A SYMPOSIUM OF VIEWS

The Geopolitics of U.S. Energy Independence

It is possible that within a decade the United States will become an energy exporter as a result of new deep drilling oil exploration and natural gas shale "fracking" techniques, as predicted by noted energy expert Phil Verleger in the lead article of the Spring 2012 issue of *TIE.*

How would or should U.S. foreign policy change in this new era of energy independence? Would America become less concerned with providing military security in the Middle East? What would this mean for the future of U.S.-Israeli relations? With the European countries becoming more dependent on Russia for energy supplies (at potentially far higher costs than Americans would face), and with Russia and Germany becoming closer economic partners, what are the implications for the future of NATO? On a broader note, to what extent would U.S. energy independence bolster isolationist foreign policy tendencies already in force in the United States?

The *Amazing* Tale of U.S. Energy Independence

By Philip K. Verleger, Jr.

A leading expert claims the United States within a decade will be an energy exporter. And it's all happening by accident.

In little more than a decade, the United States will find itself as an energy exporter and this amazing outcome will have happened by accident.

The United States will then have low-cost energy supplies for decades. If oil prices remain high, America will benefit from the difference. Today, South Korea pays around $14 per million Btus for natural gas; the United States will pay less than $4. The situation is, and will be, the same in China and Europe. They will pay more, and the comparative advantage will make it possible for the United States to remain the global economic leader. I have been studying energy issues for forty years and the data are difficult to believe. But facts are facts. U.S. energy independence, as controversial as it sounds, will lay the groundwork for the New American Century.

Specifically, the United States will be energy-independent by 2023, the fiftieth anniversary of President Richard M. Nixon announcing his "Project Independence." By energy independence, I mean the United States will export more energy than it imports. In 2023, America will be exporting natural gas, petroleum products, coal, and possibly crude oil if the federal government lifts prohibitions on the latter. The United States will also be importing some oil. On balance, though, America will be a net exporter.

The United States will reap enormous economic benefits in achieving energy independence by not following the approach proposed by President Nixon and his advisers. That plan can be described as the *high-cost dirty path to energy independence.* Nixon advocated an aggressive boost in offshore resource development, pursuit of the extraordinarily expensive fast-breeder reactor, increased coal use, and expanded shale oil development in Colorado using the very expensive techniques now at work on Canada's tar sands. Implementing Nixon's strategy would have saddled the United States with high-cost energy supplies and very high emissions of harmful global warming gases.

The path actually taken is very different. It might be called the *low-cost clean path to energy independence.* The United States came upon this course by accident. By luck, in other words, the United States is beginning to reap the benefits of large, low-cost supplies of clean natural gas. By luck, the firms developing these resources were able to take advantage of new financial instruments created by Wall Street, instruments that let them continue expanding even when prices collapsed. By luck, the United States is profiting from dramatic increases in auto fuel economy, a change that came after the 2008 gasoline price surge and GM and Chrysler's subsequent bankruptcies. By luck, the United States is also benefiting from technological advances that make lower-cost shale oil production possible.

No one can claim that our energy independence—achieved thanks to horizontal drilling, fracking, futures markets, and the auto industry's deathbed conversion to fuel economy—was planned. In 2023, the United States will just have to explain, happily, that it blundered into energy independence.

Energy independence could make this the New American Century by creating an economic environment where the United States enjoys access to energy supplies at much lower cost than other parts of the world. Such an advantage, combined with construction of new advanced manufacturing facilities and competitive domestic labor costs, could give the U.S. economy an unprecedented edge over other nations, particularly China and northern Europe. The energy cost advantage was highly visible in January 2012, when U.S. firms paid less than $3 per million Btu for natural gas while South Korean buyers paid $13.50.

Ironically, America's edge will be strengthened by energy exporters such as Russia and OPEC members. Their success in holding up crude oil and, especially, natural gas prices will strengthen the United States' twenty-first century economy. These exporters demand that buyers in Europe and China pay natural gas prices linked to crude

No one can claim that our energy independence was planned.

Philip K. Verleger, Jr., is president of PKVerleger LLC and a visiting fellow at the Peter G. Peterson Institute for International Economics. This article is an excerpt from Dr. Verleger's forthcoming book on the economic benefits of low-cost energy.

8 THE INTERNATIONAL ECONOMY SPRING 2012

SPRING 2012 THE INTERNATIONAL ECONOMY 9

Nine noted observers offer their views.

