

Carter Doctrine 3.0?

Asia Drives Oil & LNG Demand, Middle Eastern Producers Bring Supply, and the U.S. Military Provides Security



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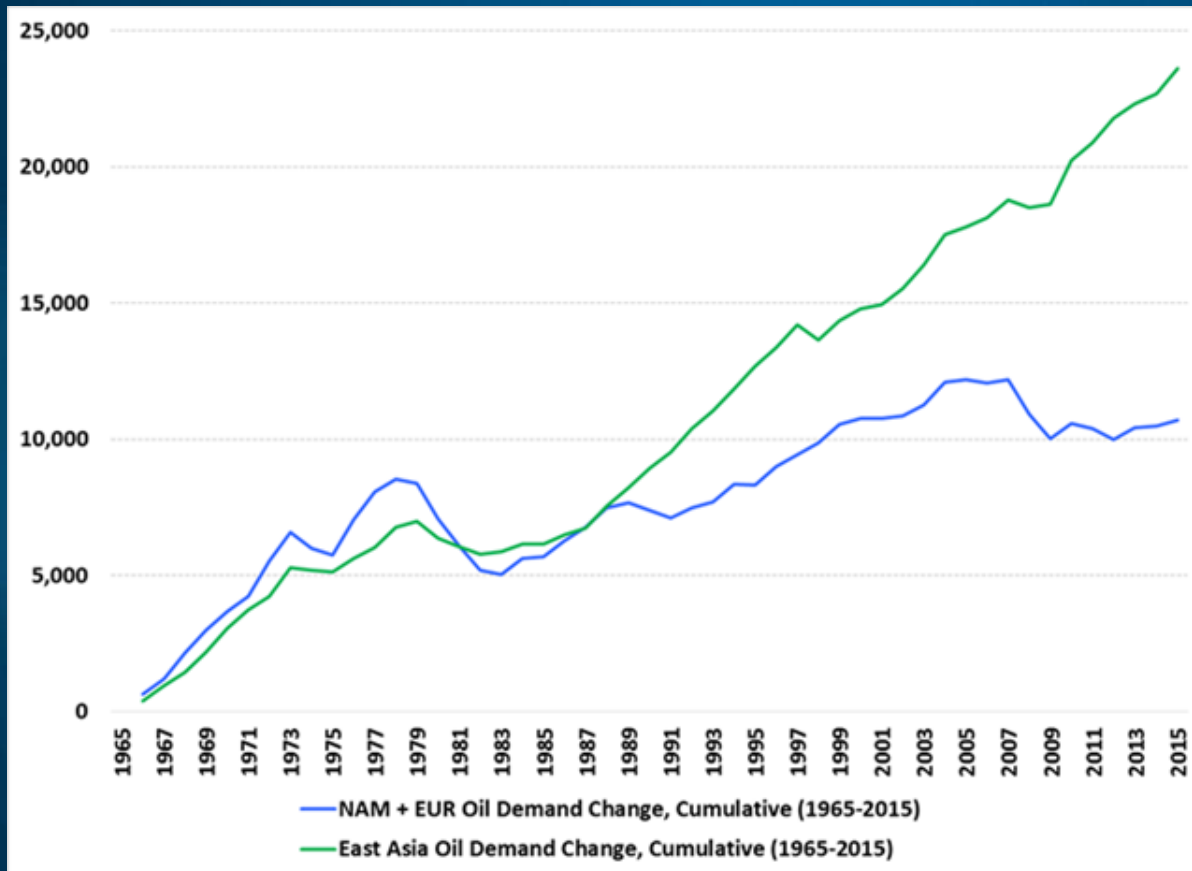
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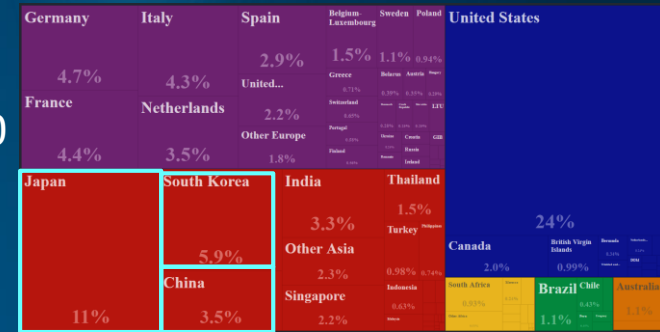
Strategic Framing: East Asia as Engine of Global Oil Demand Growth

East Asian Oil Demand Has Outpaced North America and Europe's Since the Late 1980s



Strategic Framing: Global Crude Petroleum Import Values Over Time

“Big 3” (China + Japan + South Korea) Share= 20.4% 2000

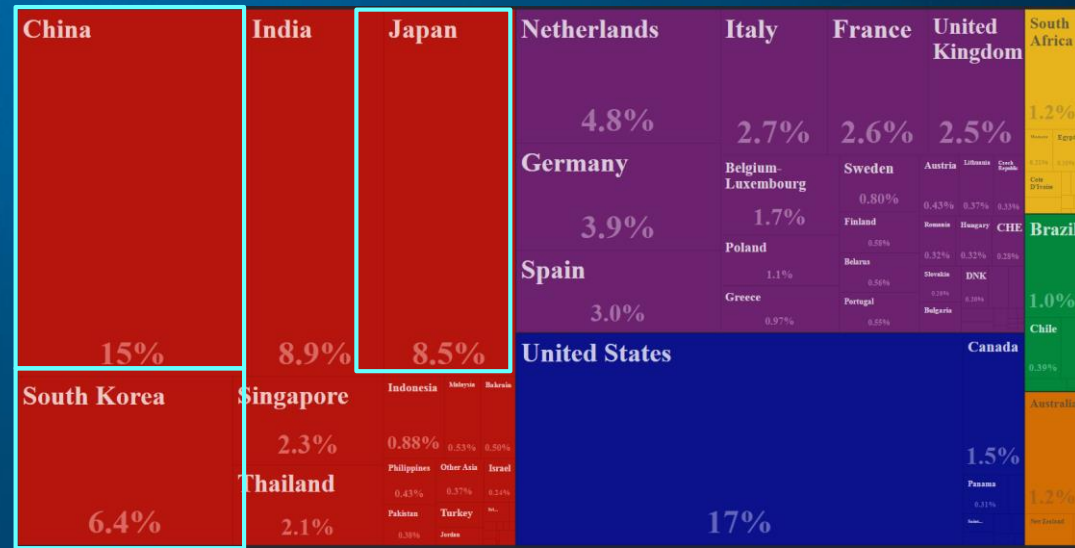


▶ Value exchanged basically doubles each time: \$374 billion in 2000, \$641 billion in 2004, \$1,380 billion in 2014.

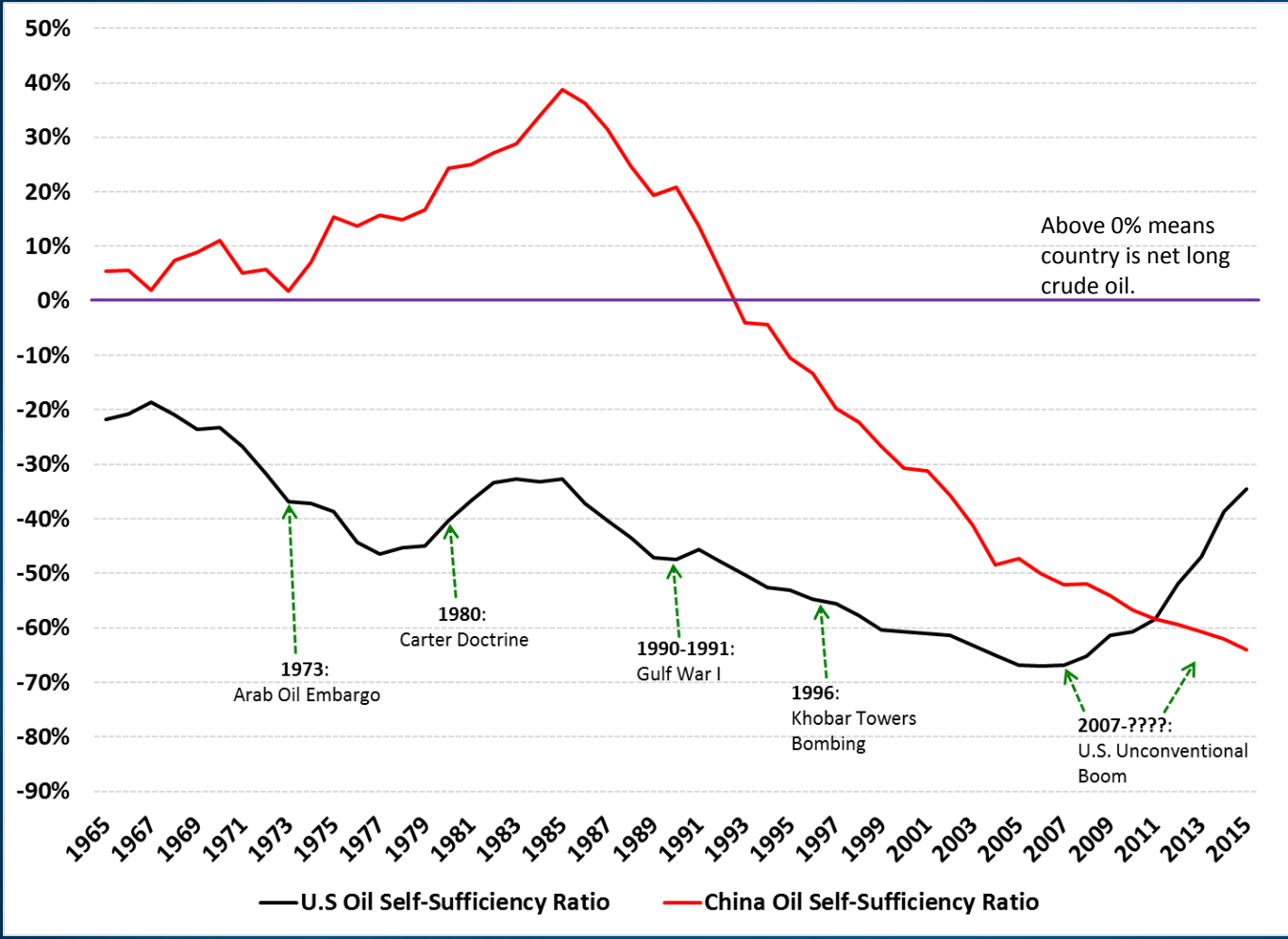
Big 3 Share= 16.6% 2004



Big 3 Share= 29.9% 2014



Shifting Sands (or Shale): Chinese and U.S. Crude Oil Dependency Levels Are Dramatically Changing



China is a focal point because in the last decade, its incremental demand growth roughly equals the current oil consumption of Japan and Malaysia combined.

