

The Bush Administration and OPEC:

The National Energy Policy Revisited

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Brief Analysis

Tomorrow's conference of the Organization of the Petroleum Exporting Countries (OPEC) in Vienna comes at a time when higher oil prices have been reflected in increased gasoline prices over the last two months. Indeed, further price hikes are possible, particularly as talk of war with Iraq has strengthened the futures market in recent days. Presently, the cartel influences rather than controls the world price of oil and, unlike in 1973, sees its role as maintaining supply. Last May, in the National Energy Review (NER), the Bush administration appeared unwilling to criticize the production policies of OPEC, which is dominated by Middle Eastern states. How has this view been affected by the events of September 11? Furthermore, how might OPEC respond as the Bush administration pursues the war on terrorism and confronts the "axis of evil," which includes two OPEC members -- Iran and Iraq?

OPEC's Perception

The last regular meeting of the oil ministers from the eleven OPEC member states took place at the end of September 2001, as the world was still trying to absorb the implications of the attacks on the United States. Oil prices had begun to dip as world economies slowed in shock. The United States, along with the governments of several other major economies, had lowered interest rates to compensate. There were also calls for OPEC to take sympathetic action, such as pumping more oil to cause prices to fall. (Saudi Arabia did quietly ship to the United States an extra 9 million barrels -- the equivalent of little more than a day's production -- but it is not clear whether it was sold or merely stockpiled.) Instead, OPEC ministers considered cutting production in order to boost prices. In the end, good sense prevailed, and the ministers decided to leave quotas as they were. Prices continued to weaken, however, and in December, OPEC members decided -- in cooperation with concerned non-OPEC producers Russia, Norway, Mexico, Oman, and Angola -- to cut production beginning January 1. The results of this decision are now being felt.

From OPEC's point of view, the December agreement rescued the world economy from the doldrums. According to Ali Rodriguez, OPEC's secretary general, "It offers a great opportunity to forge a closer and more constructive relationship with non-OPEC producers in the joint task of ensuring a stable oil market." Qatar's energy minister, Abdullah al-Attiyah, told the London Times this week, "I often ask myself what would happen to the oil market

without OPEC. The answer is chaos. You need an organization that knows how to stabilize the market, that can intervene when the prices move in the wrong direction."

Although the oil producers and oil companies -- whose profits are directly related to oil prices -- may feel that prices were moving "in the wrong direction," consumer opinion may differ. OPEC's idea of stability seems to be ever-increasing prices. When oil prices dipped to below \$10 per barrel three years ago, OPEC members spoke of recovering them to around \$15, then changed the target price to \$18, then \$25, then a range from \$22 to \$28 as prices became more buoyant. The higher the price, the more OPEC seemed to consider it the appropriate level. (It is now around \$24 per barrel.)

U.S. Energy and Foreign Policy

The events of September 11 have reduced any focus on implementing the NER, even though it was published amid much fanfare. (The extent to which the review adopted possibly poor advice offered by executives of the now defunct Enron Corporation has yet to be determined, though presumably Enron's advice was primarily about natural gas -- its main business -- rather than oil.) Yet, the main conclusion of the review -- that the United States should reduce its dependence on foreign energy supplies -- has gained wider legitimacy after many Americans began to feel let down by Saudi Arabia because of the preponderance of Saudis among the September 11 hijackers.

As the world's largest oil exporter holding the world's largest oil reserves, Saudi Arabia has long been the de facto leader of OPEC. Prior to September 11, the Saudis ensured that the cartel was neutral, if not friendly, toward the United States even though its membership includes U.S. adversaries such as Iran, Iraq, and Libya. Indeed, the kingdom was recognized in the NER as being "a linchpin of supply reliability to world oil markets." Since September 11, a potential source of major difficulty has been the dominance of Muslim nations in the cartel -- Algeria, Indonesia, Iran, Iraq, Kuwait, Libya, Qatar, Saudi Arabia, and the UAE; only Nigeria and Venezuela are non-Islamic. So far, the troubles between Israel and the Palestinians have not led to threats about a 1973-style embargo, but the virulent rhetoric in some Arab countries concerning Palestinian terrorism and the toughness of the Israeli response could lead to a reaction against the United States.

One particularly thorny issue is the dependability of Saudi Arabia as an oil supplier. On September 1, 2001, Crown Prince Abdullah -- concerned about America's cautious approach to Middle East diplomacy -- warned President Bush that U.S.-Saudi relations were at a crossroads. September 11 suggested that the warning might well have proceeded in the opposite direction. Despite a Saudi public-relations campaign to rehabilitate the kingdom in the eyes of the American public, concern about the durability of Saudi-U.S. links remains among officials handling military, intelligence, and financial cooperation. Even oil companies, traditionally sympathetic to the Saudis, are appearing skeptical in their comments. Last month, the chief executive of Exxon-Mobil, Lee Raymond, failed to achieve a breakthrough in talks with Prince Saud al-Faisal, the Saudi foreign minister who is also organizing foreign investment to exploit gas reserves. Similarly, John Browne -- the head of BP, part of a consortium led by Exxon-Mobil -- said that his company would invest in the plan only if the commercial terms were right.

The reliability of oil supplies should be a factor in the Bush administration's decisions concerning the next step in the war against terror. If Washington wants to persuade the region and the world that it is prepared to take strong measures to end the threat posed by Saddam Husayn and his weapons of mass destruction, it will need to show that it has considered the dangers of oil-supply disruption and associated price hikes. One route may be to work more closely with non-OPEC states, particularly Russia, which is now exporting almost as much oil as Saudi Arabia.

As for this week's OPEC meeting, it is expected to be short -- merely a confirmation of the current production quotas. The United States has been silent on whether it has other preferences. Little has been done to translate into policy the NER analysis, which warned: "Periodic efforts by OPEC to maintain oil prices above levels dictated by market

forces have increased price volatility and prices paid by consumers, and have worked against the shared interests of both producers and consumers in greater oil market stability."

Simon Henderson is an adjunct scholar of The Washington Institute. His study of U.S. relations with the conservative Arab Gulf states will be published shortly.

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