Oil and the New Economic Order

by Gal Luft

February 2008
Institute for the Analysis of Global Security (IAGS)

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The recent series of multi-billion dollar acquisitions of chunks of major financial institutions like Citigroup, Merrill Lynch, Morgan Stanley, Blackstone Group and Bear Stearns by foreign governments, many of them authoritarian, non-transparent and unfriendly to the West – a buyout of America's prime symbols of economic prowess - symbolizes not only our economic decline but also the emergence of sovereign wealth funds as power brokers in international relations. These government-owned investment funds, some controlled by oil rich autocrats and some by Asian powers like China and Singapore, are pouring billions into hedge funds, private equity funds, real estate, natural resources, media conglomerates and other nodes of the West's economy. It is estimated that sovereign wealth funds owned over $3 trillion in assets at the end of 2007 and within one decade they could balloon to $15 trillion, equivalent roughly to America's projected gross domestic product.

Unlike ordinary investors motivated solely by desire to maximize the value of their shares, governments have a broader agenda—to maximize their geopolitical influence and sometimes to promote ideologies that are blatantly anti-Western.

While much of the economic activity is generated by the Asian funds, it is five Gulf Persian states--Abu Dhabi, Dubai, Qatar, Kuwait and Saudi Arabia—that account for nearly half of the world sovereign wealth funds assets. A quick review of the past several months' roster of those countries' acquisitions provides a glimpse into the scale of things to come. Prior to injecting $7.5 billion into the distressed Citigroup, Abu Dhabi's fund, sized at $900 billion, purchased a $622-million stake in AMD, the world's second largest chip manufacturer, and bought 7.5 percent of the Carlyle Group. Dubai, an emirate of only one million people, bought 22 percent of the London Stock Exchange (an additional 24 percent of the Exchange was bought by Qatar), 20 percent of Nasdaq, as well as portions of Deutsche Bank, the British bank HSBC, Euronext stock exchange, the huge hedge fund Och-Ziff Capital Management, Daimler, Sony Corp., MGM Mirage and the luxury retailer Barneys. Kuwait's Investment Authority injected billons to both Citigroup and Merrill Lynch.

Some dismiss the fear of Arab money acquiring portions of Western economies as a new form of jingoism, deriding the "fear mongers" as disciples of those who propelled the "Japanese-are-coming" hysteria of the 1980s. Sovereign wealth funds, they believe, are a blessing to our economy as they provide capital for big companies in distress and support the tumbling dollar. Without the cash infusions to large banks a financial meltdown of gigantic proportions could ensue. Furthermore, it is claimed, such rescue packages create an incentive even for the least friendly foreign governments to protect their investment by ensuring our prosperity. Some even argue that because governments tend to be terrible at managing money it would be the people of those countries—not us—who stand to lose the most from the current shopping spree. Such views are compelling. The aversion to accept an organ donation

from an unsavory person is indeed dwarfed by the pain involved in not doing so, and one cannot blame troubled CEOs for seeking salvage from those who can provide it most expeditiously. Furthermore, to date there is little evidence that sovereign wealth funds attempt to assume control of firms they invest in and to the degree that such attempts were made no foreign policy motive could be detected.

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The shifting balance of wealth does matter

