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Written Testimony Before the
House Select Committee on Energy Independence and Global Warming

Hearing entitled
Oil Shock: Potential for Crisis

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Good morning Chairman Markey and Members of the Committee and thank you for holding this hearing to highlight America's extreme dependence on oil and its vulnerability to the potentially devastating consequences of an oil crisis.

I spent more than three decades in the U.S. Navy. My missions changed but my motivation never did; my driving imperative was to protect the blood and treasure of the American people. When I look at the dangers facing the country now, it is impossible to ignore the looming and worsening menace of oil dependence. Senior officers throughout the military share this concern. They know that increasing dependence on overseas oil is putting a strain on U.S. military forces and saddling them with costly missions for which they were not designed.

The use of large scale military force in volatile regions of underdeveloped countries is difficult to do right, has major unintended consequences and rarely turns out to be quick, effective, controlled and short lived. The Persian Gulf is just about on the other side of the world from the United States. It takes more than 3 ships in the U.S. Navy to keep one ship on station: one there, one going, one coming. Pretty much the same ratio holds for airplanes and, as we are learning in Iraq, for soldiers and Marines. You just got back, you're there or you're getting ready to go again. A major military presence in the Gulf region raises local resentments and dangers that work against what the U.S. is trying to achieve. This is not just a post-9/11 phenomenon. It was true well before 9/11 in terms of the effect of major U.S. military forces staged or spending large amounts of time in the Gulf region. So after all this major military effort, what's the bottom line? Gas is pushing $3 a gallon, we're extending the tours of soldiers in the Gulf region to 15 months, and we're more subject to events in the Persian Gulf than we ever were in the past.

Now, why has American security policy developed in this way? The fast pace of operations in the region has given little pause for reflecting on overall trends and effectiveness. American forces have been engaged in the Middle East since the tanker wars of 1987, and events have seemed to demand increasing our military force, not reducing it. But driving this engagement is America's ever growing dependence on petroleum. This dependence has influenced successive administrations to strengthen military engagement rather than to search for other means—perhaps politically more difficult but in the long run more cost-effective means—for boosting energy security.

No amount of military force can alter the fundamentals of oil dependence. Oil is the life-blood of our economy. We consume more than 20 million barrels of oil per day, a quarter of the world total. More than 60 percent of the oil we use is imported. Nearly 70 percent of our oil consumption goes toward transportation, which relies on oil-based fuels for 97 percent of its delivered energy. In the

event of an oil crisis, the economic consequences will be severe, and they will impact hundreds of millions of average Americans.

It was this state of affairs that caused me to join the Energy Security Leadership Council, a group of business leaders and retired senior military commanders who are committed to reducing U.S. oil dependence in order to improve national security and strengthen the economy. The Council was organized by Securing America's Future Energy, or SAFE, a non-partisan group that is educating the public about the nation's current state of energy insecurity.

On November 1, in partnership with the Bipartisan Policy Center, SAFE conducted *Oil ShockWave*, an executive crisis simulation developed over the last two years to illustrate the strategic dangers of oil dependence. *Oil Shockwave* confronts a mock U.S. cabinet with highly plausible geopolitical crises that trigger sharp increases in oil prices. Participants must grapple with the economic and strategic consequences of this 'oil shock' and formulate a response plan for the nation. Last week's event featured former Treasury Secretary Robert E. Rubin, former Deputy Secretary of State Richard L. Armitage, former CENTCOM Commander General John P. Abizaid (U.S. Army, Ret.), former Secretary of the United States Navy and 9/11 Commission Member John F. Lehman, former White House Press Secretary Mike McCurry, former National Economic Advisor Gene Sperling, former EPA Administrator Carol Browner, 9/11 Commission Executive Director Dr. Philip D. Zelikow, and Pulitzer Prize-winning author Daniel Yergin.

Designed by finance, energy, industry, and national security experts, *Oil ShockWave* cannot be dismissed as sensationalism. The scenario that was played out last week involved violence and unrest in Azerbaijan and Nigeria along with worsening diplomatic relations with Iran. Though set in 2009, these events could have been ripped from today's headlines.

