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State of the Union 2007: Recognizing the Threat of Strategic Oil Dependency

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In the State of the Union address, President Bush called a spade a shovel. Building on his earlier statement that America is "addicted to oil," he said:

> For too long, our Nation has been dependent on oil. America's dependence leaves more vulnerable to hostile regimes and to terrorists, who could cause huge disruptions of oil shipments, raise the price of oil, and do great harm to our economy.

The President called on Congress to double the capacity of the strategic petroleum reserve and for America to provide global leadership to encourage our friends and allies to consider policies to enhance their energy security. To improve the global energy balance, America's friends and allies should increase their production of oil, natural gas, and substitute fuels; diversify their supplies as much as possible away from unstable regions; make fuel consumption more efficient through technological innovation; and increase their Strategic Petroleum Reserves (SPRs).

The United States, said the President, must oppose "foreign actions that undermine free, open and competitive markets for trade and investment in energy supply"—a not-so-veiled reference to the policies of Organization of Petroleum Exporting Countries (OPEC) and its individual member states.

A Strategic Threat. The United States is the largest oil importer in the world, importing 13.5 million barrels per day (mbd), which accounts for 63.5 percent of total U.S. daily consumption. Oil from the Middle East—specifically, the Persian Gulf—accounts for 17 percent of U.S. oil imports, and this dependence is growing.

The U.S. government predicts that by 2025, the country will import 68 percent of its oil.The measures of the Energy Policy Act of 2005 will slow the growth rate of U.S. dependence only slightly. Recognizing the threat of strategic oil dependency, President Bush has suggested a number of measures, including increasing domestic drilling.

The President is right about this threat. Today, the U.S. faces a dire geopolitical challenge. Two-thirds of the world's oil reserves are concentrated in the increasingly unstable Middle East. The Persian Gulf will remain the largest and most important oil producer on the planet. Today, the leadership of the Islamic Republic of Iran is launching a bid to acquire both conventional and nuclear capabilities that will threaten its oil-producing neighbors, as well as America's allies, such as Egypt, Turkey, and Israel. Iranian dominance of the oil fields of the Gulf countries, some of which are populated by Shi'a Muslims, is an escalating strategic threat.

So are the virulently anti-American policies of the Venezuelan President Hugo Chavez, who embarked on Marxist-style nationalization of foreign-owned

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energy assets, including those of Chevron, Conoco, Exxon Mobil, BP, Norway's Statoil Arlington, and American Energy Systems. Chavez, a self-proclaimed Marxist and Trotskyite, has called President Bush the "devil" at the U.N. General Assembly and told Yankees to "go to hell." He recently rolled out the red carpet for Iranian president Mahmoud Ahmadinejad, a long-term friend and ally. Vladimir Putin's Russia is selling billions of dollars of arms to both Iran and Venezuela.

Russia, the main Eurasian oil exporter, at 4 million barrels per day, is increasingly nationalistic. Western energy companies in the giant Sakhalin-2 project were given the boot. Chevron is restricted from expanding the vital Caspian Pipeline Consortium route to export more Kazakhstani oil, and Gazprom reneged on its promise to admit American and European companies to develop the giant Shtokman field in the Barents Sea of the North Atlantic.

Nigeria, another major producer, faces chronic corruption and ethnic violence, while Angola, another fast-growing African exporter, is joining the the quasi-monopolistic Organization of Petroleum Exporting Countries (OPEC) cartel.

Not a single oil producing province is stable and at peace. It is only a matter of time until a major conflagration in the Middle East or simultaneous crises in two or more secondary energy producing regions will lead to a massive spike in oil prices, possibly triggering a global recession.

Monopolistic Price Controls. Since its creation in 1960, OPEC, which is dominated by Persian Gulf producers, has successfully restricted its member states' petroleum production, artificially distorting the world's oil supply to line its members' pockets. Over the years, OPEC has been quick to cut supply and slow to increase production, bringing oil prices to today's high levels.

Most OPEC member countries and other oil producers have high levels of government economic regulation and corruption, as documented in the Index of Economic Freedom, published by The Heritage Foundation and The Wall Street Journal. Thus consumers are effectively paying two premiums on oil: one for security and one for its suppliers' economic inefficiency and monopolistic behavior.

