The Oil Drum
DISCUSSIONS ABOUT ENERGY AND OUR FUTURE

Council on Foreign Relations -"National Security Consequences of Oil Dependency"

Posted by Nate Hagens on December 5, 2006 - 4:05pm
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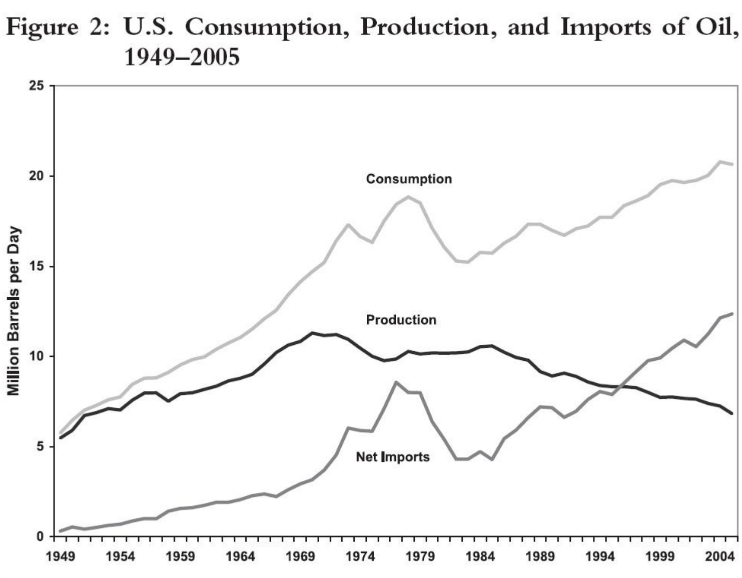
Tags: conservation, council on foreign relations, gas tax, imports, think tank [list all tags]

With little media fanfare as of yet, a major report by the political heavyweight think tank Council on Foreign Relations was recently released. "Independent Task Force Report #58 - National Security Consequences of Oil Dependency" (*pdf warning*) paints a somewhat more urgent picture of our energy situation than most other oil and energy research coming out of Washington. Though there is no mention of the words "Peak Oil' in the 90 page report, to the astute reader it is clear that this group of experts, led by ex-CIA chiefs, John Deutsch and James Schlesinger, understand that the era of cheap energy is ending, and that our dependency on oil has major geopolitical implications with few easy answers. The bombshell in this report is the admission that the United States will be unable to achieve energy independence, and should focus instead on reducing our dependency on oil. Though this concept is nothing new to readers of this site, coming from a highly respected mainstream think tank (CFR), recommendations such as conservation, gasoline taxes, and gasoline rationing might be an uncomfortable but necessary wake up call to some of the conservative (cornucopian?) decisionmakers in our nations capital. Indeed, this report may be the next integral step of political eye-opening (the first being the Hirsch Report last year) that hastens our national efforts towards addressing our energy addiction.

This post is a general summary of the report, along with some interspersed comments and conclusions.



Our oil import dependency(pg. 31) (Click to enlarge)

The Council on Foreign Relations has a long history of analysis and research dissemination on issues of national policy from great and respected minds. When I was in graduate school, I often had a copy of their "Foreign Affairs" periodical, which I never managed to read more than a chapter or two but felt it was cool to carry around (youth). The last time I read it was earlier this year when it contained an article on Americas first strike capability vis-a-vis the rest of the world with our nuclear arsenal. This is a heavyweight organization whose work is read and respected at the highest levels around the world.

Our ever vigilant energy/environment media hawk Leanan first posted a reference to this story here, but because of travel it wasnt until a few days ago that I had a chance to review the 90 page document. In my opininon, this is a watershed report, not so much for new analysis or information, but for the fact that a respected mainstream organization such as Council on Foreign Relations implies that the invisible hand of the market will not solve our energy problem.

INDEPENDENT TASK FORCE REPORT #58

The grey boxes below are quotes from the report, which is well worth reading.

