



# **U.S. GEOPOLITICAL CHALLENGES AND OPPORTUNITIES IN THE ERA OF LOWER OIL PRICES**

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### Cover Photo

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## Executive Summary

Since late 2014, new oil supply and Organization of the Petroleum Exporting Countries (OPEC) decisions have pushed global prices down and ushered in a new era of energy abundance. Even as oil prices remain lower, U.S. shale producers have continued to contribute to global production and to add marginal supply whenever prices move up slightly. Furthermore, even as supply has increased, improved energy efficiency has reduced demand growth. Combined with difficulties in coordinating production cuts, these factors will likely keep the market sufficiently supplied going forward and maintain the lower prices, the recent rebound notwithstanding.

These developments have reset the connection between energy and geopolitics. Today, producers, not consumers, are bearing the primary risks in the new geopolitics of energy. For oil consumers, lower crude oil prices will reduce the tensions from supply uncertainty. Furthermore, moving away from a scarcity mindset can broaden energy and foreign policy options.

The United States, as a major consumer and a resurgent producer, is benefiting from this shift. Declining energy security tensions among large Asian consumer countries could open opportunities for U.S. engagement. Similarly, lower oil prices could set the stage for positive evolution in the Middle East as countries like Saudi Arabia are incentivized to refashion their oil-dependent economies.

The shift in power balance from producers to consumers will also create new challenges for the United States. U.S. policymakers will have to find ways to support producer countries facing instability in an era of declining oil revenues. U.S. adversaries are taking advantage of this new uncertainty. Russia, for example, has used offers of budgetary support to extend its reach into unstable countries like Venezuela.

Lower prices will upend geopolitics globally. The changes are seen particularly clearly in three geographic areas:

- *Russia*: The new era of lower oil prices is a challenge to Russia and will moderately increase its dependence on outside investors for its energy industry, even as it allows Moscow to maneuver for influence in cash-strapped countries plagued by instability.
- *The Middle East*: Lower oil prices have created the opportunity for some level of U.S. disengagement from the Middle East. In the newly well-supplied global market, the necessity to intervene in the Middle East to maintain stability and quash price

swings driven by geopolitical risk has decreased. However, the United States' interests in the region go well beyond energy, and Washington still needs geopolitical stability in the Middle East to achieve its goals.

- *South and East Asia*: The two big rising Asian powers – China and India – are enormous beneficiaries of this new economic reality. For large-scale energy importers, low prices and more resilient supplies have almost no downsides. On the geopolitical side, China – as the more advanced country – has been able to take greater advantage of the new context than has India, though New Delhi appears to be moving to catch up. The United States needs to monitor developments in the region and be prepared to work with both countries on how to best capitalize on this new abundance.

To confront a changed energy geopolitics environment, the United States will need new economic and diplomatic strategies. The United States is well placed to capitalize on these opportunities through a three-pronged approach:

- *Refocus energy diplomacy*: Lower oil prices will require rethinking the foreign policy certainties of the past. To start this process, the National Security Council should initiate an inter-agency analytical exercise, coordinated by the National Intelligence Council, focused on understanding:
  - » How Russia is cultivating new influence abroad through energy ties, including how U.S. policy should create new economic options for energy-exporting countries so they have alternatives to Russian investment
  - » Whether or not China's Belt and Road Initiative (BRI) is likely to move in a more mercantilist and anti-Western direction
  - » Whether efforts by Saudi Arabia and other key energy-producing U.S. allies to adapt to a post-oil world will succeed.
- *Ensure global market stability through continued global engagement*: The United States must keep oil markets open and ensure geopolitical stability worldwide to prevent price shocks or major supply adjustments. For this reason, the United States should not rely on its newfound energy abundance to reduce its global engagement. In the Middle East, it must recognize its continuing interest in the region's stability. On BRI, the United States should work to

shape the project with China rather than simply countering it, noting that such engagement benefits U.S. allies. Specifically, the United States should cooperate with China where there are mutual interests, while working to evolve Beijing's investments toward greater transparency and sustainability. In countries facing budget instability, the United States must support economic diversification as a means of precluding capital injections from U.S. adversaries like Russia.

- *Lead efforts to fight climate change:* To keep employing energy diplomacy in an era of lower oil prices, the administration should engage in global efforts that address climate change. Such sustained engagement should continue regardless of the administration's sentiments on the Paris Agreement. A clean energy future will depend on an open supply of newly key resources like rare-earth minerals and heavy metals. The U.S. administration should engage with resource-rich countries to protect open investment environments and stable access to those resources.

## Introduction

It has been three years since global oil prices collapsed on the back of market oversupply from U.S. shale production and Saudi Arabia's Organization of the Petroleum Exporting Countries (OPEC)-backed decision not to intervene to curb supply.<sup>1</sup> In January 2014, the spot Brent crude price, the major international crude oil benchmark, was \$108 per barrel; by January 2016, it reached a low of \$26. Throughout 2017, even as OPEC and other oil-producing countries cut production to try to force a price recovery, prices increased but remained well short of recent previous highs. The global benchmark has stayed above \$60 per barrel, while the U.S. benchmark has also risen, but not too far beyond 2015 levels.<sup>2</sup> In fact, in the face of global growth and increasing geopolitical risk, prices have remained notably low.

This generally lower-price period is likely to be long-lasting. Even as a number of national oil companies face declining production and prices remain resiliently low, U.S. shale producers have proven that they will remain a formidable part of the global supply pool and that they can keep adding marginal production when prices move up slightly. Additionally, improved energy efficiency is moderating demand growth. These factors, combined with difficulties in coordinating production cuts, have led to the expectation that the market will remain sufficiently supplied for some time to come. The Energy Information Administration's Short-Term Energy Outlook projects a stable Brent price of around \$62 per barrel in 2018.<sup>3</sup> The February 2017 International Energy Agency (IEA) Oil Market Report concluded that though demand was expected to strengthen in 2018, non-OPEC supply could more than offset it, preventing further price appreciation this year.<sup>4</sup> Numerous forecasts by financial institutions and news organizations echo these conclusions. Citigroup's commodities research offers a bearish forecast, with both Brent and West Texas Intermediate prices averaging below \$55 in 2018 with further downward pressure in 2019.<sup>5</sup> Even the relatively bullish forecast by Goldman Sachs sees prices, after a brief period over \$60 per barrel, declining through 2020.<sup>6</sup> Market-wide surveys agree with these price ceilings. A late December 2017 Reuters poll projected average 2018 Brent crude prices at \$59.88 and average 2018 WTI prices at \$55.78.<sup>7</sup> Likewise, a December Wall Street Journal survey found that banks similarly believed prices would hold between \$50 and \$60.<sup>8</sup> A Deloitte poll found that two-thirds of oil executives surveyed did not see prices breaking \$70 in the United States until at least 2020. The annual survey by Reuters columnist John Kemp places prices in the \$60–\$70 range through 2020.<sup>9</sup>



In this environment, many international oil companies are shelving the most cost-intensive projects in their investment portfolios. Rather than the “lower for longer” scenario that observers first assumed characterized the slower-than-expected price recovery after 2014, producers and consumers are now adjusting to the possibility of a “lower forever” world. Changing demand signals match these new supply constraints. The international focus on climate change, especially the commitments made under the Paris Agreement, will put downward pressure on demand for fossil fuels in general. Government incentives and private sector support for investment in electric vehicles will affect demand in the transportation sector, the primary driver for oil demand.

This new outlook is changing the geopolitics of energy as the risks shift from consumers to producers. For oil consumers, low crude oil prices extending for years to come will reduce the long-standing tensions that have historically arisen from uncertainty around the supply and availability of oil. China, for example, is moving away from oil-focused investments in danger spots throughout the world. Instead, it has grown comfortable with the energy security offered by buying supplies in a global open market. Furthermore, moving away from a scarcity mindset will create opportunities for new policies and innovative energy and foreign policy. The United States,

## **Rather than the “lower for longer” scenario, producers and consumers are now adjusting to the possibility of a “lower forever” world.**

as a major consumer and a resurgent producer, stands to broadly benefit from this shift, as the authors have argued in recent CNAS reports.<sup>10</sup> As a rising exporter, it can contribute its own production to supply stability and reassure its allies and partners of its reliability as a counterpart, given its track record of not unilaterally limiting energy trade for political reasons. Declining tensions among the large Asian consumer countries over energy security issues could create substantial opportunities for innovative U.S. policy change. A burgeoning consumer–producer relationship between China and the United States can tie the two competitors into a less adversarial stance.