But the hullabaloo about sovereign wealth funds only really matters if in the coming years the deterioration in the relations between the West and some of the investing countries were to continue. If tension subsides there is little reason for concern; if not, then indulging in Arab (or Chinese for that matter) wealth, could be outright dangerous. The key issue to understand is that there is a fundamental difference between state and private ownership. Lack of transparency among many of the investing governments allows them to engage in unfair dealing and blur the fine but clear line between government and private economic activity. Unlike ordinary shareholders and high net wealth private investors who are motivated solely by the desire to maximize the value of their shares, governments have a broader agenda—to maximize their geopolitical influence and sometimes to promote ideologies that are blatantly anti-Western. Mitsubishi Estate, the Japanese company that bought the Rockefeller Center in 1989, was not Tokyo's handmaiden and its wealth was derived from the hard work and brain power of the Japanese people, not from drilling holes in the ground. Most important, Japan was—and still is—an American ally. This can hardly be said about Vladimir Putin's Russia, Communist China or the 11 country representatives occupying the Vienna offices of the Organizations of Petroleum Exporting Countries (OPEC) whose members use their revenues to fund the proliferation of radical Islam, develop nuclear capabilities, and serially violate human rights. As is now known to all, for decades the de facto leader of OPEC, Saudi Arabia, has been actively involved in the promotion of Wahhabism, the most puritan form of Islam, and its charities and other governmental and non-governmental institutions have been bankrolling terrorist organizations and Islamic fundamentalism. To this day, the Kingdom's petrodollars pay for an incendiary education system and fuel conflicts from the Balkans to Pakistan. With a little over one percent of the world's Muslim population, Saudi petrodollars today support 90 percent of the expenses of the entire faith. U.S. Undersecretary of the Treasury in charge of fighting terrorist financing Stuart Levey recently said in an interview: "If I could snap my fingers and cut off the funding from one country, it would be Saudi Arabia." And yet, it is now the Saudis who are planning to establish the world's largest sovereign wealth fund. With its top economic position in the Middle East, its ownership of a quarter of the world's

oil reserves and a growing national surplus, a tsunami of Saudi investment is already gathering offshore.

The elevation of Saudi Arabia and its Gulf sisters to the position of supreme economic power is a direct result of the rise in oil prices which enabled these countries to accumulate unprecedented wealth. With oil rising from $25 to nearly $100 per barrel in just six years, oil-rich countries have more than quadrupled their revenues, raking in some $700 billion in revenues last year alone. The resulting transfer of wealth is already creating a structural shift in global economy, causing oil importers economic dislocations such as swollen trade deficits, loss of jobs, sluggish economic growth, inflation and, if prices continue to soar, inevitable recessions. The impact on developing countries, many of which still carry debts from the previous oil shocks of the 1970s, is much more severe. Three-digit-oil would undoubtedly slow down their economic growth and exacerbates existing social illnesses; it also makes them economically and politically dependent on some of the world's most nasty petro-regimes.

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The coming economic order

The transfer of wealth is only in its early stages as oil prices are not going down anytime soon. This is a result of greed, not scarcity. While enjoying almost unlimited access to investment opportunities in the West, oil rich governments do not feel the need to reciprocate by opening their economies to foreign investment. The opposite is true: together owning 80 percent of the world's reserves, they practice resource nationalism, stick to quotas and obstruct international companies from investing in their territories, limiting them to, at best, minority share. This is why Big Oil's access to equity oil and gas reserves has been in constant decline for decades resulting in insufficient production of new oil. Exxon Corporation's investment portfolio provides a revealing example. Despite the fact that more than three-quarters of global oil reserves are in the Middle East and Russia, only five percent of Exxon's investments between 2000 and 2005 were in these two regions. This is not because of the company's lack of interest in exploring there but rather due to the protectionism and restrictive business environment which exists in these regions. What adds to the migration of wealth from the West is the mischief of non-state actors like al-Qaeda who wish to drive prices even higher through energy terrorism. Determined to weaken the Western economy the jihadists have made attacking oil, which they call "the provision line and the feeding to the artery of the life of the crusader's nation," a central part of their plan. Over the past four years, attacks on oil facilities in Iraq have denied the global oil market 1-2 million barrels per day. Had this oil been in the market, the price per barrel would have easily dropped by $20-$25. For the U.S. and the EU, each an importer of roughly 12 million barrels a day, the