> "Founded in 1921, the Council on Foreign Relations is an independent, national membership organization and a nonpartisan center for scholars dedicated to producing and disseminating ideas so that individuals and corporate members, as well as policymakers, journalists, students and interested citizens in the United States and other countries, can better understand the world and the foreign policy choices facing the United States and other governments. The Council does this by convening meetings; conducting a wide-ranging Studies program; publishing *Foreign Affairs*; the preeminent journal covering international affairs and U.S. foreign policy; maintaining a diverse membership; sponsoring Independent Task Forces; and providing up-to-date information about the world an U.S. foreign policy on the Council's website, www.cfr.org.
>
> THE COUNCIL TAKES NO INSTITUTIONAL POSITION ON POLICY ISSUES AND HAS NO AFFILIATION WITH THE U.S. GOVERNMENT. ALL STATEMENTS OF FACT AND EXPRESSIONS OF OPINION CONTAINTED IN ITS PUBLICATIONS ARE THE SOLE RESPONSIBILITY OF THE AUTHOR OR AUTHORS
>
> The council will sponsor an Independent Task Force when (1) an issue of current and critical importance to U.S. foreign policy arises, and (2) it seems that a group diverse in backgrounds and perspectives may, nonetheless, be able to reach a meaningful consensus on a policy through private and nonpartisan deliberations. Typically, a Task Force meets between two and five times over a brief period to ensure the relevance of its work.
>
> ...Task Force Reports reflect a strong and meaningful policy consensus, with Task Force members endorsing the general policy thrust and judgements reached by the group, though not necessarily every finding and recommendation. Task Force members who join the consensus may submit additional or dissenting views, which are included in the final report...."

It seems that our dependence on oil and natural gas was deemed a current and critical enough issue to convene a Task Force (#58), chaired by John Deutsch and James Schlesinger and directed by Stanford Professor David Victor. The Task Force itself was comprised of 27 members who read like a whos who of American politics and industry. In the Foreward to the Report, CFR President Richard Haass makes the following profound remarks (emphasis added):

> In recent years, energy prices have surged. President George W. Bush, in this year's State of the Union address, warned of an addiction to imported oil and its perils. Yet there is no consensus on what should be done to shake the addiction. Virtually everything concerning energy has changed - except U.S. policy.
>
> The Council on Foreign Relations established an Independent Task Force to examine the consequences of dependence on imported energy for U.S. foreign policy. Since the United States both consumes and imports more oil than any other country, the Task Force has concentrated its deliberations on matters of petroleum. In so doing, it reaches a sobering but inescapable judgement: the lack of sustained attention to energy issues is undercutting U.S. foreign policy and national security.
>
> The Task Force goes on to argue that U.S. energy policy has been plagued by myths, such as the feasibility of achieving "energy independence" through increased drilling or anything else. For the next few decades, the challenge facing the United States is to become better equipped to *manage its dependencies* rather than pursue the chimera of independence.

Though they appeal to different crowds, it seems Richard Haass shares some common ground with Richard Heinberg.

OVERVIEW AND INTRODUCTION

The Overview of this report is excellent. Here are some excerpts:

> The challenge over the next several decades is to manage the consequences of unavoidable dependence on oil and gas that is traded in world markets and to begin the transition to an economy that relies less on petroleum. The longer the delay, the greater will be the subsequent trauma. For the United States, with 4.6 percent of the world's population using 25% of the world's oil, the transition could be especially disruptive.
>
> During the next twenty years (and quite probably beyond), it is infeasible to eliminate the nation's dependence on foreign energy sources. The voices that espouse "energy independence" are doing the nation a disservice by focusing on a goal that is unachievable over the foreseeable future and that encourages the adoption of inefficient and counterproductive policies. Indeed, during the next two decades, it is unlikely that the United States will be able to make a sharp reduction in its dependence on imports, which currently stand at 60% of consumption. The central task for the next two decades must be to manage the consequences of dependence on oil, not to pretend the United States can eliminate it.

