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Do Governments Need to Go to War for Oil?

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Do Governments Need to Go to War for Oil?

David R. Henderson*

Introduction

In his book, *The Age of Turbulence*, Alan Greenspan wrote:

I am saddened that it is politically inconvenient to acknowledge what everyone knows: the Iraq war is largely about oil.¹

He made clear, in a later interview with broadcaster Charlie Rose, that he wasn’t simply saying that many people’s motive for the war was oil, but also that that motive made sense. Greenspan gave no evidence for his assertion. But in making it, he confirmed the views of many opponents of the war, and even some supporters, that the 2003 war on Iraq was, or at least should have been, about oil. He also joined a long list of prominent people who have made the case for war for oil ever since the Organization of Petroleum Exporting Countries (OPEC) formed an effective cartel that raised the world price from $3 per barrel to $11 per barrel in the fall of 1973.

Yet the case for “war for oil” is profoundly weak. The pragmatic case against war for oil, which rests on basic economic analysis, is fundamentally strong. This case rests on a few facts. First, no oil-producing country, no matter what it does to its oil supply, can cause people in another country to line up for gasoline. Second, an oil-producing country cannot impose a selective embargo on a target country because oil is sold in a world market. Third, the only way a country’s government can hurt another country using the “oil weapon” is by cutting output; doing so will hurt all oil consumers (not just the target country), will help all oil producers, friend and foe alike, and will hurt the country that cuts its output.

“War for oil” threats

Before I make the case against war for oil, consider how long many people in the foreign policy establishment has taken as given the idea that the US government needs to use military force to keep the world supply of oil flowing.

professor and defense consultant with intimate links to high-level US policy makers.” The author expressed frustration at the high price of oil and argued that no non-violent means of breaking the cartel’s back would work. Even massive conservation, he argued, was unlikely to solve the problem. Moreover, he claimed, “there is absolutely no reason to expect major new discoveries.” So what options were left, according to “Ignotus”? He wrote:

The goal is not just to seize some oil (say, in accessible Nigeria or Venezuela) but to break OPEC. Thus, force must be used selectively to occupy large and concentrated oil reserves, which can be produced rapidly in order to end the artificial scarcity of oil and thus cut the price. Faced with armed consumers occupying vast oil fields whose full output can eventually bring the price down to 50 cents per barrel, most of the producers would see virtue in agreeing to a price four or five times as high, but still six times lower than present prices. This being the ultimate goal, there is one feasible target: Saudia Arabia.

Ignotus’s article, though one of the most articulate, was far from the only call in the USA for a US invasion of a Middle East oil country. Of course, no such US invasion occurred in the 1970s. Nevertheless, Ignotus’s kind of extreme thinking made respectable the idea that the US government should seriously consider invading countries in the Persian Gulf to drive down the price, or assure the supply, of oil.

On January 1, 1975, just two months before Ignotus’s article appeared, Secretary of State Henry Kissinger had stated that military force should not be used “in the case of a dispute over price,” but should be considered “where there is some actual strangulation of the industrialized world.” Kissinger did not say what he meant by “strangulation.” In May of that year, Secretary of Defense James R. Schlesinger made further threatening noises.

Indeed, in 1977 President Jimmy Carter issued an order for the US military to start a Rapid Deployment Force. The idea of such a force was to give the government the ability to quickly send a substantial invasion force to various parts of the world. After the fall of the Shah of Iran in 1979, the Rapid Deployment Force became focused on the Persian Gulf. In 1983, during the Reagan administration’s tenure, this Rapid Deployment Force became known as the US Central Command (CENTCOM). The cost of this force, even in years of relative peace, has been high. Although the US government tends to hide the cost of various programs, making it hard for analysts, let alone average citizens, to know these costs, one analyst, Earl Ravenal, estimated that the fiscal year 1985 budget for CENTCOM at US$59bn, $47 billion of which, he claimed, was for the Persian Gulf alone. At the time, that amounted to a full 1% of the USA’s GDP. To put that $47bn in perspective, in today’s dollars, it would be $94bn.