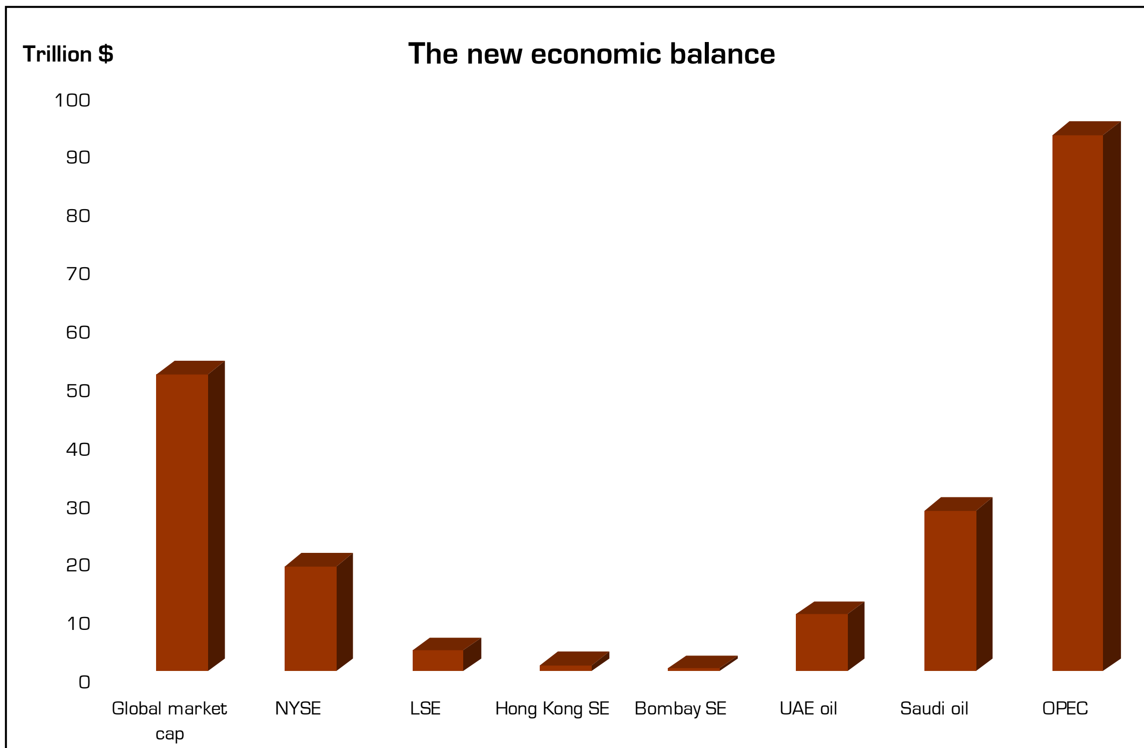
terrorist premium alone costs $65-$85 billion a year. Had this money stayed in the West it would have been sufficient to cover Citigroup's reported losses ten times over. Things could get much worse on this front if terrorists succeed in attacking one of Saudi Arabia's mega-facilities, something that has already been attempted several times. In February 2006 suicide bombers drove trucks full of explosives into Abqaiq, the world's largest oil processing facility, and in April 2007, scores of terrorists who had undergone flight training intending to crash planes into Saudi oil facilities were arrested. A successful attack against the Kingdom's oil sector—the idea that jihadists are prepared to sacrifice their lives in order to hurt the West economically is in itself hair-raising—could easily send oil to above $200 a barrel for an extended period of time, causing incalculable economic losses and a far greater transfer of wealth to Middle Eastern governments.

at $100 oil OPEC could potentially buy Bank of America in two months worth of production, Apple Computers in two weeks and GM in just 6 days. It would take less than three years of production for OPEC to own 20% (which essentially ensures a voting block in most corporations) of every S&P 500 company.