Source: BP Statistical Review, Authors' Analysis

What is the Carter Doctrine?

- ▶ “Let our position be absolutely clear: An attempt by any outside force to gain control of the Persian Gulf region will be regarded as an assault on the vital interests of the United States of America, and such an assault will be repelled by any means necessary, including military force.”

—President Jimmy Carter, 1980 State of the Union Address

Main Focus:
USSR, Iran

Main Focus:
Iran, Iraq

Main Focus:
Iran, non-state actors, broader regional stability.

1987-1988:
“Tanker War”
operations

1990-1991:
Operations Desert Shield &
Desert Storm

Mar. 2003-Dec. 2011:
Operation Iraqi Freedom
and subsequent activities

April 1980:
Iran Hostage
Rescue Attempt

1991-2003:
Multiple military actions against Iraq

Aug. 2014-????:
Campaign against ISIS

1980

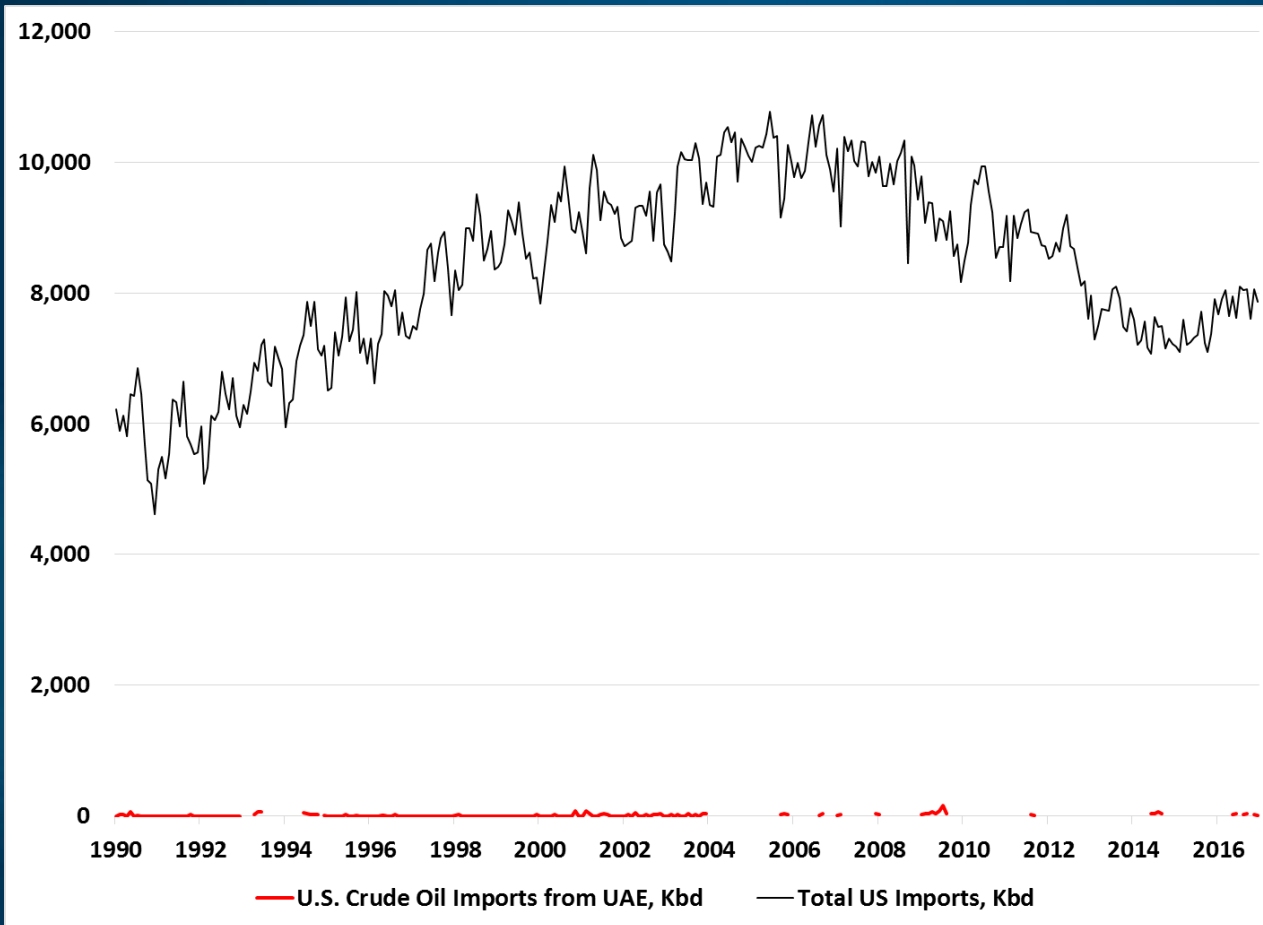
1990

2000

2010



What Does Military Underwriting of Energy Security Actually Mean?



Source: EIA, UAE Embassy

- ▶ Hint: It's Not a Mercantilistic Quid pro Quo.
- ▶ The oil exporter cited in this example, the UAE, sends hardly any oil to the U.S. and yet is one of our most important regional security partners and a robust proponent of continued intensive U.S. engagement in the Gulf region. The UAE Air Force flies F-16s more advanced than those in the USAF, the UAE armed forces actively participate in missions against ISIS and al-Qaeda, and the government has granted U.S. forces access to the strategically-located Al-Dhafra airbase since 1990.

**Expect a Sustained U.S. Military
Presence in the Gulf Region**

Undermining US-GCC security guarantees?

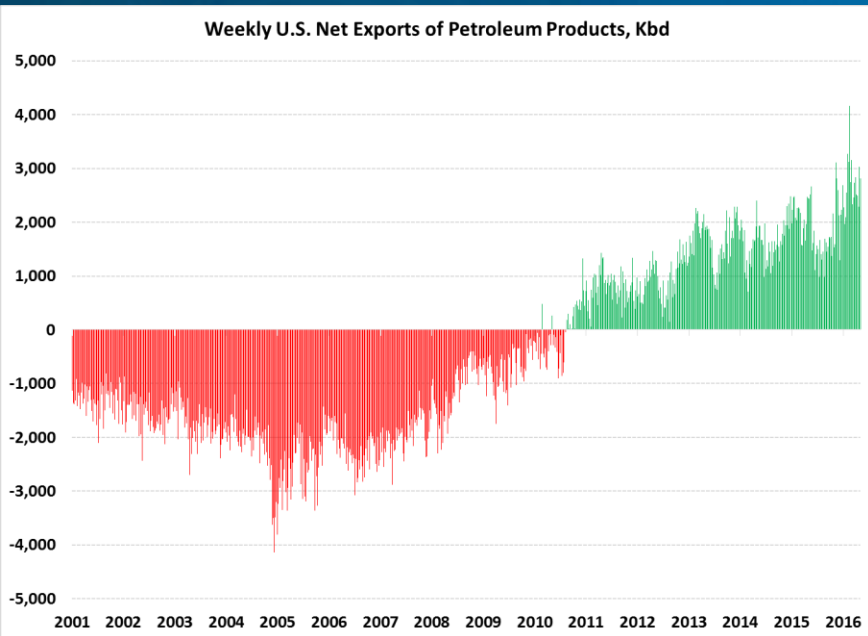
Is the Carter Doctrine needed when we have ...

- ▶ Rising US self-sufficiency in oil
- ▶ Diversification of global oil supply, particularly in the West
- ▶ Diverging US and Saudi/GCC strategic priorities in the Middle East
 - ▶ Arab Spring uprisings (particularly in Egypt)
 - ▶ Syrian civil war
 - ▶ Shia-led governance in Iraq
 - ▶ Iran nuclear program
- ▶ Revival of US isolationism, hostile to involvement in the Middle East
 - ▶ Trump worldview is transactional rather than strategically rooted
- ▶ Growing Mideast-Asian economic dependence
 - ▶ China imports more Mideast oil than US does
- ▶ A realization that oil (still strategically valuable) is widely available
- ▶ Evolution of the US transportation sector toward increasing efficiency and away from oil

Myth Busting...

