Unfinished business: 1973 Arab oil boycott

By AMY MYERS JAFFE and EDWARD L. MORSE

TODAY marks the 30th anniversary of the Arab oil boycott, and the unprecedented quadrupling of oil prices, which revolutionized the global energy business. The embargo inspired the industrial West to undertake dramatic and important actions to prevent oil blackmail from recurring.

In the intervening years, those efforts have borne significant fruit. The liberalization of markets together with 1.5 billion barrels of Western strategic oil stockpiles make it difficult for any oil exporter to consider a repeat of 1973. But the measures adopted to counter the revolution of the Organization of Petroleum Exporting Countries remain incomplete and security elusive. More than $4 trillion has been taken out of the hands of consumers as a result of OPEC's price-setting, and new risks have emerged in the interim.

Thirty years of trying not withstanding, American oil supply continues to be highly insecure. We have to worry increasingly about internal political and economic stability in oil-producing regions. We are distraught over the threat of international terrorism to energy targets. We need to consider the massive deterioration of energy infrastructure at home and worldwide, and conservatives remind us of the rise of China and its rapidly growing oil use. On top of that, greens chastise us about the environmental consequences of continued reliance on fossil fuels.

The vision initially adopted in the aftermath of the 1973 oil embargo was the right one — share the burden of disruptions equitably, foster diversity of fuels and of supply, build strategic stocks to prevent blackmail, and create liberal markets with open access globally to resource development and trade. In the aftermath of 9/11, completing this counterrevolution of a free and depoliticized market for oil should be on top of the U.S. international agenda.

Before the OPEC revolution, companies competing with one another for markets determined oil prices, which were dramatically lower than they have been since. Today, OPEC regulates supply in pursuit of the narrow revenue interests of its members. It sets a floor on prices that is significantly higher than what markets would determine. Key members prevent companies from accessing their resources.

Before 1973, oil was an ordinary commodity; since then it has become a critical instrument of foreign policy, not simply for oil producers but for major Western governments, including the United States with its unilateral oil sanctions.

At the time of the embargo, a fixed exchange rate regime had just given way to freer and more flexible rates. Since then, global trade and investment barriers have been steadily coming down. But unlike other areas of the world economy where market flexibility has become the norm, oil remains an anachronistic exception.

What needs to be done to complete the counterrevolution to OPEC?

The creation of the International Energy Agency as the watchdog for the key energy consuming countries of the industrialized world was a stellar example of smart policy. The IEA administers the use of strategic stockpiles, promotes alternative fuels and encourages market mechanisms to boost energy efficiency.

But China, India and other emerging markets are not members of the IEA and today they represent the fastest-growing importers of oil and natural gas. They must be brought into the IEA soon, lest they pursue bilateral ties to oil producers, exchange arms or political votes for oil and further politicize rather than defuse oil as a commodity.

Jaffe and Morse were project director and chair of the joint Task Force on Strategic Energy Policy of the James A. Baker III Institute for Public Policy of Rice University and the Council on Foreign Relations.

The United States should look seriously at ways to bring the rules of global oil trade and investment in harmony with the rules governing trade in manufactures and services. This would mean discriminating actively against those countries that do not permit foreign investment in their energy resources and that limit their exports to manipulate prices. This is a tough policy, but one that is essential to the counter-OPEC revolution. Liberalization and open access for investment in all international energy resources would mean their timely development rather than today's worrisome delays. Without global norms across the oil world, the world experiences capital and politically constrained limitations of supply that crimps the global economy today and perpetuates poverty in the energy poor countries of Africa and Asia. The example of Russia over the past five years, with its rapid growth in oil production following economic liberalization, should serve as a shining example to other still-closed countries.

The United States also needs to get its act together at home. Initially, the United States did its fair share, decontrolling domestic oil prices and setting tough mileage standards. But today, the United States lags behind the rest of the industrial world in energy policy. Japan and the European Union, unlike the United States, imposed huge taxes on oil consumption of 400 percent or more, virtually halting the growth in oil demand and promoting technologies that enable drivers to drive more each year, using less fuel and facilitating exports of energy efficient motor vehicles.

The United States has taken a reverse course and is now, ironically, the most significant subsidizer of OPEC. America's rising imports — now 10.2 million barrels per day, up from 6.79 million b/d in 1991 — represent more than a third of the increase in oil trade over the past 10 years and more than 50 percent of OPEC's output gains.

The United States needs to take demand management seriously. All U.S. government fleet vehicles should be highly efficient hybrid vehicles or natural gas and electric power cars. If U.S. taxpayers resist energy taxes, then U.S. policy should include higher mileage efficiency standards on all vehicles, including sport utility vehicles. Higher taxes could at least be placed on inefficient vehicles.

Thirty years ago, the West vowed to become less reliant on OPEC. Meanwhile, we have increased our dependence on the Middle East in critical ways. The world now relies almost exclusively on Saudi Arabia to hold spare capacity in standby readiness to remedy global oil supply disruptions. We have not confronted the consequences of this high dependence on Saudi largesse, which could some day potentially limit the international community's freedom of movement in important policy areas such as human rights, political reform, and international finance and banking reform.

Nor have we confronted the potential oil market consequences of political instability or terrorism in Saudi Arabia that might result in lower Saudi exports.

The oil industry has done its part over the past 30 years. Industry research and development has meant that deep-water resources, frontier arctic resources or the tar sands of Canada can provide huge, incremental new supplies of oil at prices much lower than today's. A decade ago, Canada produced virtually no oil from tar sands. These oil-bearing structures are increasing their productivity year after year and, about the same size as Saudi Arabia's reserves of conventional oil, deserve more attention from U.S. policy-makers, as do the oil sands of Venezuela and Russia.

But perhaps most important is the need to take seriously Russia as a global oil supplier, a role it will assume this decade as pipelines are built to the Asia Pacific area. Russia can well become an exporter that rivals Saudi Arabia in scale and global reach. Convincing Moscow that its interests and ours coincide far more than its interests and OPEC's should become a critical part of our global oil agenda.

Finally, finding a creative way to revitalize Iraqi oil, with its huge reserves, and to induce Baghdad to produce to an ever-enlarging production capacity should be a major goal of this administration.

Beyond oil strategies, there is no question that if even 10 percent of the money spent defending Kuwait and Saudi Arabia since 1990 (and similar sums for the U.S operations in Iraq) are put toward developing alternative fuels such as solar and fuel cells, the United States could be importing much less oil and exporting new technology energy equipment today, enhancing both security and the global environment.

It is time to complete the counterrevolution to OPEC and create an energy regime that is no more politicized than other areas of trade and payments. Until Americans get a grip on the fact that their unbridled energy use is not free of consequences, celebration of the 1973 oil embargo will remain a sobering, rather than festive, occasion.