This is eloquent and spot on. It is both easy and appealing to believe that we can replace our hydrocarbon usage, but such a belief takes away both the urgency and the drive that urgency creates. It was refreshing to read such frank language from a senior policy missive.

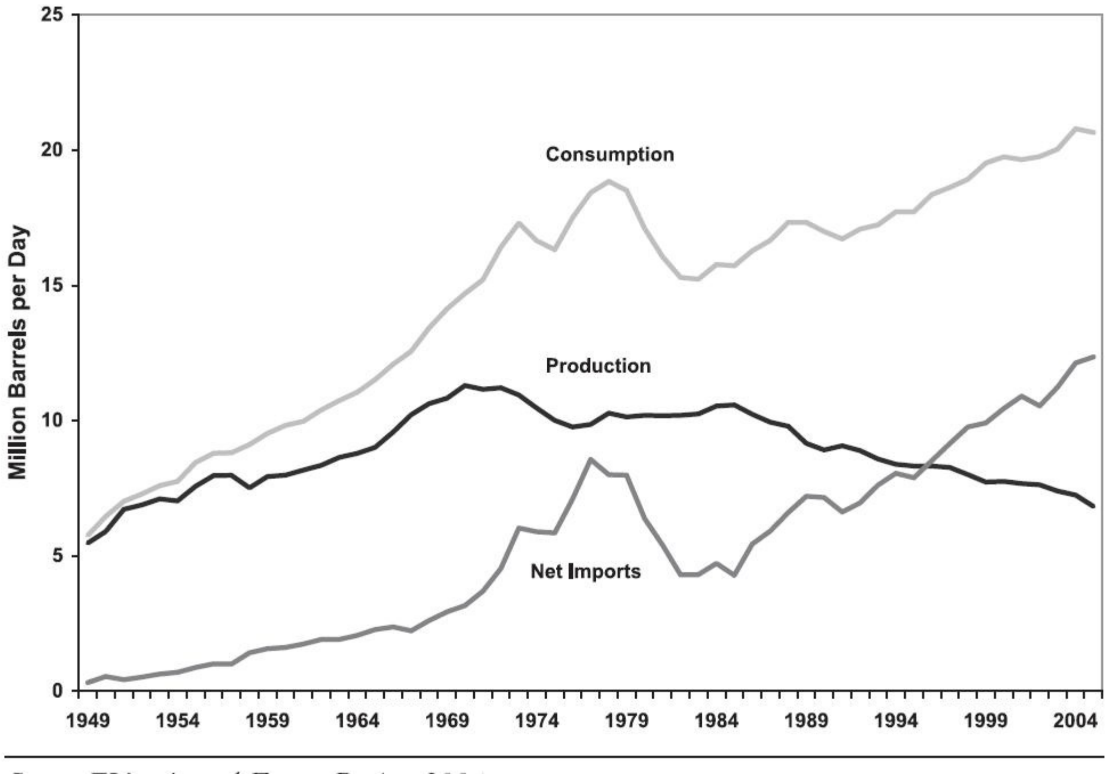
> For the last three decades, the United States has correctly followed a policy strategy that, in large measure, has stressed the importance of markets. Energy markets, however, do not operate in an economically perfect and transparent manner. For example, the Organization of Petroleum Exporting Countries (OPEC), quite notably, seeks to act as a cartel. Most oil and gas resources are controlled by state-run companies, some of which enter into supply contracts with consumer countries that are accompanied by political arrangements that distort the proper functioning of the market. These agreements, such as those spearheaded by the Chinese government in oil-rich countries across Africa and elsewhere, reflect many intentions, including the desire to "lock up" particular supplies for the Chinese market. Some of the state companies that control these resources are inefficient, which imposes further costs on the world market. And, some governments use the revenues from hydrocarbon sales for political purposes that harm U.S. interests. Because of these realities, an active public policy is needed to correct these market failures that harm U.S. economic and national security. The market will not automatically deliver the best outcome.