Finally, of course, the US government initiated the first Gulf war at least partly over oil. President George Bush, sr, stated that his military action in the Persian Gulf was partly about “access to energy resources that are key … to the entire world.” Bush claimed that if Saddam Hussein had gotten greater control of oil reserves in the Middle East, he would have been able to threaten “our jobs” and “our way of life.” James A. Baker III, Secretary of State at the time, claimed that Saddam Hussein, by controlling much of the world’s oil, “could strangle the global economic order, determining by that whether we all enter a recession, or even the darkness of a depression.” And the ever-present Henry Kissinger wrote that an unchecked Saddam Hussein would be able to “cause a worldwide economic crisis.”

Yet the advocates of war for oil have never confronted some basic economic realities. Economists are often criticized for their pessimism, but an understanding of how oil markets work leads, not to pessimism, but to optimism about a secure oil supply.
No price controls, no line-ups

When many Americans over the age of 50 worry about Middle East producers playing havoc with the world oil supply, they think back to the gasoline line-ups that we had in the USA in 1973 and 1979. But no cut in supply by a foreign producer can cause us to line up for gasoline. The organization responsible for that fiasco was the US government. President Nixon had imposed a freeze on all prices on August 15, 1971. He gradually relaxed controls on prices, but when OPEC raised the price in the fall of 1973, Nixon’s price controls prevented the price of oil and gasoline from rising sufficiently. Whatever else economists may disagree on, one thing they agree on is that a price control that keeps the price below that which would have otherwise existed in a competitive market will cause a shortage. The reason is that at a price below the competitive price, consumers will demand more than otherwise and producers will supply less.

President Ford and Congress altered the price controls and President Carter inherited them and kept them. Although Carter did, in 1980, sign legislation to phase out price controls, a tightening of world oil supplies in 1979 combined with the price controls to cause further shortages. The good news is that since then the US government and most governments around the world have refrained from imposing price controls. The result has been that people in those governments’ countries have not had to queue for gasoline.

The impotence of selective embargoes: musical chairs with everyone seated

To say that a reduction in the supply of oil cannot cause a shortage is not to say that it cannot cause harm. In any country where the amount of oil consumed exceeds the amount produced, that is, any country that is a net importer of oil, a rise in the price will cause more harm, measured in dollars, to consumers than the gain in dollars that it provides to domestic producers. But the key is that the supply must fall. If the supply of oil does not fall, nothing important changes.

Imagine that the government of country A currently sells oil to people in country B and wishes to harm people in country B by refusing to sell to country B or by reducing sales to country B. What happens next depends crucially on whether government A cuts its own oil production or maintains its production. Assume that government A maintains its production. This means that government A must look around for people in other countries to sell the suddenly-freed-up oil to. To make the issue more concrete, consider the case of the USA. In August 2010, as Table 11.1 shows, the five most important exporters of oil to the USA, in order of importance, were Canada, Mexico, Saudi Arabia, Venezuela, and Nigeria. Total imports from these countries were 56% of US imports. Of these five, the one most likely to want to hurt the USA currently is Venezuela or, more accurately, Venezuela’s government under Hugo Chávez. Interestingly, Chávez has done the exact opposite, actually subsidizing oil exports to favored groups in north-eastern parts of the USA. But imagine the worst: imagine that Chávez wants to target the USA using the “oil weapon.” So he cuts sales to the USA by about one-half, or 500,000 barrels per day. Then consumers in the USA get 500,000 barrels a day fewer than they wish to buy. They will look for other sources of oil. Where will they find them? Remember that Chávez needs to find people in other countries to sell this freed-up 500,000 barrels a day to. Let’s say he ships the oil to buyers in China. Then those buyers in China will find that they want to buy 500,000 fewer barrels from their suppliers, say Iraq or Saudi Arabia. Presto! The American buyers’ problems are solved because they can get their 500,000 barrels from Iraq or Saudi Arabia. In short, when the government of one country tries
to selectively target people in another country, but still wishes to maintain its output, it cannot succeed. The selective “oil weapon” is a dud. It’s like a game of musical chairs with the same number of chairs as players. The game would be awfully boring, which is why it is not played that way. But in the case of international trade, boring is good.