No doubt perpetual high oil prices will create a new economic world order, shifting the economic balance between OPEC and the West in the direction of those who own the precious commodity. Robert Zubrin points out that in 1972 the U.S. spent $4 billion for oil imports, an amount that equaled to 1.2% of our defense budget. In 2006, it paid $260 billion which equals to half of our defense budget. Over the same period, Saudi oil revenues grew from $2.7 billion to $200 billion and with it their ability to fund radical Islam. In the years to come this economic imbalance will grow by leaps and bounds. To understand the degree of the forces at play it is instructive to visualize the scale of OPEC's potential wealth in comparison to the consuming countries: imagine that OPEC members are corporations and a barrel of oil is a share. At $100 oil, OPEC's market capitalization based on its proven reserves stands today at roughly $92 trillion. This is about half of the world's total financial assets or almost twice the market capitalization of all the companies traded in the world's top 27 stock markets. Saudi Arabia's oil alone is worth $27 trillion, seven times the total value of all the companies traded on the London Stock Exchange. If one adds the worth of OPEC's huge gas reserves as well as additional oil reserves that have not yet been discovered, the disparity more than doubles. If oil prices climb to $200, as Venezuela's president Hugo Chavez recently warned, the disparity would double again. Such monumental wealth enables unprecedented buying power of the oil countries. For demonstration sake, at $100 oil OPEC could potentially buy Bank of America with two months worth of revenue, Apple Computers in two weeks and General Motors in just 6 days. It would take less than three years of production for OPEC to own a 20 percent (which essentially ensures a voting block in most corporations) of every S&P 500 company. Of course, takeovers of such

magnitude are unlikely, at least in the foreseeable future, but what is clear about the new economic reality is that while the economic power of America and its allies is constantly eroding, OPEC's 'share' price is on a solid upward trajectory.

liquidity problems. With soaring oil prices, Middle Eastern governments will have the ability to buy any global company, create panic in markets at a whim and to increasingly use financial holding as a means of extortion and overt intimidation if and when political differences emerge.



With high oil prices here to stay and with the International Energy Agency projecting that "we are ending up with 95 percent of the world relying for its economic well being on decisions made by five or six countries in the Middle East," it is hard to see how OPEC's massive buying power would not upset the West's economic and political sovereignty. This is particularly true in light of the prospects of future bailouts in sectors other than banking should the U.S. economy continue to melt. As populations in Western countries age and dwindle, it is only a matter of time before the under funded healthcare and retirement systems begin to face similar

To date, the influx of petrodollars has not translated into overbearing presence of government agents in corporate boardrooms. In fact, many of the sovereign wealth finds buy holdings under the 5 percent benchmark that triggers regulatory scrutiny and forego board seats. But at the current rate of investment and a few more years of three-digit-oil foreign governments might be more willing to translate their wealth into power, dictating business practices, vetoing deals, appointing officers sympathetic to their governments and dismissing those who are critical of them. The "fair and balanced" Fox News provides a glimpse into what stock

ownership can buy. Saudi Prince Alwaleed bin Talal, whose $10 million check was rejected by Mayor Rudy Giuliani because Alwaleed had suggested that the 9-11 attacks were the result of America's policies in the Middle East, now holds 5.46 percent of Fox's parent company News Corp. Two years ago, the prince boasted that he had personally called News Corp's chairman Rupert Murdoch to complain about Fox's coverage of the riots in France. Since the riots were carried out by Muslims the network rightly labeled them as "Muslim riots." Alwaleed said he "picked up the phone and called Murdoch to tell him these are not Muslim riots, these are riots out of poverty. Within 30 minutes the title was changed from 'Muslim riots' to 'civil riots'." The financial troubles of international media conglomerates promise much more of this. Last year, with mainstream news organizations in the U.S. reporting falling earnings and downbeat financial assessments, information ministers, tycoons and other officials of the 57-nation Organization of the Islamic Conference (OIC) gathered in Saudi Arabia where they were urged to buy stakes in Western media outlets to help change "anti-Muslim" attitudes around the world.