Admission that the market has been an appropriate mechanism historically for energy but may not be so in the future was mentioned several times in this report. For a country built on the invisible hand, this is kind of a radical suggestion (though one I agree with).

The Introduction layed out several policy suggestions which were then detailed in the report. Among them were adopting a mix of gasoline taxes, stricter CAFE standards and gasoline rationing system that would cap the total gasoline consumed in the nation. The Report also advocated removal of worldwide subsidies for oil consumption, removing the protectionist tariff on imported ethanol, reducing oil infrastructure vulnerability, helping oil producing countries better manage their oil revenues, and the creation of an Energy Security directorate within the National Security Staff to coordinate interagency energy policy. It also concluded with a paragraph on global warming, stating that this was an important international policy issue but beyond the scope of this Task Force, other than that many of the answers to reducing carbon emissions were also answers for reducing oil dependency. The lead author, David Victor, had previously written another Report specifically on climate change.

FINDINGS: THE US ENERGY SYSTEM AND THE ROLE OF IMPORTED OIL AND GAS

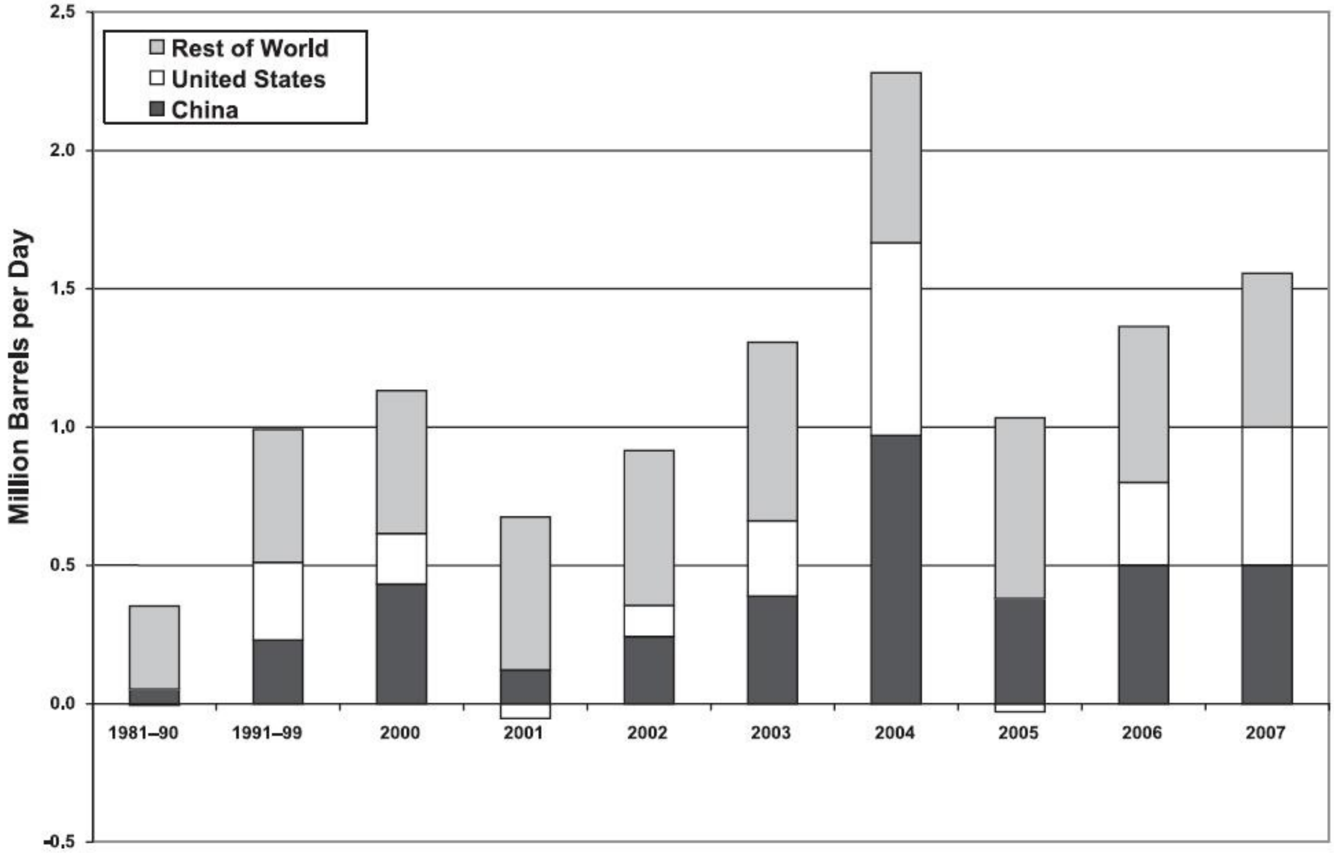
Figure 2: U.S. Consumption, Production, and Imports of Oil, 1949–2005