There are three complications in this musical chairs story, none of which changes the bottom line. First, it is unlikely that the government of Venezuela, or of any country, would maintain output simply by selling the freed-up output to people in only one other country. It is also unlikely that people in the targeted country would get supplies from producers in only two other countries. But that complication doesn’t change the conclusion. Second, one main reason for the particular pattern of oil exports and imports was probably transportation costs. An oil user in New Orleans is more likely to buy from Venezuela than from Iran because the cost of shipping from Venezuela is so much lower than the cost of shipping from Iran. It follows, therefore, that when a country’s government disrupts this pattern by cutting off oil supplies to a nearby country, transportation costs rise. The higher transportation cost acts like an excise tax, the burden of which is typically shared by the buyers and sellers. The disrupting government would be hurt by having to accept a somewhat lower price from a more-distant buyer. The people in the disrupted country would be hurt by having to pay a somewhat higher transportation cost to get their oil. But the maximum hurt in either case would be no more than the difference in transport costs and this would be a small number, probably under $2 per barrel. For the hypothetical 500,000-barrel production cut, therefore, the maximum hurt to US consumers would be $1m. dollars per day or $365m. per year, a very small number. To put this in perspective, it is about $1.20 per year per US resident. The third complication relates to Venezuela specifically. Venezuela’s crude oil is heavy and sour. Many refiners around the world can’t handle Venezuela’s oil, which means that Venezuela, in the short run, is stuck selling its oil to the USA.

The economics of a reduction in supply

Of course, a government of an oil-producing country can do substantial harm to the people of another country by cutting the amount of oil it produces and sells. I use the word “government” on purpose for two reasons. First, outside Canada, the USA, and Britain, almost all the world’s oil

<table>
<thead>
<tr>
<th>Table 11.1</th>
<th>Top 15 Sources of US Oil Imports, August 2010 (mbpd)</th>
</tr>
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<tbody>
<tr>
<td>Canada</td>
<td>2,483</td>
</tr>
<tr>
<td>Mexico</td>
<td>1,282</td>
</tr>
<tr>
<td>Saudi Arabia</td>
<td>1,132</td>
</tr>
<tr>
<td>Venezuela</td>
<td>1,022</td>
</tr>
<tr>
<td>Nigeria</td>
<td>985</td>
</tr>
<tr>
<td>Russia</td>
<td>786</td>
</tr>
<tr>
<td>Algeria</td>
<td>565</td>
</tr>
<tr>
<td>Angola</td>
<td>484</td>
</tr>
<tr>
<td>Colombia</td>
<td>372</td>
</tr>
<tr>
<td>Virgin Islands</td>
<td>339</td>
</tr>
<tr>
<td>Iraq</td>
<td>281</td>
</tr>
<tr>
<td>United Kingdom</td>
<td>266</td>
</tr>
<tr>
<td>Brazil</td>
<td>251</td>
</tr>
<tr>
<td>Kuwait</td>
<td>251</td>
</tr>
<tr>
<td>Ecuador</td>
<td>242</td>
</tr>
<tr>
<td>Total of All Imports</td>
<td>12,341</td>
</tr>
</tbody>
</table>

Source: US Energy Information Administration
is produced by governments. Second, restricting supply, to have a substantial effect, would have to be done by a government. The reason is that even the biggest private producer in an oil-producing country has too small an output relative to world output to have a substantial effect on the world oil price.

Any government that wants to hurt a particular country by reducing its oil supply faces three huge problems. First, an oil producer cannot single out particular countries or consumers to hurt. If one oil producer cuts supply, then, all other things equal, the world oil supply is lower than otherwise and the price will be higher. All oil consumers are hurt and their hurt is proportional to the amount of oil they use. Thus the “oil weapon” is an incredibly blunt tool that, when used, will hurt friend and foe alike. Second, the oil-producing country, by cutting output, will cause the world price of oil to rise, which will help other oil producing countries that don’t reduce their supply. So, for example, if Iran’s government chose to reduce its supply of oil to hurt the USA, it would also help its avowed enemy, Saudi Arabia. Not only is oil an incredibly blunt weapon, therefore, but also, when used, it strengthens some of one’s foes.