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The gradual penetration of Shariah (Islamic Law) into the West's corporate world is another sign of our time. Islamic countries operating on the basis of compliance with Shariah have strict guidelines of economic conduct. Banks and investment houses are employing a new breed of executive--the Chief Shariah Officer (CSO)--whose sole job is to ensure compliance with Islamic law and hence attract more business from the Muslim investors. Over time, such compliance could put pressure on companies not consistent with Islamic principles to become more "Islamic." Imams sitting on Shariah boards could be pressured to withhold their approval of any business dealing directly or indirectly connected with countries or institutions that are offensive to Islam. The first signs of this can be seen in China, where pork, while offensive to Muslims, is a central part of the cuisine. Sharia compliant funds invested in property force their tenets to limit the sale of pork and alcohol. "I need to go through each tenant's balance sheet to ensure that the non-sharia elements are at an acceptable level," said one trust manager.

To be sure, the U.S. bears the sole responsibility for its current economic predicament and it would be a gross injustice to blame the Chinese, from whom we borrow one billion dollars per day or the oil countries, from whom we buy oil for another billion, for our plight. After all, Americans are known for their exuberant spending, gas guzzling and low saving rates. With net foreign debt in access of $3 trillion and with annual current account deficit of $600-$700 billion a year the U.S is the world's largest debtor nation, desperately

dependent on foreign capital to keep the economy afloat. We are clearly reaping what we have sown. But economic considerations aside there is a war to be won here and in order for us to prevail we need not only effective militaries, robust diplomacy, determined populace and strong convictions but also an economic program other than the one employed today which is, in essence, enrichment of those who wish us ill.

Vigilance and reciprocity

Fighting the war on terror economically does not mean lifting the drawbridge and becoming hermits. America’s commitment to open markets and free flow of capital around the world has been a source of respect and admiration. Reversing it through investment protectionism would only hurt U.S. prestige while undermining economic growth and job creation at home. In the near term the most America can do to arrest the current economic trend is to hedge the risk of sovereignty loss with a healthy dose of vigilance. The U.S. already has a rigorous safeguard mechanism against undesirable foreign investors, the Committee on Foreign Investment in the U.S. (CFIUS), to protect national security assets in sectors such as telecommunications, broadcasting, transportation, energy and minerals in which there is a clear potential danger to national security. Europeans, who, by and large, are more lax in protecting their sovereignty, would be well advised to institute similar mechanisms. Reciprocity is no less important. As mentioned, many of the countries investing in the West are notorious for their inhospitality to foreign investors and their egregious violations of free trade principles. The least we can do is demand that foreigners treat us as we treat them. Despite being the lead violator of free trade by dint of its leadership of OPEC, two years ago, with U.S. support, the Saudis were admitted to the World Trade Organization. This was a terrible blunder. Since the admission, America’s generosity toward the Saudis was rewarded with nothing but continuous manipulation of oil prices. When President Bush recently went to Riyadh with a gift of 900 precision-guided bombs to appeal to the Saudis to increase oil production the Saudis were quick to respond with a slap in the face. Within one hour the kingdom's oil minister announced that oil prices would remain “tied to market forces” – read, the whims of the OPEC cartel - and the Saudis would not open the spigot. The lesson: enjoying the benefits of free trade is an earned privilege not an entitlement, and foreign governments wishing to acquire assets in the West should be obliged only if they show similar hospitality to Western companies.

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Turning oil into salt

This brings us back to oil. In the long run the way to roll back OPEC's influence is by reducing the inherent value of its commodity. The key to this strategy is parked in our garage. Two thirds of the oil we use is consumed in the transportation sector, most of that by cars and trucks. Since the life span of an average car is nearly two decades, continuing to make cars that can run on nothing but petroleum and hence locking our transportation sector, with its 220 million cars and trucks in the U.S. and 200 million in the EU, to oil for the coming decades is utter recklessness. In order to avoid OPEC's economic hegemony consumers should do their utmost to strip oil of its power, turning it from a strategic commodity into just another commodity. This is exactly what happened to salt in the 19-Century. Throughout history salt was used to preserve food, enabling armies to march across continents; it was used for the production of munitions that allowed empires to fight each other. Hides were cured with it and silver was separated from ore by its sodium. Those who owned the precious mineral acquired wealth and international prestige; those who didn't had to either pay for it or fight for it, just like with oil today. Replace the words "British", "Portugal" and "salt" with "American", "Saudi Arabia" and "oil" in the following excerpt from Mark Kurlansky's bestseller *Salt: A World History* and see how similar the 18-century reality was to our own days':