US Oil Imports vs Exports(pg. 31) (Click to enlarge)

Americas transportation sector revolves around oil. 68% of our oil usage goes to this sector, and 96% of the transportation sector uses oil. Many of the same conclusions of the Hirsch report were repeated here: long lead times, long average vehicle life, etc. And though we once produced what we consumed, this has not been the case for decades and the trend of increasing imports will continue. The Report also spent considerable time on the growth in Chinese demand for oil, and Chinese government policys to secure oil. Indeed, when looked at graphically, a large % of the increase in world oil demand has come from 2 countries:

Figure 4: Annual Growth in World Oil Demand



Source: EIA, *Short-Term Energy Outlook,* February 2006 (1981–90 and 1991–99 are annual averages).

One of the things I liked about this report was how bluntly they stated that their conclusions differed from some of the conventional energy rhetoric that has been common in the media recently. Given the large group of intelligent, connected people on the Task Force, this means these ideas will be gaining traction with our decisionmakers. They outline several 'myths' about energy along with supporting discussion:

> ***Myth #1: The United States can be energy independent.***
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> No, because liquid fuels are essential to the nation's transportation system. Barring draconian measures, the United States will depend on imported oil for a significant fraction of its transportation fuel needs for at least several decades.

The report points out that, concerned about increases in oil imports to 50% of consumption in the 1970s, US curtailed consumption to only require 1/3 imports. However, this trend has reversed and our infrastructure is so dependent on oil, that coupled with continued declines in domestic production, import dependency is above 60% and expected to rise in the coming decades.

> ***Myth #2: Cutting oil imports will lower fuel prices.***
>
> Probably not. If policies aimed at cutting imports also reduce demand for fuel, then prices in the world market may decline. However, policies that mandate reduction of imports while demand stays high will force some consumers to turn to higher-priced substitutes to meet their needs.

In other words, cutting demand is the key to reducing import dependency.

> ***Myth #3: Large Western companies like Exxon Mobil, BP, Shell, and Chevron control the price of oil.***
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> No, the resources and production controlled by large international oil companies are small compared with the NOCs. The pace of increasing extraction of hydrocarbons probably rests largely with NOCs, many of which are not governed solely by economic considerations. The international major companies control only about one-tenth of the world's proven hydrocarbon resources.

This was a big takeaway from the report for me. The fact that 90% of world reserves are controlled by National Oil Companies as opposed to market-incentivized public companies, belies the fact that dollar per barrel pricing will not necessarily dictate world oil flows. Publicly traded oil behemoth Exxon Mobil is only ranked 14th in proven reserves (below 13 national oil companies). An important distinction between public and private energy ownership, along nationalistic boundaries, seemed to be a big concern of the authors. With a nations security one day on the line, can oil importing countries rely on oil exporters to accept money in trade for energy?

> ***Myth #4: There's plenty of low-cost oil ready to be tapped.***
>
> Unlikely. For the past 150 years the world has used low-cost oil, such as in Saudi Arabia and East Texas. Over the long run, progressively higher-cost sources of oil will need to be tapped. That, on average, will translate into higher oil prices. The world cannot "drill its way out of this problem."