Third and finally, to continue with the weapon analogy, the oil weapon blows up in its user’s face. Specifically, any country that produces less than about 10% of the world supply will find that the price increase it gets will not compensate for the reduction in revenues due to lower production.

On this third point, consider the case of Saddam Hussein in 1990. When he took over Kuwait, he controlled oil production of 4.3mbpd in a 60mbpd market. His motive for taking over Kuwait was probably not, as Kissinger, Baker, and George H.W. Bush feared, to cut output and increase the price at all, but simply to have more oil to sell. A thief does not steal a television set to watch TV; instead he steals a TV to fence it. Similarly, an oil thief wants to steal oil to sell it.

Nevertheless, imagine that Saddam Hussein, wanting to hurt the USA, had cut output by 1mbpd. (You have to use your imagination here because Saddam was a US ally.) This would have been 23% of 4.3mbpd, but only 1.7% of world output. A reasonable estimate of the world’s short-run elasticity of demand for oil is \( -0.1 \). What that means is that a 10% reduction in world output leads to a 10% increase in price. Therefore a 1.7% reduction in output would have caused a 17% increase in price, raising the world price from about $20 per barrel to about $23.40 per barrel. The harm to the USA, which had been importing about 8mbpd at the time, would have been $27m. per day (8mbpd x $3.40), or $9.9bn per year. At the time, this would have been less than 0.2% of US GDP. Note also that even with this $3.40 per barrel increase, Saddam Hussein’s revenues would have been lower than had he not cut output at all. He would have brought in $77m. per day (3.3mbpd x $23.40) or $28.2bn a year, but had he not cut output, he would have brought in $86m. per day (4.3mbpd x $20), or $9m. per day more, which, on an annual basis is 4.3mbpd x $20, or $32.4bn. It’s true that by producing less, Hussein would also have had lower costs. So let’s bias the analysis in favor of his getting a gain from cutting output by assuming that the cost of oil production for the last 1mbpd was $5 per barrel, a number that virtually all observers would regard as being on the high side. Then his cut in output would have saved him $5m. per day. So he would have given up $9m. per day in revenue to save $5m. per day, which would not have been a good deal for him. In short, there is good reason to think that if Saddam Hussein had been as ruthless as he appeared to be, he would have wanted to cut output by less than 1mbpd, or maybe even not at all.

Of course, 1mbpd is less than 4.3mbpd. Therefore the estimated damage from the hypothetical 1mbpd cut in oil output by Saddam Hussein is well below the actual damage done to the USA
by the United Nations’ 1990–91 restrictions on output from Iraq and Kuwait, restrictions for which the US government was a key instigator.

Moreover, even these estimates of hurt are overstated. Why? Because producers in other countries do not sit passively by when the price of oil rises. When the price increases, producers produce more. This is for two main reasons. First, to the extent producers expect the price increase to be temporary, they will produce more quickly from existing reserves. Second, there are some sources of supply that weren’t worth exploiting at the previous lower price but are worth exploiting at a higher price. This increased production from other producers moderates the price increase from a given producer’s cut in output, further limiting the damage that can be done to countries, such as the USA, that are net importers of oil. It is interesting to note, in this context, that within months of the 1990 UN embargo, other producers, by increasing their output in response to the higher price, had made up for most of the supply lost.9

An aside on “dependence” on foreign oil

Many people worry about the fact that the US is dependent on foreign oil. But the basis for the worry is lacking. First, notice the use of the word “dependent.” The image that creates is of a poor, helpless waif, US consumers in this case, seeking the good will of the powerful oil producing nations. When I hear the term “dependent,” I think of the character in the musical, Oliver, saying meekly, “Please, sir, I want some more.” But a little economics is needed here. Remember that international trade in oil is just that: trade. Both sides gain from trade. Both sides, therefore, are dependent on each other. As the above calculations show, if one side decides not to export to the other, that side loses too. Producers of oil “depend” on the dollars, euros, and yen that buy that oil. This fact is commonly recognized when the topic is US exports; many Americans worry that we don’t export enough because they want our exporters to earn money from people in other countries. But somehow this simple fact gets lost when the topic is exporters of oil in the Middle East or Venezuela. “Dependence on foreign oil,” because it is so one-sidedly misleading, is a term that belongs in the dustbin of history.