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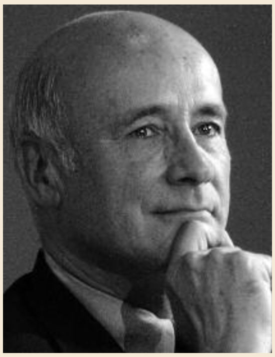
For the Middle East, perhaps more sincere confrontation with modernity will take place.

DANIEL PIPES
President, Middle East Forum

An energy self-sufficient United States will have a particularly dramatic impact on the Middle East. First, Washington will be largely freed from having to kowtow to the oil and gas pashas. Second, a loss of control over the price of energy will weaken the perceived strength of the oil-exporting countries. Third, they will probably experience lowered income.

In all, one of the core reasons that makes the Middle East so prominent in world affairs will diminish and with it the outsized presence of the region on the world scene. As it is a region suffering from deep maladies—extremist ideologies, conspiracy theories, tyranny, a culture of cruelty, a tribal social order, and more—that lesser role will be a healthy change. No longer quite so buoyed by energy revenue power and money, perhaps a more sincere confrontation with modernity will take place.



One should be cautious about jumping to conclusions.

JOSEPH S. NYE, JR.
University Distinguished Service Professor, Harvard University, and author,* The Future of Power *(2011)

Phil Verleger always makes an interesting argument. At this stage, one can only speculate about the geopolitical effects. Clearly, the strengthening of the U.S. economy enhances American economic power and runs against the current fashion of portraying the United States in decline. But one should be cautious about jumping to conclusions. A balance of imports and exports is only a first approximation of independence. As I argue in *The Future of Power,* interdependence involves both sensitivity and vulnerability. The United States may be less vulnerable in the long run if it imports less, but oil markets are fungible and our economy will remain sensitive to shocks from sudden changes in world oil prices. A revolution in Saudi Arabia or a blockage of the Straits of Hormuz could still inflict damage upon us, as well as upon our allies. Even if we did not have additional interests in the Middle East such as Israel or non-proliferation, it is unlikely that a balance of energy imports and exports will free us from military expenditures to protect oil routes that some experts estimate at $50 billion per year.

At the same time, America's bargaining position in world politics should be enhanced. Power arises from asymmetries in interdependence. You and I may both depend on each other, but if I depend less than you do, my bargaining power is increased. For decades, the United States and Saudi Arabia have had a balance of asymmetries in which we depended on them as the swing producer of oil and they depended on us for ultimate military security. Now the bargains will be struck on somewhat better terms from our point of view. In the area of natural gas, Russia has enjoyed leverage over Europe and its small neighbors through its control of supply through pipelines. As North America becomes self-sufficient in gas, liquefied natural gas from various regions is freed up to provide alternative sources for Europe and this will diminish Russian leverage. In East Asia, which has become the focus of American foreign policy, China will find itself increasingly dependent on Middle East oil. American efforts to persuade China to play more of a role in producing public goods of stability in the region may be enhanced, and China's awareness of the vulnerability of its supply routes to American naval disruption in the unlikely case of conflict could also have a subtle effect on the balance of bargaining power.

A balance of energy imports and exports does not produce pure independence, but it does alter the power relations involved in energy interdependence.

The impact on U.S. foreign policy? Huge.

ANDERS ÅSLUND
Senior Fellow, Peterson Institute for International Economics

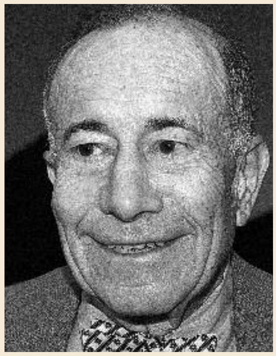
Phil Verleger has got it right. Today, there is little doubt that the new methods for producing unconventional natural gas and oil are causing a complete paradigm shift in the United States and the global energy situation. The United States is already self-sufficient in natural gas, and its dependence on oil imports is set to fall.

This change will have a huge impact on U.S. foreign policy. Most obviously, U.S. interests in the Middle East will decline along with U.S. energy imports. The United States is unlikely to engage in wars such as the Gulf War of 1991 or the war in Iraq, but presumably it will no longer accept being the global policeman either. The United States' reluctance to engage in Libya might be the new standard, and U.S. reluctance in Syria is even greater. U.S. defense expenditures will probably decline. The result may be more prolonged civil wars and failed states in the greater Middle East. European countries will feel greater pressure to become serious about defending themselves and their neighborhood.