U.S. “Energy Independence” a Fallacy

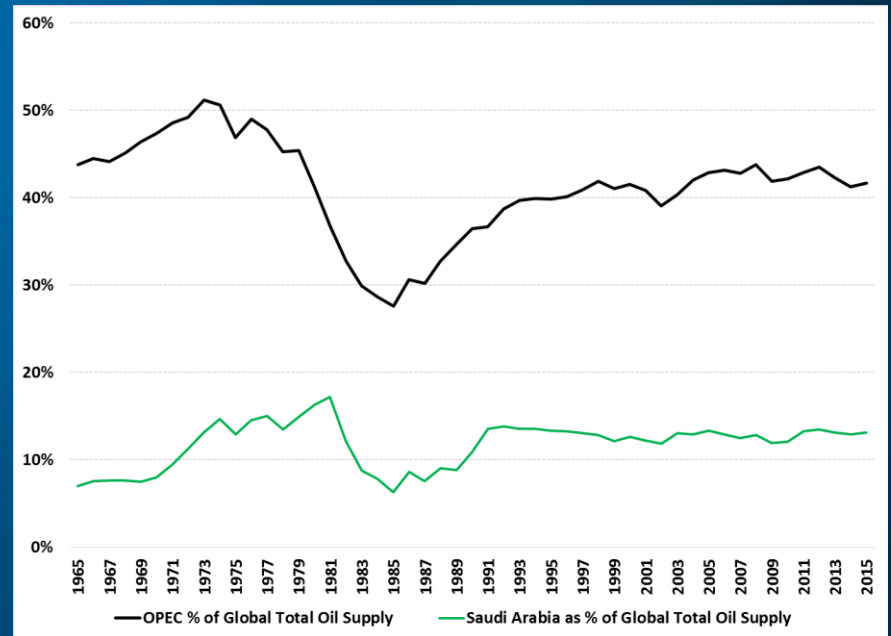
- ▶ Continued deep integration with global crude and refined products markets.
- ▶ Prices are influenced by factors outside US control (spare production capacity among major suppliers; rates of demand growth; inventories; geopolitics; natural disasters)
- ▶ Even full self-sufficiency in oil would not remove U.S. exposure to events in Middle East.
- ▶ An outage in the Middle East will influence US prices no matter where America’s oil is sourced



And a Reminder of Reality

Saudi Arabia and OPEC Underpin Global Oil Supply Security

- ▶ Over the past 25 years, OPEC has accounted for 41% of global oil supplies.
- ▶ Saudi Arabia alone has accounted for an average of 13% of global oil supplies during that time, making it the largest global supplier.
- ▶ KSA is sole source of spare capacity able to cover outage of a medium-sized supplier on short notice.
- ▶ An outage in the Kingdom would severely rattle the global economy.



Markets Function Best Within a Framework of Stability

- ▶ American security ensures energy flows through the Strait of Hormuz, which include 20% of globally traded oil supply and roughly 30% of global LNG supplies.
- ▶ No other powers have the force projection or logistics capacity to independently assume the task and prospects for broad multi-lateral military cooperation are likely weak, at best.
- ▶ Strength of Gulf militaries has improved in the past decade
- ▶ But forces are generally deliberately composed to prioritize internal security and not threaten family-based rule.
- ▶ Insufficient capacity to guarantee *external* security of oil shipments without U.S. assistance.



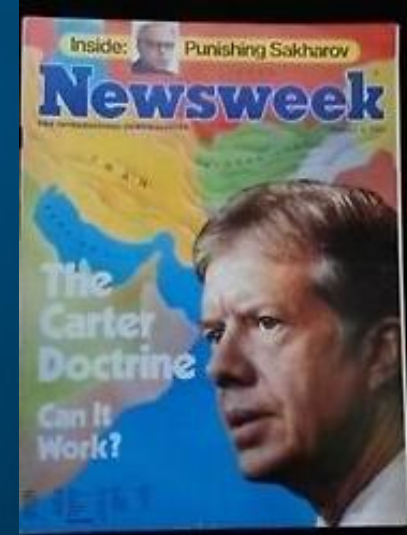
Source: Defense Industry Daily

Additional Factors Favoring Continued U.S. Military Role

- ▶ **Secondary strategic benefits of large Middle Eastern military footprint.** Even if China or Russia – or others – were capable of securing the Gulf and trade routes, Washington would likely be unwilling to step aside.
 - ▶ Strategic benefits include forward presence and existing access to bases that facilitate strategic priorities in the CENTCOM area of responsibility, especially counter-terrorism.
- ▶ **GCC States are Highly Adept Lobbyists in Washington.** The UAE in particular has developed impressive prowess in Washington, funding think-tanks and appointing an ambassador who has been effective in dispelling prior hostile attitudes toward his country (home of two 9/11 attackers)

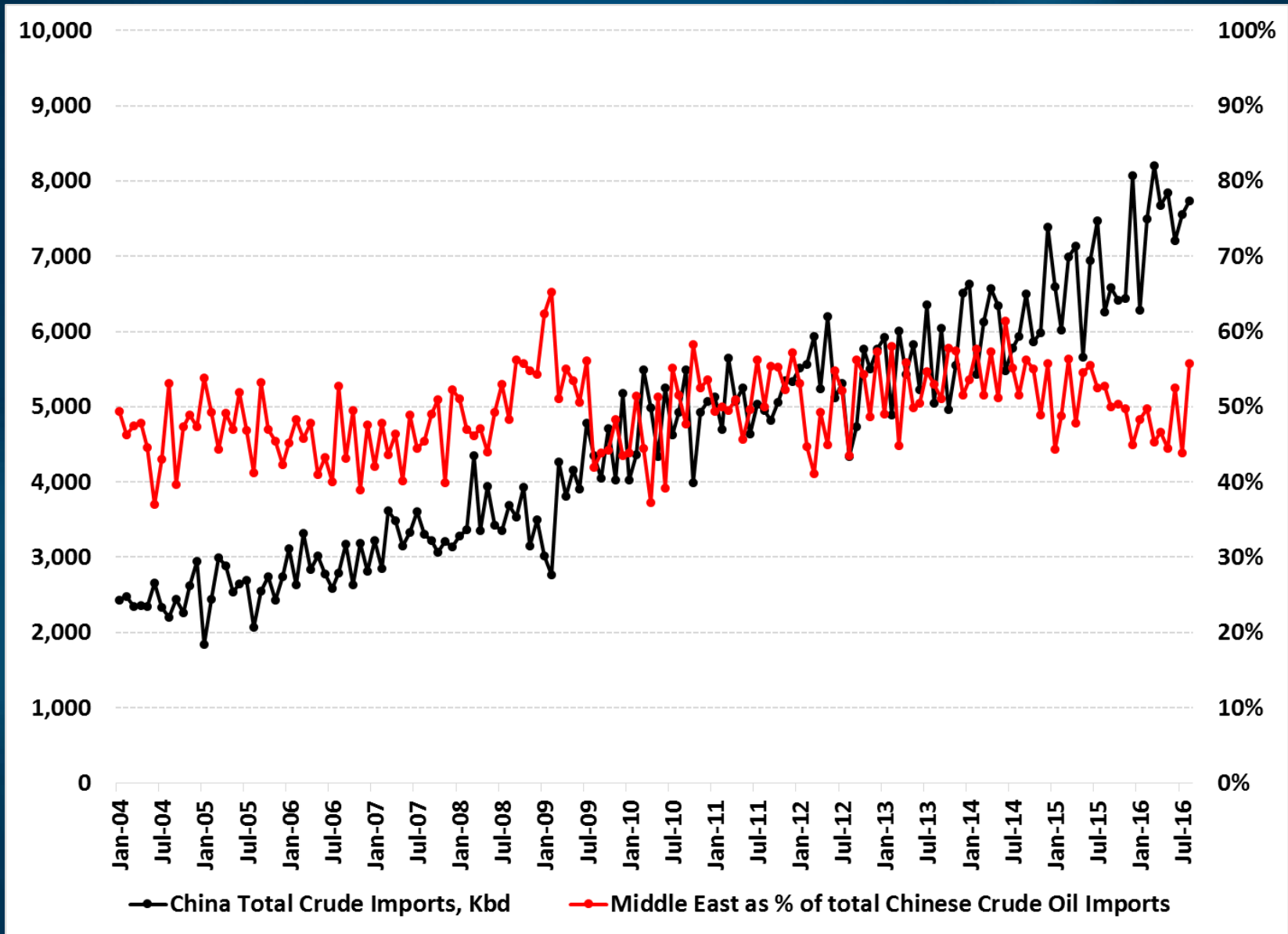
The upshot?

- ▶ **The U.S. likely to remain primary security guarantor of Gulf oil & gas supplies for foreseeable future. The Carter Doctrine effectively remains intact.**