The resilience of modern economies to oil price increases

One important economic fact that many people remember from the 1970s is the presence of “stagflation,” that is, the simultaneous occurrence of inflation and stagnation or slow growth. Even many economists at the time believed that a major cause of this stagnation was higher prices of oil and gasoline. Yet more recent research10 by economists Rajeev Dhawan of Georgia State University and Karsten Jeske of the Federal Reserve Bank of Atlanta has shown this belief to be false. There is no doubt that a net importer of oil will suffer a loss when the price of an import rises. So, for example, if the USA imports 6mbpd, as it did in 1973, and the price of oil rises by $9, the loss to the US economy (assuming Americans do not own shares in any of the foreign companies that export to the US) is $54m. per day or about $19.7bn per year. In 1973, GDP was $1,383bn, which means that the price increase of oil should have made GDP $19.7bn, or 1.4%, less than otherwise. In an economy whose normal growth rate of real GDP was 2 to 3%, this 1.4% drop would not have been enough to cause a recession and stagflation. Why, then, did economic growth fall by substantially more than 1.4% in the early 1970s, putting the US economy into a deep recession?

The added cause, according to Dhawan and Jeskie, was price controls. Price controls on any good, imported or domestic, will cause not only a shortage, but also a misallocation. Without
price controls, the goods go to their highest-valued uses. When price controls are in place, the good is allocated more randomly, either by line-ups, government fiat, or both. In the case of gasoline, it was both. Price controls on gasoline caused people to line up for it. That meant that it tended to go to those with the lowest value of time, such as students or retirees, rather than to those who valued the good most. In such a case, there are two economic losses: the loss in valuable time for all who line up and the loss due to misallocation of the good. When government steps in to allocate, as the federal government did in the 1970s, the good tends to go disproportionately to those with more political pull rather than to those who value it most. Also no central planners, however brilliant and well-intentioned they are, can know the highest-valued uses when there are literally millions of uses and users. So, for example, the federal government decided to allocate gasoline based on historical allocation. If 90% of the previous year’s gasoline were available, the government required gasoline refineries to sell 90% of last year’s sales to each location. This meant that expanding suburbs went without and that rural areas, where people had traveled a lot the previous year because they had been confident of getting supplies, got too much. Americans in short, got to experience a little Sovietization of the US economy. An analysis that omits the substantial costs of misallocation by waiting and misallocation by central planning is incomplete.

Certainly Dhawan’s and Jeske’s evidence is consistent with experience in the economies that have avoided price controls on oil. For example, despite huge price increases on oil since 2002, economic growth in the USA, which imports even a higher percentage of its oil than it did in the 1970s, remained strong. Oil prices increased from an average of $23.78 (inflation-adjusted to 2006) in 2002 to an average of $58.30 in 2006, an increase of 145%. Yet during that same time, annual US economic growth averaged 3.2%, which is at the high end of the normal range of growth rates.

Other cases for war for oil

I have dealt with the main argument most people make for going to war over oil, namely to ensure the continued supply of oil rather than a reduction. But are there other grounds for war for oil? There appear to be four other cases.