Let me give you a brief synopsis of *Oil ShockWave*. In May of 2009, violence in the Baku, the capital of Azerbaijan, disrupts a major oil pipeline carrying about 1 million barrels per day to the Turkish Mediterranean port of Ceyhan. With spare capacity lacking, markets fear a supply crunch if the pipeline remains out of action. The news causes about a 12 percent spike in oil prices in a single day. Shortly thereafter, unrest in the Niger delta of Africa cuts off an additional increment of oil production. Iranian events compound these problems in subsequent weeks. Faced with the prospect of harsh economic sanctions from the U.S. and the European Union (EU), Iran announces that it will immediately reduce its oil exports by 350,000 barrels per day, and that further reductions are possible unless the U.S. and EU abandon the sanctions process. The move reduces spare capacity below half-a-million barrels per day. Oil prices spike to $145. When Venezuela announces it will join Iran by matching its production cut, oil prices climb to $160. The whole simulation covers four months.

By the end of *Oil ShockWave*, events have disrupted 1 percent of world oil production—hardly an inconceivable shortfall given the threats directed at the world's far-flung oil production and distribution network. As for the geopolitical and economic impacts, they, too, were vetted by experts for realism, but that doesn't make them any less frightening: oil prices reach $160 per barrel. Gas prices soar to over $5.00 per gallon. Double-digit inflation ensues, and the U.S. and world economies teeter on the edge of recession.

I want to stress that *ShockWave* is not a prediction of the future. It is a simulation that demonstrates how an oil crisis could develop. But the scenario is based on facts—and dangers—that are already exist today. This realistic approach is not surprising given the expertise of the people who consulted on different aspects of the simulation:

Bruce Averill, Senior Coordinator, Critical Infrastructure Protection Policy, U.S. Department of State
General Ronald Bath and **Jaime Taylor,** The RJ Bath Group
Kara Baynton, Senior Energy Analyst, ARC Financial
Rand Beers, former Special Assistant to the President and Senior Director for Combating Terrorism
Paul Domjan, Director, John Howell and Company
David Frowd, former Head of Strategy and Planning in Shell's Upstream Headquarters
Richard Haass, President, The Council on Foreign Relations
Randall J. Larson, Director, The Institute for Homeland Security
Dr. Kimberly Marten, Department Chair, Political Science, Barnard College, Columbia University
Ronald E. Minsk, Counsel, Alston & Bird LLP
Daniel Poneman, Principal, The Scowcroft Group
David Sandalow, Senior Fellow, The Brookings Institute
Peter Tertzakian, Senior Energy Economist, ARC Financial
Jeff Werling, Executive Director, Inforum, University of Maryland Department of Economics
Robert F. Wescott, President, Keybridge Research LLC

Lessons of *Oil ShockWave*

It is useful to review some of the key points that I took away from *Oil ShockWave*.

First, there is really no such thing as 'foreign oil.' Oil is a fungible global commodity. Thus, a change in supply or demand *anywhere* will affect prices *everywhere*.

Second, oil markets are currently precariously balanced. As a result, even small disruptions can have dramatic effects. This means that a supply shortfall of approximately 1 percent could cause prices to surge.

Third, the price of crude oil may rise quickly as a result of a supply shock, especially when spare capacity is tight. It will not necessarily take much time to go from $90 to $160.

Fourth, once oil supply disruptions occur, little can be done in the short term to protect the U.S. economy from its impacts. There are few good short-term solutions. For instance, efforts to restrict America's driving habits through speed limits or bans on driving raise difficult questions about enforcement and, even if successful, their impact would be limited. As *Oil ShockWave* makes clear, such measures would be at odds with political calculations that are seemingly ever-present in today's highly partisan Washington atmosphere.

Fifth, there are a number of supply-side and demand-side policy options available that would significantly improve U.S. oil security. Stronger fuel-economy standards, increased domestic oil production, and responsible development of alternative fuels and infrastructure are the most effective steps we can take, but their impact will not be felt for at least a decade.

Sixth, foreign policy and military responses are limited, because oil dependence is major constraint on strategic flexibility. This is true for the U.S. and even more so for many of our major allies.

Seventh, the Strategic Petroleum Reserve (SPR), the emergency supply of federally owned crude oil stored in underground salt caverns, offers only limited protection against a major supply disruption. The *ShockWave* cabinet had to be concerned that any announcement of a release of oil from the SPR could actually contribute to an increase in oil prices by sending the message that U.S. government was declaring the onset of a crisis. Also, the military leaders objected to using the SPR for domestic purposes, arguing that it should be kept in reserve for use by the armed forces.

