How OPEC Keeps America Hooked on Imports of Oil

Politics, Cartel's Price Moves Abet Habit That Looms Large Amid Threat of War

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Staff Reporters of THE WALL STREET JOURNAL

All seven presidents of the past 30 years, Democrat and Republican alike, have tried to wean the U.S. off imported oil. All have failed.

In 1973, President Nixon pledged to end oil imports by 1980 through Project Independence. The U.S. imported 40% of its oil that year. In 1979, President Carter said imports wouldn't ever rise again. They did. Today, with the U.S. importing 60% of its oil, President Bush says hydrogen power will lead to energy independence.

Mr. Bush is almost certain to be proved wrong, at least in the next couple of decades.

Despite an increasingly energy-efficient economy, the U.S. remains hooked on foreign oil for two reasons. The Organization of Petroleum Exporting Countries, especially Saudi Arabia and its neighbors, is skillful in its management of oil prices to maintain America's dependence. And the U.S. lacks the political will to do what's necessary to weaken the cartel or reduce the American appetite for oil.

With American troops poised for war in the Persian Gulf, which dominates oil exports and has two-thirds of global reserves, the consequences of oil dependency are starker than ever. The U.S. relies on some of the world's most volatile countries to supply a component that is critical to American society. Political turmoil in the region, in 1973 and 1979, produced oil-price jumps that ravaged the U.S. economy. In 1991, the U.S. sent 500,000 troops to the region to expel Saddam Hussein from Kuwait to ensure that he didn't grab an even-larger share of Gulf oil.

The primary issue is price. OPEC manages production to try to keep prices higher than they would be if set in a free market, but low enough to make alternative fuels and technologies uncompetitive.

"If we force Western countries to invest heavily in finding alternative sources of energy, they will," Saudi Arabia's influential oil minister, Sheik Ahmed Zaki Yamani, said in a 1981 speech at a Saudi petroleum university. "This will take them no more than seven to 10 years and will result
in their reduced dependence on oil as a source of energy to a point which will jeopardize Saudi Arabia's interests."

The U.S. could make rules to force Americans to use less oil or achieve the same end by raising the price through tariffs or taxes. Of the 19.5 million barrels of oil Americans consume every day, about 11.5 million are imported. Roughly half the oil consumed in the U.S. goes for cars and trucks.

Some economists are reviving old proposals to boost the gasoline tax. Others are crafting new ones. One of President Bush's favorite economists, Harvard University's Martin Feldstein, suggests that the government cap overall gasoline sales and distribute fuel vouchers electronically. Owners of gas guzzlers would buy vouchers from owners of fuel-efficient cars, creating an incentive to use less gasoline and develop fuel-efficient technologies without pumping money into the government's pockets.

But neither the White House nor the Democratic opposition is interested. Cheap oil benefits the U.S. The lowest gasoline prices in the industrialized world boost auto sales, tourism and suburban construction. Lower diesel prices reduce trucking costs and help businesses along the supply chain.

"If you let the price of oil go artificially high, it will hurt our economy," says Commerce Secretary Don Evans, a former Texas oil-patch executive.

**Vulnerable to Instability**

At the same time, reliance on imported oil makes the U.S. vulnerable to instability in Venezuela and the Middle East, and leaves a key economic lever in the hands of a foreign cartel. Every recession since 1973 has been preceded by a big run-up in oil prices. And while only about 20% of U.S. oil imports comes directly from Persian Gulf members of OPEC, the Gulf effectively sets prices because it produces the lowest-priced oil and has 90% of the world's extra capacity.

The only time in the past three decades that U.S. oil imports have declined substantially was between 1979 and 1983, when they fell by 40%. One reason was the deepest recession since the Great Depression, which cut demand for energy. Another was the almost-simultaneous rise both in oil prices after the Iranian revolution of 1979 -- when fears rose again of a cut-off in oil -- and in the fuel efficiency of American autos between 1979 and 1983, as the U.S. began enforcing new fuel-efficiency standards. Many Americans dumped gas guzzlers for smaller cars. President Reagan ended oil-price controls, setting off a boom in domestic drilling and arresting, through the mid-1980s, the downward spiral in U.S. oil output.

