Don't Blame The Saudis; Consider the irony--one Bush administration reason for war in Iraq was to reduce our dependence on Saudi Arabia's oil

Author(s): Fareed Zakaria

Last week oil prices finally stopped rising. They now hover around $43 a barrel, a 20-year high. The average American family will spend about $2,700 on gasoline this year (driving 22,000 miles). That's twice as much as it spent on gas two years ago. These prices are having a predictable consequence. The consumer price index has risen 4.9 percent to date, versus 1.9 percent last year. And last week President Bush's economic adviser, Gregory Mankiw, acknowledged that a $10 rise in the price of oil probably translates into a half-percentage-point drag on economic growth. For countries like Japan, China and India, the effect is even greater. How did this happen? And can Washington--or anybody--do much about it?

The answer that flashed on our television screens is instability in the Middle East. Pipeline explosions in Iraq, tensions with Iran and terror attacks in Saudi Arabia all contribute to what analysts call the "security premium" on the price of oil. But that premium might be exaggerated. Oil prices are rising for broader, structural reasons. The world may have to get used to expensive oil.

The largest ingredient in current oil prices has been a massive increase in demand. This year's growth is double what it has been for the past six years (on average). That's because the United States is in recovery, Japan's economy is finally back and Asia--particularly China and India--is growing fast. In fact, this year is likely to have the strongest global growth on record in three decades--unless oil prices choke it off.

While demand is up, supply can't rise much. For a variety of reasons, almost no oil-producing country has "surplus capacity"--the ability to put substantially more oil into the market. Oil companies have been slow to increase investments in production, and these expenditures take a few years to bear fruit. "Right now oil markets are tighter than they were on the eve of the 1973 oil shocks. And they will stay tight for the next two years. That makes the geopolitics of oil crucial," says Daniel Yergin, the chairman of Cambridge Energy Research Associates.

If there is trouble anywhere, it will probably cause an oil shock. And think of the possibilities--instability in Venezuela, Nigeria, Indonesia, Libya, Saudi Arabia or, of course, Iraq. Last year the markets could absorb the loss of Iraqi oil (during the war). This year they can't. Iraq has to stay online. And all these other countries have to stay stable.

There is only one country with significant surplus capacity--Saudi Arabia. Saudi Arabia has increased its production repeatedly over the past two years, or else prices would be higher still.
than they are. And the Saudis are making investments that will increase their surplus capacity by the year-end. In a tight oil market, Saudi Arabia is the pivotal player.

Consider the irony. One of the Bush administration's (privately stated) reasons for going to war in Iraq was to reduce our dependence on Saudi Arabia's oil power. It was a reasonable idea. But having botched the occupation, with Iraqi oil more insecure now than before the war, America is today more dependent on Saudi Arabia than ever before. Fortunately the Saudi regime has proved a responsible and reliable player, in this realm. "The Saudis are the central bankers of the world of oil. And they take that role seriously," says Yergin.

What to do about this new reality? George Bush proposes increased U.S. production in Alaska. John Kerry calls for increased conservation. Bush is correct to argue that some increase in American production is important. In 1973, the United States imported one third of its oil from abroad. Today it imports two thirds. And exploration does not have to be ecologically devastating. Even if the major oilfields that are assumed to exist were discovered in the Arctic National Wildlife Refuge, only a few thousand acres of the 19 million-acre refuge would be affected.

But the more lasting solution to America's oil problem has to come from energy efficiency. American demand is the gorilla fueling high oil prices—more than instability or the rise of China or anything else. Between 1990 and 2000 the global trade in oil increased by 9.5 billion barrels. Half of that was accounted for by the rise in U.S. imports.

America is consuming more because it is growing more—but also because over the past two decades, it has become much less efficient in its use of gasoline, the only major industrial country to slide backward. The reason is simple: three letters—SUV. In 1990 sport utility vehicles made up 5 percent of America's cars. Today they make up 55 percent. They violate all energy-efficiency standards because of an absurd loophole in the law that allows them to be classified as trucks.

Bashing the Saudis is easy these days. Controlling our own wastefulness is more difficult. But make no mistake as to which one will make a difference.

Source Citation  (MLA 7th Edition)
Zakaria, Fareed. "Don't Blame The Saudis; Consider the irony--one Bush administration reason for war in Iraq was to reduce our dependence on Saudi Arabia's oil." Newsweek 6 Sept. 2004: 55. Academic OneFile. Web. 12 Mar. 2015.