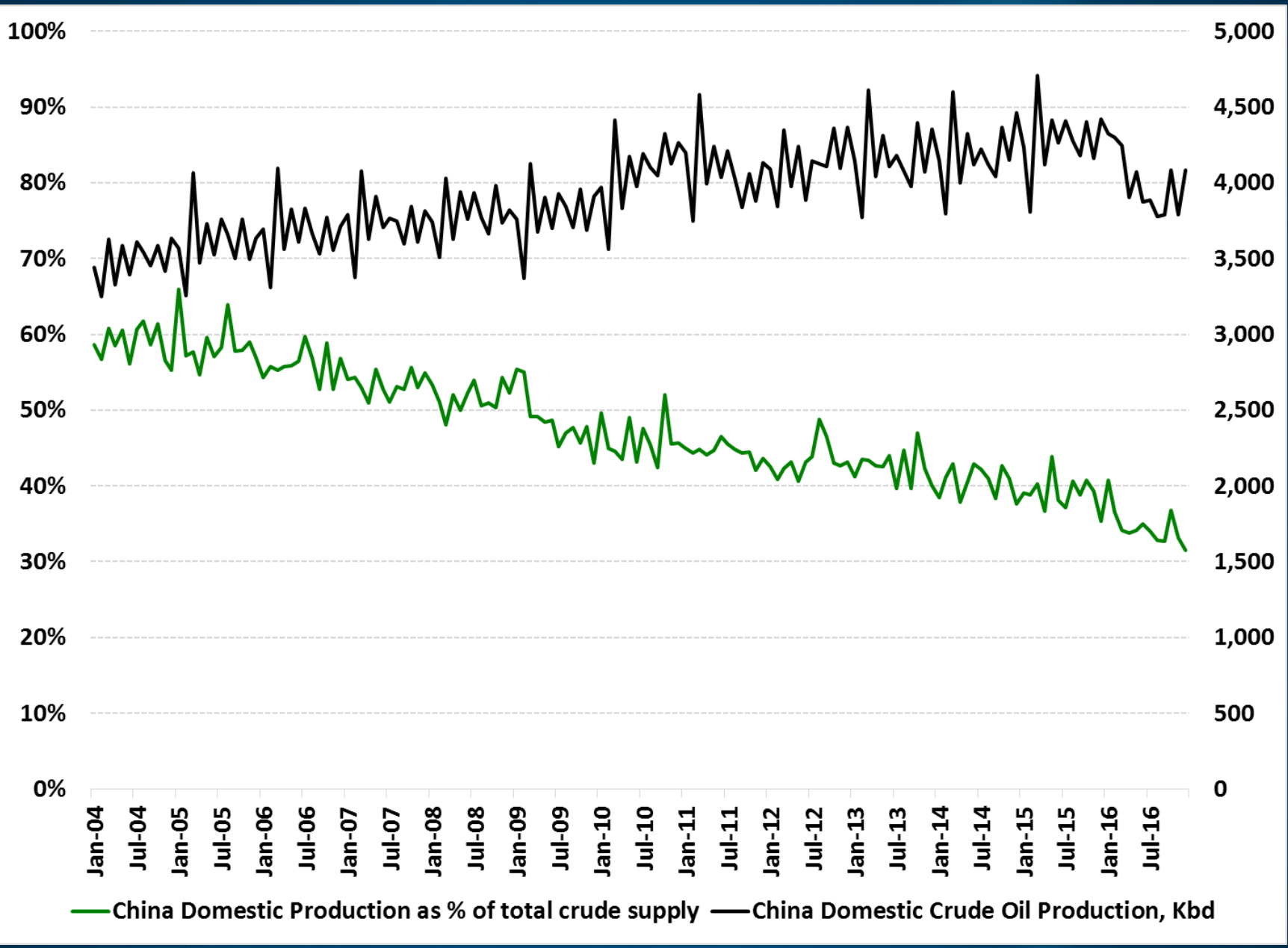


Evolving Energy Supply Relationships Between Middle Eastern Exporters and East Asian Importers