Prices hit $40 a barrel in 1979 -- $100 a barrel at today's prices, after accounting for inflation -- and were expected to double during subsequent years. Saudi Arabia worried that high prices would backfire. And to reduce U.S.
imports, President Carter championed an $88 billion plan to develop synthetic oil from abundant U.S. reserves of coal and shale.

So Saudi Arabia started selling oil at prices several dollars a barrel lower than the OPEC $34-a-barrel standard. Then, in 1985, as the cartel was facing increasing competition from Alaskan and North Sea oil fields, Saudi Arabia and Kuwait engineered a price crash. After a meeting in which OPEC decided to go after market share rather than prop up prices, Sheik Yamani, the Saudi oil minister, said to several reporters: Let's see how the North Sea can produce oil when prices are at $5 a barrel. At low prices, the Persian Gulf countries have an unbeatable edge. In the mid-1980s, it cost them a couple of dollars a barrel to produce oil. It cost about $15 to produce a barrel off the coast of Britain and Norway or in the U.S.

The move was a warning to the U.S.: Forget about energy independence. Besides being the world's largest consumer and importer of oil, the U.S. is also one of the largest producers. The price decline, to about $12 a barrel, was so devastating to the economies of Texas, Louisiana and other oil-rich states that then-Vice President George H.W. Bush toured the Persian Gulf in 1986, urging countries to rein in their output and raise prices.

"Isn't that what you wanted? A free price in oil," OPEC's president, Rilwanu Lukman of Nigeria, goaded Mr. Bush when the two met in Kuwait. Mr. Bush eventually reached an understanding with Saudi Arabia's King Fahd, to limit production and seek a 50% rise in oil prices to a target price of $18 a barrel (or $30 in today's dollars). Over the years, OPEC has adjusted its target range and now generally aims for between $22 and $28 a barrel.

OPEC's strategy has largely worked. Since the mid-1980s, the U.S. thirst for oil has increased. President Carter's synthetic-fuel program couldn't compete with the new OPEC prices and was ridiculed for its massive, money-losing projects.

The U.S. is far more energy-efficient than it was in 1973, when Arab nations cut off oil exports to the U.S. because of America's support for Israel during the October war. It takes about half as many barrels of oil to produce each $1 of economic output today as it did 30 years ago, according to Cambridge Energy Research Associates, a consulting firm.

But most of the gains in fuel efficiency came in the early 1980s when oil prices were high. Electric utilities and other large customers switched to natural gas, which was seen as a cheaper and cleaner alternative, and less vulnerable to disruption because it was produced in the U.S. and Canada. In 1979, 13.5% of electricity was produced by oil; that figure dropped to 4.1% in 1985 and about 3% today. Home heating went through a similar transformation, from oil to natural gas.

When oil prices declined after 1985, the pace of energy efficiency slowed. The U.S. became somewhat less dependent on oil mostly because of long-term changes in the structure of the economy, not because of energy-saving technology. Nine energy-intensive industries -- aluminum, agriculture, chemicals, forest products, glass, metal casting, mining, steel and petroleum -- account for 80% of industrial energy use. Many of those industries are in decline. Newer ascendant ones, such as software and communications, don't use as much energy. Petroleum accounts for 40% of total U.S. energy consumption, down from 50% in 1973.

In the 1990s, gasoline prices fell lower than they had been since the oil embargo of 1973, taking inflation into account. OPEC was determined to keep prices relatively low to retain market share.
and scare off rigs in other regions. The American government didn't require further increases in automobile fuel efficiency. With the economy surging, consumers flocked to minivans, SUVs and other fuel hogs.

To lessen dependence on oil, economists say, the U.S. would have to raise the price of gasoline substantially. It would take an additional $1-per-gallon tax, on top of the average current tax of 41 cents, to reduce gasoline consumption by about one-fourth, according to Congressional Budget Office estimates.

