

# Middle Eastern Energy and U.S. National Security

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## ABOUT THE AUTHORS



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Simon Henderson is the Baker fellow and director of the Bernstein Program on Gulf and Energy Policy at The Washington Institute, specializing in energy matters and the conservative Arab states of the Persian Gulf.



## Brief Analysis

On November 29, 2005, Edward Morse, David Goldwyn, Simon Henderson and Paul Simons addressed The Washington Institute's Special Policy Forum. The forum, titled "Where Are Oil Prices Headed in 2006?" marked the publication of the Institute's policy focus, *Reducing Vulnerability to Middle East Energy Shocks: A Key Element in Strengthening U.S. Energy Security*, by Simon Henderson and Patrick Clawson. Edward Morse is executive advisor at Hess Energy Trading Company and former publisher of *Petroleum Intelligence Weekly*. David Goldwyn is president of Goldwyn International Strategies and former assistant secretary of energy for international affairs and deputy to UN ambassador Bill Richardson. Simon Henderson is a London-based senior fellow at The Washington Institute and author of *The New Pillar: Conservative Arab Gulf States and U.S. Strategy*. Paul Simons is deputy assistant secretary of state for energy, sanctions, and commodities and former deputy chief of mission at the U.S. Embassy in Tel Aviv. The following is a rapporteur's summary of their remarks.

**[Download \(http://www.washingtoninstitute.org/templateC04.php?CID=227\)](http://www.washingtoninstitute.org/templateC04.php?CID=227)** The Washington Institute's new policy focus, *Reducing Vulnerability to Middle East Energy Shocks: A Key Element in Strengthening U.S. Energy Security*, by Simon Henderson and Patrick Clawson.

**[View \(http://www.washingtoninstitute.org/documents/43974413f28b7.pdf\)](http://www.washingtoninstitute.org/documents/43974413f28b7.pdf)** Edward Morse's PowerPoint presentation in PDF format.

**[View \(http://www.washingtoninstitute.org/documents/439742f361805.pdf\)](http://www.washingtoninstitute.org/documents/439742f361805.pdf)** David Goldwyn's PowerPoint presentation in PDF format.

Edward Morse

In the 1950s and 1960s, world oil production expanded briskly from year to year, and a tremendous investment machine existed to satisfy the ever-growing demand. Then the industry entered a period of tight supply constraints, characterized by the oil crises of the 1970s. By the 1980s, the demand picture changed fundamentally; world oil demand in 2000 was not much different than it had been in 1980. This created the overcapacity off of which the world has been living ever since. OPEC production capacity today is lower than it was in the 1980s. The world oil industry has been living off investments made in the past.

In another example of the decades-long cycle that has characterized the oil industry for 135 years, since the late 1990s the world has entered a new period of tight supplies. The basic story for the next few years will be the same as the last few years: The global system remains supply-constrained and vulnerable to upside price risks. The direction of oil price is and has been on the rise, though there are short-term fluctuations such as the recent price downturn.

Sustained economic growth is driving demand. The other side of the picture is the bleak supply outlook. Non-OPEC supply is increasing at a much slower rate than demand and most of it is too sour -- sulfur heavy -- for the refining system. OPEC's excess capacity has been used up and its capacity growth is paltry. Multiple factors have led to underinvestment in new production capacity, including the systematic underestimation of future price levels. Also, the high price of oil has led resource owners to insist on high payments for exploration rights of potentially profitable sites, which slows down the rate of investment and the growth of supply.

Much the same picture applies to refining. Refinery capacity was rapidly expanded in the 1980s, in pace with the same demand growth that characterized the 1960s and 1970s, in what was a favorable regulatory environment. Reduced demand in the 1980s led to surplus refining capacity; in 1987 spare refinery capacity in the United States alone was 9.9 million barrels per day. Since then, with low returns on capital, there has been limited investment in capacity. Investments have in part been guided by environmental regulations instead. Investments in both production and refining will come to the rescue, but only over time. The next few years will be ones of considerable vulnerability to political shocks.

