

The Geopolitics of Oil

The Gathering Energy Crisis

The world will witness a growing struggle for secure access to oil through the end of this century and into the next. This gathering energy crisis deserves the highest priority in the councils of government. Few other problems are more complicated; few other problems will be more difficult to solve. Moreover, many of the policies which we are currently pursuing to deal with the energy crisis are only making it worse.

The purpose of this report is to identify the nature of the energy problem, analyze its underlying causes, and propose policies which can mitigate the impact of the gathering energy crisis. The most important conclusions from the Committee's study of the geopolitics of oil may be summarized in six major findings:

1) *Oil exports from the Persian Gulf and North Africa are not likely to rise substantially in the next 10 years.* Within each of the Persian Gulf and North African oil producing states, pressures are mounting to reduce the level of oil production or at least hold production constant. These pressures include rising oil prices, which have led to greater revenues per barrel of oil produced, diminished opportunities for investing oil revenues within the Middle East and abroad, and an increasing awareness that Middle East reserves are gradually running out. The Middle East producers have learned that they do not have to sell more oil to finance their economies. They can achieve the same goal by selling less, thereby driving up prices.

The growth of these pressures to limit oil production has significant implications for the world market. First and foremost, it means that the oil consuming nations cannot rely upon the Persian Gulf producers to ease the growing stringency in the world oil market even if the

conflict between Iraq and Iran is settled. Although temporary production surpluses, such as the one prior to the Iraq/Iran conflict, may occur from time to time, for most of the rest of this century the market will remain generally tight. Continued tightness of the market, in turn, means that any major disruption will have a significant impact unless action is taken to mitigate such effects.

The growing pressure for conservation of oil resources has another significant implication which has received far too little attention. As the consuming countries reduce their consumption, the producing countries may simply reduce their production by a similar amount. If this occurs, efforts by the consumers to reduce imports in the hope of driving down world oil prices are likely to be less than wholly successful. The national security value of reducing oil imports may be significantly less than is commonly believed. As a result, the United States and its allies might be well advised to devote far more attention and financial resources to contingency planning and oil stockpiling, which can reduce the impact of a supply disruption.

2) *Even if the present conflict between Iraq and Iran is settled quickly, a major oil supply disruption within the next decade is likely.* In the last decade the world experienced two sizable oil supply disruptions. As we enter the 1980's, the probability of new disruptions is even higher than it was 10 years ago.

The current hostilities between Iran and Iraq manifest the immediacy of the problem facing the United States and the other industrialized nations because of their dependence on Middle East oil. The conflict has curtailed exports entirely from both countries, resulting in a loss of roughly 3.8 million barrels of oil a day. Although the fighting so far has been confined to two nations, the danger remains great that it could spread to other

producing countries, threatening oil exports from the entire Gulf region—nearly 18 million barrels of oil per day.

It is likely that the present conflict will leave the Middle East even more unstable than it was before the outbreak of hostilities. Should Iran emerge as the more successful contestant, the government of Ayatollah Khomeini is likely to renew its efforts to export the Iranian revolution to neighboring countries with even greater revolutionary fervor. On the other hand, an Iraqi triumph would be equally unsettling. An Iraqi victory could further expand Iraq's influence over other countries in the region, including Kuwait and Saudi Arabia, and thereby lead to greater regional instability. Iranian setbacks on the battlefield could weaken the government's ability to hold that country together and could ultimately result in the disintegration of Iran. At this time, however, some form of cease-fire and temporary settlement or a drawn-out war of attrition appears to be more probable than a clear-cut victory by either side. The underlying tensions that led to the present dispute would remain, and the antagonisms engendered by the current conflict would make a renewal or intensification of hostilities a constant threat in the future. Growing divisions in the Arab world as countries in the region take sides between the warring parties are likely to increase instability even further in the future.

The dispute between Iraq and Iran is only a part of a continuing pattern of local instability and regional conflict. Thirteen of the present Arab heads of state, or more than half, have reached power by forcibly removing their predecessors in one way or another; in the past 15 years, besides major Arab/Israeli conflicts, Arabs have fought Arabs in 13 fierce wars. While the Egyptian/Israeli peace treaty has contributed significantly to overall stability in the Middle East, systemic problems, exacerbated by the present conflict, will keep the Middle East unstable for the foreseeable future.