However, in some circumstances, new kinds of low-oil price tensions will emerge and require a rethinking of U.S. strategic priorities around the world. Now is the time to plan for how to reap the benefits of these market developments, as well as reduce geopolitical risk.



*Changes in global oil demand patterns, such as the advent of electric vehicles like the one pictured above, may be ushering in a “lower forever” scenario. (Miles Willis/Getty Images)*

## New Geopolitical Challenges

The era of lower oil prices will contribute to a reshuffling of the system of alliances and producer–consumer relationships that have been the cornerstone of oil geopolitics since 1973. At that time, an OPEC embargo – instituted when a core of Arab producers, led by Saudi Arabia, sharply cut production to increase prices and take power away from the then-dominant major international oil companies – was a major disruptive event. Today, new centers of supply, especially the U.S. shale patch – which, since the 2015 repeal of the crude export ban, can directly reach a global market – are enabling greater flexibility and possibilities in foreign and security policies. International sanctions against Iran were made possible by their limited effects on price due to increased U.S. output, which lessened the cost for several countries that had been large purchasers of Iranian crude. Oil sanctions on Russia were seen as economically feasible to Europeans and Americans in part because of the supply flexibility and alternatives available from the U.S. oil patch.

For China, the world's largest oil importer, the shift to lower prices has also been a major boon. For most of the past two decades, one of the principal aims of China's foreign policy has been to reduce the risks around oil availability by purchasing production assets and establishing close ties with the governments of oil-producing countries, especially those not allied with the United States. But the new oil market dynamics have eased China's fears of energy vulnerability and freed it to more aggressively pursue its broader aims of becoming

the dominant actor in Asia and a rival to the United States for global influence. Yet, at the same time, China and the United States have an opportunity to build a strong bilateral relationship around their shared interests in a well-supplied, secure global energy market. Beijing could see the U.S. abundance of oil and natural gas as a strategically important source of stability for global energy markets.

**The era of lower oil prices will contribute to a reshuffling of the system of alliances and producer–consumer relationships that have been the cornerstone of oil geopolitics.**

This flexibility is also evident with other regional powers. India, a close U.S. strategic and economic partner, began receiving shipments of U.S. crude for the first time in September 2017, expanding the country's options for managing its energy relationships. The export of crude to India is helping to cement a burgeoning bilateral relationship, which has productively focused on energy priorities. States with that level of energy supply flexibility can give themselves more breathing room to pursue new bilateral relationships or avoid making a choice between economic and other foreign policy priorities (as Iran's oil customers were able to do during the multilateral sanctions effort).

Lower oil prices immediately challenge a set of countries with national economies heavily skewed toward resource revenues. These countries had enjoyed windfalls from high prices but did not diversify their economies or build robust institutions to cope with shrinking revenues. Faced with the prospect of declining resource wealth, they are at risk of societal and economic instability. Venezuela is the most extreme example of this downward spiral. Petróleos de Venezuela, S.A. (PDVSA), the state-owned oil company, is responsible for a significant percentage of Venezuela's gross domestic product and tax revenue, but it has seen years of declining production as a result of underinvestment and now faces tremendous challenges to sustain output in the low-price environment.<sup>11</sup> In this context, President Nicolás Maduro has delivered authoritarian policies and faced enormous domestic unrest. The United States responded to Maduro's harsh rule with financial sanctions, and China has pulled back its long-standing financial support, further darkening the country's economic outlook.



*Increased flexibility in an era of lower oil prices has allowed the United States to use its resources to forge closer ties with partners like India. Pictured here, Texas Governor Greg Abbott is handed a cargo manifest for the first U.S. crude oil shipment to India. (Indian Embassy to the United States)*

For prominent producer states, the potential persistence of lower oil prices is forcing decisions that will have economic and strategic implications. The most stunning example of this has been Saudi Arabia, where decades of stasis have given way to a burst of political, institutional, and economic policy shifts as a new generation moves to grab the reins of power. Crown Prince Mohammed bin Salman's Saudi Vision 2030 is a plan to dramatically diversify the economy away from its dependence on oil and create a 21st century developmental state.

In neighboring Iraq, lower oil prices have not caused the same kind of internal reassessment. The challenges facing Iraq have clear energy dimensions. Baghdad has been focused on restoring production while complying with OPEC production quotas and restoring security to encourage international investment. The recent Kurdish referendum led Baghdad to seize oil fields formerly run by the Kurdistan Regional Government (KRG), undermining the autonomy of the KRG and creating conditions for the central government to control all oil exports, including those through the Kirkuk-to-Ceyhan pipeline to Turkey.

As prices remain low, similar challenges will spread to other producers with precarious macroeconomic and budgetary conditions. Cash crunch conditions will enhance risk and instability in some regions and will challenge the United States and other major energy consumers and global powers to adopt new strategies for promoting diversification. Such an effort is much more likely to succeed if it is undertaken while the global economy remains strong, giving producer countries the breathing space to begin to put in place policies to reduce dependence on oil revenues alone.

Washington also will need to think through its interests and strategies for securing the maritime flow of energy and enhancing the resilience of energy infrastructure.

## **Cash crunch conditions will enhance risk and instability in some regions and will challenge the United States to adopt new strategies for promoting diversification.**

Other major consumer countries, especially China and, to a lesser extent, India, will also consider whether and to what extent they become, over time, more involved in guarding sea lanes delivering their oil supply from the Persian Gulf and across the Indian Ocean. It remains to be seen what direct financing, technology, and infrastructure assets they will provide to expand their influence over, and thus contribute to the stability of, the physical and financial energy trading of the future.



*The persistence of lower oil prices is forcing producer states to diversify their economies. The Saudi Vision 2030 plan is a particularly ambitious example. Pictured above is a panel on Saudi Vision 2030 and the United Nations' Sustainable Development Goals 2030. (United Nations Development Programme/Flickr)*

Lower oil prices are also affecting more powerful and economically stable oil-producing countries, especially Russia. Lower oil prices and tensions with the United States and the European Union have pressured Russia's economic growth, encouraging Moscow to pursue more diverse economic and energy relationships with China and countries in the Middle East. At the same time, Russia has sought opportunities in this low-oil price environment with fragile energy-producing allies such as Venezuela. The United States has yet to develop strategies to respond to Russia's offer of emergency financial support to struggling commodity-producing countries. It is unclear for how long Russia could continue such assistance. However, the recent, modest upward swing in oil prices has been enough to allow Moscow to purchase foreign currency to stabilize the ruble, suggesting future Russian fiscal stability.<sup>12</sup>

In an era of lowered U.S. dependence on global energy markets, Washington needs to consider its appetite to provide aid and security to regions roiled by energy price-led instability. These new dynamics affect both short-term emergency aid and long-term development assistance. Since 1945, U.S. security interests in the Middle East have been substantially driven by concerns over the stability and price of the energy supply. The focus in the future may very well be on



whether governments that are important to U.S. interests in the region can both weather the immediate impacts of lower oil prices and, over the intermediate and long term, diversify their economies away from a preponderant dependence on fossil fuel extraction. The inability to do this could complicate other regional U.S. security interests that depend on the cooperation of countries like Iraq and Saudi Arabia, with profound consequences for U.S. foreign policy.

In other regions, vulnerable energy producers already present risks to U.S. foreign policy interests, a trend that could grow more prominent in the U.S. security calculus in the future. Venezuela fits this mold now. The United States might need to address such risks in other important countries, such as Mexico, where energy trade is a cornerstone of relations with the United States; Libya and Nigeria, which are both at the frontlines of the fight against Islamic militant groups like ISIS and Boko Haram; and Algeria. Conversely, the United States will see relief of some international tensions, especially within or among the large Asian consumer countries, which will create opportunities for innovative policy change and a diminishment of political risk. The perception in Beijing that China can benefit from an oil-producing United States weakens a potential friction point between the two major global powers.

## **A persistent lower-oil price environment will also influence how nations think through the transition to a future low-carbon energy mix.**

This paper will highlight the key policy challenges and opportunities that the United States will face in the persistent lower-oil price environment in three key geographic areas: Russia, the Middle East, and South and East Asia. A persistent lower-oil price environment will also influence how nations think through the transition to a future low-carbon energy mix. Despite the temptation to use this new abundance to withdraw from global responsibility, the United States should stay engaged with key partners. In fact, Washington's new position of strength enables the country to effect change. While robust demand for fossil fuels will continue for the foreseeable future, U.S. foreign policy will also have to include consideration of the geopolitical implications of a low-carbon energy future. This paper offers a guide for U.S. policy-makers to consider and plan for the implications of key geopolitical trends in the low-price era.