This has been a central them at theoildrum.com, and really the underlying logic of Peak Oil. There is a difference between productive capacity and actual production, and politics will couple with geology to dictate that spread. Also, as was discussed here, the 'best-first' principle will result in both higher prices and resources being taken away from the non-energy sector as we move into the second half of the age of oil. Net energy analysis should be incorporated into future energy policy discussions.

Myth #5: Renewable energy and nuclear power can quickly reduce dependence on oil and gas.

Cellulosic biomass, a renewable fuel with a potential for significant scale, is a leading contender to directly displace transportation fuels. However, the full potential of this technology will take time to develop, and there are no commercially viable cellulosic biomass production units in operation today. Moreover, this biomass source of liquid fuels will need to compete with liquid fuels derived from coal and natural gas, which are also attracting investment. Electricity—whether derived from renewable energy (e.g., photovoltaics, hydropower, geothermal, and wind), nuclear, or other sources such as coal—at present substitutes only for a tiny fraction of oil used in the United States and other advanced countries. Improvements in plug-in hybrid and all-electric cars could change that situation in the future.

These topics have been the bread and butter discussions here at the oildrum.com. The Report was very clear that nuclear power will be a vital part of our energy future and needs to be increased in its % of the overall power mix.

FINDINGS AND RECOMMENDATIONS: THE CONDUCT OF US FOREIGN POLICY

In the concluding section, the CFR Task Force suggest five goals, with supporting actions for each, on how to manage our dependence on hydrocarbon fuels while pursuing our foreign policy aims simultaneously.

Expand Sources of Oil and Gas Production and Protect Transit Routes of These Fuels to Markets

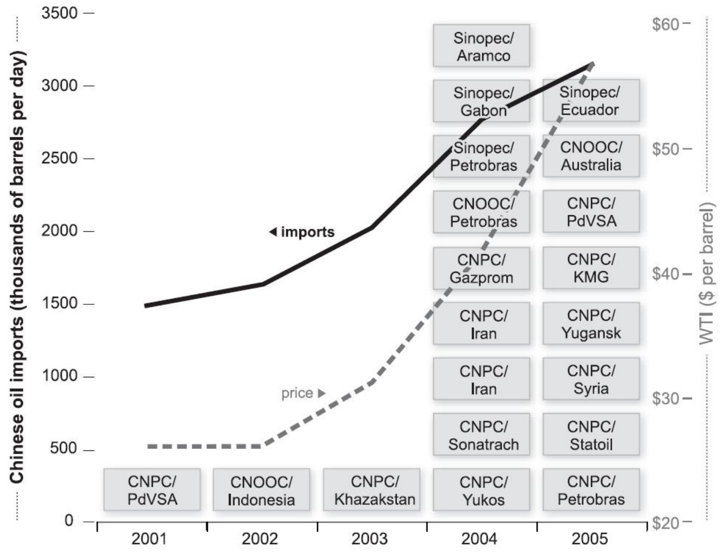
Encourage Efficiency of Energy Use in All Markets

Promote the Proper Functioning and Efficiency of Integrated Energy Markets

Revitalize International Institutions and Collective International Efforts

Integrate Energy Issues into US Foreign Policy Apparatus

Figure 6: Trends in Rising Chinese Oil Imports, Prices, and Number of Political Oil Deals



Source: Sinopec Corp., CNOOC Limited, and China National Petroleum Corporation. Price

Several pages were devoted to the foreign affairs implications of developed and developing nations signing long term contracts for oil, thus removing this portion from the openly bid for export market. Of particular concern was Chinas locking up of long term contracts, and the rate at which this is accelerating.

The Reports conclusion was really laid out in the Overview and rehashed briefly at the end. Following the concluding comments, two Task Force members, Michael Granoff (CEO of Pomona Capital) and David Goldwyn (President of Goldwyn International), offered an 'Additional View', which is transcribed below (it has a particularly hawkish and urgent tone).