3) *Oil has become a political instrument in the hands of the major oil producing nations.* Oil is no longer merely an economic commodity. It has become a source of political leverage in the hands of the major oil producing nations. Virtually all the OPEC producers, particularly those in the Middle East, have used their oil at one time or another to pursue noneconomic objectives. Oil has been used to induce the United States, France, Germany, Italy, Japan, and Brazil to trade advanced weapon systems and certain technologies which

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have military applications to the Middle East. Oil has been used to obtain economic concessions, including assistance in building refineries, petrochemical plants, or other industries which otherwise probably would not have been granted. Oil has been used to influence the foreign policies of the industrialized and Third World nations, particularly their policies on the Arab/Israeli dispute and the Egyptian/Israeli peace process. And oil is being used to influence what otherwise would be considered internal, national policies, such as the decision of the U.S. government whether to fill its Strategic Petroleum Reserve.

The tightening of the world oil market, which is a product of political as well as economic and other forces, is the single most important factor that has allowed oil to become a political force. The instability and stringency of the world oil market have made consuming nations willing to pay a political price for privileged access to oil.

The increasing number of transactions involving direct sales between the producing and consuming governments without oil company intermediaries is another significant development which has expanded the producers' control over their oil. In 1973, 90 percent of the oil traded in the world was sold by private oil companies. By 1979 the figure had dropped to below 50 percent. Now that the Middle East countries are dealing directly with an increasing number of foreign governments, the producers can make noneconomic concessions a part of the bargain much more easily.

4) *Unless there is a major shift in current policies, the next two decades could witness growing competition among the governments of the consuming nations for scarce crude supplies.* Even if all present plans to reduce oil consumption, increase indigenous production, and accelerate the use of alternative fuels succeed, the industrialized countries will remain heavily dependent upon oil imported from unreliable or insecure sources for the rest of this century and probably well into the next. As a result, the world is likely to witness increasing competition by the governments of the consuming nations for privileged access to foreign sources of oil. Such competition will lead to higher prices and greater political and military concessions in return for oil. The number of government-to-government transactions is likely to increase, as individual consuming nations futilely attempt to lock up an assured source of supply in a world of uncertainty.

As competition for oil becomes more

divisive and extends deeply into the political sphere, the strains on the free-world alliance are likely to become severe. Such strains will affect all the industrialized countries whether or not they are "energy independent."

Unless the industrialized countries rapidly develop a common approach to dealing with oil supply stringencies, more intense competition among the consuming nations for oil could drive ever deepening divisions among the allied countries, creating new openings to be exploited by potential adversaries and increasing the danger of violent conflict in the Middle East.

5) *The Soviet Union's growing interest in the Middle East and its increasing control over Western Europe's energy supplies pose grave dangers for the Western alliance.* Tensions in the Middle East and competition among the industrialized countries for oil could be exacerbated by economic, energy, and military developments in the Soviet Union over the next 20 years. During the 1980's a serious economic slowdown in the U.S.S.R. is likely to be aggravated by the rising cost and lagging output of its national energy programs, especially oil production.

Whether or not Soviet production is adequate for Soviet and Eastern European needs in the 1980's, the Soviet Union can be expected to seek to expand its influence in the Middle East. By gaining greater influence over the Middle East producers, the Soviets can obtain leverage over Western Europe, the United States, and Japan. Increased influence over the highly profitable Arab oil producers could also give the Soviets a way to redress adverse domestic economic trends and improve the terms of trade in their economic competition with the West.

An oil shortage in the Soviet Union would simply mean that the pressure on Soviet leaders to expand their influence in the Middle East could be substantially increased. Because the Soviets are not likely to possess the hard currency to buy oil on the world oil market, to the extent that the Soviets need to obtain oil, they might attempt to secure it through political manipulation, intimidation, or use of force against the Middle Eastern producing countries. By exploiting local unrest, giving aid to dissident groups, using diplomatic pressure, and supporting revolutionary movements sympathetic to Moscow, the Soviets can substantially expand their influence in the region without having to take overt action against any of the Gulf states.