## **Russia: Risks and Opportunities in an Era of Lower Oil Prices and Sustained Sanctions**

Oil has historically funded the Russian state, while natural gas has provided the majority of its coercive energy export power with Ukraine and other Central and Eastern European countries. Large oil rents have allowed both Russian companies and Russian individuals to purchase significant stakes in projects and businesses around the world and gain influence in regional politics. The new era of lower oil prices is a challenge to Russia and will moderately increase the country's dependence on outside investors for its energy industry, even as it allows Moscow to maneuver for influence in cash-strapped countries plagued by instability.

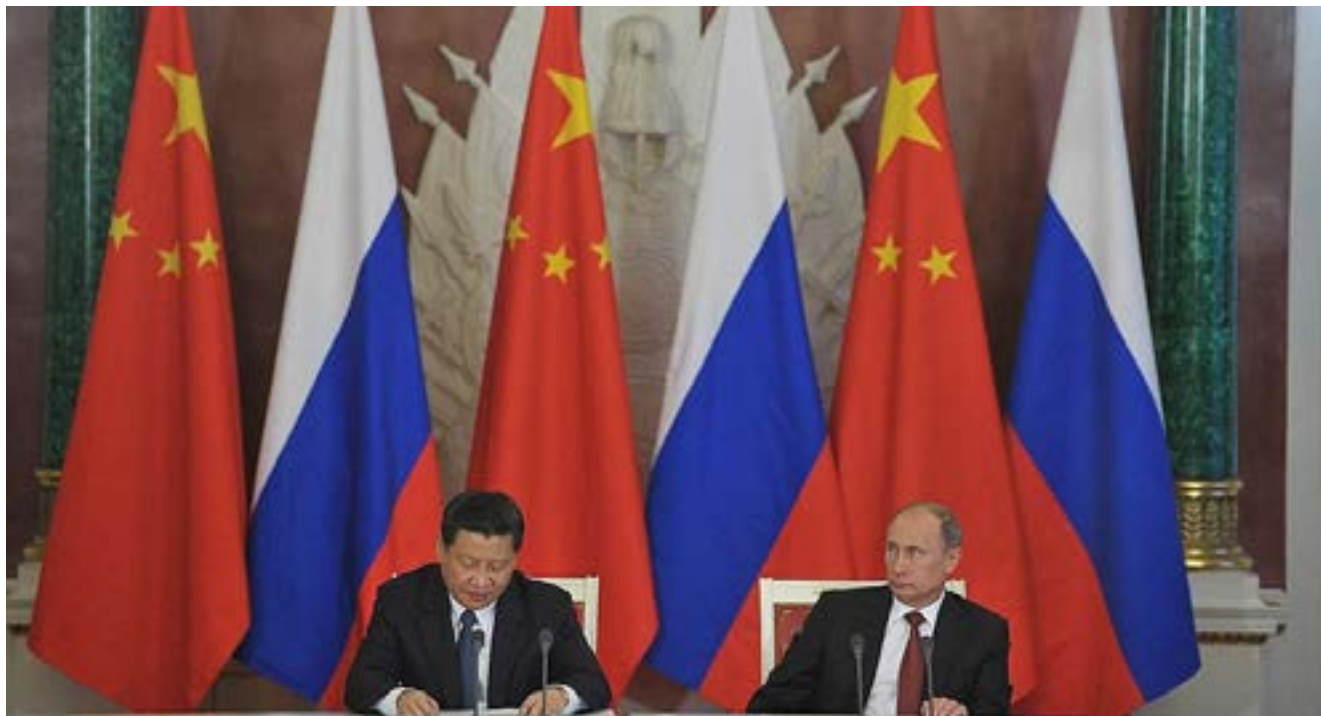
### **Preparing the Russian Economy for Lower Oil Prices**

There is no question that, with the energy sector making up one-third of gross domestic product and providing one-half of the revenue funding its budget at the time of the oil price collapse, Russia has been one of the countries most negatively affected by the oil price bust. But Russia has been able to avoid worst-case economic outcomes by pursuing an effective combination of ruble depreciation, drawing-down of its reserve fund, strong budgetary discipline, and active courting of new energy markets. Nonetheless, Russia's economic outlook remains seriously constrained. Its reserve fund is almost entirely depleted, production in its large legacy fields is falling, and the oil sector requires large-scale investment to replace its reserves.<sup>13</sup> Its production-expansion prospects are concentrated in high-cost, technologically challenging projects that are unlikely to be fully completed in a "lower forever" world.

In addition to these price-driven realities, three additional factors are forcing Russia and its energy industry to look elsewhere for both new customers and the type of large-scale investment needed to fund the complex new wave of Russian oil development. These are U.S.–EU sanctions on Russia, an emerging consensus among developed economies (with the notable exception of the United States) on cutting greenhouse gas emissions, and the declining energy intensity of Europe.

In this context, China has beckoned as a prize for Russian oil producers. Cooperation between the two countries has been growing for decades. However, it was the joint transatlantic sanctions on Russia that led Russian elites to embrace a so-called pivot to Asia.<sup>14</sup> China is important to the Russian energy industry both





*With limited access to Western capital, China has been a key source of financing for Russia, though some have criticized Chinese investors' approach as too "slow-moving." Above Chinese President Xi Jinping meets Russian President Vladimir Putin. (The Kremlin)*

as a customer and as a source of capital. China is Russia's main export destination for oil.<sup>15</sup> In 2016, for the first time, Russia beat Saudi Arabia to become China's top source of oil,<sup>16</sup> a position it solidified in 2017 and expects to grow going forward.<sup>17</sup>

China has injected substantial amounts of capital into the Russian economy. In 2016 and 2017, Chinese companies closed four transactions each worth over a billion dollars in the Russian energy space.<sup>18</sup> Additionally, the two countries agreed to create a joint \$10 billion investment fund, denominated in renminbi (China's currency) and rubles to elude U.S. and EU sanctions, to finance cross-border infrastructure and energy projects.<sup>19</sup> Notably, Chinese firms provided financing in key moments of need. For example, they acquired a stake and offered loans for the sanctioned Yamal liquefied natural gas project after it had been cut off from Western capital markets.<sup>20</sup>

Notwithstanding the collaboration between China and Russia, the relationship is not what Russians might have hoped. Russian businessmen complain that China's slow-moving investment approach has not resulted in an immediate influx of cash.<sup>21</sup> For example, while Chinese firm CEFC China Energy did eventually agree to purchase a stake in Russian state oil champion Rosneft in September 2017, it was the Qatar Investment Authority (QIA), along with Swiss trading firm Glencore, that first

acquired the shares when Russia needed to quickly raise funds in the depressed oil environment in December 2016. China has not backfilled European partners that pulled back from Russia over recent years and has not indicated that it will align its strategic interests narrowly with Russia in a way that would jeopardize its ability to partner with, or balance, other strategic foreign partners. This has been a bitter lesson for President Vladimir Putin and the Russians.

As a result, Russia finds itself still dependent on its role as an exporter to the European market and on Western cooperation. That is why Russia has put significant diplomatic energy into its Nord Stream 2 pipeline project, which would run under the Baltic Sea to transport gas from Russia into Germany. But the project has also become a target for those who want to pressure Russia and seek to scale back Russian-European energy cooperation. Last year, the United States introduced sanctions that could be applied against European companies that participate in Nord Stream 2 and other Russian energy projects in Europe. The European Commission recently proposed new regulations that could render the Russian Nord Stream 2 project unprofitable. Meanwhile, German support for the pipeline may be weakening, although Chancellor Angela Merkel's new government, based on a Grand Coalition of German political parties will likely continue to support its construction.<sup>22</sup>

### Lower Oil Price as an Opportunity for Russian Meddling

Russia's approach to the new lower-oil price world, however, has focused on more than macroeconomic stabilization and attracting foreign investment to Russia. Throughout the downturn, in fact, Putin has adopted an assertive external policy stance, seeking to gain legitimacy at home and influence abroad by going on the geopolitical offensive, especially in states plagued by the twin curses of declining resource revenues and growing instability. Doing so allows Russia to present itself as a mediating influence in local and regional conflicts and gain influence at the negotiating table. In Libya, for example, Rosneft has signed oil purchasing agreements as Russia presents itself as the mediator between the UN-recognized Prime Minister, Fayez al-Serraj, and General Khalifa Haftar, who controls the oil-heavy eastern portion of the country.<sup>23</sup>

In the Middle East, Russia has supported President Bashar al-Assad of Syria. Syria itself is not a major energy producer, but it is situated in the world's most important energy supply region. Russia's play in Syria has made Moscow one of the arbiters of the Syrian civil war and the fight against ISIS. For the United States, Russia's role in Syria has created another point of negotiation between the United States and the European Union on one side and Russia on the other. This adds to existing topics of contention between Russia and the United States, such as the annexation of Crimea, unrest in eastern Ukraine, Russia's violation of the Intermediate-Range Nuclear Forces Treaty, and its meddling in the 2016 U.S. election. As Russia takes more active roles in countries struggling with lower oil prices, it promises to add more issues to this list.