Fracking is bound to have great impact on Russia. President Vladimir Putin is strongly against fracking—purportedly for environmental reasons—realizing that it poses a great threat to Gazprom, which sticks to onshore giant fields, pipeline delivery to Europe, and long-term contracts with high prices, but this arrogant state corporation is not only rigid but also extremely wasteful and inefficient. Foolhardily, it behaves like a monopoly, even when it is not, and it has priced itself out of much of the European market. Its production is plummeting because of lack of demand. In the second quarter of 2012, its annualized output fell by a staggering 12.5 percent. Gazprom is losing against all possible competitors. It has lost market shares to cheap liquefied natural gas, which was originally designated for the U.S. market, and more efficient independent gas producers, notably Russia's Novatek. Thus, shale gas is defeating Gazprom indirectly. The United States can calmly turn its back on Eurasian energy issues.

Plentiful cheap gas is bound to reduce oil prices eventually. The last decade of rising energy prices has brought about a surge of authoritarianism, but with moderating gas and oil prices the reverse trend is likely. The rents feeding corrupt authoritarians in former Soviet countries and the Middle East will presumably dwindle. The rulers will have to adjust, providing more freedom to the population while reducing their own revenues.

The conclusion is that the United States should focus more on democracy building in foreign policy, while paying less attention to energy policy, which has worked out in spite of government efforts.



The United States will be less globally conspicuous but isolationism will become ever more remote from reality.

CHARLES WOLF
Distinguished Corporate Chair in International Economics, RAND Corporation, Professor, Pardee Rand Graduate School, and Senior Research Fellow, Hoover Institution

My guess is that the assumption is as likely to be wrong as right. Setting that caveat aside, but nonetheless accepting the assumption, I think its consequences would be enormous.

For commodities that are homogeneous, as is the case for oil and gas, only a single price for each (apart from CIF differences) must prevail in world markets. Removing the world's largest importer (the United States) from the demand side of these two global markets, and adding it to the supply side (where the United States would become in effect a non-affiliated OPEC partner) will dramatically affect prices in both oil and gas markets. When further allowance is made for China's large ongoing investments to expand global oil and gas supplies (especially in Africa), oil and gas prices are likely to plummet—a 50 percent decrease from current prices would not be implausible. OPEC's break-up might well ensue as a byproduct.

U.S. foreign policy and military security concerns are not thereby likely to be diminished. Such collateral events as the following would account for our continued concerns: Iran's persistent pursuit of deliverable nuclear weapons (if not by then having been already acquired); Saudi concerns with countering this development; also the heightened concerns of other Sunni elements in the Middle East; Egypt's restiveness still further aggravated by these circumstances; and Israel's concerns about what to do and how to do it in the face of these developments. In sum, I doubt that the area will be more quiescent as a result of the sharp change in relative oil and gas prices. That said, it's as plausible that U.S.-Israeli relations will become more harmonious in these circumstances as it is that they will become less so.

Recalling my earlier reference to the prevalence in world markets of one price for homogeneous commodities, I'd opine that Europe would become less dependent on Russian energy supplies, rather than more dependent. Oil and natural gas would become buyers' markets, rather than sellers' markets. European buyers will have a suppliers' queue lining up with offers!

Finally, something of a "pivot" toward Asia may still be evident in U.S. foreign policy after a decade. Also, the United States will have ample domestic as well as international reasons for adopting a somewhat less conspicuous role in world affairs. Nevertheless, isolationism will become even more remote from reality a decade hence than it is now.

An energy-independent America must be thought of in a broader context.

JOHN LEE

Michael Hintze Fellow for Energy Security and Professor, Center for International Security Studies, Sydney University, and Visiting Scholar, Hudson Institute

The consequences of any hypothetical significant lessening of American dependence on energy imports from the Middle East needs to be understood alongside other developments in the geo-strategy of energy over the next two decades.

Importantly, China's dependence on foreign oil will rise from about 50 percent to 80 percent over the period, with up to 90 percent of imported oil coming from the Middle East (and less than 5 percent from Russia). This is taking place within a framework of deepening strategic competition in Central Asia and the porous far-eastern Siberian border between China and Russia, and deepening competition in East Asia and the Indian Ocean between America and China. This will heighten China's future sense of strategic isolation (in Eurasia and East Asia) and vulnerability over the possibility of American-led interdiction of energy imports in Gulf waters or else on either side of the Malacca Straits.

