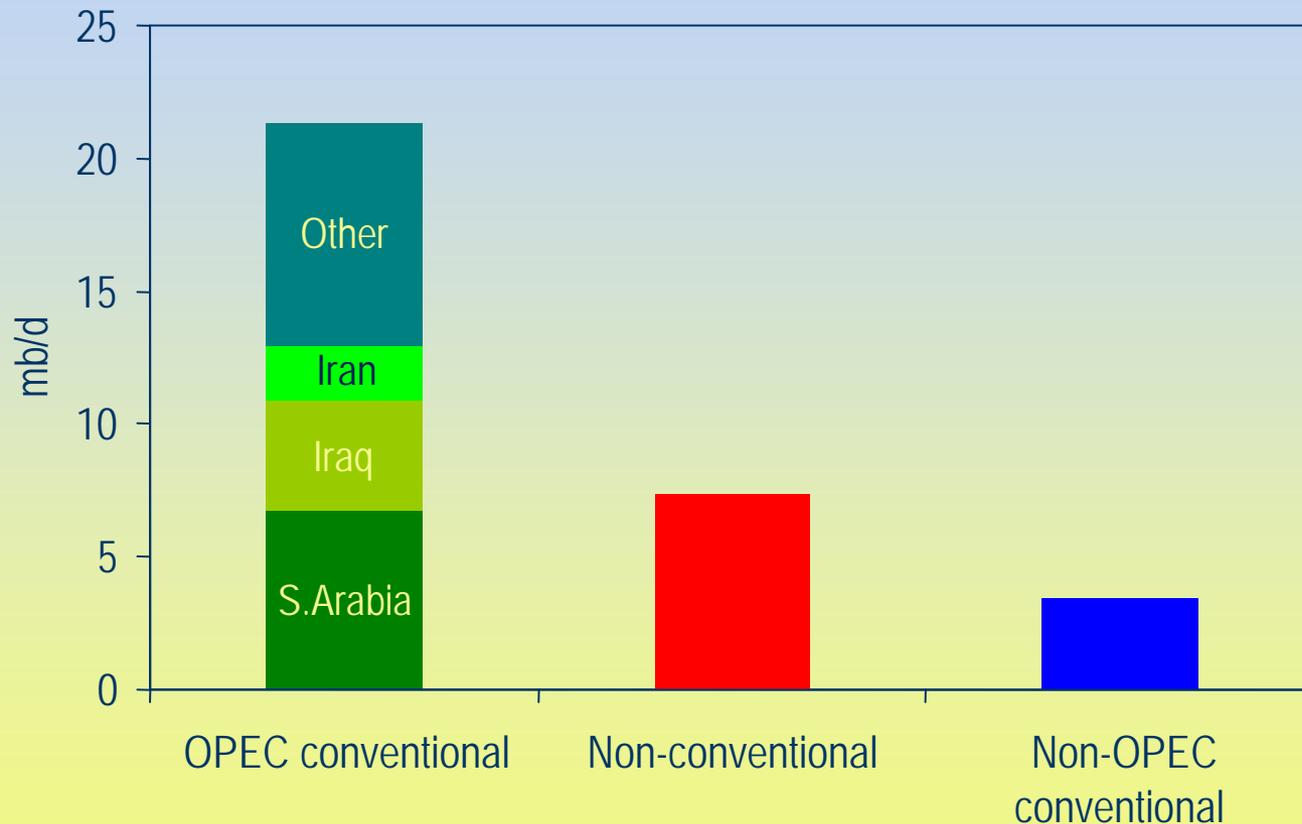
- Conflicts between producers
 - ◆ Vietnam - China
 - ◆ Iran - Qatar
 - ◆ Iraq-Kuwait
 - ◆ Caspian resources
- Conflict between Importers and Exporters
 - ◆ 1970s Arab oil embargo
- However, liberal energy (and other) markets could fail as a consequence of other more serious conflict

Conflict Over Energy Supplies and Concepts of Energy Security

Concept of Energy Security has changed over time

- 1950s - concept linked to military preparedness
- 1973 - Independence from foreign oil, countermeasure of “oil weapon”
- 1980s-1990s - protect economy against the negative impacts of oil shocks, “loss of economic welfare”
- Post September 11- high national security costs of dependence on oil regimes whose interests are antithetical to the U.S. Oil funds hostile regimes

IEA Base Case Reference Scenario: Increase in World Oil Supply, 2004-2030



Under a business as usual scenario, world will increasingly rely on Persian Gulf and unconventional oil, including about 3.5 to 4 million b/d of Canadian tar sands production, 1.5 to 2 mb/d of upgraded heavy oil, 2.4 mb/d of gas to liquids and 1.7 mb/d of coal to liquids, oil shale, etc

Concept of Energy Security Has Changed Because Market Risks Have Changed

- The possible spread of conflict or instability from Iraq into other oil producing countries or the escalation of a proxy war involving Saudi Arabia, Syria, Turkey and Iran over the outcomes in Iraq
- A confrontation with Iran over its nuclear aspirations that results in sanctions against Iranian oil exports or an Iranian or terrorist threat to oil shipping through the strategic Strait of Hormuz through which 16 million barrels a day of Mideast oil passes each day
- Attacks on oil facilities (by Al-Qaeda and others)
- A work stoppage or strike by oil workers, possibly motivated by political trends involving power sharing or human rights issues related to internal instability in a major oil producing country
- Domestic unrest or political crises, ranging from a leadership succession problem to a radical revolutionary challenge to an existing regime in a major oil exporting country or struggles over the division of oil rents that disrupt production, exports and investment (Nigeria, Indonesia, and Bolivia)
- Poor and failing governance leading to criminality and black market trade in oil products, potentially crisscrossing with terror networks
- Destruction of oil production or fuel manufacturing infrastructure following a severe storm or natural disaster

Other Dimensions of the New Security Issues

Growing concentration of both oil and gas supplies (Middle East and Russia) increases:

- Market power of exporters with the resultant wealth transfers
- Political leverage on dependent importers

Russia increasingly assertive to defend and expand its sphere of influence, using energy levers.

- ◆ Russia controls pipelines from Central Asian producers of gas and oil and extract rents
- ◆ Ukraine, Lithuania, Georgia, Belarus.
- ◆ Russia used energy policy to gain control over pipelines transiting Eastern European countries (Russian gas for the EU).
- ◆ Buying participation in North African gas suppliers to Europe
- ◆ Wanting to buy gas distribution assets in EU

Dealing With New Security Issues

- Diversify geographically and amongst energy sources.
- Pipelines restrict flexibility to diversify energy sources. (although it also restricts options of supplier). The EU will diversify towards LNG and gas from the Middle East to reduce Russian leverage.
- Europe should also facilitate the interconnection of pipeline and electric transmission grids.
- Consuming countries must
 - ◆ increase the flexibility of energy using industries and transport vehicles to shift amongst alternative fuels
 - ◆ lower the oil intensity of its economy
 - ◆ increase the shares of alternative fuels and energy sources in its mix of primary energy use. (However, for countries with large coal deposits energy security may come at the cost of higher CO₂ emissions)