**Putin has adopted an assertive external policy stance, seeking to gain and influence abroad by going on the geopolitical offensive, especially in states plagued by the twin curses of declining resource revenues and growing instability.**

Russia's biggest play in vulnerable energy states has been in Venezuela. Following years of mismanagement, Venezuela's economic and political stability has suffered a precipitous decline exacerbated by the 2014 fall in oil prices. Oil production has fallen 30 percent since



*As protests, pictured above, and unrest in Venezuela have mounted and the economic and political situation has deteriorated, Rosneft has offered investment and funding to the Nicolás Maduro government. (John Moore/Getty Images)*

its peak in 1998.<sup>24</sup> In late 2017, major bond-rating firms downgraded state-owned oil company PDVSA to default status.<sup>25</sup> Meanwhile, delays in payment on Venezuelan sovereign debt risk triggering a default.<sup>26</sup> A January 2018 Bloomberg model gave a one-year default probability of 93 percent.<sup>27</sup>

Russia holds a significant stake in this developing situation. Russia and Rosneft have lent the country at least \$17 billion, including \$6 billion from Rosneft to PDVSA.<sup>28</sup> With each new deal, Russia has acquired additional stakes in the country. Russia has solidified its place in the country in part due to a higher tolerance for risk even while other untraditional investors in Venezuela have balked. For example, China, which has lent as much as \$62 billion to Venezuela since 2005, has generally refrained from criticizing Maduro's regime<sup>29</sup> but has curtailed its involvement in the country following slow repayment, corruption, and mistreatment of its firms.<sup>30</sup>

Today, Rosneft is one of the major players in the country and is looking to expand its role. As Rosneft

CEO and former Russian Deputy Prime Minister Igor Sechin has stated, “Rosneft will never leave Venezuela.”<sup>31</sup> Downstream, Russia’s importance is even more marked. As of August 2017, Rosneft was selling about 225,000 barrels per day of Venezuelan oil, approximately 13 percent of the country’s oil exports.<sup>32</sup> As part of a \$485 million loan from Rosneft in 2016, PDVSA used a 49.9 percent stake in subsidiary Citgo as

## **Rosneft CEO has stated, ‘Rosneft will never leave Venezuela.’**

collateral. Citgo owns significant assets in the United States, leaving open the possibility of a U.S.-sanctioned Russian company owning major U.S. domestic mid-stream and downstream assets if PDVSA cannot pay its notes (although Rosneft has expressed interest in exchanging this high-risk collateral for additional upstream rights in Venezuela).

The August 2017 U.S. financial sanctions on Venezuela and the subsequent targeting of specific individuals, aimed at curtailing the country’s access to finance in response to a crackdown by Maduro on protests following his centralization of power, increased the country’s need for Russian financial support to keep itself afloat. This gives Moscow more opportunities to deepen its role in the country, but at the same time it will make Putin more vulnerable to accusations of throwing good money after bad and will add to the risk of a dramatic loss of influence should the regime fall.

### **Russia and Iraq**

Russia has also deepened its involvement in Iraq, including its relationship with the KRG, in the lower-oil price era. Since the fall of Saddam Hussein, the KRG has tried to establish greater independence, and oil production has offered it a potential way to achieve this goal. Faced with lower oil prices and high costs to protect production (security for operations can be as high as 30 percent of foreign investment), the KRG is a risky bet for outside money.<sup>33</sup> In addition, a bad track record in fulfilling commitments to foreign investors has made finding funds a more challenging process for the KRG.<sup>34</sup> Here, Russian companies’ tolerance for high risk has placed them once again in the middle of a major geopolitical debate. To help the KRG solve a missed-payment dispute with Dana Gas, a United Arab Emirates producer, Rosneft lent the government

as much as \$3 billion, including a 20-year prepayment scheme that promises to keep Russia present in the regional economy over the long term.<sup>35</sup> Gazprom Neft, the oil subsidiary of Russian state natural gas company Gazprom, has considered additional investment in the region.<sup>36</sup>

In October 2017, Iraqi military forces seized the Kurdish-held city of Kirkuk and its surrounding oil fields. As in Syria, Russia has presented itself as a mediator and a counterweight to the influence of the United States. But, like Washington, Moscow has had to balance its sympathy to Kurdish aspirations with its continuing support for Iraq as an entity. And given Baghdad’s success in gaining control of much of what had been the KRG’s oil supplies, the viability of the KRG’s Russian debts have become more problematic.<sup>37</sup>

The longer oil prices remain low, the more likely it will be that producer countries unable to adjust or reform will face growing instability. With increased experience at intervening in such situations, will Putin’s Russia continue to be eager to play a role? Putin’s Syria venture, in which Russia’s main tool was military, is clearly and rightly seen in Moscow as a success. In both Venezuela and the KRG, Russia’s main role was financial, and the outcomes appear to be much less clear-cut. At a moment when many U.S. policymakers are skept-

## **At a moment when many U.S. policymakers are skeptical about future foreign security involvement, it would be counterproductive if they also ceded foreign influence to Russia in the soft power realm of economics and finance.**

tical about future foreign security involvement, it would be counterproductive if they also ceded foreign influence to Russia in the soft power realm of economics and finance. If the United States pulls back, more countries will look to Russia or China as a lender of last resort. Increased ties to these U.S. competitors will complicate Washington’s geopolitical picture. The United States should not let its newfound energy abundance distract it from building long-term connections with countries facing difficult political and economic choices.



## The Middle East: Geopolitical Hedging, Regional Conflict, and Saudi Upheaval

In the early months of 2014, in the aftermath of OPEC's decision not to cut production in the face of falling oil prices, Saudi Minister of Petroleum Ali al-Naimi reiterated his expectation that the dramatic price drop would be short-lived and would be followed by a V-shaped price recovery. That did not occur. There is little doubt that the Saudi royal family and political establishment were unprepared for the sea change in global oil markets. That shock, along with President Barack Obama's signing of the Iran nuclear deal less than a year later, undermined both of the main pillars of Saudi regime self-confidence: the kingdom's role as market-maker in oil, and its long-standing alliance with the United States dating back to President Franklin Roosevelt's meeting with King Abdulaziz Ibn Saud in February 1945.

### Low Prices Reshape Engagement in the Middle East

This paper has already discussed how changing market forces enabled oil sanctions against Iran to be highly effective, even before the 2014 price collapse. They also shaped both Iranian and Saudi actions in the run-up to the 2015 Iran nuclear deal. When Saudi Arabia decided to protect its market share in the fall of 2014, it was substantially motivated by the expectation that a nuclear deal with Iran might be forthcoming and that Saudi Arabia should not be enabling a successful Iranian market re-entry by restricting its own production and sustaining higher prices. For Iran, one of the elements creating pressure to come to an agreement in 2015 was the growing competition among oil producers and the rising costs of not being able to get back into the oil game.

More broadly, the oil price collapse, and the attendant imbalance of excess supply, has meant that the rising instability in the past several years in the Middle East – from the creation of ISIS' caliphate to the intensification of Shia–Sunni tensions and the emergence of Iran vs. Saudi proxy conflicts to the civil war in Syria to the feud between Qatar and Saudi Arabia/United Arab Emirates – has broken one of the strongest patterns in international political economy in recent decades: When Middle East tensions rise, oil prices rise with them, undermining global economic confidence and putting downward pressure on global growth. That is not what the market has seen in the past few years. Today's upward pressure on oil prices is caused by the strongest global economy since the 2008 financial crisis and growing confidence

in the sustainability of that growth, and it has little to do with Middle East tensions.