Greater economic interdependence between Russia and Western Europe does not imply the formal dismantling of NATO since Russia will remain a distrusted player. But it does mean a greater Western European appetite for Russian involvement in EU-led multilateral forums and diplomacy. One likely ramification is a decreased desire for an expanded NATO, or a greater overt emphasis on military containment of Russia on the part of Western Europe. This will cause European capitals to want to have their cake and eat it too: privately welcoming the American presence as the ultimate security guarantor while seeking to publicly downplay both the American military presence and the existence of any constraint on Russian assertiveness in Eastern Europe. This will almost certainly add to Washington's frustrations with its European security partners, and possibly lead to a greater focus on the Middle East and Asia at Europe's expense.

Critical for America will be China's response to its increasing energy dependency on the Middle East. Stubbornly wary of relying solely on international commodity markets for securing energy needs, China will seek to dramatically deepen political, diplomatic, and even strategic relations with major oil suppliers such as Saudi Arabia. China is likely to enhance its naval presence in the Persian Gulf, Indian Ocean, and on either side of the Malacca Straits since Beijing is perennially fearful of energy security chokepoints that could be exploited by Washington.

Washington is unlikely to sit back and allow Beijing significantly more influence and presence in its traditional areas of influence, especially given that Iran, Pakistan, and Afghanistan will remain countries of interest and concern. A greater Chinese influence in authoritarian Middle Eastern countries such as Saudi Arabia and Iraq, in addition to Iran, will also complicate American hopes of encouraging political and social reforms in these countries. In other words, U.S.-China strategic competition is likely to deepen in the Middle East, Indian Ocean, and East Asia even if American energy independence becomes a reality. Note that China has excellent relations with Israel and any greater Chinese strategic and diplomatic activity in the Middle East is unlikely to greatly affect U.S.-Israeli relations.

Finally, isolationist foreign policy tendencies are unlikely to take hold for the simple reason that American economic interests are global since production processes and markets are globalized. Isolationist tendencies would be overwhelmed by business, diplomatic, political, and military interests.

The United States could continue to shape the global marketplace.

DAN MAHAFFEE
Director of Policy and Board Relations, Center for the Study of the Presidency and Congress

If the United States becomes a net energy exporter within a decade through expanded oil exploration, alternative energy innovation, and natural gas shale "fracking" techniques, we can continue to shape the global marketplace. As a result, the future will look an awful lot like the balance of power we enjoy today.

With the development of new U.S. energy exports, our close allies will be a natural destination for these products. While post-nuclear Japan will be a major destination for U.S. energy, there is already an existing open-market affinity between the United States and Europe. Although Germany may need to seek closer relations with Russia for its energy needs, it could also turn to its more natural ally, the United States, for exports, as well as U.S. expertise to help harness Europe's own sources of energy from European shale formations. Ultimately, the United States may find itself in a position of power, not in terms of barrels or BTUs, but rather in the technical expertise we develop in cutting-edge energy extraction. In this respect, investments today in our education system and science infrastructure may be the deciding factor.

The deep and longstanding alliances with NATO for security, and the IEA for energy, will likely prove much stronger than short-term relationships with Russia; such a marriage of convenience will likely collapse as the Putin regime begins to use energy policy to control relationships with Europe and the Russian "near-abroad."

As for the Middle East, while the United States may be able to develop its own domestic oil supplies, the extraction cost of Middle Eastern energy resources will remain the cheapest option, at least for the foreseeable future. Natural gas cannot and will not replace oil on a one-for-one basis across the U.S. energy supply; the Middle East, particularly Saudi Arabia and the Gulf States, will remain vital to the global energy portfolio. However, the United States can no longer separate itself from regional energy issues, as the health of the global energy supply impacts the global economy, which, in turn, impacts the United States.

Ultimately, maintaining America's historic lead in energy technologies and innovations is essential to U.S. security interests, especially as future conflicts are increasingly likely to involve energy scarcity.

Budget sequestration, not fracking, will limit America's role as the guardian of Persian Gulf security.

ARIEL COHEN
Senior Research Fellow, Kathryn and Shelby Cullom Davis Institute for International Studies, Heritage Foundation

The lure of isolationism may appear as the United States is increasingly self-sufficient in energy, yet self-sufficiency, or even energy exports, does not mean "energy independence." Such a notion may exist in an autarkic Soviet Union, but not in the globally plugged-in America.

