Oil and Politics, Thirty Years after the Arab Oil Embargo

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Brief Analysis

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The effects of the 1973 oil embargo by the Organization of the Petroleum Exporting Countries (OPEC) can still be felt. Although the United States has successfully curtailed OPEC's ability to use oil as a weapon or as leverage for political blackmail, the resource remains a viable instrument of foreign policy for OPEC member states. In particular, these states have been able to maintain the price of oil well above what it would otherwise be. The embargo was part of OPEC's overall assumption of an increased role in the oil market. The organization quickly established a price floor, permitting oil to be traded at a level often 100 percent higher than its market value. OPEC members claim that this price floor creates a stable international environment, but a more apt description is that it secures a steady flow of revenue for them. Estimating where oil prices would stand were the market free from OPEC's influence is difficult. Nevertheless, it is sobering to realize that increased prices since the 1973 embargo -- which itself caused an immediate four-fold increase -- have transferred some $5 to 10 trillion from the hands of U.S. consumers to OPEC nations.

As the possessor of the world's largest oil reserves, Saudi Arabia holds center place in concerns about the political use of oil. Because of these reserves, Saudi Arabia has inevitably become a U.S. foreign policy partner, shielded by a protective U.S. umbrella. Yet, U.S. dependence on Saudi oil has produced two clear and present dangers. First is the corrupting impact that this dependence has had on U.S. policy, most visible in U.S. fawning over Saudi actions that in fact deserve little if any praise (e.g., Washington's excessive praise when Saudi Arabia increased its oil exports in response to Venezuelan strikes; the use of U.S. taxpayer money to build a center in Riyadh for consumer-producer dialogue about energy when it is Saudi policies that have so raised the costs to consumers). Second is the risk that the kingdom will follow the same trajectory of other oil-producing countries such as Iran and Venezuela -- that is, significant, even revolutionary change that dramatically reduces oil output (e.g., current oil production in Iran is only half what it was before the 1979 revolution).

Because of its extensive resources, Saudi Arabia has taken two very different approaches to oil policy. On the one hand, Riyadh has attempted to balance world oil markets, a role that requires it to adjust its production to accommodate others, thereby making Saudi policy dependent on foreigners. On the other hand, the oil giant is in a position to take political advantage of its oil. For example, many Saudis have a strong sense that their destiny is to use oil revenue as a means to propagate Islam. Hence, Riyadh allocates portions of its oil revenue for the maintenance of the kingdom's two holy mosques and for the promotion of Islamic propaganda abroad.

Although oil suppliers will continue to have leverage, oil consumers can regain market control by managing demand, as Europe has done. The European Union ensures that its members' oil purchases are made according to its own strict policies. Unfortunately, the United States has not taken similar measures, instead allowing itself to be buffeted by the demands of the producers.

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U.S. policy is to promote a diversity of oil sources, including ample non-OPEC sources. Although the diversification of oil supplies makes excellent sense, the increasing U.S. dependence on oil, regardless of its supplier, is a problem. Eventually, alternative sources of oil will be depleted; hence, as long as oil plays such a large role in U.S. energy consumption, the United States runs the risk of having to return to heavy reliance on the Middle East. The simple fact is that the extremely volatile Middle East has the world's largest proven oil reserves. Over the long run, the only effective way to reduce reliance on Middle Eastern resources is to reduce reliance on oil. The United States would do well to act sooner rather than later toward this end.

Growing international demand for oil is a powerful indication that oil dependency is a serious problem. Oil-guzzling policies in the United States, coupled with rapidly growing consumption in Asia, the fastest-growing energy market, will create an unsustainable situation in the future. For example, as the mode of transportation in China evolves from bicycles to automobiles, oil demand may increase by as much as 40 million barrels per day over the next twenty-five years, a colossal amount that even Saudi Arabia will be unable to meet.

Instability in the oil market provides another reason to opt for oil substitutes. The recent trend of oil shocks foreshadows a future of price volatility. Such shocks do not stem from market factors. Rather, they are due to various unpredictable circumstances (e.g., geological instability; terrorism) that make the oil market prone to disruptions. For example, al-Qaeda's growing interest in attacking oil facilities illustrates the vulnerability of the international oil production and distribution system. While the select few Western countries that belong to the International Energy Agency enjoy the security of petroleum reserves, most nations do not. In any case, a drastic supply shortage would prove detrimental to agency members and nonmembers alike.

Such considerations show that oil will soon become an economic burden. Fortunately, there are steps that can be taken to ameliorate the oil problem. One approach is to increase conservation efforts, a method that proved effective in the 1970s (e.g., after the 1973 embargo, more fuel-efficient automobiles were developed). Another option is to increase the use of nonpetroleum oil sources (e.g., by recycling items such as vegetable fats and tires). Realistically, however, neither approach would generate enough energy to meet current U.S. oil needs. The only way to drastically reduce reliance on conventional oil is to promote new transportation fuels. Dramatic changes (e.g., to hydrogen-powered vehicles) would be very difficult to implement; the transition costs would be enormous. More attractive are hybrid vehicles, which can use the existing system of gas stations. The rechargeable hybrid vehicle demonstrates how such an evolution can occur. The success of alternative vehicles and fuels will depend on market strategies and entrepreneurial skills aimed at making these vehicles and fuels more attractive and cost effective. Unless other energy sources (whether natural gas or electric power) are popularized in the U.S. transportation market, the United States will continue to be beholden to oil, and the goal of minimizing OPEC's clout will not be met.

Ironically, the most progressive countries of the Middle East are those that lack significant oil reserves. Rather than allowing the people a voice in governance, oil-rich regimes often dispense patronage and eliminate taxation. A recent International Monetary Fund report showed that countries with ample oil resources were the most likely to have low growth rates, while countries lacking such resources were more likely to have experienced faster growth and enhanced economic performance. In this sense, oil is antithetical to progress and democracy. As long as oil-rich states Middle Eastern remain addicted to easy oil money, they are unlikely to reform quickly.

This Special Policy Forum Report was prepared by Haleh Zareei.

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