Lower oil prices have created an opportunity for some level of U.S. disengagement from the Middle East. In the newly well-supplied market distinguished by lower oil prices, the necessity to intervene in the Middle East to maintain stability and quash price swings driven by geopolitical risk has decreased. A no-longer-tight market, therefore – combined with increased domestic shale production and lower Middle East imports – requires less U.S. stabilizing intervention abroad. Indeed, beginning after President Obama failed to enforce his red line in Syria in the summer of 2013, the view that the United States was pulling back from regional commitments came to be widespread throughout the Middle East, in capitals with extremely diverse interests and orientations including Riyadh, Tehran, Damascus, Tel Aviv, Cairo, and Ankara. While the U.S. intervention against ISIS began to put a brake on this belief, it reemerged strongly after the Russian military intervention in Syria in 2015. Candidate Donald Trump's rhetoric, critical of U.S. allies and negatively portraying Muslim immigrants, reinforced this view, though as president he has put considerable effort into reassuring Middle Eastern allies of continued American support.

**Lower oil prices have created an opportunity for some level of U.S. disengagement from the Middle East.**



*President Donald Trump, pictured above with Saudi Crown Prince Mohammed bin Salman, has put considerable effort into reassuring Middle Eastern allies of continued American support, even as lower prices have created opportunities for disengagement. (Mark Wilson/Getty Images)*



But the perception of the United States walking away from the Middle East, even if widespread in the region, is almost certainly overstated. The United States' interest in the Middle East has never been narrowly focused on oil. Issues of terrorism, nuclear proliferation, Iran as a threat to the regional order and beyond, and broad-based support for Israel all remain. Even in the energy sphere, while the United States is no longer dependent upon the direct flow of Middle Eastern oil, the world economy is. Moreover, U.S. economic vitality depends upon a strong world economy. Thus, while the United States might be less tied to particular regimes, it is unlikely to be exiting the Middle East anytime soon. But perceptions often count as much as or more than reality. And a powerful perception in the region is that, as a result of low prices, the United States has less at stake in the region and is pulling back.

One result of the perception of lack of U.S. interest and possible withdrawal has been growing hedging efforts by Middle East countries with both Russia and China. Middle Eastern energy producers have emerged as an important source of cash for the Russian

a central role in building consensus and enforcing compliance from other countries. This rapport has even allowed the two countries to paper over their roles supporting different sides in the conflict in Syria. In October 2017, in the first-ever visit by a Saudi monarch to Russia, King Salman bin Abdulaziz Al Saud reaffirmed the relationship, reiterated the two countries' commitment to supply cuts, and supported the signing of various memoranda of understanding between the Saudi national oil company, Aramco, and Russian companies including Gazprom Neft and privately owned petrochemical company Sibur.<sup>41</sup>

Parallel with these moves, the Saudis have sought to bolster Western and Chinese financial interest in their economy as a means of compensating for their loss of influence as a result of the decline of oil producer power and leverage. The principal instrument for this strategy is the proposed sale of 5 percent of Aramco. Selling shares to U.S., European, and Chinese investors is designed to increase the stake of major powers in preserving stability in the kingdom and to increase the diversity of inbound investment. The Saudis originally planned to accomplish this through an international initial public offering (IPO)

## **The Saudis have sought to bolster Western and Chinese financial interest in their economy as a means of compensating for their loss of influence as a result of the decline of oil producer power and leverage.**

economy – and a source of cash more amenable to quick, politically driven and strategically motivated transactions. The degree of involvement of national leaders in deals between Russia and the Middle East attests to the highly political nature of these transactions. As part of the QIA–Rosneft transaction, President Putin awarded Russia's top state honor to the emir of Qatar.<sup>38</sup> In addition to the QIA–Rosneft deal, Russia's sovereign wealth fund has partnered with major Middle East investment funds, including Abu Dhabi's Mubadala, Qatar Holding, and Saudi Arabia's Public Investment Fund, the sovereign wealth fund controlled by bin Salman, to finance projects in Russia.<sup>39</sup>

Since 2016, motivated by the lower oil price environment, OPEC has been cooperating with Russia in capping production to draw down extensive global inventories and raise energy prices. The relationship between Russia and Saudi Arabia has been particularly strong. The two countries are the biggest producers within the so-called OPEC+ group, and both were leaders in spearheading stated production cut targets in 2017, though Russia lagged behind Saudi Arabia.<sup>40</sup> Together, they have played

in either New York or London, in order to set the stage for Riyadh becoming a much more influential actor in global financial markets.

But difficulties in sorting out the financial operations of Aramco and limited enthusiasm among potential buyers have led Riyadh to consider a plan B: some sort of “private placement” to a consortium comprising at least one of China's main international oil companies and one or both of China's sovereign wealth funds. Such a deal would be easier to accomplish given the comfort in Beijing with deals that include an overtly geopolitical element, as well as a much lower bar in terms of transparency. The downside of the Chinese “private” alternative is that it would not include a Western element and would not send a signal to markets of the kingdom's role as a major modern financial player. The Saudis are now reportedly considering doing an IPO in Hong Kong that would include a “private placement” component.

Recent events in Saudi Arabia have underscored the scale and political urgency of Crown Prince Mohammed bin Salman's reform efforts. The Aramco listing would be a prelude to building the Public Investment Fund into

the world's largest. In early November, dozens of ministers, royal family members, officials, and senior military officers were detained as bin Salman sought to remove the potential obstacles to his initiatives. While this was predominantly an effort to consolidate power on the part of the crown prince, the regime was also attempting to "claw back" ill-gotten wealth to ease the budget burden engendered by lower oil prices. Saudi officials have said that the target in this regard is \$100 billion.

The broader aim of the new Saudi regime appears to be to augment the waning power it derives from being at the center of global oil production in a lower-oil price world by monetizing its energy resources to become a major global financial actor, and on that basis to transform the Saudi government into a development-focused state along Asian lines, wherein the central government prioritizes the promotion of a robust private sector as a priority for macroeconomic growth. One key element of this is breaking the link between the royal al-Saud extended family and the government budget, a second is to remove the many restrictions on women in society and the workforce, and the third is to return the kingdom to

**The broader aim of the new Saudi regime appears to be to become a major global financial actor, and on that basis to transform the Saudi government into a development-focused state.**

"moderate" Islam. This will be a tall order for a society not known for tolerating rapid change. The privileged status of the royal family and the Wahhabist clergy have been long-standing features of Saudi society. These objectives are driven by the Saudi realization of the financial realities of persistent lower oil prices interacting with regional and global geopolitics, especially the need to counter Iran's desire for greater influence and the desire to improve the relationship between Saudi Arabia and the United States.

The United States has spent decades building a Middle East security architecture, in large part to protect its own access to resources. Even in an age of abundance of hydrocarbon resources, it still has direct national security interests in protecting that architecture, whether supporting Saudi reform efforts, protecting the sovereignty and stability of Iraq, or reducing the tensions arising from Iran's destructive regional activities. Continued engagement in this region will remain a foreign policy imperative.

## China, India, and the New Asian Geopolitics of Energy

Unlike Russia and Saudi Arabia, which are both facing very tough challenges in coping with the negative consequences of a low-price energy world, the two big rising Asian powers – China and India – are enormous beneficiaries of this new economic reality. For large-scale energy importers, low prices and more resilient supplies have almost no downsides. On the geopolitical side, China – as the more advanced country – has been able to take greater advantage of the new context than has India, though New Delhi appears to be moving to catch up.

In her recent book on energy and global politics, Harvard University's Meghan L. O'Sullivan captures the scale of the economic benefit to China in one statistic: "China's daily oil import bill at the end of 2016 was roughly \$400 million less than it was 18 months earlier for the same amount of oil."<sup>42</sup> The gains for India have been proportionally similar. For both countries, the world's largest and third-largest oil importers respectively, low prices have substantially mitigated the impact of the weak global recovery in recent years, enabling them to sustain high rates of economic growth.

Equally important, the new lower-priced energy world has reduced fears that China and India would be directly competing for energy resources in a world of increasing energy scarcity. While in recent years China has increased the military gap between itself and India, Beijing remains concerned about India's expansion of its naval power in the Indian Ocean, as both powers compete to build naval infrastructure (ports) throughout the region.<sup>43</sup> Broadly speaking, the shift in the oil market has eased some, but by no means all, of the biggest fears around conflict in the Indian Ocean.