A second major development which

has been relatively neglected is the growing dependence of Western Europe on the Soviet Union for gas supplies. France, Italy, and West Germany already import roughly 15 to 20 percent of their gas from the Soviet Union and the West Germans have found it necessary to announce that they intend to limit their dependence upon Soviet gas to no more than 30 percent of their total consumption. To the extent that the U.S.S.R. is able to increase its gas exports to Western Europe, it can strengthen its economic influence over the West and constrain Western Europe's ability to join the United States in cooperating on political, economic, and even military matters. Western Europe's dependence on Soviet gas is likely to sharpen divisions among the United States and its allies on such matters as East-West trade, transfer of sensitive technology to the Soviet Union, and sanctions for Soviet conduct which the allies consider offensive, such as the invasion of Afghanistan.

6) *The economic slowdown in the developing countries and the huge increase in their foreign debt jeopardize economic development and threaten to undermine the international financial system.* Although some less developed countries (LDC's) are fortunate enough to have substantial hydrocarbon and other energy resources, for many less developed countries continued economic growth will depend upon importing oil at least through the end of this century. This dependence puts these countries in a dilemma. On the one hand, they need imported oil to fuel their economic development; on the other hand, the cost of foreign crude is among the main impediments to more rapid economic growth. By 1990, if they manage to sustain economic growth, the import bill of the less developed countries could reach \$100 billion (1980 dollars). Future increases in the price or disruptions in the supply of oil could push many less developed countries into bankruptcy. Money these countries should be spending on strengthening their economic base would have to be diverted into paying for oil, with debilitating consequences for their economic development plans.

The prospect of economic stagnation is almost certain to foster political and social instability in many developing countries, creating serious problems for U.S. foreign policy. These possibilities pose an important dilemma for the United States as well. Accelerated growth and economic development in the LDC's, which is a general aim of U.S. foreign and economic policies, is

likely to mean a higher LDC demand for oil and for special arrangements with the producers. This in turn could put further pressure on world oil prices and supply—a result that U.S. energy policy would prefer to avoid.

Conclusion

An energy policy aimed solely at reducing imports will not adequately insulate the United States from the gathering energy crisis. American energy self-sufficiency is highly unlikely within this century, let alone within the next 10 years. Even if all the initiatives enacted by Congress succeed in meeting their objectives, the United States will still import several million barrels of oil per day at the end of the 1980's. The oil industry itself concedes that if the federal government adopted all the industry's recommendations, we would still be unable to do more than hold domestic oil production constant and cut imports by half. Moreover, our allies will remain even more heavily dependent upon the Middle East for oil. If a major supply interruption should occur, the impact upon the economies of our allies would quickly be felt in the United States.

The assumption that energy independence is economically feasible has had a profound impact on U.S. energy policy. It has led the country to focus almost exclusively on long-term policies for reducing imports—policies which will not eliminate the main dangers of the gathering energy crisis. It has led government officials to underrate the importance of near-term policies, such as emergency preparedness, foreign policy, and defense strategy initiatives which can reduce the likelihood and impact of a supply interruption even though they would not reduce the level of our imports.

This is not to suggest that reducing petroleum imports through enhanced domestic energy production and conservation is not an appropriate policy to pursue. The creation of the Energy Security Corporation, for example, will, over the long run, help check U.S. dependence on foreign energy and vulnerability to supply interruptions and improve our balance of payments. The full utilization of this nation's substantial energy resources can substantially reduce our dependence on foreign oil and our concomitant vulnerability.

Nevertheless, the United States must reorient its approach to the gathering energy crisis. We must recognize that the energy problem is not only a long-term issue but that it is an immediate concern.

And we must recognize that the energy problem has many international aspects. As a consequence, our foreign and defense policies must be considered as much a part of our overall energy policy as our traditional programs to reduce oil imports.