The first is increased supply. In all of the analysis so far, I took as given that the amount of oil produced in a given country does not depend on who produces it. But that assumption flies in the face of so much of what we know about socialism versus free markets. Socialism is high-cost, uninnovative, and inefficient, whereas production by private firms tends to be innovative and efficient. And the simple fact is that about 90% of the world’s oil is produced under socialism, that is, government ownership. As The Economist noted recently, Exxon Mobil, which, in early August 2006, was the world’s most valuable listed company, with a market capitalization of $412bn, was only 14th in the world when measured by the amount of oil left in reserves. The 13 “companies” above it were all government owned. Number one among these was Saudi Aramco, number two was the National Iranian Oil Company, and so on through the list that included Russia’s Gazprom, Venezuela’s PDVSA, and Nigeria’s National Petroleum Corporation. The article noted just how inefficient government oil producers are and highlighted Venezuela’s PDVSA as an example, partly due to actions taken by President Hugo Chávez since he came to power in 1999. So if the US government took over a socialist oil bureaucracy and sold it to a private for-profit firm, the supply of oil could increase due to increased efficiency.

But even one who agrees with the above facts about the inefficiency of government production would not then necessarily be driven to believe in war. The only legitimate case for
war, in my view, is to repel a foreign invasion of the homeland or to prevent an imminent such invasion. But I state the case because it is certainly one that some people could make. Again, though, one would have to consider the costs of war to weigh against these benefits. The obvious costs of an invasion to establish privatization—the slogan isn’t exactly ringing—are the substantial costs of arming, feeding, and supporting a substantial military. Moreover, there could be unintended consequences. People in the country invaded could well be upset about the invasion and could sabotage production so that the hoped-for output never emerges. Whether or not the US government’s motive in invading Iraq had any connection to oil, that intervention seems to have led to sabotage of production and shipping of oil. The amount of oil produced in Iraq in 2004 and 2005, the two years after the US invasion, was below what it was when there were no UN sanctions restricting Iraqi supply. Indeed, the amount of oil produced in Iraq in those years was below even the amount produced during the last five years of sanctions, from 1998 to 2002. During those years, production averaged 2.328mbpd; in 2004 and 2005, by contrast, production was 2,011 and 1,878mbpd, respectively.13

The other case for war to increase supply is that war is a particularly violent antitrust action to break up an international monopoly, namely OPEC, and reduce market power, thus increasing output. This, in fact, was the case made by “Miles Ignotus” and others in the 1970s that was referenced earlier. But, as noted, no individual producing country with an annual output the size of Iraq’s output would produce enough that it would have an incentive to withhold output. Taking over a country that produces as much as Iraq produces, therefore, would not lead to much of an increase in world output. War as an international antitrust action, therefore, would work only if directed against a number of producers. That would make the war even more expensive.

Cheap oil

Another argument for war for is for consumers to get cheaper oil. But as we shall see, this argument collapses to the previous argument, the argument for increased supply.

There are two ways to get oil cheap. One is to steal it. Think of the image of “armed consumers” that the above-mentioned “Miles Ignotus” wrote about. The first obvious point to make against such a case for war is that it is wrong. We teach our children not to steal. We do so, presumably, not just because we want our children not to steal but also because we want them to grow up to be adults who do not steal. How does it suddenly become right to steal when a number of adults get in control of a government?

Interestingly, the second, more-subtle, argument against stealing oil is that it would not benefit the majority of consumers in the country whose government stole it. The reason is that if the government stole it, it would likely hand it over to an oil company. The government could do so in two ways. Either it could sell the oil to the company at market rates, in which case neither the company nor the consumers the company sells to would benefit. Instead, the government would benefit. The other way is that the government could give the oil to the company or sell it at a below-market rate. In that case, the company would benefit, but consumers would not. Instead, the company would turn around and resell the oil at the world market price: the consumers in the company’s country of headquarters would get no special deal. So not only is stealing wrong, but also it wouldn’t even benefit consumers.