These new realities in the energy markets have had a big impact on China's external policies. As China's urban development efforts hit full stride in the early 2000s and oil import levels began to sharply rise, Beijing began to focus its external efforts systematically on securing reliable sources of oil as a major national security goal. This desire led directly to the massive increase in China's engagement with Africa and a growing interest in Latin America. This included support for a number of non-democratic regimes – Sudan and Angola in Africa and Venezuela in South America. According to Erica Downs, an expert on China's national oil companies, these firms spent an average of \$20 billion a year on foreign upstream acquisitions from 2009 to 2013.<sup>44</sup> Many of those investments were made in countries that could rely on China's protection from international scrutiny.



*China remains concerned about the expansion in Indian naval power and has sought to build its own ports in the region. Pictured above, the Chinese-operated Gwadar Port in Pakistan. (Umargondal/Wikimedia Commons)*

While China's need for large imports of oil and gas will not diminish in the near future, several factors will blunt its fears about scarcity of supply. These include the end of the urbanization-driven building boom and a shift to a more consumer-based economy, a strong push on the energy efficiency side slowing demand growth, and the United States' shift from the world's largest importer to an oil and gas exporter. Each of these factors has taken

**At a time when China is moving away from some elements of market-based reform domestically, its confidence in the energy markets is increasing.**

away much of Beijing's anxiety around its energy vulnerability. As a result, China has been able to move away from what, despite its "offensive" appearance, was in fact a quite defensive external posture. China saw itself vulnerable to either competition for limited global supply or some kind of U.S. effort to use its naval control of the sea lines of communication linking China to Middle East producers. Either might undermine domestic economic growth and with it political legitimacy. While these fears

have not completely disappeared, they are no longer top of mind in Beijing. Importantly, at a time when China is moving away from some elements of market-based reform domestically, its confidence in the energy markets is increasing.

### **Energy and the Belt and Road Initiative**

The most important expression of this shift is the increasing importance being given to China's Belt and Road Initiative (BRI), which President Xi Jinping inaugurated in 2013 to bring economic interdependence and security to some of the world's most persistently unstable countries and regions. At the recently completed 19th Congress of the Chinese Communist Party, BRI was enshrined in China's constitution as one of the country's major defining ambitions. When the initiative was first announced, its emphasis on energy infrastructure development was seen very much in terms of continuity with China's commercial diplomacy beginning early in the last decade. Many factors have fed China's ambitions in proposing BRI. The lower-oil price environment makes it more feasible from the Chinese perspective, because Beijing can use resources it would have otherwise dedicated to securing overseas energy assets to translate this plan into reality.

Thus, BRI's focus on energy has much more to do with enabling Central Asian countries to address their



own energy needs (and, as a consequence, bringing them under Chinese influence) rather than a continuing quest for natural resources to feed China's needs. It envisions nothing less than the creation of a "community of common destiny" in the geographies between Asia and the Middle East and Europe, whereby large-scale investment in energy and infrastructure creates a dynamic for political stability and peace. At the same time, the initiative aspires to create a natural market for the output of China's own excess capacity in processed metals and other materials and goods, as well as an outbound destination for Chinese finance that cannot find reliable, productive returns at home. While the existing project pipeline is a small proportion of what is planned on paper, China's ambitions represent a significant opportunity for Beijing to pivot from protecting its own supply chains to building entirely new ones.

Like many other powers before it, China works hard to portray the inevitability of its rise. BRI is part of this effort, as was China's earlier desire to highlight its dramatic growth in foreign reserves (which reached \$4.2 trillion in 2015) as a sort of "great financial wall of China" to counter speculation against the renminbi. These efforts failed as China lost over a quarter of its reserves, almost \$1.25 trillion, between summer 2015 and late 2016 when the country imposed very strict capital controls to stem the outflow of capital. BRI is hardly bound to fail, but, as the United States has experienced around the world in recent decades, development efforts in politically challenging zones require much more than large financial

commitments to succeed. China is proposing investing enormous sums in countries where basic security is fragile or nonexistent.<sup>45</sup> Beijing will need to balance the need to protect its massive BRI investments to its west while simultaneously asserting its presence in the East and South China Seas.

Part of Xi's challenge in promoting BRI is skepticism among China's business establishment, which has been more interested in investing in the United States, Europe, Latin America, and the stable Gulf kingdoms. While Downs has found that China's state-owned oil companies are responsive to pressure to invest in BRI geographies (partially in order to sustain their ability to invest elsewhere as well), private businesses have been holding back.<sup>46</sup> In response, China has introduced far more guidelines for outward investment by Chinese firms, even if the financing for such investments is originally sourced from resources held outside of China.

The implications of the new lower-price environment are increasingly entering the U.S. foreign policy debate concerning China. O'Sullivan argues that "[i]n this instance, what is good for China has largely been good for the rest of the world and for the United States in particular." She supports increased U.S.-China collaboration on energy given that "the current global energy situation does weigh definitively in favor of China's continued adherence to the broad contours of existing institutions." The Atlantic Council's Gal Luft is explicit about encouraging the United States to participate constructively in BRI, especially where it dovetails with the administration's pre-existing energy priorities.<sup>47</sup>



*Chinese businessmen have been more eager to invest in peripheral Belt and Road Initiative (BRI) locations like Latin America than traditional BRI geographies in Asia. Pictured above, then-Chilean President Michelle Bachelet meets Chinese Premier Li Keqiang for a BRI summit. (Pool/Getty Images)*



On the other side are those who see the new oil price environment as empowering China to become more of a revisionist power. These analysts suggest that BRI is a mercantilist project that, if successful, will put China at the center of a powerful economic and political land-and-sea geography and facilitate the marginalization of the United States as a Pacific power. Daniel Kliman, former Senior Advisor for Asia Integration in the Office of the Under Secretary of Defense for Policy and current CNAS Senior Fellow, has chided U.S. policymakers for getting caught “flat-footed” at the scale of Beijing’s vision and warns that, if it is not careful, the United States will not be able to develop a strategically coherent response and will risk “a China-centric economic and security order extending across Eurasia and along the Indian Ocean rim.”<sup>48</sup>

While Kliman argues that it would be a mistake for the United States to take a purely oppositional approach to BRI, others are proposing a tougher approach to China’s larger foreign policy priorities which, in some circumstances would involve strongly cautioning other countries about the pitfalls of Chinese-led financing. Analysts like Dan Blumenthal have criticized China for overhyping BRI and failing to live up to the moniker of a “responsible stakeholder” that previous administrations have applied to it. He has complimented the Trump administration’s first National Security Strategy for “competing with China more vigorously in all domains of national power: military, economic, diplomatic, informational.”<sup>49</sup>

## **Principled engagement on BRI would complement a wider strategy that would allow the United States and China to cooperate closely on energy issues.**

The Trump administration would be smart to address BRI in a way similar to its approach to Russia in Ukraine and Syria. There, the administration is skeptical of Russian actions but is trying to test Moscow’s cooperative rhetoric by engaging in diplomacy around Ukraine and Syria. Not doing so would make the negative outcome a self-fulfilling prophecy. So far, the United States has avoided an explicit anti-BRI strategy.

Principled engagement on BRI would complement a wider strategy that would allow the United States and China to cooperate closely on energy issues. United States self-interest is served by China’s transition to a higher

proportion of low-carbon energy, including research, development, and deployment of carbon capture and storage systems; further innovations in energy efficiencies; and the next generation of nuclear power plants. Demonstrating that the Trump administration’s intended withdrawal from the Paris Agreement will not slow the bilateral focus on clean energy would be seen as a positive area of cooperation between Washington and Beijing, and it may increase the potential for shaping the geopolitical impact of BRI.

### **India’s Energy Future**

Like China, India is enjoying new advantages from the low-price environment. Prime Minister Narendra Modi is taking advantage of the market conditions and the greater supply resiliency that the lower prices reflect to shift India’s geopolitical configuration to align more with the United States, while still maintaining its freedom of action with traditional economic partners like Russia. The lower-oil price environment is pushing India to aggressively pursue acquisitions of production capacity in addition to drilling domestically. The 2016 acquisition of the Vankor oil field project by the overseas investment unit of state-run Oil & Natural Gas Corporation thus goes hand in hand with the inaugural September 2017 delivery of crude oil exports from the United States.<sup>50</sup>

When, under both the George W. Bush and Obama administrations, the United States was working to build support for sanctions against Iran, India opposed pressure from Washington, though it eventually complied with sanctions by reducing crude oil purchases. At the time, India cited its long-standing ties with Tehran and its energy security needs. Gulf states were overwhelmingly focused on their ties with Pakistan, limiting the desirability of India pursuing closer relationships with Arab producers.