Recommendations

1) *The United States should build a "Domestic Petroleum Reserve" by filling the Strategic Petroleum Reserve as rapidly as possible and by encouraging private stockpiling of petroleum and petroleum products.* Ample emergency oil stockpiles are the single most reliable and cost-effective means of deterring oil import disruptions and reducing their impact. According to one study, in the event of a major supply interruption, each additional barrel of stored oil has the potential to offset close to \$200 in GNP loss. Despite the tremendous value of an ample oil stockpile, the U.S. government presently has less than 20 days' supply of normal imports stored in the Strategic Petroleum Reserve. Until recently the government has refrained from filling the reserve out of fear of offending the producing countries.

The tremendous value of adequate reserves has been demonstrated by the war between Iraq and Iran. Because world stocks were high at the outbreak of hostilities, the fall in production did not lead to an immediate price rise. In contrast, during the Iranian revolution in 1979, when world stocks were low, the supply shortfall caused world prices to nearly double.

U.S. energy policy should give highest priority to building an adequate Domestic Petroleum Reserve, consisting of publicly owned stocks in the Strategic Petroleum Reserve and privately owned stocks. Congress has already attempted to redress our inadequate reserves of oil by mandating in the Energy Security Act that the Department of Energy fill the Strategic Petroleum Reserve. President Carter, however, has not filled the Strategic Petroleum Reserve above the minimum rate of 100,000 barrels a day required by law. The new Administration should immediately fill the Strategic Petroleum Reserve at a significantly higher rate unless the world supply situation deteriorates, making such a fill rate impracticable.

The United States should also consider new methods to encourage private firms, both those in the petroleum industry and others that consume petroleum, to privately build and hold their own re-

serves so that they are better prepared for a shortage. Private firms do not have to comply with complicated procurement regulations and other restrictions that hamper government efforts to purchase and stockpile oil. Although the government should discourage hoarding during a crisis, it should promote rather than interfere with private sector efforts to build stocks in anticipation of a sudden shortfall.

Finally, the United States and its allies should develop a collective strategy for using public oil inventories to mitigate the effects of any major supply interruption. The mere existence of oil stockpiles does not assure stability in a disruption if they are not used wisely. The effective use of worldwide inventories will depend upon whether we and our allies can develop a common strategy for drawing down stocks at the appropriate time.

2) *The United States should develop plans in concert with its allies to prepare for an energy emergency.* Although a major oil supply disruption within the next decade appears to be a virtual certainty, the United States and its allies do not have adequate plans in place to mitigate the impact. Continued use of oil as a political weapon is also inevitable in the next decade. Yet the United States and its allies have not developed a collective policy to resist the efforts of those who use oil for political, diplomatic, and military ends.

At the international level, the United States and its allies should develop new arrangements to deal with the problems posed by increased government-to-government transactions, use of oil for political purposes, and, most importantly, the impacts of a major oil supply disruption. Unfortunately, the efforts already undertaken through the International Energy Program and at summit meetings are not adequate to deal with these challenges. The United States and its allies should jointly develop new collective measures to cushion the impact of a major supply interruption and reduce the ability of producing governments to use oil as a political weapon.

At the domestic level, the United States should give high priority to developing plans to reduce the social and economic dislocations that inevitably accompany any significant shortfall in oil supplies. Unfortunately, until recently this task has received low priority from the Executive Branch.

The impact of a major supply interruption upon the U.S. economy should be analyzed. Careful study should also be made of the government's ability to

gather data quickly during an emergency. Unless the government can quickly and accurately assemble information to convince the public that the crisis is real, the public will be unwilling to make the sacrifices necessary to mitigate its impact. In addition, Congress and the Executive should consider alternative policies for assuring the efficient and equitable distribution of available supplies in an emergency, including gasoline rationing and standby taxes on gasoline and other petroleum products. The Emergency Petroleum Allocation Act of 1973, which provides the basis for the government's authority to control the price and allocate supplies of oil, will expire on 30 September 1981. The effectiveness of this law and of possible alternatives to it should be carefully studied well before the expiration date.

Congress should also consider whether revisions in the Emergency Energy Conservation Act of 1979 are necessary. To date, federal and state efforts to implement this act, which allocates legal responsibility for restraining demand during an emergency, have not been satisfactory.