Several times, OPEC's supply-fixing strategy has brought devastation to the U.S. and global economies:

- The 1973-74 Arab oil embargo resulted in a worldwide economic recession, lasting from 1974 to 1980.
- OPEC's 1980 failure to increase production in the face of the Iranian revolution resulted in historically high oil prices of $81 per barrel in 2005 dollars.
- OPEC's refusal in 1990 to increase production sufficiently to keep prices stable when Saddam Hussein occupied Kuwait caused another spike.
- OPEC's resistance since 2004 to add productive capacity has sent oil prices to over $70 a barrel, once again endangering the world's economic growth.

Transferring Wealth, Enabling Terrorism. The only serious challenge to the organization came in 1978 when a U.S. non-profit labor association, the International Association of Machinists and Aerospace Workers (IAM), sued OPEC under the Sherman Antitrust Act, in IAM v. OPEC. The case was rejected in 1981 by the U.S. Court of Appeals for the Ninth Circuit. OPEC, the court ruled, could not be prosecuted under the Sherman Act due to the foreign sovereign immunity protection it claimed for its member states.

That decision was wrong. Government-owned companies that engage in purely business activities do not warrant sovereign immunity protection, according to prevailing legal doctrines.

High oil prices, which OPEC facilitates, serve to transfer wealth from Western consumers to petroleum producers. This wealth transfer, among other things, funds terrorism through individual oil wealth and government-controlled foundations. It also permits hundreds of millions of dollars to be spent on radical Islamist education in madrassahs (Islamic religious academies).

Furthermore, the oil-cash glut in the Gulf states and elsewhere blocks much-needed economic reform in oil-producing countries. State subsidies for everything from health care to industry to bloated bureaucracy continue unabated, funded by Western consumers.

Congress Gets Into Action. Growing concerns over energy prices have at last prompted the 109th Congress to examine the legal hurdles that prevent the United States from defending its economic and national security interests. In the early part of 2005, a group of senators introduced the "No Oil Producing and Exporting Cartels Act" (S. 555), known as NOPEC, to amend the Sherman Act to make oil-producing and exporting cartels illegal. This amendment would modify sections of the Sherman Act to allow the U.S. Department of Justice or the Federal Trade Commission to bring suits against OPEC for its monopolistic practices.

Recommendations for Congress. Building on President Bush's initiatives the U.S. Congress should:

- **Defend American businesses and consumers.** Congress should send a strong and long-overdue signal to OPEC oil barons that they must stop limiting production and investment access. Any legislation should allow private suits against OPEC. If OPEC is to be reined in, individuals and companies that it has damaged must also be allowed to bring suits against the cartel. As the IAM v. OPEC decision made clear, it is up to Congress to amend the Sherman Act rather than rely upon the courts.
- **Remove tariffs on imported ethanol.** Making fuel-flexible cars viable will require lifting the U.S. tariff on imported ethanol (currently 54 cents per gallon). The U.S. ethanol industry relies on corn and grain sorghum, which yields much less ethanol per pound than the sugar cane that is used abroad.
- **Call on major energy consumers to expand energy policy coordination.** While European countries have a joint petroleum reserve and national petroleum reserves that can withstand up to 12 weeks of a major oil market disruption, Asian countries' SPRs (with the exception of Japan's) have insufficient capacity. Congress and the Bush Administration should call on Asian countries to cooperate in building a system of SPRs to supply major consumers, including China, India, and Japan. The Administration should encourage the European Union countries to coordinate their energy policy, especially vis-à-vis Russia and the Middle East, on which they are woefully dependent. The U.S. should also initiate a global effort to coordinate the energy policies of major energy consumers, including China and India. This can be done under the aegis of International Energy Agency (IEA).

Conclusion. President Bush sounded a clarion call to promote U.S. energy security, which, due to America's growing dependence on imported oil, is inseparable from increasing instability of the oil markets. Congress and the Administration should work together to reduce dependence on foreign oil; to allow import of a cheap alternative fuels, such as sugar cane ethanol; and address, with US allies, threats to oil supplies at home and abroad.

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