China Dependency Trends: Crude Oil

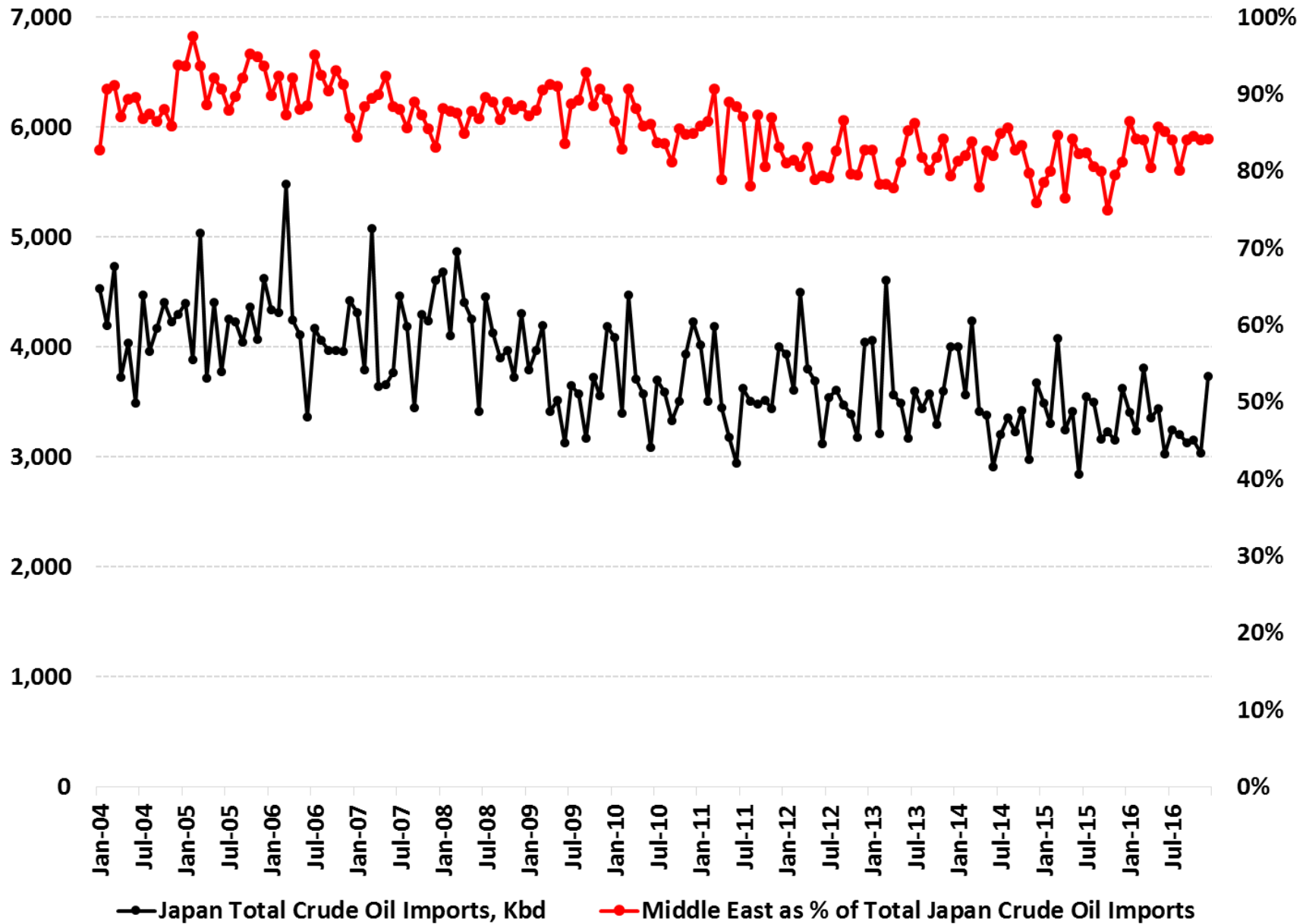


China Dependency Trends: Domestic Production Can't Keep Pace With Demand

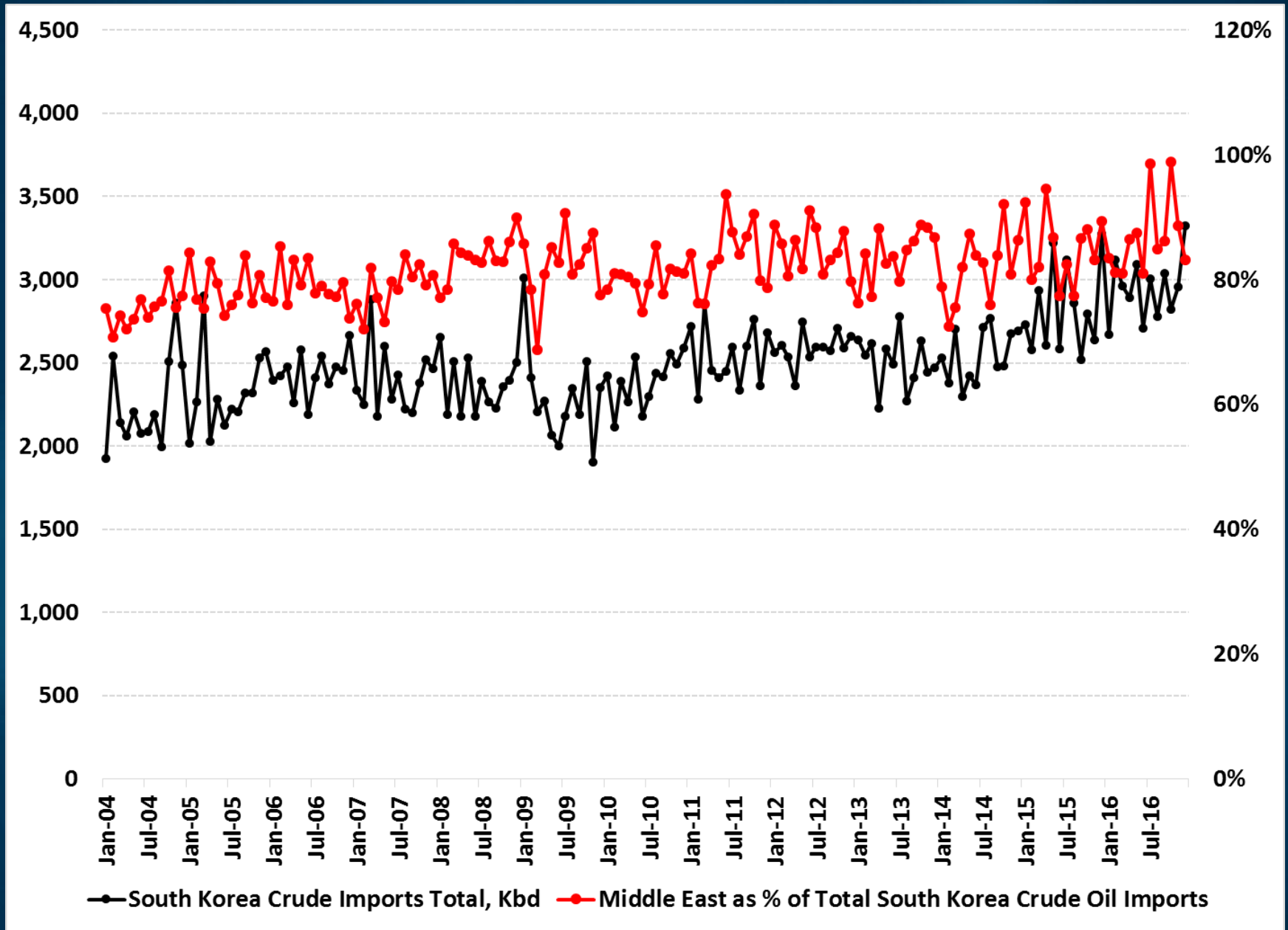


Source: Bloomberg, Authors' Analysis

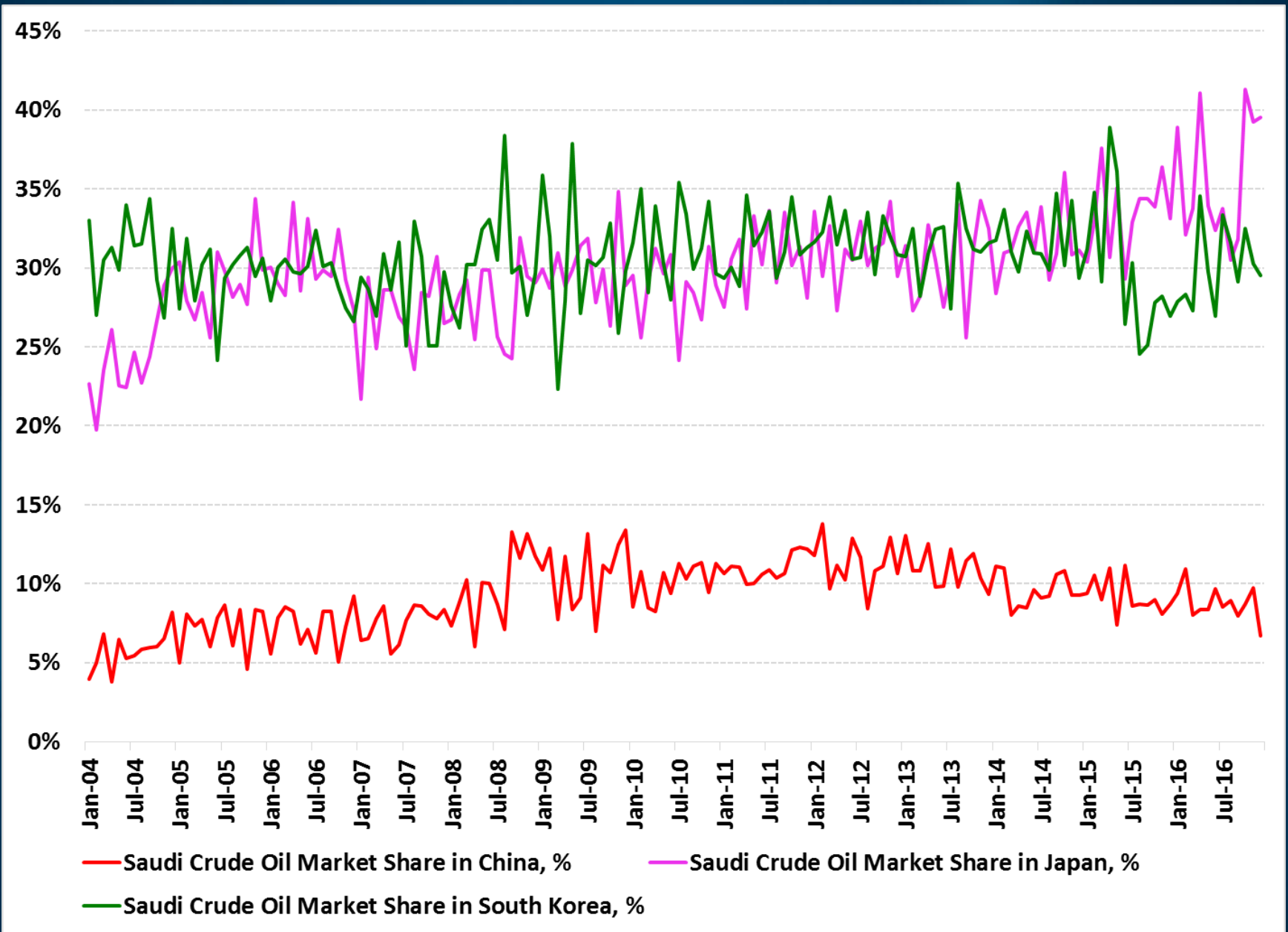
Japan: Crude Oil Dependency Trends



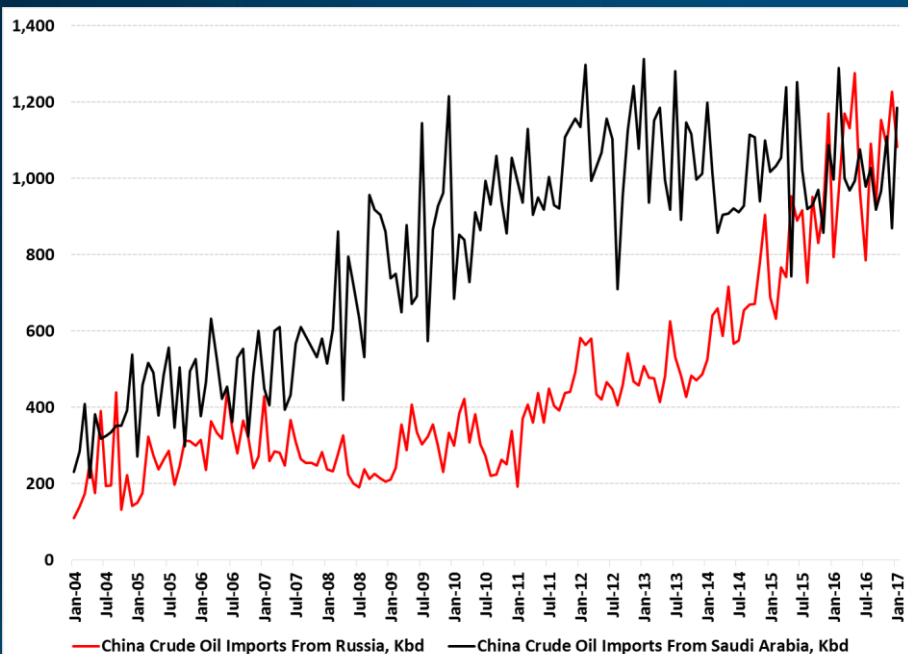
South Korea: Crude Oil Dependency Trends