First, ten years from now we will still be importing oil for transportation. Simply, the competitive advantage of major oil exporters, such as the Persian Gulf countries, Canada, and Venezuela, will make their exports more economically attractive. Second, if the current trends persist, environmental regulations will continue to pile up, making drilling for oil in the lower forty-eight, Alaska, and along U.S. continental shelves very difficult. Finally, the United States will not become a market-maker for oil prices: this privilege will remain with Saudi Arabia, which exports most of the oil it produces.

Thus, it is the potential military capability constraints, coming from budget sequestration and ill-thought-through military budget cuts, not fracking, which are likely to limit our involvement as the guardian of the Persian Gulf security.

Another major factor is the political dynamics inside the Arab world, as demonstrated just recently with the election of the Muslim Brotherhood leader to the presidency of Egypt. Over the coming decade, it will be more and more difficult for the authoritarian, conservative Gulf leaders to rely openly on America for security. As we pointed out in a recent Heritage Foundation paper, political instability and uprisings may occur as the Saudis face a difficult succession to the throne. If protests get out of control, all bets are off, with tremendous implications for the Saudi ability to be a market maker for oil.

Thus, our diminishing capabilities due to budgetary constraints, and the Arabs' religious-political constraints, may create a confluence of circumstances leading to a diminished U.S. involvement in ensuring peace in the most crucial geo-economic region of the world, the Gulf.

The Israeli dimension of energy is almost inconsequential to all this. The United States provides minimal forces to Israel, which operate an over-the-horizon anti-missile radar, and there is a small U.S. contingent in the peacekeeping force in Sinai. The military aid to Israel, which is going to the U.S. manufacturers and represents a subsidy, will continue, while the civilian aid may come under scrutiny, especially as the Israeli Treasury will benefit from the natural gas revenues, with the Leviathan and Tamar offshore gas fields coming online. However, the military pressure that may come against the Jewish state from Muslim Brotherhood-dominated Egypt, from Hamas-ruled Palestinian territories, and in the future, Syria and Jordan, may bring about a severe test of U.S.-Israeli ties.

The future U.S. shale gas exports to Europe may adversely affect Russia. Here's why. The Qataris and the Europeans invested tens of billions of dollars in the liquefied natural gas terminals in Europe. These are sunk costs. With LNG pouring into the European markets—be it from offshore fields or from U.S. shale gas, the Gazprom piped gas may become less competitive.

The Western Siberian fields are old, and to develop new fields, either offshore or in the Arctic, would be very expensive and will cost hundreds of billions of dollars Moscow currently lacks. Gazprom is a government monopoly and not the most nimble one at that. Chances are the Russians will be outmaneuvered in the European gas market—even if the Germans and others are shooting themselves in the foot by shutting down nuclear power generation.

Little if any of that will affect NATO. That is a collective security organization, which survived the Cold War and the Soviet Union and will survive shale gas. It generates security for the Europeans and for the United States—a public good that Russia cannot provide even if it wanted to. Germany is not going to dissolve NATO. Yet again, defense spending is too low in Europe (less than 2 percent versus the United States' 4 percent).

If the United States follows Europe's model, we will have a hollow defense force which will be unable to protect us, let alone project power and keep the world's energy supply secure in the Middle East.

The views are those of the author only.

The implications may be most profound for emerging economies where Washington seeks closer ties.

GARY KLEIMAN
Senior Partner, Kleiman International Consultants

The implications of emerging U.S. energy independence may be most profound for the emerging economies in all regions where Washington now routinely seeks closer commercial and diplomatic ties. Hydrocarbon and other commodity prices have recently retreated in part due to new conventional and alternative technologies, as well as traditional physical demand and supply concerns and financial asset repositioning. The per barrel oil benchmark is again under $100, which seems to be a flagging global economic growth marker and level OPEC aims to protect, although most developing country budgets assume a lower floor.

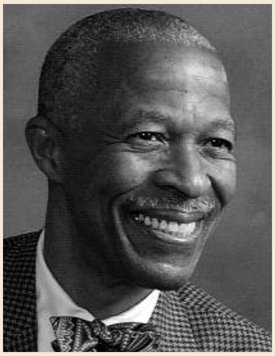
Should U.S. production breakthroughs continue to depress values, Asia as a net importer would be a winner with reduced fiscal, inflation, and balance-of-payments strains. India, with a current account deficit, would get relief, while China's surplus could revert to the 3–5 percent of GDP historical norm.