David Goldwyn

Not only is the Middle East essential to supporting and maintaining U.S. energy needs, but all signs indicate that U.S. dependence on the region will grow in coming decades. American dependence on Middle Eastern energy supplies will in fact double in the next thirty years. Even if the United States were to overcome its energy reliance -- an unlikely scenario -- other nations would still depend on Middle Eastern oil and therefore would be sensitive to the concerns of Middle Eastern governments. The dependence on the Middle East by consuming nations creates a political vulnerability for the United States, in that Washington may find it harder to persuade consuming nations to cooperate on political initiatives to which Middle Eastern oil producers object. In this era of globalization, because of the existence of a global oil market, this political dependence exists irrespective of how much Middle Eastern oil the United States consumes. Therefore there exists no unilateral answer to energy problems for the United States, only a global solution, and one that specifically involves China and Russia. This problem of foreign policy competition is only becoming worse as resource nationalism becomes more powerful.

Several steps by the U.S. government could improve energy security. The United States should lead the international community through its actions at home by promoting energy conservation significantly through more fuel-efficient vehicles, supporting investment in new technologies and infrastructure, and adopting a national technology policy to replace the wide ranging and ambiguous congressional legislation that has no definitive strategy or focus. In addition, new foreign policy approaches are needed to better promote stability in oil-rich Africa and Latin America and to modernize the collective energy security system set up in the 1970s. It is also vital that the international community modernize the collective energy organization, the Organization for Economic Cooperation and Development. The United States should also promote a free market in energy. Finally, energy should be utilized as a soft power tool to elevate and encourage the U.S. brand worldwide.

Simon Henderson

The United States cannot escape the fact that the world economy depends on Middle Eastern oil and therefore supply disruptions would affect it also. Energy self-sufficiency is a worthy ambition, but it cannot insulate the United States from events elsewhere. Over the course of the next two or three decades, alternatives to oil for transport will

emerge, partly through market mechanisms because of high prices. But in the next few years, there is no silver bullet. This does not mean that there is nothing to be done.

The Washington Institute's new policy focus, *Reducing Vulnerability to Middle East Energy Shocks: A Key Element in Strengthening U.S. Energy Security* (coauthored by Simon Henderson with Patrick Clawson), describes a series of measures that can and should be taken. In part, the U.S. government is already working on several actions. It is important that the recent reduction in gasoline prices does not have the political effect of making it seem the problem has passed. Elements of the solution include organizing the energy policy process to integrate all national objectives; improving information and strengthening coordination; preparing alternative plans for responding to an energy shock, beyond the use of oil reserves; increasing the role of oil reserves; and providing more capacity and more flexibility in each part of the energy supply system.

Internationally, the United States should promote antiterrorism best practices; encourage political reform as part of the fight against violent extremism; deter attacks by hostile states; and project sufficient military, particularly naval, force. These are not theoretical proposals. Recent comments by Iranian leaders suggesting action against Persian Gulf exports mean there is no time to be lost. The Washington Institute's new report should provide an important contribution to policy formulation and political debate.

Paul Simons

Over the last three months, the price of oil has been decreasing. The Energy Department's forecast is that in 2006 the average price will be approximately \$65 per barrel.

The U.S. government is working to bolster America's energy security. It is increasing the Strategic Petroleum Reserve to ensure that the government can be in a position to calm unsettled markets -- the recent offer to release reserves after Hurricane Katrina is an example of how effective such a policy can be.

The United States is also active internationally on energy security issues. It is conducting bilateral talks with China and with India and is drawing those countries into a more coordinated approach to strategic oil reserves. Washington has been actively encouraging the diversity of oil supply beyond OPEC as exemplified by the establishment of the Baku-Ceyhan-Tablisi pipeline to bring Caspian oil to world markets.

The Bush administration has placed great emphasis on transforming energy technology. President Bush has a clear vision for a postpetroleum world; the U.S. government has committed considerable resources to the pursuit of that vision. The U.S. government is also actively encouraging technologies to improve energy efficiency, such as the multiple incentives offered for hybrid automobiles.

This rapporteur's summary was prepared by Jamie Chosak.

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