3) *The United States, in conjunction with its allies, should give high priority to measures that will enhance the stability of the Middle East and deter Soviet advances in the region.* As long as the United States remains vulnerable to a supply disruption, the United States should give high priority to programs that can reduce the likelihood of such an occurrence. One of the best ways to do this is by enhancing stability in the Middle East. Greater stability in the Middle East could also reduce the likelihood that oil would be used as a political weapon against the United States and its allies.

The present conflict between Iraq and Iran makes the task of promoting stability in the Middle East all the more difficult for the United States. Although the conflict appears to have drawn some of the neighboring countries closer to the West, it has also demonstrated the limited influence of the United States among the principal belligerents. The United States should continue working actively to keep the conflict from spreading to other nations. At the same time, it is vital that the United States and its allies maintain their commitment to keep the Strait of Hormuz open.

Over the longer term, U.S. policy in

the region should adhere to certain basic principles. Wherever possible, the United States should rely upon local governments to provide local security. In order to further this objective, the United States and its allies should develop a coordinated program to increase military assistance and military training for friendly states in the Middle East to enhance their own ability to deal with internal disruptions and to defend themselves in regional conflicts.

Certain threats, however, particularly overt threats emanating from the Soviet Union, may require a stronger response than any individual Middle East country or group of countries can provide. To deal with these threats, the United States should enhance its ability to project military power in the region. This can be done through a rapid deployment force and, in conjunction with the facilities arrangements already being made by the United States, by encouraging local leaders to develop facilities for their own armed forces which are compatible with the support requirements of Western military forces in the event countries in the region call for outside assistance. Since stable supplies of petroleum are of importance to countries throughout the world, the United States should not have to bear sole responsibility for this effort. Our allies should play a role with U.S. leadership in developing a common strategy for deterring Soviet advances and dealing with other contingencies.

The United States should also pursue its efforts through the Camp David peace process to resolve the Arab/Israeli conflict. The Egyptian/Israeli peace treaty and continuing dialogue has reduced significantly the probability of a new Arab/Israeli war. This peace process should receive maximum encouragement and support from the United States and its allies as a viable means of finding a solution to the wider dispute. Although no solution to this conflict can guarantee the West's access to Middle East oil, resolution of the dispute would remove one of the most often cited causes of instability in the Middle East.

4) *The United States, in concert with its allies, should promote and support programs for accelerating petroleum exploration and development in areas outside the Middle East.* Programs to accelerate and diversify petroleum exploration and development in areas outside the Middle East could significantly in-

crease aggregate world petroleum supplies by the late 1980's. Greater oil production would limit both the demand on Middle East oil and the severity of future price increases. Development of additional production capacity outside the Middle East would also mean that more oil could be available to offset cutbacks due to a supply disruption. Even if the United States is not the direct recipient of these additional supplies, we will enhance our political and economic position by diversifying the sources of production and by helping to reduce our allies' dependence on insecure Middle East oil.

In April 1979, President Carter called for the development of "a broader international strategy" for expanding and diversifying petroleum exploration and development. To date, however, the United States has not articulated a coherent, comprehensive, international energy supply policy aimed at diversification.

Mexico and Venezuela are foremost among the countries most likely to offer the United States and our allies important opportunities for reducing our economic dependence on Middle East oil. The United States should demonstrate its willingness to work with Mexico toward building a mutually beneficial partnership which includes Mexican energy development. The United States should also encourage Mexico to install excess oil production capacity that could be more readily used to raise exports rapidly during an international energy emergency.

The United States should also attach high priority to encouraging development of Venezuela's vast heavy oil deposits. In addition to providing technical cooperation and financial assistance through the Energy Security Corporation, the United States, through bilateral or multilateral negotiations, should provide Venezuela with the market security that development of its heavy crude resources requires.

Finally, the United States should mobilize strong support for bilateral and multilateral programs for financing petroleum exploration and development in the less developed countries. High priority should be given to insuring adequate funding for these programs as a means of enhancing the energy security of all oil importing nations, including the United States.