Insignificance of Gulf's Imperiled Oil

June 9, 1987 p. 34

By S. FRED SINGER

President Reagan is warning that if the U.S. Navy doesn't defend oil shipping in the Persian Gulf, Americans may soon be waiting in gasoline lines again. In fact, the price decontrol that was one of his first acts upon taking office in 1981 made such queues a thing of the past, regardless of supplier problems.

In the wake of the attack on the USS Stark, the issue of a U.S. presence in the gulf has been further confused by a largely irrelevant debate in Congress and the press. On the one hand we hear that the U.S. is receiving only about 10% of its oil from the gulf, and that's cited as a reason for staying out. On the other hand, we are reminded that America's allies, Western Europe and especially Japan, are highly dependent on gulf oil and require U.S. support. The numbers are correct; the logic is not.

A significant interruption in the world oil supply would raise the price to consumers everywhere—no matter where their oil comes from or how much they import. Oil is a fungible commodity: There is a single world price. If Japan were to experience a shortfall—either of Arab oil or of Iranian oil—then Japanese consumers would bid up the price to satisfy their demand, causing U.S. consumers to pay the same high price. But the supply interruption may never become significant enough to cause shortages and push up the price.

With about one-eighth of Free World oil in gulf tanker traffic, as much as one-half of that traffic would have to be interrupted on a steady basis to make a strong impact on the price. That translates to about 20 supertanker sinkings a week! Any lesser interruption can be made up by existing pipelines and from the excess production capacity of other suppliers—and they'll be glad to do it.

Contrary to conventional expectations, the cost of the lost oil and of the tankers will ultimately be borne by the gulf oil suppliers, not by consumers. Iran and the Arab oil states must also pay the full cost of insurance out of their oil profits. The economics of the oil business dictates that gulf oil delivered to Houston has to compete in price with oil from Mexico and Texas. After subtracting shipping and insurance costs, the oil-well owner "nets back" the remainder.

The bottom line on the benefits of avoiding modest oil-supply dislocations: hardly any for the U.S. or its allies. The question then becomes: Is it worth risking American lives in order to lower insurance premiums for Kuwait and other gulf producers?

In any case, to prevent a world oil supply interruption—if this is indeed America's purpose—the U.S. must not only stop tanker attacks by Iran, but also Iraqi attacks on Iranian oil carried by Iran or by third parties. Otherwise U.S. actions would be construed as a direct military involvement in the Iran-Iraq conflict, rather than as an undertaking to protect oil shipments to Free World consumers or to uphold the principle of free navigation.

One can certainly imagine scenarios that lead to more severe interruptions: for example, a complete closing of gulf oil traffic by a blocking of the Strait of Hormuz. But such an event would likely be temporary and could be met by appropriate diplomatic and military action at that time. In the meantime, the strategic oil stockpiles, for which taxpayers have invested tens of billions, could replace most of the lost oil and keep the price from exploding. The combined reserves of OECD nations now amount to nearly half a year's worth of gulf tanker traffic.

Even if the U.S. Navy is successful in protecting tankers against hostile aircraft, land-based missiles and artillery, speedboats, mines, frogmen, etc., there may be little the U.S. can do to protect other links in the oil transport chain: loading platforms, pumping stations, pipelines and oilfield installations. The Arab oil nations are full of Shiites, many of whom could be recruited by the ayatollah to serve his cause and reap eternal rewards. Sabotage and terrorism may become rampant, fueled by religious fanaticism, political and economic grievances, and hatred toward infidel Westerners who are "exploiting the Arab oil patrimony."

Having baited the trap by leasing Soviet tankers, Kuwait may be trying to draw the U.S. into a risky combat situation—perhaps even with Soviet collusion. But for the foreseeable future, America's oil supply is not threatened.

Mr. Singer is visiting eminent scholar at George Mason University. He has written frequently for the Journal on world oil prices and other topics.

Letters to the Editor

THURSDAY, JULY 9, 1987

Oil Supply in Dire Strait

Fred Singer's June 9 editorial-page article, "Insignificance of Gulf's Imperiled Oil," minimizes the impact that could be felt as a result of the closure of the Strait of Hormuz. As an analyst of the spot and futures oil markets, I would expect that the immediate reaction to such a development would be skyrocketing prices as companies outbid one another for available supplies—either as a hedge to avoid paying even higher prices later or as a speculative trade in the hope of reselling the oil later at higher prices.

History provides two cases of relatively small interruptions that had significant oil-price impacts. The 1973-74 Arab oil embargo lasted five months and involved a cut of about 14% of international trade in crude oil. The price impact was a quadrupling from \$3 to \$12 per barrel. The Iran-Iraq war, coincidentally, also removed about 14% of oil from international trade and caused spot prices to rise by a factor of three, from \$14 a barrel to over \$40 a barrel. A partial closure of the strait could easily involve around 14% of total world oil trade, and who could say whether the conflict might not result in major damage to other land-based oil installations?

ROBERT BOSLEGO

Winchester, Mass.

* * *

Mr. Singer is correct in arguing that hostilities in the Persian Gulf do not threaten America's oil supply. But he makes the mistake of assuming that the U.S. has offered to protect Kuwaiti ships primarily out of concern for the security of oil supplies.

The real reason for this U.S. step is twofold. First, we seek to take a stand on Iraq's side by helping Kuwait, one of Iraq's foremost backers. Second, we are telling Iranian leaders that their efforts to gain hegemony over the Persian Gulf will not be tolerated. Both of these, I believe, are correct positions, and they justify the help that has been promised to Kuwait.

DANIEL PIPES
Director
Foreign Policy Research Institute
Philadelphia, Pa.