With the new price realities, India’s energy geopolitics is producing a more complex set of ties. As China has moved to balance its own ties with Iran by forging stronger links to Saudi Arabia and the Sunni states, India has sought to make sure that it remains a relevant player for the Gulf monarchies, especially Saudi Arabia, given the large investments that Indian firms have in the region and the predominance of Indian citizens among the huge expatriate community in the Gulf. This is also partially the result of India’s uncertainty about the strength of the U.S. commitment to Gulf stability. The United Arab Emirates, which has had more balanced relations with India and Pakistan, is facilitating the expansion of Saudi-Indian ties. The Gulf states, for their part, are seeking to play a larger role in the provision of oil to India, having

lost market share in exports to both China and the United States. At the same time, they have expanded their engagements in South Asia with India, given the continued economic and political weakness of Pakistan.

The rush to acquire assets under low-price conditions is also pushing India to dramatically deepen its ties with Israel. Modi's visit in July 2017 was the first by an Indian prime minister, and Israeli leader Benjamin Netanyahu reciprocated by visiting India in January 2018. Indian oil companies are actively involved in offshore exploration projects in Israel, especially in the aftermath of the deadlock in efforts to negotiate a large Indian investment in Iran's Farzad B project. In sum, the rapidly deepening relations between India and the United States under Modi and Trump – a big element of which concerns energy – is being replicated in the shifting relations in the region that are drawing India closer to U.S. allies at the expense of its long-standing ties with Iran.

The United States should continue to keep energy cooperation on the agenda with India. This goal will be particularly relevant going forward, since the Modi government has prioritized increasing energy access in a sustainable manner. The lower-oil price environment is an opportunity to lock in the positive momentum created by growing energy trade.

## Low Energy Prices and the Politics of Clean Energy

U.S. energy diplomacy has traditionally focused on access for the United States and its allies to hydrocarbon supply. As Secretary of State Rex Tillerson described it in January 2017, foreign policy should help ensure that the United States and its allies are “not captive to one or a dominant source” of supply.<sup>51</sup> However, in a world of abundant oil supply and low prices, the vulnerabilities associated with oil scarcity are no longer as salient as they once were. In addition, more and more countries are realizing that diversification means much more than increasing optionality for oil imports. Rather, diversification is now also rooted in moving toward technological solutions – now more available and affordable – that shift energy demand away from oil entirely. The development is somewhat counterintuitive, as ordinarily lower oil prices would discourage the development of alternatives to oil. But an overarching focus globally on climate change and air quality concerns has bolstered policy support and popular activism (including shareholder pressure) for off-fossil fuel measures, regardless of the availability of cheaper oil.



*Technological gains are allowing clean energy sources like wind and solar to displace fossil fuels like coal, potentially altering the geopolitics of energy permanently. Pictured above, a wind farm in California. (David McNew/Getty Images)*

Notably, impressive technological gains in clean energy – from solar and wind that are displacing coal (and, eventually, natural gas) in the power sector to electric vehicles that will displace some transportation sector oil demand in future years – are providing important support to the trend.<sup>52</sup> The dual benefits of cutting oil import dependency and addressing climate change will increasingly form the basis of energy policymaking around the world in the coming years. Even though the current U.S. administration has shifted domestic policymaking away from a focus on climate change, most countries, as well as many U.S. states, cities, and companies, will retain that focus, and the trend is likely to grow stronger, not weaker, in the future.

## A Race for Clean Energy Dominance

That said, while lower oil prices may improve U.S. relations with China based on a mutual interest in open markets for energy, competitive threats could emerge in the area of clean energy. China's strategic investments in next-generation energy solutions are enshrined in its current Five-Year Plan: “We will move faster to make breakthroughs in core technologies in fields such as next generation information and communications, new energy, new materials, aeronautics and astronautics, biomedicine, and smart manufacturing.”<sup>53</sup> China has a stated intention of creating internationally competitive national champions in key sectors under its Made in China 2025 strategy, bolstered by its Belt and Road Initiative. In fact, new-energy vehicles and equipment as well as electric power equipment (especially “new energy and renewable resources equipment”) are two of the 10 priority sectors under the Made in China 2025 plan.<sup>54</sup>

In this regard, U.S. companies might find themselves at a disadvantage not just in the Chinese market, which has normally been closed to foreign manufacturers that do not pursue joint ventures with Chinese firms, but also in third-country markets where China will look to capture economic opportunities and bolster its influence by deploying clean energy technology and financing. The cost-competitiveness of Chinese solar panels, whose manufacturers enjoy generous direct state support, means that they are already the cheapest solutions in growing markets like India.<sup>55</sup> Should the United States back away from its support of clean energy deployment, not just domestically but internationally as well, American companies will find it even harder to capture economic advantages abroad.

On international cooperation around low-carbon deployment, the United States may also find itself at a disadvantage in a soft-power competition with Beijing. China is currently working to operationalize its South-South Climate Cooperation Fund, which, on paper, promises \$3.1 billion for funding of mitigation and adaptation projects in the developing world.<sup>56</sup> By contrast, the United States has said it will not fulfill its pledges to the United Nations-backed Green Climate Fund, which contains a Private Sector Facility that had been designed to attract private sector involvement in mitigation projects in countries where such investments would not otherwise be profitable.

China's manufacturing dominance has not gone unchallenged, however. Policies to give its companies a competitive advantage have already triggered trade and intellectual property skirmishes. The election of Trump is poised to accelerate moves to counter China's subsidies. Most recently, in its first major trade action against China, the Trump administration on January 22, 2018, announced that it would impose tariffs of 30 percent on all solar imports based on a case brought forward by two domestic solar manufacturers before the International Trade Commission under Section 201 of the Trade Act. That action risks spilling over into broader retaliatory action by China and other Asian trading partners (given that the tariffs applied to all imports, not just from China, though they were premised on Chinese support to its solar industry). Disputes are not confined to a United States-China dynamic, either. The United States and India, who generally champion a closer bilateral economic and strategic leadership, fought a long battle in the World Trade Organization (WTO) over domestic content requirements in India's solar deployment strategy, a dispute that ended in the United States' favor.

## A New Competition for Natural Resources

Moreover, the race toward clean energy could very well shift the geopolitical landscape of natural resources. As the competition for access to oil becomes less prominent, other commodities essential to clean energy applications, such as lithium, cobalt, and rare earths, will become more prized. As with oil, the geopolitical dispersion of such minerals is fairly constrained, raising the prospects of the same type of security-of-supply concerns that have characterized oil markets for decades.

In the case of lithium, resources are heavily concentrated in China and Australia as well as the so-called Lithium Triangle of Argentina, Chile, and Bolivia. Meanwhile, nearly half of global cobalt reserves are located in the Democratic Republic of the Congo, while China accounts for around 83 percent of current rare earths supply. Though overall global supplies are ample, the concentration of resources in select countries, many of which have faced political instability that has threatened mine output, raises questions of supply vulnerabilities and risks of a mercantilist approach to development and trade of these resources. By way of example, China in 2010 temporarily cut off rare earths exports to Japan following Japanese detention of a Chinese fishing boat captain in an area disputed by both countries. The trade action came at a time when rare earths supplies were already constrained by Chinese export quotas, which were eventually challenged in and overturned by the WTO in favor of opponents that included the United States and Europe. There are fears that China may be willing to use its dominance in rare



*The move toward clean energy could alter the geopolitical landscape of natural resources and create a competition for access to materials, such as lithium and cobalt, necessary for clean energy applications. Pictured above, a lithium mine in Nevada. (Doc Searls/Wikimedia Commons)*



earths for geopolitical goals in the future, seeking opportunities to leverage its monopolistic control over a valued set of commodities. Though China has boosted exports since the WTO ruling, the subsequent drop in rare earths prices has had a chilling effect on new rare earths mining ventures outside of China, thereby reinforcing Chinese control over global production. The time is now for the United States to ensure that no one power or group of powers can achieve market dominance in these essential raw materials for the next-generation clean energy economy.