> *"To the British Admiralty the solution to lack of salt was to acquire through force or diplomacy places that could produce it. Portugal had salt […] but needed protection […] And so England and Portugal formed an alliance trading naval protection for salt."*

All this ended with the invention of canned food, refrigeration and complex chemistry. Salt is no longer a strategic commodity shaping global trends and salt rich domains like Orissa, Tortuga, Boa Vista, Turk Island, Salt Cay and Great Inagua that once held as much sway as today's tiny Emirates are not even known to geography buffs. They still export salt and we still buy the mineral from them but they cannot build the world's largest towers and shopping malls, accumulate the most sophisticated weaponry and be kowtowed to by world leaders.

Turning oil into salt entails a shift toward a global transportation system based on next-generation, non-petroleum fuels and the cars and trucks that can run on them. The first step should be to ensure that every car put on the road is a flex fuel car, which looks and operates exactly like a gasoline car but has a $100 feature which enables it to run on any combination of gasoline and alcohol. Alcohol may be objectionable to the Saudis but for America it can be a real

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savior. Millions of flex fuel cars will begin to roll back oil's influence by igniting a boom of innovation and investment in alternative fuel technologies. The West is not rich in oil, but it is blessed with a wealth of other energy sources from which alcohol fuels - such as ethanol and methanol – capable of powering flexible fuel vehicles, can be affordably and cleanly generated. Among them: hundreds of years' worth of coal reserves, vast rich farmland, and billions of tons a year of agricultural, industrial and municipal waste. In an alcohol economy, scores of poor developing countries which right now struggle under the heavy economic burden caused by high oil prices would be able to become energy exporters. With hot climate and long rainy seasons countries in south Asia, Africa and Latin America enjoy the perfect conditions for the production of sugarcane ethanol, which costs roughly half the price and is five times more efficient than corn ethanol. (The advantages of sugar ethanol over corn ethanol are so stark that the farm lobby through its champions in Congress made sure to keep it off the U.S. market by imposing a 54 cent a gallon tariff on imported sugarcane ethanol. Indeed, U.S. energy policy currently favors oil imports from countries like Saudi Arabia and Venezuela over alternative fuels from a friendly country like Brazil.) Hence, a shift to alcohol enabled cars will enable developing countries to become important energy suppliers, generate revenues and emerge as a powerful force that could break OPEC's dominance over the global transportation sector. In addition, coal, nuclear power, solar and wind energy can make electricity to power electric and plug-in hybrid cars – only 2% of U.S. electricity is generated from oil. Plug-in hybrids have an internal combustion engine and liquid fuel tank, and thus are not limited in size, power, or range, but also have a battery that can be charged from an electric socket and can power some twenty or thirty miles of driving, giving the consumer the choice of driving on electricity or liquid fuel. The combination of electricity and alcohol fuels would introduce choice and competition into the global transportation sector which is currently 97% petroleum dominated. Some countries have already begun to transition their economies away from oil. In Brazil, eighty percent of the new cars are flex fuel and alcohol is served in every gas station, a key reason why last year Brazil became energy independent. In Israel a government supported electric car venture which aims to turn Israel into the first oil free economy was announced earlier this year. The plan is to set up a network for charging and battery-replacement stations and offer electric cars that would go about 100 miles on a single charge. In a small country like Israel where one cannot drive very far, the electric range offered by current batteries is quite sufficient. For tiny Israel, knocking oil off its pedestal is for obvious reasons a matter of survival. "Oil is the greatest problem of all time—the great polluter and promoter of terror. We should get rid of it," said Israel's President Shimon Peres at the dedication ceremony for the project. For America, a perpetuation of the petroleum standard guarantees a metastasizing sovereignty loss, economic and political decline and eventual enslavement to OPEC and its whims. Turning oil into salt is a far more prudent alternative.