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ECONOMIC VIEWPOINT

By Jeffrey E. Garten

Let's End Our Dangerous Dependence on the Saudis

A White House push for fuel-efficient cars and more oil from Russia would go a long way toward safeguarding the U.S.

Among the critical problems that Congress should address when it returns on Jan. 23 is American energy policy. Thus far President Bush has emphasized increasing production in the U.S., while giving short shrift to the potential for conservation. And since the September 11 attacks, there is another big shortcoming to the Administration's plan--it keeps intact our dangerous dependence on Saudi oil. Now it's time for some tough decisions involving both foreign and domestic policy.

Saudi Arabia supplies 14% of our petroleum imports. However, its real leverage comes from its 2 to 3 million barrel-per-day surplus capacity and its willingness to turn its own spigot on and off to keep oil prices within relatively moderate ranges. When it fails to act, as it did two years ago, prices can soar and play havoc with our economy. The crucial Saudi swing role is why the Bush Administration tolerates the kingdom's policies of subsidizing Islamic fundamentalism in its schools and abroad, as well as the involvement of Saudi citizens in a number of major attacks against Americans, including September 11, over the past seven years.

Outside the Administration, a number of American foreign policy experts have been demanding that Saudi Arabia reform its religious schools that breed intolerance, cease supporting extremists, and grant its people more political freedom. Sounds good, but these prescriptions are no more than a wild leap of faith that so radical a transition could occur peacefully and with oil supplies still being managed in America's interest. After all, not only is the kingdom in a political earthquake zone, but the Saudi leadership is ripe for destabilization owing to its living in luxury even as the country's per capita standard of living has dropped by half since 1980.

The precariousness of Saudi Arabia as an ally now means that the Administration should view reducing our links to it as an essential outcome of the anti-terrorist campaign. We may not be able to achieve total energy independence, and with 25% of the world's reserves, Saudi Arabia will always remain a big player in oil markets. But we should do much more to reduce our strategic vulnerability.

For starters, Washington and Corporate America should help Russia accelerate its production and its exports to undermine Saudi Arabia's role as the pivotal swing producer. Russia could become the world's largest oil producer this year and it could expand its output by at least half its current 6.9 million barrels per day within the next several years. Russian exports have already been increasing rapidly, but to expand them even more, Moscow needs billions of dollars of investment in pipelines, ports, and related transportation infrastructure. For their part, U.S. companies need a more favorable tax and regulatory environment from Moscow as well as more equitable production-sharing agreements before they will seriously invest. In the wake of the post-September 11 improvement in Washington-Moscow ties, now is the time to intensify efforts to strike a cooperative deal. For example, the U.S. and Russia could perhaps create some long-term supply arrangements. The U.S. could begin with giving preferences to Moscow in filling our strategic reserve as a quid pro quo for more accommodating Russian investment rules in the energy sector.

We also need to enlarge and revamp the global system of holding emergency stocks. America's strategic stockpile should be doubled to reach at least 1 billion barrels, or 90 days' worth of imports. The U.S. should also encourage energy importers such as China, Brazil, and India to hold larger reserves. Washington should then press for coordinated management of all these stocks and be prepared to use them to influence prices. This would constitute a sharp change of policy, because to date the industrial nations have only set stocks aside as insurance against any major supply disruption.

Bush needs to focus on energy conservation at home, too. The Administration is pushing research on fuel cells as an alternative to the gas-guzzling internal combustion engine. Unfortunately, the payoff will be decades away. A higher tax at the pump would help cut consumption but that's probably a political nonstarter, especially in the wake of Bush's recent "over my dead body" declaration about new taxes. The best alternative is to legislate higher auto mileage standards, which have now reached the lowest

levels in two decades. Tax breaks for purchasing hybrid electric-gasoline cars that get upwards of 50 miles per gallon--already available--should also be considered.

Are these three measures unrealistic? No more so than thinking that we can close our eyes and maintain the status quo with Saudi Arabia. As Edward Morse, who chaired a recent Council on Foreign Relations study on strategic energy options told me: "The biggest risk is in doing nothing." Yet unless some dramatic measures are taken soon, that's effectively the course we will be on.

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