## Recommendations

Identifying strategies to address energy opportunities and vulnerabilities will be an essential part of defining U.S. priorities and promoting influence abroad in the coming decades. U.S. relations with the European Union, China, Russia, and India will include significant energy components. Whether or not the United States ultimately intervenes in certain foreign arenas to balance the challenge from Moscow, Washington must be aware of Moscow's creeping international influence in this domain and must focus on understanding how much leverage Russia's approach will cultivate. A low-oil price environment offers an opportunity for the United States to alter its approach to traditional relationships in the Middle East. Likewise, China's investments in Asia represent long-term challenges and opportunities for the United States, in both hydrocarbons and clean energy. A ranking of U.S. priorities and a unified approach to discerning when, where, and how to respond will allow the United States to appropriately understand and address the intersection of energy and geopolitics.

*Better understand the new global energy geopolitics.* To address these myriad challenges, U.S. policymakers need to develop strategic alternatives to maximize U.S. leverage in a lower-oil price world. To start this process, the National Security Council should initiate an inter-agency analytical exercise, coordinated by the National Intelligence Council, focused on three lines of inquiry:

- How Russia is cultivating new influence abroad through energy ties, including how U.S. policy should create new economic options for energy-exporting countries so they have alternatives to Russian investment
- Whether or not China's BRI is likely to move in a more mercantilist and anti-Western direction

- The prospects for efforts by Saudi Arabia and other key energy-producing U.S. allies to prepare themselves for a post-oil world.

*Facilitate global energy investment.* Executive branch agencies should provide advice to governments and national oil companies in countries afflicted by instability and declining prices to better understand alternatives for raising capital. Such work should include assisting countries in improving the information flow required by private sector players, helping countries bolster their ease of doing business to attract investors on commercial terms, and advising in countries' negotiations with global creditors in order to stave off prepayment deals or in-kind payments with Russia and/or China as a means of restructuring loans.

*Reaffirm the U.S. commitment to protecting the integrity of global oil markets.* Successfully keeping oil markets open will prevent any price shocks or major adjustments to supply. A stable market should also improve price predictability and facilitate long-term economic planning, reducing the risk of budgetary problems that could provoke instability and external malicious activity in poorer oil-producing countries. Thus, U.S. efforts should focus on ensuring stability and predictability in markets by deterring major disruptions. The United States should, at the same time, engage other relevant powers, including China, on developing greater burden-sharing of this global responsibility. Efforts should include more engagement through the IEA, with both traditional U.S. partners who have relied on the U.S. Strategic Petroleum Reserve as a buffer and rising



*Stockpiles like the U.S. Strategic Petroleum Reserve can preserve stability in a lower-oil price world and help facilitate long-term planning. Pictured above are storage tanks that make up part of the U.S. Strategic Petroleum Reserve in Texas. (Department of Energy)*



powers that have sought to build their own stocks, though with less transparency than is desirable. Other initiatives could include the use of targeted infrastructure investment to improve storage capabilities and help countries diversify their energy sources. Finally, the United States should uphold global trade arbitration mechanisms by not engaging in trade practices (such as retaliatory tariffs) that would hurt multilateral mechanisms and give freer rein to would-be coercive use of energy.

*Maintain an active U.S. approach to Middle East geopolitics.* While it may be tempting for the United States to use its energy abundance as a reason to shift its focus away from the Middle East, it must recognize its continuing interests in the region. Washington must be particularly sensitive to the capacity that Middle Eastern countries will have to manage domestic and regional affairs with less money coming in from its hydrocarbon receipts. The United States should remain broadly supportive of its Gulf allies, and especially Saudi Arabia's reform efforts, but it must also work to prevent the expansion of proxy wars between Iran and Saudi Arabia. Melding together these myriad goals will demand more active engagement from Washington.

*Engage with China to shape BRI to support common goals.* China's Belt and Road Initiative remains a work in progress. The United States should recognize that engaging with China on BRI is in its interests, as well as beneficial to its regional partners. In its engagement with China, the United States should offer cooperation where there are mutual interests and capabilities, while also encouraging China to ensure greater transparency and sustainability in its investments, especially with regard to financing. The United States plays an important role in multilateral development institutions like the World Bank, which could be leveraged to pair with Chinese-origin investments in developing countries. Both countries should pursue opportunities for formalizing their strong mutual interest in maritime cooperation, particularly in open energy trading routes from the Persian Gulf. In its engagement with partner countries who are participating in BRI projects, the United States should encourage them to ensure that Chinese investments maintain high standards; it should also be ready to offer the expertise of the U.S. private sector in infrastructure development where it is desired and appropriate.

*Broaden the concept of energy diplomacy.* If the United States hopes to successfully employ energy diplomacy in an era of lower oil prices, the administration should remain engaged in global policy efforts that address climate change, regardless of its sentiments on the Paris Agreement. Though unconventional oil and gas production has been the main driver to date of the lower-oil price environment, a growing focus on clean energy investment to address both climate change and oil and gas dependency will support demand trends in this direction. The U.S. administration should ensure that the divisions of the bureaucracy that focus on energy, especially at the State Department and the Department of Energy, are mandated and funded to participate in global efforts to address climate change and deploy low-carbon energy. In particular, diplomatic efforts on energy should focus on coordinating emissions reduction goals and strategies, encouraging best practices with respect to clean energy development, and enabling open access to clean energy for all economies, especially those with a heavy dependence on hydrocarbons. As China, India, and other large emerging markets look to leapfrog some of the traditional oil-intensive aspects of economic development and industrialization, the U.S. administration should align its policies with these shifting priorities for Beijing and New Delhi, and accordingly identify opportunities for collaboration with each country, both in terms of research and development for clean technologies and for best practices in deploying low-carbon solutions in third countries.

*Support open trade and investment environments for next-generation commodities.* The U.S. administration should immediately begin engaging with resource-rich countries to ensure open investment environments and stable access to resources that will underpin growth in clean energy deployment. In particular, the United States should bolster its economic relationships with key producers of lithium and cobalt in Latin America and sub-Saharan Africa, as well as develop its own resources of these minerals in addition to rare earths. The United States can also help countries that restrict foreign mining companies' access, like Bolivia, to develop modern regulatory regimes that will promote the investment needed to unlock vast reserves of lithium. Moreover, the United States can also offer export financing for infrastructure projects that will facilitate market access for mining operations. Importantly, the United States should avoid its own export restrictions on these commodities to establish an example to other countries and demonstrate leadership on open markets.

## Conclusion

The new lower-oil price environment will have profound implications for international peace and security. The United States has, since 1945, made strong political and security commitments to a variety of allies and partners around the world as a means to secure access to hydrocarbon resources. These promises structured the overall outlook of the U.S. policymaking community. As importantly, these commitments, and the fears of attendant instability if they were not upheld, constrained the available policy choices. These constraints resulted in a continued U.S. footprint in key strategic regions, such as the Middle East. They also limited the opportunities for cooperation with other consumer countries similarly focused on protecting their access to energy, such as a rising China engaging with African partners.

As U.S. concerns over scarcity recede, the commitments by the United States will necessarily evolve. The constraints of a higher-oil price environment will not weigh on them as heavily. The pull of certain regions on the attention of U.S. officials will decline. Similarly, U.S. policymakers will find increased flexibility in their decisionmaking. U.S. leaders may welcome the opportunity to disengage from particular geopolitical problems. Concurrently, other consumer countries will likely also experience the same additional maneuverability. Different consumer countries may therefore find

confluences of interest that previously were not possible. There may even be the temptation to see the flexibility created by lower oil prices as an escape from commitments rather than an opportunity to shape new ones.

### **As U.S. concerns over scarcity recede, the commitments by the United States will necessarily evolve.**

Yet U.S. engagement on global energy issues should not diminish. Rather, these issues can now be addressed from a position of greater strength. The United States will still be invested in developments in Russia, the Middle East, and South and East Asia. Though the specifics may vary, the need for consistent and engaged U.S. leadership will remain constant. The United States is exceptionally well positioned to influence the next 50 years of global energy development due to its new role as an energy exporter combined with its continued leadership in energy-related technologies. Turning inward on energy may be possible given that U.S. domestic resources are so vast, but such an approach would be counterproductive. Rather, it is time for a strategy to keep global energy markets stable and assist U.S. partners with adapting to new realities. It is also a time for laying the foundations for an approach to dealing with the next generation of materials required for a low-carbon energy mix.

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