Market Share Battles

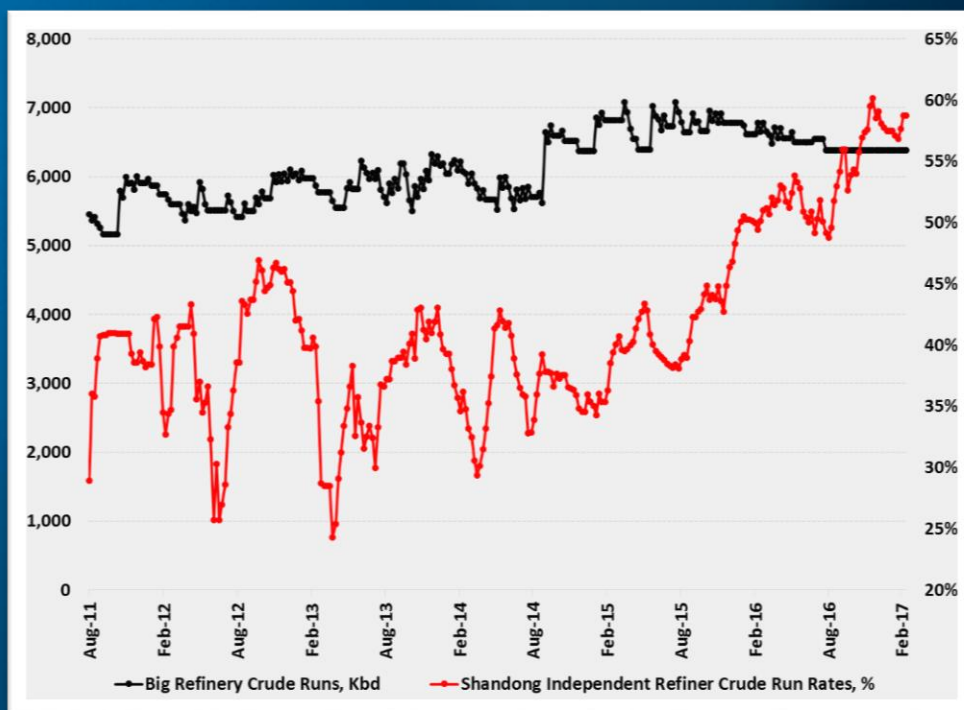


Rise of the “Teapots” Strongly Tracks Increase of Russian Crude Into China

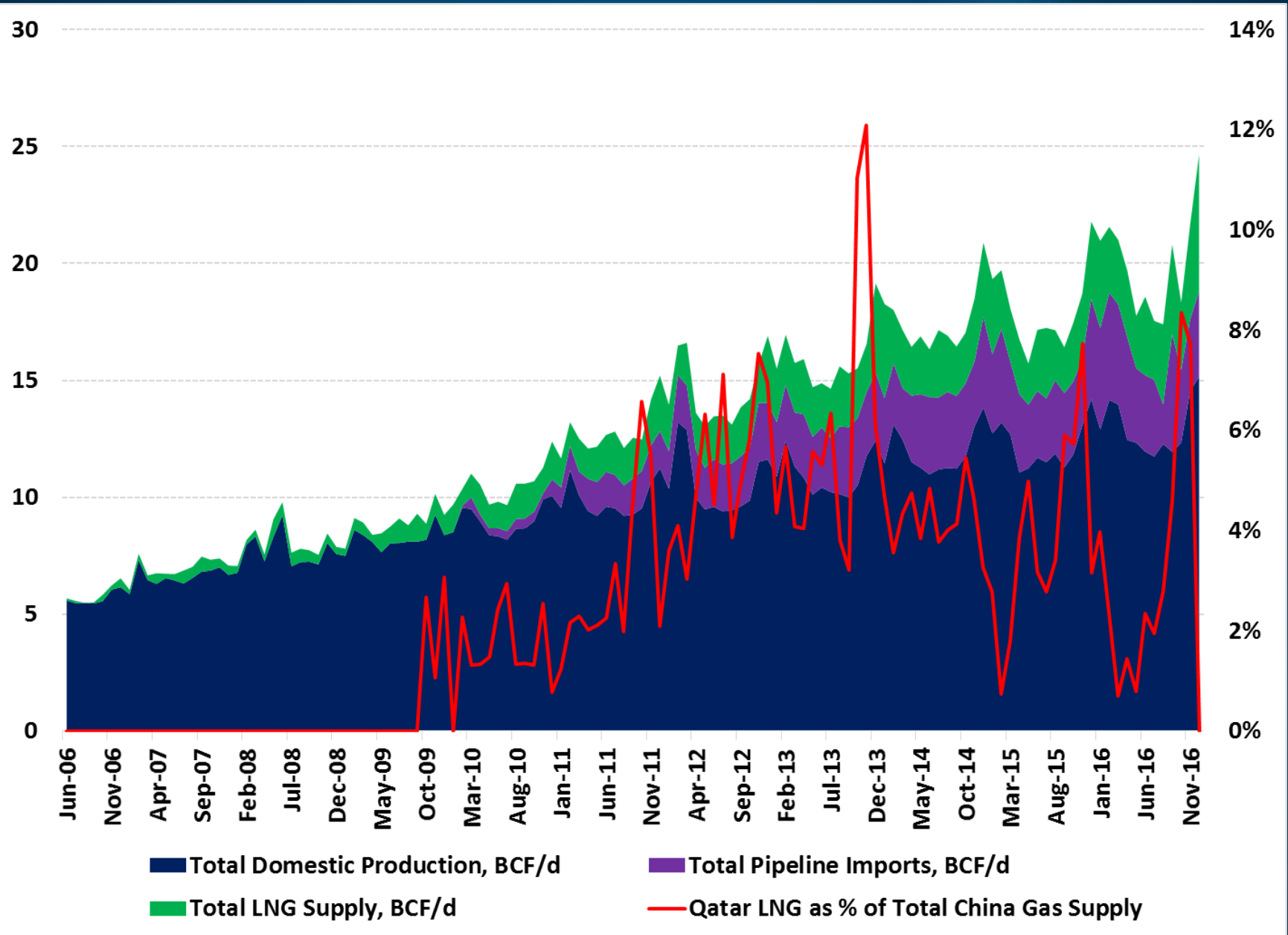


▶ Russian exporters have been more amenable to trade with the Chinese independent refiners.

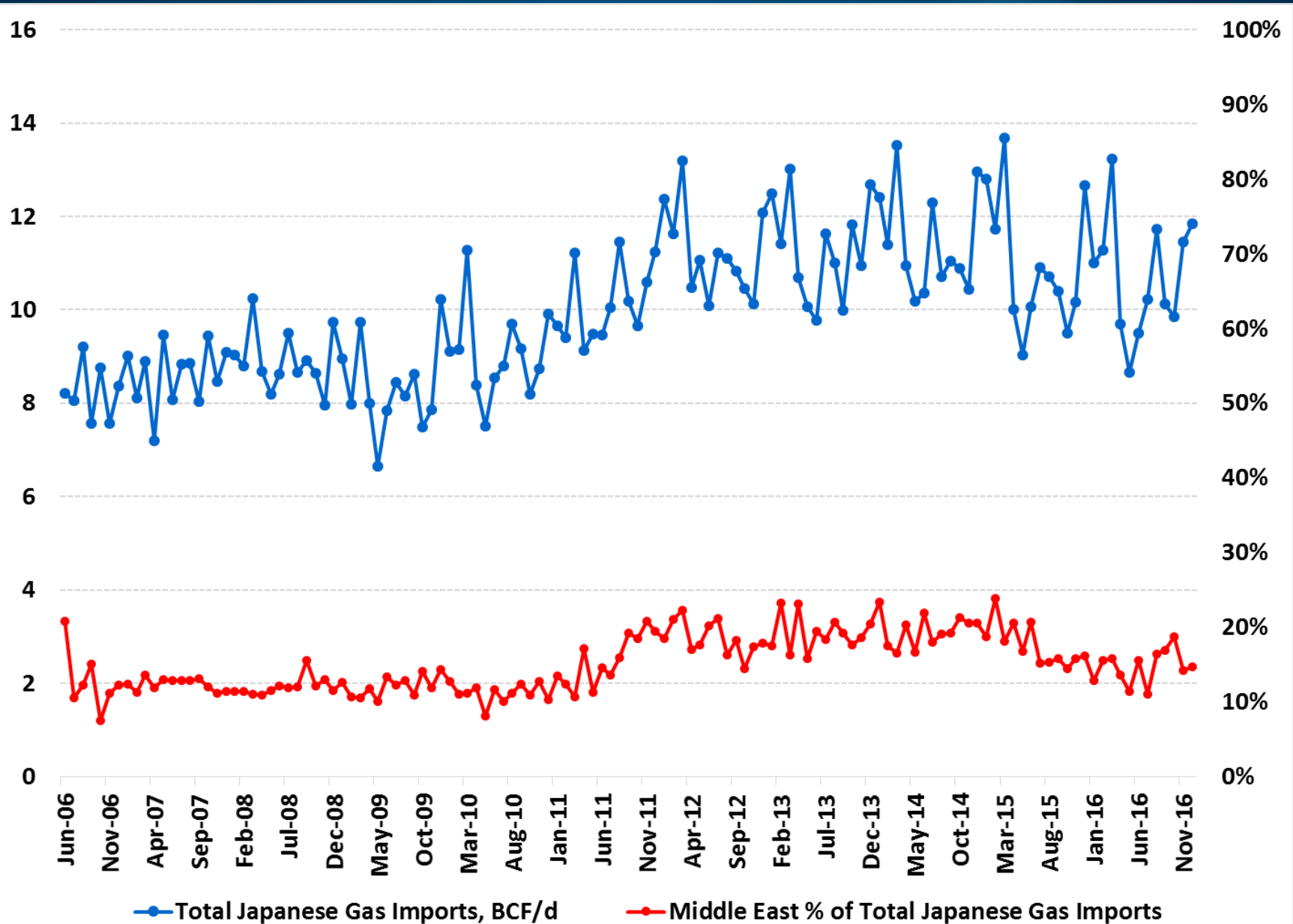
▶ The independent refiners have played a major role in driving China’s incremental growth in crude runs over the past 18-24 months.



