

Militarization of Energy Security

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The purpose of this talk is twofold: (1) to briefly cover some of the highlights of a paper co-authored with my colleague at the Naval Postgraduate School, Daniel Moran, titled “The Militarization of Energy Security.”¹ This is a paper published in the January 2008 issue of our e-journal *Strategic Insights* and is the opening chapter in an edited volume that will be published by Routledge in the summer of 2008 titled: *Energy Security and Global Politics: The Militarization of Resource Management*. The volume includes a series of papers by a variety of authors, including the Baker Institute’s own Ron Soligo and Amy Jaffe, that were compiled by us at the Naval Postgraduate School as part of a project for the Long-Range Analysis Unit at the National Intelligence Council, which was preparing a national intelligence estimate on energy and national security; (2) I’d like offer up some thoughts of how this framework might be applied to today’s circumstance in international energy markets and to consider the prospect that deliberate actor calculations or miscalculations over the functioning or perceived non-functioning of those energy markets might lead to armed conflict between developed states.

The possibility that access to energy resources may become an object of large-scale armed struggle is one of the most alarming prospects facing the current world system. The political stability of advanced societies, and the continued prospects for

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¹ Link at <http://www.ccc.nps.navy.mil/si/2008/Feb/moranFeb08.asp>. This speech includes some verbatim text from Moran/Russell article.

economic and social improvement in developing countries, are both linked to the operation of international energy markets. The increasing scale and complexity of these markets since the end of the Second World War has been one of the primary drivers of global economic growth. Like all international markets, the market for energy is sensitive to war and upheaval, whatever the cause. Energy markets are efficient at discounting risk, and there is a long history of price spikes and shortages whenever large-scale violence, chiefly but not exclusively in oil-producing regions, threatens established patterns of production and consumption. Strategic planners in the United States and elsewhere are well aware of the degree to which the anticipated effect of military operations on the price and availability of oil and natural gas needs to be considered in their work.

My co-author and I asked the authors to analyze whether specific countries or regions of the world would “militarize” their energy security and, secondly, whether such a process would increase the likelihood of interstate armed conflict in response to energy issues. We assembled this group of experts – drawn from economists, political scientists and people generally interested in security studies. Thus we asked “guns and bombs” people to sit in a room with a bunch of economists, who, as rule don’t much talk to each other.

Security studies people – I suppose I’m in this group – look at strategic problems and consider the prospect that these problems could cause actors to arrive at a decision to use force that would cause a generic breakdown in the international system. Such prospects are generally discounted by economists, who are for the most part wedded to the workings of the market and stakes that all actors have in the orderly functioning of those markets. These stakes represent powerful inhibitors on certain kinds of behavior, like war, which can in and of themselves compromise the functioning of markets upon which all depend. Indeed, evidence today is on the side the economists, who point to the absence of armed conflict between and among developed states in the post World War II era as part of a general acceptance in the developed world that war just doesn’t pay. We are not arguing here the world is not a violent place. Far from it. Warfare associated with state fragmentation, warlord clashes and conflict between a variety of contestants seeking power and influence, and attempts by the developed world to suppress actors

operating outside accepted behavioral norms – all these are certainly present today. Setting these aside, however, it remains difficult to imagine warfare today between the developed states on a scale like that which existed in the World Wars – a prospect acknowledged in even the most alarmist of today’s strategy documents. For example, one of the whole bases of the most recent Quadrennial Defense Reviews, for example, is to try and re-orient the military capacities our security apparatus towards irregular warfare. This is simply an acknowledgement of what I’ve described as the generally accepted view; that large-scale conflict between and among the developed states is regarded as unlikely.

However, it is conditions in the energy sector where planners today regard it easiest to imagine major states reconsidering their reluctance to use force against each other. “Energy Security” is now deemed so central to “national security” that threats to the former are liable to be reflexively interpreted as threats to the latter. In a world in which territorial disputes, ideological competition, ethnic irredentism, and even nuclear proliferation all seem capable of being normalized in ways that constraining the actual use of military forces, a crisis in global energy supplies today stands as perhaps the last all-weather casus belli when thinking worst case scenarios for global conflict.

I acknowledge the bias of the security studies school of thought here, who are prone towards believing the worst, doubt the ability of individuals and institutions to act predictably in weighing the costs and benefits in their decision-making process of deciding to use force, note that states have in the past taken decisions to go to war with their best customers, and, last, but not least, that second order effects of decisions made by states can produce unintended consequences that in and of themselves force changes in the cost-benefit calculus of states in regarding their strategic circumstances. One of the celebrated instances of this latter phenomenon is the series of interactions between the United States and Japan that lead to the decision in the United States to freeze Japanese assets in June 1941, which we saw as a way to increase incremental pressure on the Japanese military to get them to cease their objectionable behavior in China. The step resulted in a defacto oil embargo, which, while not initially realized by Roosevelt, is the decisive point at which the Japanese Army signs on to the Japanese Navy’s plans to go to

war with the United States. My colleague Dan Moran has done a wonderful chapter in the book on this case.