Europe and Japan have especially high gas taxes -- $3.16 a gallon in Britain; $1.75 in Japan -- so drivers there overwhelmingly choose smaller, fuel-efficient vehicles. "To reduce oil consumption, the most obvious thing to do is to tax gasoline and make fuel economy a desirable feature," says Loren Beard, a senior manager for energy planning at DaimlerChrysler AG in Detroit.

Overall, Germany, France and Japan need only half as much oil as the U.S. to produce the same amount of economic growth. Given the higher gasoline prices in Europe and Japan, the International Energy Agency in Paris expects their oil imports to grow more slowly in coming decades than those of the U.S.

**Political Poison**

But even small gasoline-tax increases are political poison in the U.S. The first President Bush agreed to a five-cent-a-gallon tax increase in 1990 despite his famous "no new taxes" pledge. Partly because of that, he lost his re-election bid. President Clinton pressed for a broad energy tax in 1993, but settled for a modest 4.3-cents-a-gallon levy. Officials in the current Bush administration say they considered higher gas taxes when they put together their first energy plan in 2001, but quickly rejected them in any form.

A tax increase by itself wouldn't solve the oil-import problem. Higher gas-pump prices would lessen demand for oil, which could lead to a glut and lower wholesale oil prices. OPEC could cut back on production, to boost prices, as it did when oil prices slumped in 1998. If OPEC encouraged prices to sink, the U.S. and other consuming countries would have to consider soaking up extra supply -- by greatly expanding the reserves of oil they maintain for emergency use -- in order to prop up prices and prevent OPEC from gaining an even-stronger hand in controlling supply.

Boosting supplies of oil outside the Persian Gulf would also help make the U.S. less dependent on OPEC. But the Bush administration hasn't been able to persuade Congress to start drilling in the Alaska National Wildlife Reserve, and environmental regulations have put much of the Rockies, along with the Atlantic and Pacific coasts, off-limits for new rigs. Oil companies are using technology to extend the lives in old fields, but domestic supply continues its long swoon to about 5.8 million barrels a day, one-third less than when President Nixon set his energy-independence goal in 1973.

Elsewhere, Russia, central Asia and Africa are expected to broadly expand production over the coming decades. Even when taken together, however, these oil regions don't have the reserves to affect U.S. reliance on the Persian Gulf, which has the bulk of the world's reserves in cheap, easy-to-tap fields. OPEC nations "are back in charge," says Vito Stagliano, an energy official in the first Bush administration.
Rep. Charles Rangel of New York, the top Democrat on the House Ways and Means Committee, says the U.S. may be able to use its military might to change the oil balance of power. If the U.S. seizes Iraq's oil fields during a war and turns Baghdad into a reliable ally, that could reduce the concerns about U.S. reliance on Persian Gulf oil. "If we control all that oil," Mr. Rangel says, "we don't need a damn gasoline tax." But the political consequences of the war are hard to foretell, especially if Saddam Hussein destroys Iraq's oil wells, or if other Gulf oil fields become terrorist targets. A democratic Iraq is also likely to see the economic virtues of strengthening OPEC, not weakening it.

President Bush is looking for a technological fix. He has seized on the technology of hydrogen-powered fuel cells, budgeting $1.7 billion over the next five years to try to produce hydrogen-powered cars and trucks. But the challenges are daunting. Hydrogen now costs four times as much as gasoline, fuel cells are clunky and expensive, and the U.S. lacks an infrastructure of hydrogen pumps to match the nation's gasoline stations.

And OPEC is ever vigilant to the possibility that the U.S. could kick its oil habit. In the late 1980s, Kuwait's oil minister shooed away a businessman who approached him at a bar in a London Hotel. Sheik Ali Khalifa al-Sabah explained that the man "wanted to sell me on an engine that works on water. If I thought it worked, I would have bought it and killed it."

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Updated March 17, 2003 11:59 p.m.