Politics et Cetera
A publication from The Political Forum LLC
Monday, December 3, 2007

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In this Issue

THEY SAID IT

The lessons of history, confirmed by evidence immediately before me, show conclusively that continued dependence on relief [i.e. welfare] induces a spiritual and moral disintegration fundamentally destructive to the national fiber. To dole out relief in this way is to administer a narcotic, a subtle destroyer of the human spirit. It is inimical to the dictates of sound policy.

--Franklin D. Roosevelt, 1935 State of the Union message.

THE NEW WELFARE QUEENS.

Two of the top three exporters of oil to the United States are friendly, relatively civilized, well-intentioned, stable, and cooperative countries. In fact, they are the United States' closest neighbors, Canada (#1) and Mexico (#3).

Outside of these two relatively normal countries, however, the list of nations that export oil to the United States and to the rest of the world is a virtual "Who's Who" of tyrants, thugs, terrorist states, patrons of terrorist states, terrorist states-in-waiting, and all-around dysfunctional freak shows. Saudi Arabia, Venezuela, Iran, Russia, Nigeria, Kuwait, etc. etc. Is it any wonder then that oil is at the heart of many of the modern world's most serious and most violent confrontations?

Republicans have always publicly denied that the war on terror is one such confrontation, that the war on Islamism in general and the war in Iraq in particular have anything whatsoever to do with oil. But even they don't really believe that. Everyone knows that the war is, in part, about oil; not in the way that the Bush-bashing, anti-war left thinks it is, mind you, but in a very real way nonetheless. The war on terror is about oil in that oil provides the funding for Wahabbist evangelism and for Wahabbist violence. Oil provides the means by which states and non-state actors alike pursue bigger and better bombs with which to kill infidels. Oil is one of the principal reasons that the United States can't simply abandon the Middle Easterners to their own sectarian devices, as sometimes seems tempting. Oil is, quite literally, the engine that drives the modern global economy. The war on terror is about oil in that *everything* is about oil.

Now, it doesn't take a genius or an energy analyst to understand that in a world in which everything is about oil, the aforementioned freak shows hold a great deal of sway. And with oil now at $90+/barrel and pushing $100, the amount of trouble that the oil-producing freaks can cause is likewise pushing upward.

These are facts with which even President Bush and his dastardly "neocon" advisors have publicly grappled. Recall that Bush himself declared in his 2006 State of the Union address that the United States has an "oil addiction" that it needs to break if it is to have the economic independence necessary to carry out its foreign and domestic policies effectively. Victor Davis Hanson, a classicist, military historian, conservative author, and onetime advisor to Vice President Dick Cheney, has repeatedly noted the deleterious effects of oil, and high-priced oil in particular, on the ability of the United States to shape the geopolitical environment. Just last month, he put it this way:

> The Middle East is raking in billions each week. At best, our so-called friends in cash-laden Saudi Arabia subsidize fundamentalist mosques and hate-filled madrassas worldwide. At worst, our enemies in petrol-rich Iran are after the bomb, send weapons into Iraq to kill Americans and fund Hezbollah jihadists.
>
> War in Iraq, rumors of fighting in the near-future in Iran and tension on the West Bank only panic markets, raise oil prices and further enrich our grinning enemies.
>
> The nearly half-trillion dollars we will soon pay for imported oil does a lot more than prop up Russia's Vladimir Putin, Venezuela's Hugo Chavez and Iran's Mahmoud Ahmadinejad. The petrodollar drain also contributes to our trade deficits, falling dollar and a general demoralization of the American people.
>
> Our oil habit not only makes us dependent on some creepy suppliers, but we look like fools as we work nonstop to hand over our earnings to those who are rich by an accident of sitting atop oil someone else found and developed.

One would be foolish to deny the obvious impact that oil has on world affairs; and one would be just as foolish to deny the obvious dangers involved in pouring billions of petrodollars into the dysfunctional oil-producing states. If and when Iran gets its bomb, it will have been financed through petrodollars. Putin continues to consolidate power and to antagonize virtually the entire global community, and he does so on the strength of petrodollars. Likewise, does Hugo Chavez strengthen his hand in Venezuela and indeed throughout Latin America. The developed world's dependency is unquestionably an exacerbating factor in many of the world's problems.