> We subscribe to the report's analysis and recommendations, but the report understates the gravity of the threat that energy dependence poses to U.S. national security.
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> Energy is a central challenge to U.S. foreign policy, not simply one of many challenges. Global dependence on oil is rapidly eroding U.S. power and influence because oil is a strategic commodity largely controlled by regressive governments and a cartel that raises prices and multiplies the rents that flow to oil producers. These rents have enriched and emboldened Iran, enabled President Vladimir Putin to undermine Russia's democracy, entrenched regressive autocrats in Africa, forestalled action against genocide in Sudan, and facilitated Venezuala's campaign against free trade in the Americas. Most gravely, oil consumers are in effect financing both sides of the war on terrorism.
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> Transformation in the use of energy, especially in transportation where oil is unrivaled, in our government's approach to energy research, development, and deployment, and in the way we conduct our foreign policy, is essential. Achieving this transformation requires efforts on at least three fronts.
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> First we must integrate energy and foreign policy. For example, we must engage China and India at a presidential level on the impact of their investment practices on regional stability and our common interest in a free market for energy; we must engage Europe on its growing dependence on Russian energy exports and Russia's monopolistic practices. We must also consider asymmetrical means, like support for power and water

infrastructure to compete for political influence in Latin America and Africa.

Second, the United States must expand and deepen the collective energy security system forged by the United States and institutionalized in the International Energy Agency in 1974 - not least by bringing China and India into the system. The report endorses this effort but is not sufficiently precise on the best methods; it suggests that the International Energy Forum could be tapped, but that institution is ill-suited as it allows oil producers a veto on its activities.

Third, the United States should use its economic power as a component of its energy strategy. For example, we should consider ways to give preferential access to the U.S. market to producing countries that support a free market in energy. This instrument is blunt and difficult to wield, but among the steps we can take are to make access to energy transportation systems a condition of any new free trade agreement with the United States; limit the ability to access and invest in liquefied natural gas re-gasification facilities on U.S. soil to exporting countries whose markets are also open to U.S. investments; and pursuit of rules to govern fair access and competition within the energy sector as a priority in the next World Trade Organization negotiating round.

All told, an incremental approach to the challenge - as advocated in this report - will not be adequate.

THE BOTTOM LINE

This report did not contain a great deal of new energy information for a frequent viewer of this website. However, the fact that such a powerful group of people delved deeply into the Peak Oil issues, even if it fell under the guise of national security, gives me confidence that awareness now exists at the highest decisionmaking levels of our country(and Id like to think that's a good thing). Perhaps the grassroots message of Peak Oil, discussed here and elsewhere is starting to take hold. Though specific energy reports like CERAs may give the industry misplaced confidence due to confusion between oil production and production capacity, an acknowledgement that even in the best of scenarios, we need to start planning immediately appears to occuring behind the scenes.

To me, this was not a business-as-usual report. Explicitly stated was the suggestion that the energy market will not give the correct signals to solve this problem. The 800lb gorilla (again) was the dire implications for US (and world) economic growth that would presumably accompany reduced consumption, gasoline rationing, and conservation. I also was reminded, that as oil becomes more scarce on the world markets, there exists large factions of motivated, connected individuals who are used to wielding influence. Though conservation will play a role (it must), I get the sense from this document, that alliances and sides will be chosen through the international diplomatic arena, and that local and regional adaptation and mitigation to Peak Oil will be decoupled from the geopolitical game of Risk . The US, due to our dependency on energy imports, is not in the position of strength it once was.

Washington DC, and our nations leaders are being increasingly bombarded with a plethora of energy warnings and information. Sorting through the facts and rhetoric must be driving some people crazy, as this is a very complex subject not quickly internalized. It seems to me that month by month, the facts are emerging about our energy situation, from more and more credible sources, not the least of which was this recent analysis by the Council of Foreign Relations. As necessary infrastructure and demand-side change needs a long lead time (nuclear, electrified transport, import substitution for basic goods,etc.) we should not squander the opportunities we have now, while the international geo-political bear is still sleeping.