China: Gas Import Dependency

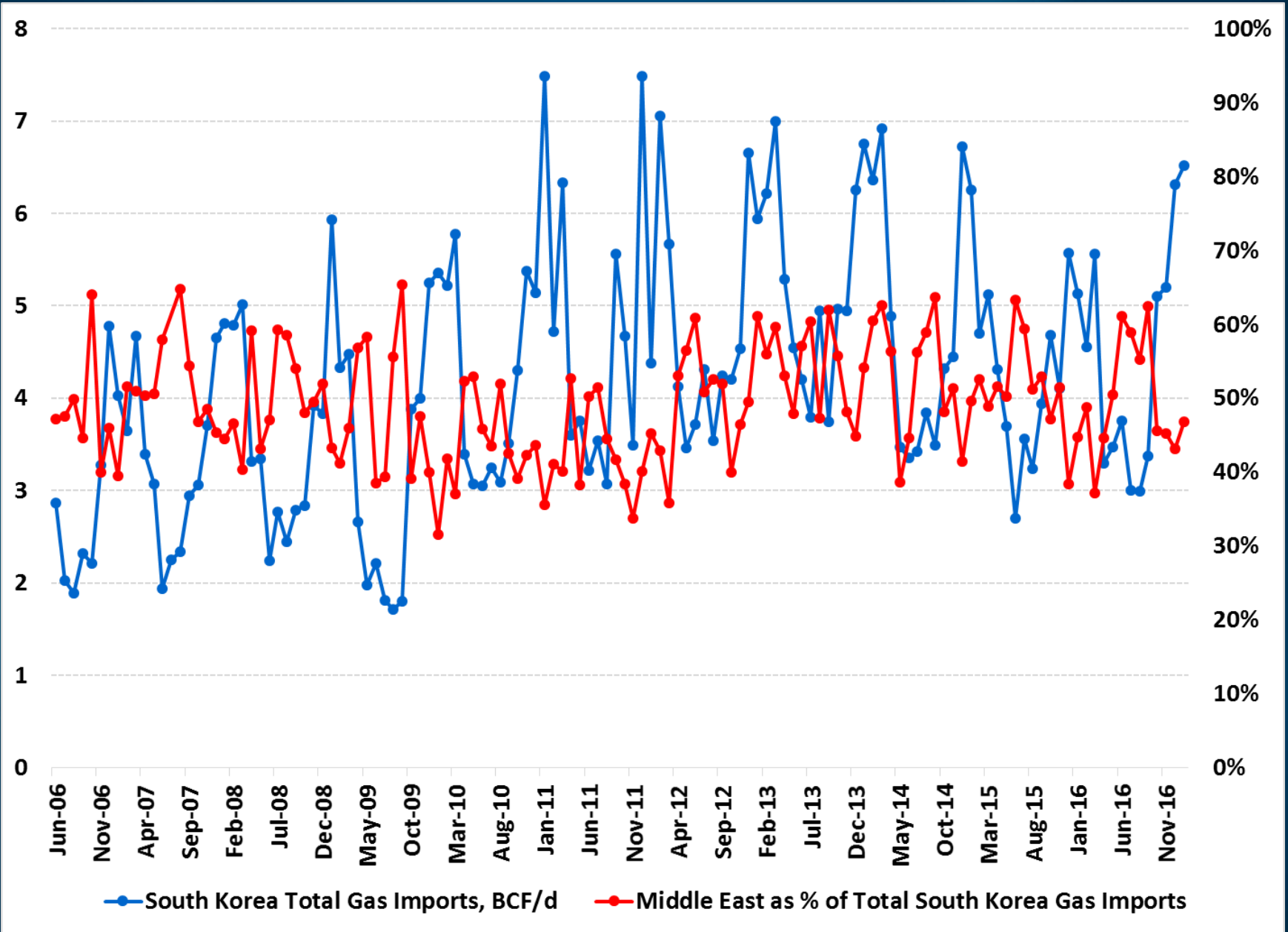


Japan: Gas Import Dependency



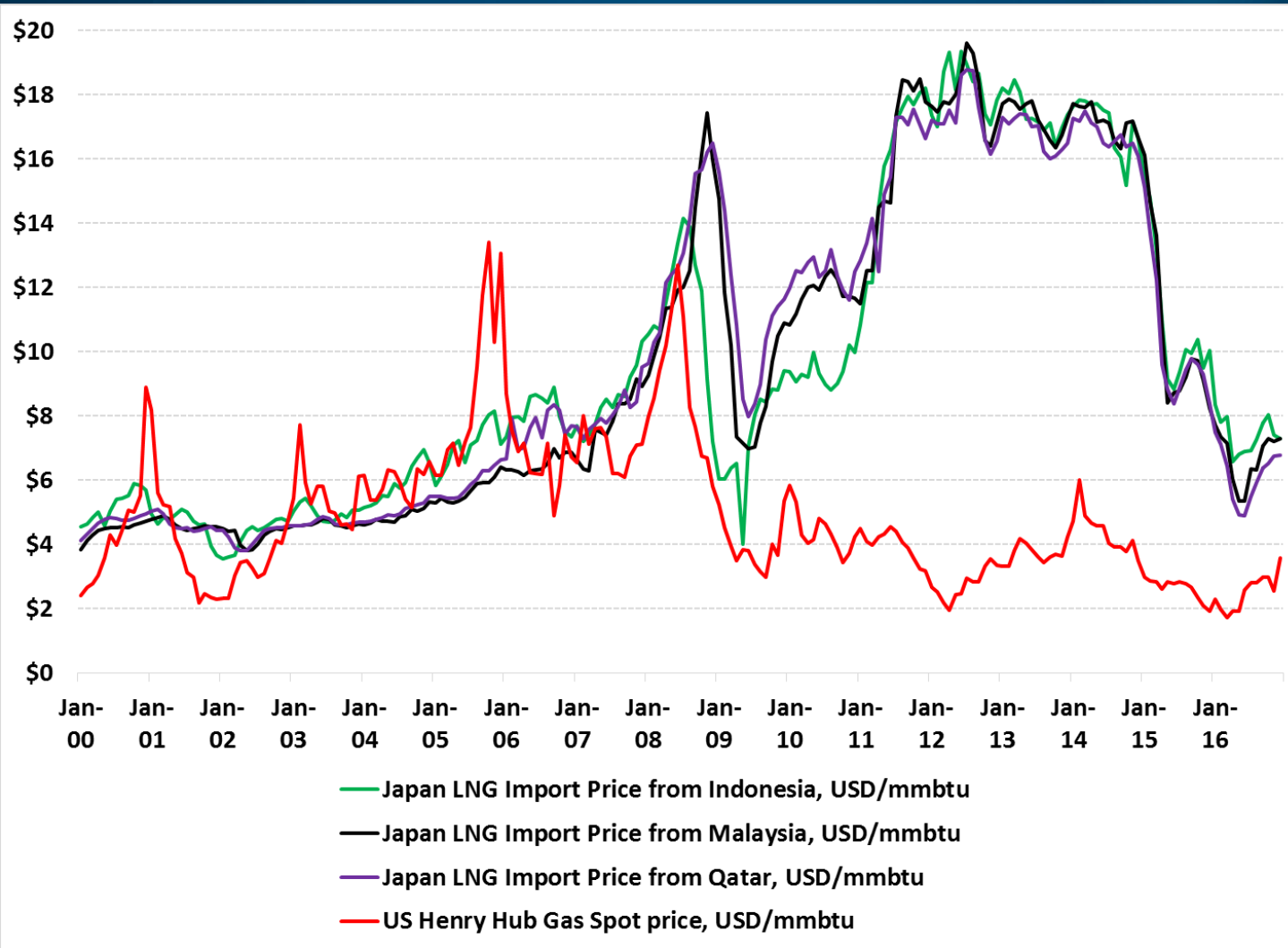
Source: Bloomberg, Authors' Analysis

South Korea: Gas Import Dependency



Key Emerging Trends: Commercial

U.S. Pressure on East Asian LNG Prices?

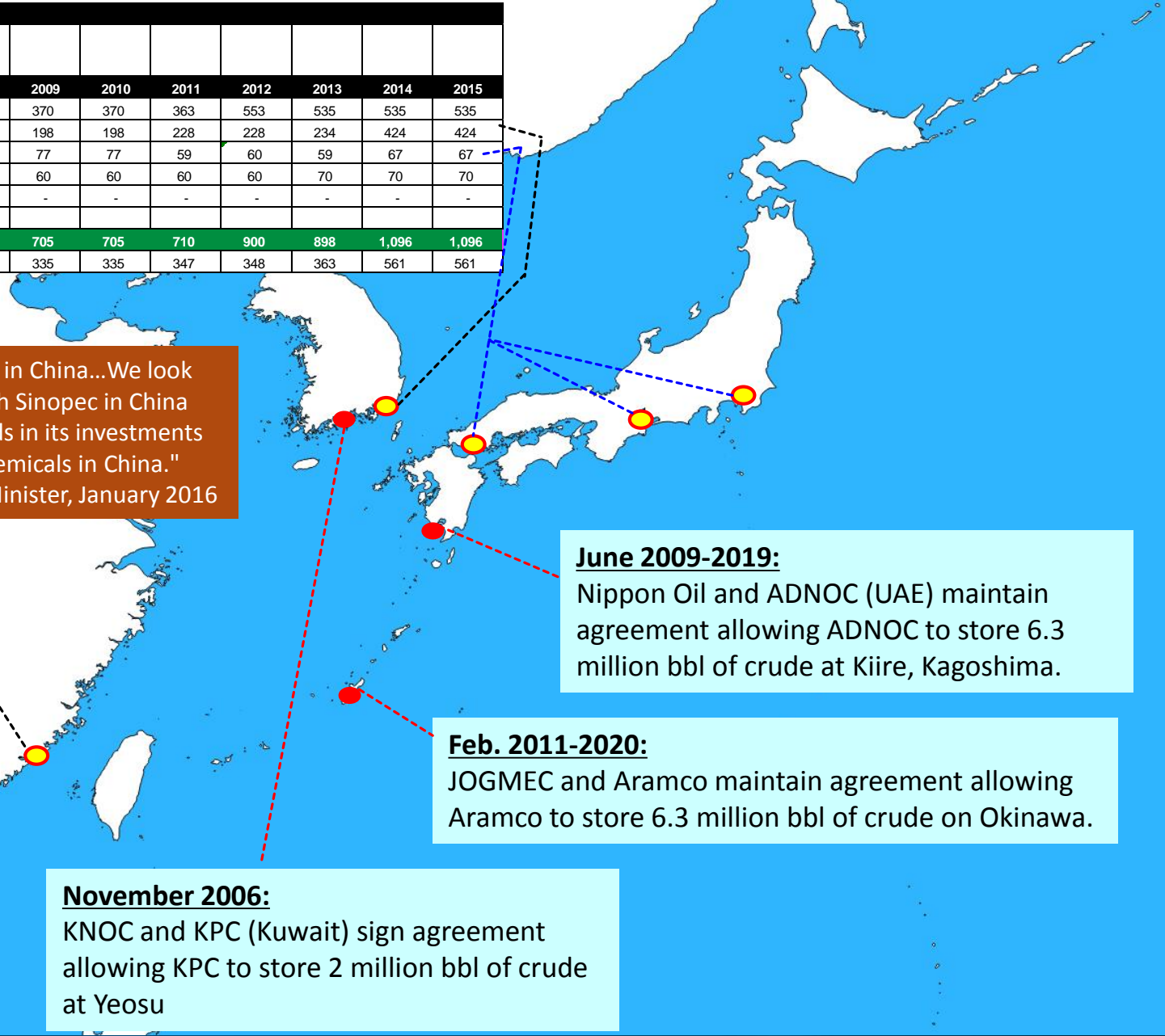


Source: Bloomberg, EIA

Middle East NOC Investments in East Asia

Aramco and Subsidiaries										
Aramco Share, kbd	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015
Motiva (USA)	363	370	370	370	370	363	553	535	535	535
S-Oil (SK)	184	198	198	198	198	228	228	234	424	424
Showa Shell (Japan)	77	77	77	77	77	59	60	59	67	67
FRER (China)	-	-	20	60	60	60	60	70	70	70
Petron (Philippines)	72	72	-	-	-	-	-	-	-	-
Cilacap (Indonesia)										
Total	695	717	665	705	705	710	900	898	1,096	1,096
Asian Market	333	347	295	335	335	347	348	363	561	561