In the Middle East and Africa, geopolitics would continue to threaten sporadic spikes and Gulf sources will be pressed to meet heavy infrastructure and social spending commitments in the coming years, but Arab World "revolutionary" buyers such as Egypt and Tunisia would be able to slash subsidy burdens faster to tackle debt overhangs. In Africa, Nigeria with 90 percent of exports from petroleum would accelerate its manufacturing and services diversification already underway if it is to tackle chronic poverty and foster a middle class in the continent's largest population. South Africa, on the other hand, would get a cost break that could compensate for the possibility of price correction in its precious metals component of the commodities complex.

In Europe, the CIS powerhouses Kazakhstan and Russia would experience indefinite 0.5–1 percent national income falls by most estimates, while new EU entrants most endangered by the eurozone debt crisis fallout such as Hungary and Romania could gain breathing space at the margin, with cross-border power supply not as important as banking health in determining spillover there.

Russian "rainy day" backup funds could be depleted in the near term, forcing a return to hefty borrowing or competitive and efficiency pushes that both could undermine the Putin state-directed model.

In Latin America, Ecuador and Venezuela, as longtime U.S. adversaries, are the most exposed proportionally to an era of cheaper and more abundant energy facilitated by fracking and renewables. As Venezuela's President Chavez stands again for reelection amid failing health, his cash hoard for populist programs at home and anti-American ones abroad is widely believed to be rapidly dwindling, and the petro boom's ebbing could yield a big foreign policy shift toward trade and investment cooperation previously considered fanciful.



In U.S. security policy, shared values, prior commitments, and strategic calculations are more important than energy considerations.

RAYMOND TANTER

Professor Emeritus, University of Michigan; President of Iran Policy Committee Publishing; and former member of the National Security Council staff in the Reagan-Bush Administration

At issue is whether energy independence will cause a revision of U.S. national security policy. Because energy is only one of the drivers, energy independence is unlikely to have the major effect implied by the Verleger thesis. During the Cold War, American participation in the Korean and Vietnam Wars did not have energy as a driver; likewise, energy is not at the core of U.S. long-term commitments to South Korea and Japan in the post-Cold War era.

Shared values, prior commitments, and strategic calculations are more important than energy regarding countries such as Israel. In my experience on the National Security Council staff in the 1980s, there was little discussion of energy in relation to Israel. Ditto for Turkey. Control of energy was more important than values and commitments for Washington to save Kuwait after Iraq's invasion in the first Gulf War, but not relevant to the takedown of Saddam Hussein a decade later, and irrelevant to the post-September 11 invasion of Afghanistan to defeat al Qaeda and the Taliban.

With respect to Iran, energy was a factor in the cooperation of American and British intelligence to overthrow the Mosaddeq government in 1953, but proliferation concerns trump energy a half century later. Concerning Saudi Arabia, energy is at the heart of the relationship. So rising oil prices and production costs, declining reserves, and increasingly available alternative fuels as well as nonconventional sources of oil are bound to make Riyadh of less consequence to Washington than it is today.

Saudi Arabia's comparative advantage in oil production and the world economy's thirst for oil converged to make the Kingdom a strategic ally in the past. But the odds that the Kingdom will survive the spreading Arab revolts are not high, and the American commitment to the royal family is mainly against external, not internal, threats. Hence, coming to the defense of the Kingdom is likely to be perceived in Washington as too costly when the threat is from within.

With European countries becoming more dependent on Russia for energy supplies, and Russia as well as Germany becoming closer economic partners, the likelihood of out-of-area involvement by NATO in such places as Afghanistan is not high. And as the saying goes, "Out of area or out of business!" Verleger suggests that American energy independence could make this era the "New American Century" by creating an economic environment where the United States enjoys access to energy supplies at much lower cost than other parts of the world and giving the U.S. economy an edge over other nations, particularly northern Europe. In the context of enhanced American energy independence, the Obama Administration's pivot to Asia is likely to be of more import for Europe than the Middle East. Finally, U.S. energy independence is likely to reinforce isolationist foreign policy tendencies already in force in the United States. A game-changing event like an Iranian nuclear weapon could wipe out the tide toward isolationism. ◆