The fact that strong states have been prepared to trust their energy security to the workings of international markets is testimony to their faith in the efficiency of those markets, and to their belief that the costs of war aimed at controlling energy resources would be so great as to outweigh the benefits. The “militarization” of energy security assumes that something has changed that would cause major participants in the energy market to reject this calculation. High energy prices would be a necessary, but not a sufficient, motivation for such a change. In addition, governments would have to believe that the normal mechanisms by which prices adjust to changes in supply and demand had broken down, or were on their way toward doing so. Prices in almost any market demonstrate three basic tendencies: short-term volatility, medium-term momentum, and long-term reversion to the mean. The meaning of these terms varies depending on what is being bought and sold, but their operation is apparent across an enormous range of economic phenomena. They represent, collectively, the self-modulating action of supply and demand, which is the economist’s equivalent of the Law of Gravity.

From the point of view of those who seek to make money in a marketplace, the first two tendencies – volatility and momentum – are of the greatest interest, since it is by mastering these that one has the best chance to “buy low, sell high.” For strategists, however, it is “mean reversion” that matters most, since it is this longer-term mechanism that provides reassurance during periods when volatility and momentum carry prices and supplies to uncomfortably high or low levels. Mean reversion does not require that prices fluctuate in perpetuity around a flat line, simply that their aggregate movement describe a relatively smooth trend, which may have a positive or negative slope, but whose variance is markedly less great than that displayed by short- and mid-term price changes. Such relationships are no more than mathematical models, which can be calculated in different ways. But for our purposes it is not the precise calculation but the general idea that matters, and specifically the military and political consequences that might follow if this general idea is abandoned.

The first task of a project designed to consider the militarization of energy security must be to identify the kinds of events or forces that would cause governments to conclude that energy prices or supplies will not revert to some established trend. Such events need not be dramatic in themselves. It is most likely that the militarization of energy security will occur as a series of small calculations (or miscalculations) conceived in response to limited crises or opportunities; each of which will, however, erode the willingness of other participants to trust the market going forward. To speak of the militarization of energy security, it is necessary to imagine that such activity reaches a scale at which the normal operation of energy markets is compromised. The scenarios that interest us need not go so far as to hypothesize “the end of history” (a phrase with a long history in itself...); but they must envision strategic intervention on a scale that is not incidental, but calls into question the future vitality of the market as a whole.

Strategic action with respect to energy may take a wide range of forms. A representative and by no means complete list of possibilities would include:

1. Direct seizure of energy assets by military means.
2. Military confrontation arising from competitive efforts to identify and exploit new energy resources
 - a. on the high seas, where legal claims of sovereignty are absent;
 - b. in archipelagic regions like Southeast Asia, where they are routinely contested; or
 - c. in Antarctica, where they are subject to a treaty regime whose resilience has never been seriously tested.
3. Indirect control of energy assets through the creation of puppet states.
4. Military overthrow of governments whose outlook or conduct are deemed inimical to the functioning of energy markets.
5. Military protection of (or attacks upon) the energy production and transportation infrastructure, including oil fields, refineries, pipelines, port facilities, etc.

6. Protection of (or attacks upon) international straits and archipelagic waters through which energy assets move.
7. Intervention to defend governments of energy-producing states against internal upheaval, on terms that incite suspicion among other market participants.
8. The development of exclusive energy trading blocs based upon commitments of mutual defense, and reminiscent of the systems of “imperial preference” that existed before 1945.
9. The conveyance of major military assets to regional energy producers in exchange for preferential market treatment, or with a view to enabling them to impose themselves upon neighboring states.

Our paper spins out some of these arguments in greater detail, but I think it’s useful for discussion purposes here to perhaps point to some recent events which point if not to outright militarization point to questions about the ability of the energy market to function in the future as they have in the past – delivering predictable supplies, with supply and demand in lock step, and, perhaps most important, markets delivering the means reversion that provides solace and comfort for the economists and strategists alike.