"Aramco would like to invest more in China... We look forward to have other projects with Sinopec in China specifically, so that Aramco expands in its investments in refining, marketing and petrochemicals in China."
 --H.E. Khalid al-Falih, KSA Energy Minister, January 2016

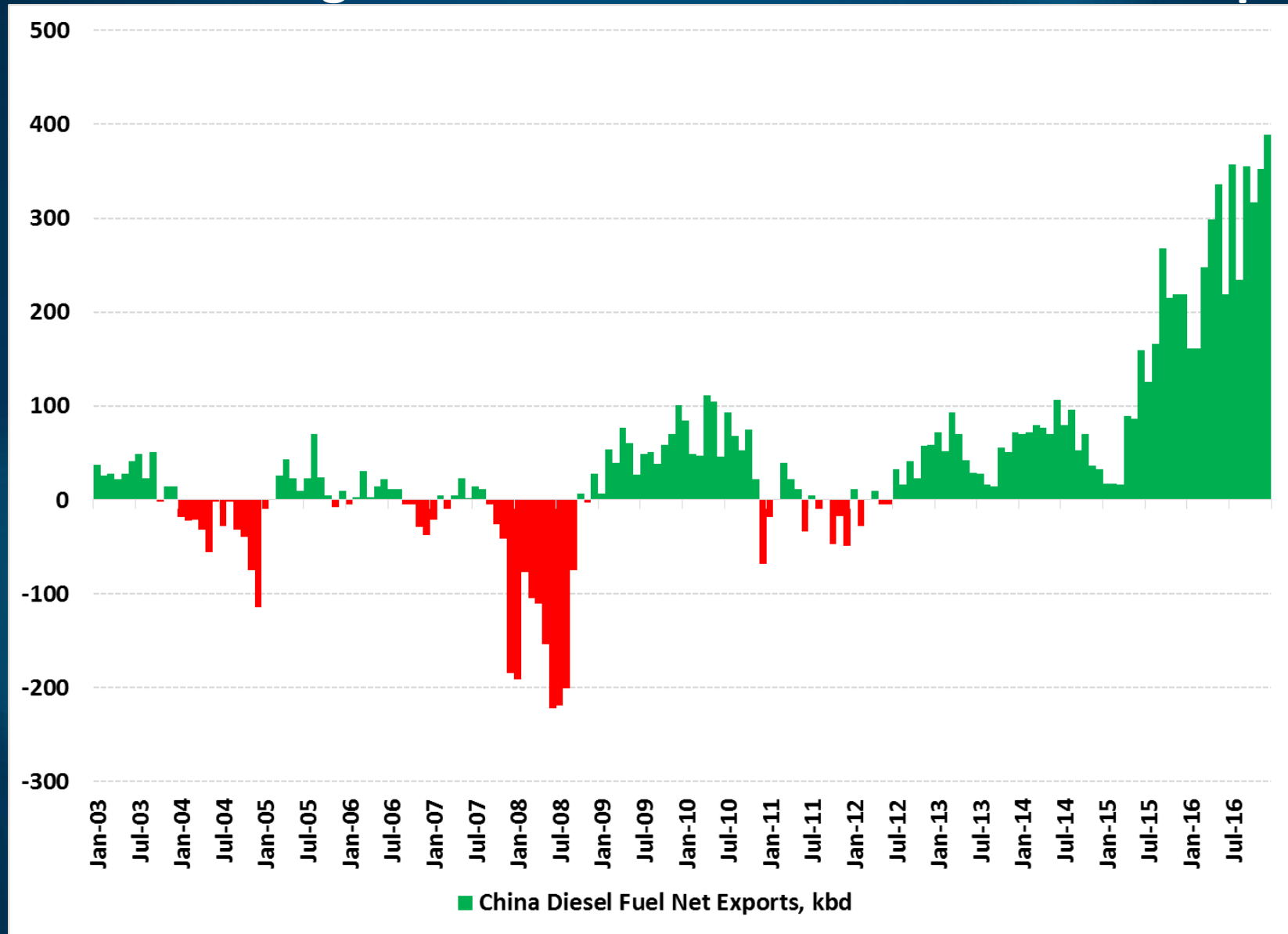


November 2006:
 KNOC and KPC (Kuwait) sign agreement allowing KPC to store 2 million bbl of crude at Yeosu

June 2009-2019:
 Nippon Oil and ADNOC (UAE) maintain agreement allowing ADNOC to store 6.3 million bbl of crude at Kiire, Kagoshima.

Feb. 2011-2020:
 JOGMEC and Aramco maintain agreement allowing Aramco to store 6.3 million bbl of crude on Okinawa.

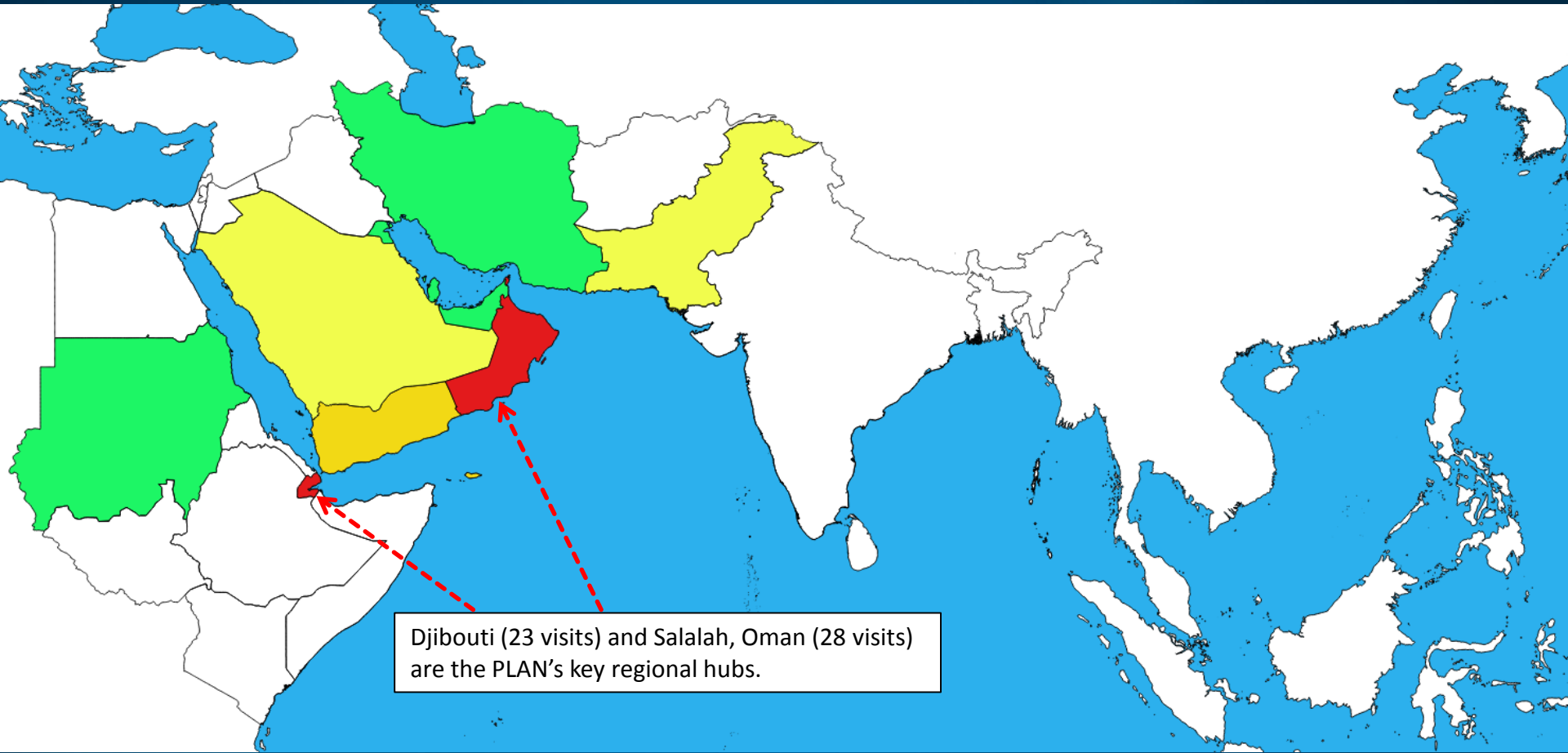
China's Emergence as a Global Refined Products Exporter



Source: JODI, Authors' Analysis

Key Emerging Trends: Security

Growing Chinese Military Presence in the Middle East/Gulf Region



Djibouti (23 visits) and Salalah, Oman (28 visits) are the PLAN's key regional hubs.

- ▶ PLAN anti-piracy deployment has been sustained since December 2008, 25 task forces have now participated.
- ▶ At least 79 port visits have occurred in the region during this time.
- ▶ China now building a base in Djibouti.

Japanese and South Korean Presence in the Gulf Region

Japan

- ▶ JMSDF active in anti-piracy operations.
 - ▶ As of mid-2015, Japan's vessels had conducted 621 escort missions and escorted 3,577 ships, according to the Ministry of Foreign Affairs.
- ▶ But expanded forward-deployment along oil supply lines would impose major opportunity costs: would logistically strain force and present risks to Japan's ability to project meaningful naval power in East Asia.
- ▶ JMSDF has less than 35 modern, high-endurance surface combatants and approximately 20 diesel electric attack submarines.
- ▶ The Cold War-vintage relationship between U.S. and JMSDF spheres of responsibility still fundamentally holds.

South Korea

- ▶ ROKN also active in anti-piracy operations.
- ▶ South Korea's naval opportunity cost of larger forward deployment would be somewhat different than Japan's. Japanese security faces threats from both North Korea and China, while South Korea's biggest security challenge is from the DPRK.



Source: Asia-Pacific Journal, Japan Focus

Thank You!

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