Finally, the stability of the entire oil-based global economy is currently dependent on Saudi Arabia's ability to increase production dramatically and over a short timeframe. But Saudi spare capacity may be completely absorbed by surging oil demand from countries like China and India. If that happens (and many indicators point in this direction), the global oil market will be especially fragile.

Last Thursday, at the conclusion of the simulation, former Treasury Secretary Robert E. Rubin credited *Oil ShockWave* with demonstrating "the critical importance of preventative action in mitigating the risks of oil dependence." This is a vital lesson. If, or rather, when the U.S. is faced with the next oil crisis, there will be no easy answers. Short-term responses such as tapping the Strategic Petroleum Reserve or implementing emergency demand measures are likely to be insufficient. Long-term policy options such as improving fuel economy, boosting domestic oil production, and promoting alternative fuels will be years away unless we set them in motion today.

Conclusion

In conclusion, let me tie things back to the policy objectives of the Committee: improved security will require greater conservation as well as increased production of petroleum and alternatives here at home. If we put these measures in place before a crisis hits, we will be less susceptible to being whip-sawed by events. We will not have to be on a hair-trigger for major military involvements. And we will be in a much better position to break the cycle of increasing oil dependence followed by increased deployments of major U.S. forces into volatile and underdeveloped regions where they are often poorly matched to the mission of oil security.

Having witnessed the attacks of September 11, 2001, we know all too well the cost of failing to address national security threats on our own terms, rather than those of our enemies. America's oil dependence threatens the prosperity and safety of the nation. Continued policy paralysis is unacceptable precisely because we can take action to improve our energy security.

The President and Congress must immediately implement a long-term strategy for reducing America's oil dependence. This is a grave national and economic security issue that demands the attention of our leaders from both parties. And responsibility cannot stop there. All Americans must become more aware of the dangers of oil dependence and more involved in efforts to address this vulnerability.

Energy security cannot be purchased with easy answers. Despite the promise of alternatives, America cannot hope to grow enough biofuels to obviate the need for improved fuel economy. Nor can we expect to derive security from vague promises of *leap-ahead* technologies. A new consensus must be forged on the anvil of tough choices using proven policy solutions. To this end, both political parties must move beyond the half-measures that have long stalled the pursuit of real energy security.

To minimize oil dependence and its associated national security risks, both political parties must discard the dogmatic approaches that have long hampered the pursuit of energy security.

Those who oppose further oil exploration in the United States must recognize that the failure to press forward with the environmentally responsible development of domestic energy resources exacerbates the dangers of oil dependence. Refusing to develop secure sources of domestic production leads to an unnecessary over-reliance on imported oil, much of which flows from less stable parts of the globe. Aside from amplifying the potential risk of a supply interruption, the preference for imported oil unnecessarily transfers billions of dollars of the nation's wealth to foreign lands.

Those who oppose vehicle fuel-economy standards must accept that the free market has not—and will not—adequately motivate the investments necessary to protect the nation in the event of an oil crisis. As such, mandating improvements in the fuel economy of our cars and trucks is one critical and unavoidable step that Americans must take if we are to halt our national descent into unmitigated oil dependence.

Congress is now negotiating the contours of a national energy bill in conference. As that bill is finalized, it is important to stress a key point: reforming and strengthening the Corporate Average Fuel Economy (CAFE) system is the single most important step we can take to reduce oil dependence.

To its credit, the Senate has already approved a proposal dramatically improving fuel-economy regulations. Rather than maintaining the one-size-fits-all corporate average that hampers the existing CAFE system and burdens Detroit's Big Three, the Senate voted in favor of flexible standards that will allow each automaker to maximize competitive advantages while ensuring steady increases in the fuel economy of the entire fleet of new vehicles. By raising the fleet-wide fuel economy of new cars and trucks to 35 mpg by 2020, these new standards could save the U.S. one million barrels of oil per day in just over a decade. That's about the same as the oil shortfall that was involved in the *Oil ShockWave* simulation. Oil savings would continue to rise after 2020, perhaps reaching three million barrels per day by 2030. That would mean vastly increased energy security for our children and grandchildren.

This Senate has put forth a sound legislative proposal that will boost energy security for decades to come. Furthermore, the President has already indicated support for reforming fuel-economy standards and increasing them by 4 percent per year, a rate that is actually faster than the one contained in the Senate's proposal. It is time for Congress to approve a comprehensive and meaningful energy bill that the President can sign.

Thank you.