It would be remiss, however, not to mention that there are those that argue that the phenomenon of militarization of energy is in fact well underway. This historian Andrew Bacevich did a piece several years ago for the *Wilson Quarterly* titled “The Real World War IV,”² in which he argued that President Carter’s threat to use nuclear weapons to defend the Gulf against outside powers touched off a sequence of actions that saw the United States consciously mobilize its military to protect the region’s oil fields. More recently, Michael Klare – a chapter contributor to our book – argues in a recent piece in *The Nation* that energy and security calculations have provided an important impetus for our [the U.S.] continued emphasis on building carrier strike groups in the Navy’s desperate quest to justify a hugely expensive multi-billion dollar shipbuilding program at

² Andrew Bacevich, “The Real World War IV,” *Wilson Quarterly*, Winter 2005, Vol. 29, No. 1.

a time when most countries around the world have given up on the idea of having any kind of Navy outside a few vessels for coastal patrol.³

The Politics – Market Gap

I would argue that the framework for analysis suggested by our concept of militarization is of interest in today's circumstance in several contexts. First, there is a growing perception around the world that international energy markets are no longer functioning in accordance with two "iron laws of the marketplace." The first of these is that rising prices provides a brake on demand and, concurrently, stimulate the development of additional supplies. As Fatih Birol, chief economist at the International Energy Agency, recently commented in the *New York Times*, "According to normal economic theory, and the history of oil, rising prices have two major effects. They reduce demand and induce oil supplies. Not this time." Demand for oil keeps increasing – forecasted to grow by another 1.2 million barrels per day in 2008 to reach an estimated 87.2 million barrels per day. Moreover, there's just no way to get around the fact that non-OPEC suppliers have plateaued and will cease to be able to significantly increase production. We look to the Saudis to increase production, but they have only committed increasing production to 12.5 million barrels a day – far short of what projections say will be necessary to keep supply and demand in any kind of reasonable balance. In short we are entering a period of resource scarcity – for a variety of reasons, which have mostly to do with capacity in the industry which is simply unprepared to deal with the rate of demand increase over the last five years.

The second feature of the market suggesting a "compromise" in function is that nobody anywhere is suggesting that the price of energy is going down any time soon. Jeff Rubin an analyst at CIBC World Markets suggested recently in the *New York Times* that we are entering a period of "unprecedented scarcity" that could produce \$200 per barrel oil and \$7 a gallon gasoline here in the United States -- to say nothing of what it might cost in Europe. What does this mean? In other words, there is no "mean reversion" coming, that will see pricing revert to historical norms. The "mean reversion" reverts

³ Michael Klare, "The New Geopolitics of Energy," *The Nation*, May 1, 2008, at <http://www.thenation.com/doc/20080519/klare>

inexorably upward, creating the specter of the “haves” and “have nots” on the consuming side of the equation relative to their ability to pay these prices.

Why are these two points relevant to the concept of militarization? First, it is these circumstances which indicate to us that there are growing perceptions that the market is already operating outside expected behavioral norms, suggesting that the functioning of markets is in fact already compromised. Second, that if states reach the conclusion that markets have ceased operating in accordance with generally accepted principles, they lose confidence in those markets to deliver in the present and in the future as they have in the past. Once this cognitive hurdle is leapt over, all bets are off, as states reassess – indeed take a more alarming view – of the ways in which these compromised markets are not operating to their benefit and are in instead creating strategic circumstances that redound inexorably to their detriment. This creates the classic circumstance that security studies experts refer to as “preventative war,” in which states perceive that their strategic circumstances get inexorably worse over time, thereby weighting the costs in favor of taking military action to improve their prospects.

Nowhere are these considerations more important than the United States, which is perhaps alone in the world with a military that might be able to intercede unilaterally and on a scale that would systematically affect energy markets. I should parenthetically note that I doubt the capacities of violent non-state actors to achieve anything other than episodic affect on energy markets. But it is ironic to mention the United States in such a context, since one could argue that there is no country in the world today more ideologically and politically committed – even militarily committed – to the functioning of world markets. While the US military presence in the Gulf is cited by many as an attempt to “take over” the region’s oil fields, I’d be among those arguing that we are using force to protect the orderly functioning of markets for all – including us. This is unsurprising, since the United States and its \$12+ trillion GDP has by far the largest global stake in the orderly functioning of these markets.

Having said that, however, I would also argue that we in the United States are concurrently blinded to the truly strategic dimensions of the impact that world energy markets have had on global financial plate tectonics over the last five years. While thousands of US and Iraqis were killed in the Iraq war and the American taxpayers were

saddled with a \$1 trillion plus in additional debt, allowing the Gulf States to become a global economic superpower courtesy of world energy markets. And they promise to get a lot richer – unbelievably richer:

- GCC GDP has grown from \$406 billion in 2003 to \$712 billion in 2006; the IMF estimates that GCC GDP could reach \$883 billion in 2008.
- GCC annual export earnings more than doubled from 2001-2006, from \$146 billion in the preceding five years to \$327 billion.
- Morgan Stanley estimates Gulf “above ground” wealth now at \$44 trillion, three times US GDP and almost as much as the total world GDP (est. \$48 trillion in 2006)
- By the end of 2007, GCC sovereign wealth funds were managing over \$1 trillion in assets. Add \$460 billion w/the Saudi Arabia Monetary Agency and estimated private holdings and the investment portfolio in the Gulf now totals \$2 trillion.
- GCC dollar holdings are now estimated at \$1 trillion – more than Japan, second only to China.
- The next time you hear someone pontificating about the new era of pax Iran in the Gulf, consider that Tehran has lost the economic competition with the GCC. The GCC bow wave has broken over them the same way it has broken over us, but, like the Iranians, we don’t get it. When I say “we,” I mean our politicians and public. My guess is that Robert Rubin at Citigroup gets it. The UBS leadership in Switzerland gets it. Officials at GE Plastics get it.

Political Reactions and Plate Tectonics

There is today a chasm in the United States in what I would argue are the general public and political domains over the changes in global plate tectonics that have been unleashed by the apparently orderly functioning of energy markets over the last 5 years. An argument can be made that ignorance surrounding the effects of these markets is as capable of producing the same kinds of miscalculations in the United States as those that existed in Japan in the 1930s.

What I'm suggesting here is that once our politicians wake up and realize what has happened and what will continue to happen, they're not going to like it. And, let's face it; there are members of our political establishment that just don't like the fact that Gulf Arabs are accumulating wealth at such a rapid rate. They don't like the prospect of wandering through these capitals, cap in hand, apologizing for past misdeeds and asking for help in the latest economic crisis *du jure*. And, they are not sure they like the prospect of \$7 a gallon gasoline by 2012 that promises to change the American way of life while the Gulf State Arabs are building underwater hotels and indoor ski slopes and manmade islands for the hyper wealthy. Last, they're not going to want to explain all this to the American people by urging them to look in the mirror, tighten their belts, and start riding their bikes to work. Just look at Obama and Clinton wandering through the rust belt mindlessly blaming people's economic problems on those bad free trade deals. A precursor of what could come on a grander scale? I'm not sure, but I am convinced – as Fareed Zakaria argued in his excellent *Foreign Affairs* piece – that our political system has become all but incapable of addressing these and other systemic problems.⁴

Other recent events provide examples of what I would argue are ominous indicators of how far behind the curve of self realization we in the United States are at this point. First, the Israeli lobby got Senator Schumer to introduce a bill threatening not to sell our arms to those bad old Saudis unless they increase oil production. Wow. I bet the Al Saud are quaking in their boots. Imagine that – we might not sell them some more F-15s as a sign of how displeased we are with them. Second, we've had an American president twice dismissed from Riyadh in the last six months – actually, laughed out of town in the regional press. I submit that the next time a president goes to Riyadh or any of the oil-rich GCC capitals; he or she will enter on their knees begging for their business.

In other words, we don't get it. We don't get the fact that markets and market functions change political realities and change the political calculations of actors about the relative distribution of power in the international system. I have news for you – that distribution is changing and has already changed in ways that reduce American's leverage around the world. We don't have the same kind of leverage we once had in

⁴ Fareed Zakaria, "The Future of American Power," *Foreign Affairs*, May/June 2008, 18-43.

Riyadh. We've squandered it – foolishly. But we don't understand it. Instead, we're now in some kind of parallel universe, where Alfred E. Neumann's plaintive “what me worry” slogan seems to characterize the political and public outlook.

But sooner or later, the chasm in perception that that exists today will close. The public and our politicians will wake up and realize that the global financial center of gravity has shifted to the oil producing states in the Gulf. And when that happens, I fear the prospect of militarization will rear its ugly head.

Conclusion

1. War happens through a combination of stupidity, irrationality and miscalculation. But the fact that conflict between developed states hasn't happened since the end of World War II doesn't mean it won't happen again. Calculations over energy are not immune to these considerations or the iron logic of preventative war.
2. Normal functioning of international energy markets may already be compromised. Even if they are not – there is a growing perception that this has in fact happened. Increased prices are not acting as a brake on demand and stimulating new supplies, as the economic theory suggests it should. Perhaps more importantly, the future may not be like the past insofar as world energy markets are concerned in that the market may not deliver the “mean reversion” of pricing. Instead, the mean reversion reverts on an upward path – a path that must inevitably shape the cost/benefit calculus of participants in the market.
3. The perceptible chasm in the United States between new market realities and their impact of the global distribution of power will one day close – and when it does, look out. It's not so far fetched to suggest the creation of a toxic mix of ugly domestic circumstance, bad leadership, and plain stupidity that all cast militarization as a useful option to restore “logic” to a systemically compromised market.”