But it is important to remember that oil dependency cuts two ways, has two sides, two victims, if you will. And though the oil-producers today almost exclusively benefit from the world's dependency on them, rest assured that this will not always be the case.

To illustrate this point, we think that it might be valuable to recall the strategy employed by the United States government, under the direction of President Ronald Reagan, to temper the ability of a previous energy-producing colossus to continue its policy of wreaking havoc throughout the world. Although it is generally accepted today that the fall of the Soviet Union was inevitable, when President Reagan took office in 1981, such sentiment was hardly widespread. History should demonstrate that Reagan was a visionary and he, better than anyone, understood the incalculable power of market forces.

Though the Soviet command-and-control economy was indeed doomed and bound eventually to collapse, the Soviet Union, like the Arab States, had managed to survive and even to thrive in the 1970s because of its energy resources. As today, the comparatively high price of oil and natural gas kept the Soviets flush with cash that their economy could not otherwise generate.

Reagan and his national security advisors (including our old friend Roger Robinson, the onetime Senior Director of International Economic Affairs in President Reagan's National Security Council) understood the Soviets' dependency on their energy wealth and thus actively set about to damage the Soviet Union by attacking that wealth. Three formerly secret but now declassified National Security Decision Directives (NSDDs Numbers 32, 66, and 75, issued in 1982 and 1983, respectively) spelled out the administration's plans to hit the Soviets where it would hurt most, including in the energy sector. Among other orders issued in these directives were the following:

> "To foster restraint . . . in Soviet military spending . . . by forcing the USSR to bear the brunt of its economic shortcomings, and to encourage long-term liberalization and nationalist tendencies within the Soviet Union and allied countries." (#32)
>
> An agreement [between the United States and its European allies] not to "commit to any incremental deliveries of Soviet gas beyond the amounts contracted for from the first strand of the Siberian pipeline . . . (#66)
>
> "A quick agreement that allied security interests require controls on [the sale to the USSR of] advanced technology and equipment…including equipment in the oil and gas sector . . . (#66)
>
> "U.S. policy on economic relations with the USSR must serve strategic and foreign policy goals as well as economic interests. In this context, U.S. objectives are:
> – above all to ensure that East-West economic relations do not facilitate the Soviet military buildup . . . .
> – To avoid subsidizing the Soviet economy or unduly easing the burden of Soviet resource allocation decisions, so as not to dilute pressures for structural change in the Soviet system.
> – To seek to minimize the potential for Soviet exercise of reverse leverage on Western Countries based on trade, energy, supply, and financial relationships." (#77)

What Reagan et al. understood was that in many cases, natural resources like oil actually tend to retard economic development and growth. They provide instantaneous and often abundant wealth to those who happen to possess them, but they also tend to destroy the impulse to create, the need to produce, the intrinsic human desire to labor and to build. Reagan understood that free money is free money. And just as the free money of welfare tends to stifle the urge to earn, so does the free money of the geographic lottery tend to stifle the creation and expansion of industry and economic diversity.

Specifically, President Reagan intrinsically understood what is commonly known as "the resource curse," or the "paradox of plenty." He knew that the Soviet economy was built on smoke and mirrors, that its socialism was highly destructive and that that destruction was both exacerbated and masked by the country's energy wealth. A dip in the price of energy . . . and voila, the collapse of the Soviet economy and eventually of the Soviet Union itself. The fall of the Soviet Union may well have been inevitable, but it certainly was no accident.

In the years since the fall of the Soviet Union, social scientists, beginning with Richard Auty, who coined the term "the resource curse" in 1993, have slowly but surely come to the same conclusions that Reagan and his national security team came to more than a quarter century ago. In her book *An Introduction to Sustainable Development*, Jennifer Elliot, detailed the advance of the resource curse theory:

> Whilst past development processes have been closely linked to the rising exploitation of physical resources, there is also evidence of a negative relationship between natural resource endowment and development trajectories. Auty (1993) was one of the first to investigate

