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The Other Oil Threat


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AS OIL PRICES CONTINUE THEIR STEADY SLIDE, and as OPEC ministers move to cut production in an effort to halt the decline, all the talk is of how low prices will go, or whether cheaper oil will lessen the threat of inflation, help keep interest rates down and stimulate global economic growth. But despite all this speculation, the dismal long-term trends haven't changed.

In fact, as we pass another anniversary of the OPEC embargo launched on Oct. 17, 1973, the developed world and America in particular are far worse off today in terms of energy security than we have ever been.

In addition to the West's continuing dependence on OPEC oil reserves, a new financial threat is emerging from OPEC's other reserves: petrodollars. In 2006, the cartel's current-account surpluses will reach $240 billion, matching the combined surpluses of Asia's developing countries, including India and China. And while the U.S. economy has become far more streamlined in its use of energy since 1973, and thus in some ways less vulnerable to oil shocks, it has become more exposed to financial shocks. In 1973, the United States was the world's largest creditor, relatively impregnable to an attack on the dollar. But today it owes $3 trillion to overseas creditors, making it much more vulnerable to foreign financial machinations.

Unlike most Asian countries, many OPEC governments camouflage the management of their reserves by farming them out to trusted private investment firms. Also, the central banks in Iran, whose reserves have more than doubled in the past three years, and in Venezuela, whose reserves grew by 30 percent, are both under the thumb of political leaders openly hostile to the United States. If a political confrontation envelops Washington and Tehran, or Washington and Caracas, the two nations could create financial turmoil by, say, asking certain unregulated hedge funds to create a spark to set off a broader investor stampede that would harm the U.S. economy. Yes, this would be an irrational move, because it could devalue their own dollar holdings. But then, extreme behavior, motivated not by economics but by nationalist politics, has characterized both countries' policies for some time now.

While the Middle East remains the huge foreign-policy mess it was in 1973, many more acute geopolitical problems related to energy have also arisen. They include Iran's presumed race to acquire nuclear weapons, Russia's attempts to use its energy industry to bully its neighbors and China's drive to lock up energy supplies by offering trade and aid concessions to states on Uncle Sam's blacklist, such as Iran, Venezuela, Sudan and Burma. Indeed, whereas U.S. oil companies ruled the roost three decades ago, today 80 percent of global oil reserves are managed by emboldened government-owned companies that reflect the political goals of their countries' leaders.

In 2006, OPEC's trade surpluses will match those of developing Asia, at a time when the U.S. is vulnerable to financial machinations.

Over the past three decades, U.S. oil imports as a percentage of domestic consumption have doubled to 60 percent. It is hard to envision another successful oil embargo, given the increasing number of petroleum suppliers from the former Soviet Union and Africa, together with U.S. and European strategic stockpiles that have been built up since 1973. But there are other problems, for never before has Islamic radicalism posed such a threat to the security of oil installations, to governments such as Saudi Arabia and to transportation choke points such as the Strait of Hormuz, through which 20 percent of the Persian Gulf's oil passes.

OPEC is also in a position to undercut the only good trend—the fact that since 1973, more money has been flowing into alternative energy. Leading venture capitalists such as Kleiner Perkins and private equity and hedge funds such as the Carlyle Group are placing bets on biofuels. Multinational companies such as GE and Toyota are embracing energy conservation to curb greenhouse emissions. But with its sway over the price of oil, the cartel is in a position to render unprofitable alternative-energy projects that were financed on the assumption of a consistently high price of petroleum. And surely this is one motivation of countries such as Saudi Arabia for not allowing prices to stay too high for too long.

Bottom line: neither the age of petroleum, nor our growing dependence on fossil fuels, is about to end any time soon. The International Energy Agency projects a 50 percent increase in global demand for oil over the next 25 years, propelled by the growing industrialization of China, India and other emerging markets. The IEA says that nearly $4 *trillion* in new investments in exploration and infrastructure will be needed in the next quarter century just to keep oil demand from not outstripping supplies. The implications range from more financial clout in OPEC's hands to more foreign-policy leverage among oil producers, and more humiliating dependence on them by the West. If there's another scenario, I'd love to hear it.

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