> what he termed this "resource curse." In recent years there has been substantial attention to the relationship between natural resources, economic growth, democracy and civil war, and in terms of contemporary geo-strategic significance of oil . . . In 1995, a study was conducted by Harvard University on the links between natural resources and economic performance encompassing the experiences of 97 countries. It identified that over time, the more a country depended on those resources, the lower their economic growth rate (with oil-producing countries amongst the worst performers). A stark illustration of the resource curse theory is Nigeria, where despite being the world's seventh largest oil exporter, the proportion of households living on less than a dollar a day increased from 27 percent in 1980 to 66 percent in 1996 (Christian Aid, 2004: 8). In 2004 Christian Aid took the analysis further in comparing the economic, poverty, and human development statistics over four decades for six oil-producing nations (Angola, Iraq, Kazakstan, Nigeria, Sudan, and Venezuela) with six non-oil producers (Bangladesh, Bolivia, Cambodia, Ethiopia, Peru and Tanzania). The oil economies were found to have achieved slower growth (1.7 percent per annum compared to 4 percent in non-producing countries).

Today, oil producing countries like Saudi Arabia, Kuwait, and Venezuela are able to provide for their otherwise under-employed populations because of oil wealth. Successful, generous, and frankly incongruous welfare states have been set up to placate the masses, and these are sustained only through the grace of energy wealth. In places like Russia, consumption and waste of consumer and luxury goods has reached new heights, as energy resources have produced vast wealth for small blocs of the population. And in Iran, of course, the government is flush with the cash necessary to wage proxy wars on at least three fronts, to pursue nuclear weapons, and to remain the chief state sponsor of global terrorism, despite a wretched domestic economy, all because of energy resources.

Throughout the oil-producing world, times are good and those governments and their allies are indeed flush with cash. But the good times will not last forever. And when the fall comes, it will likely be even more devastating than when it came to the Soviet Union. We can't prove this, of course, but the run-up in energy prices has been so great and so sustained that it seems likely to us that the dependence on energy revenues has also been exaggerated. And that, in turn, suggests that a collapse in those prices will be all the more destructive to the oil-producing economies.

But what will cause this collapse, you ask? A fair question. Certainly neither President Bush nor his successor has the ability to affect the energy market in any significant way. With global oil production at or near capacity, there is no effective means to substantively reject any single producer. Moreover, the growth in global energy demand and the ongoing expansion of energy-starved behemoths like China and India limit the United States' ability to unilaterally affect the energy market.

Nevertheless, the market will eventually solve the problem. We won't bore you or embarrass ourselves with any long-winded economic recitation, but clearly what goes up will eventually come down. Higher energy consumption leads to higher oil prices, but eventually higher oil prices lead to decreased energy consumption. Just as important, this time around, the quick and massive rise in energy prices and the lack of spare capacity should, at least in theory, encourage the growth in other sources of energy, both petroleum based and "alternative."

The Bush administration's first energy proposal included several provisions to encourage domestic energy production, one of which offered a \$3/barrel tax credit for drilling in "marginal wells." Oil was less than \$30/barrel then, which is to say that the

$3 offered as incentive by the government pales in comparison to the incentives offered since by the market. And though the federal government has been encouraging the development of alternative energy sources for three decades, the fact that there is now actual money to be made in the development of such sources is what will likely make the transition to alternative energy less "gradual" and more abrupt.

Of course, even if the development of other energy resources takes longer and is rather unenthusiastically embraced, eventually the earth itself will have a say in the matter. If, as many analysts believe, the world has already reached or passed peak oil, then the end of the energy-producers' dominance is already in sight. And though energy consumers will, in an era of terminal decline, have no choice but to develop other energy resources, current energy producers will almost certainly be unable to develop alternative sources of income. Their enfeebled and energy-indolent economies will collapse, as their enfeebled and energy-indolent populations fail to thrive without their accustomed government largesse.

Now, we'll readily grant that this is all likely to take considerable time. But if the West is indeed in a "twilight struggle" against the forces of Islamism and tyranny, as so many of our political leaders tell us, then victory is hardly around the proverbial corner anyway.

Eventually, liberty, free markets, and human enterprise will win the day. And the nations that embrace those values will be the victors. Ronald Reagan understood this a quarter century ago. And the rest of us would do well to remember it today. Oil dependency is indeed a problem for the West in its struggle against malevolent forces in the world. But in this case, dependency is a double-edged blade, one that will eventually cut energy's producers far deeper than it has cut its consumers.