This brings us to the second way of getting oil cheap. For consumers to get cheaper oil as a result of their government’s war for oil, the war would have to result in a lower world oil price. This would happen only if the war were to result in a higher world supply. Thus, the case for war to make oil cheap for consumers collapses into the case for war to increase supply.
Expensive oil

The third case for war for oil is that the purpose of making war on various countries is to make oil more expensive. This sounds absurd. Why would a government, especially of an oil-importing nation, want to make oil more expensive for its consumers? Yet, why should oil be different from other goods that government makes more expensive for its citizens? Governments often impose tariffs or limit imports using import quotas. The US federal government, for example, prevents US consumers from buying foreign sugar in excess of a tight quota, thus driving up the domestic price of sugar. To enforce these programs, as the very word “enforce” implies, governments stand ready to use force against their own producers and consumers. The famous pro-free-trade economist Henry George wrote, “What protection teaches us, is to do to ourselves in time of peace what enemies seek to do to us in time of war.”14 Governments, in short, already use force to prevent their own citizens from getting goods cheaply. Why, then, would those same governments, in their pursuit of high prices, hesitate to use force against foreigners?

Interestingly, it was a fan, not an enemy, of then President Bush, who revealed Bush’s thinking about the problem with cheap energy. In his encomium to Bush, The Right Man, the economically literate David Frum wrote:

I once made the mistake of suggesting to Bush that he use the phrase cheap energy to describe the aims of his energy policy. He gave me a sharp, squinting look, as if he were trying to decide whether I was the very stupidest person he had heard from all day or only one of the top five. Cheap energy, he answered, was how we had got into this mess. Every year from the early 1970s until the mid-1990s, American cars burned less and less oil per mile traveled. Then in about 1995 that progress stopped. Why? He answered his own question: Because of the gas-guzzling SUV. And what had made the SUV craze possible? This time I answered. “Um, cheap energy?” He nodded at me. Dismissed.15

In other words, early in his presidency, George W. Bush argued that cheap energy was the problem. Why would a man from an oil family, who himself was an oilman, and who lived most of his adult life in an oil-producing state, hesitate to use military force to “solve” the problem? I hasten to add that I don’t think that expensive oil was his goal. But certainly we cannot immediately dismiss this motive.

The case against this argument for war for oil is easy. The reason is that such a war, if “successful,” would carry two costs to the USA and no benefits. First, of course, are the substantial costs of a military invasion and occupation. Second are the net costs to the US economy of the higher price of oil. While such a war, if it increased the price, would help producers in Alaska, Texas, Oklahoma, New Mexico and other oil-producing states, the costs to consumers would be higher, in dollar terms, than the gains to producers. This conclusion is a well-established result in the economic literature on trade. But to establish it here, consider the following calculation. In 2002, the last full year before the March 2003 invasion of Iraq, domestic production of oil was 9mbpd, domestic consumption of oil was 20mbpd, and imports were 11mbpd. World prices in 2002 averaged about $23 per barrel. Imagine that the invasion reduces world supply and raises prices by $4 per barrel. Then domestic producers gain $4 per barrel on 9 mbd, or $36 million per day, while domestic consumers lose $4 per barrel on 20mbpd, or $80m. per day. Thus the loss to consumers exceeds, by a large margin, the gain to domestic producers. This leaves out two small effects of the price increase. First, producers will produce a little more because of the higher price and make some profit on this additional production. Second, consumers will cut back somewhat on consumption, making consumers’ losses slightly
lower. But these two effects are small, which means that the earlier conclusion that consumers’ losses outweigh producers’ gains holds up.

It is possible that in pointing to cheap energy as a problem, President Bush was concerned about the environmental costs of cheap energy. But then a solution that has a much lower cost than war is to impose a tax on energy so that the revenues from the tax can be used for something valuable. If the cost matters, then going to war to drive up the price of oil is low on the list of solutions.

In short, to make the case that the US government should declare war on oil-producing countries to drive up the price is to argue that the US government should spend taxpayers’ money on war to cause US consumers to spend more money on oil. Think of the war for oil in this case as a particularly violent restriction on imports.

**Benefiting particular oil firms**

The fourth and final case that could be made for war for oil is that the war might be fought to benefit specific firms that produce oil, firms, let’s say, that get to take over oil production in the invaded country. It’s easy to see the attraction of such a war. A particular firm would bear the costs of the war only in proportion to its net income (through the corporate income tax) but could get benefits from the war out of all proportion to its net income. In other words, certain firms might lobby for the war because they can “privatize” the benefits but “socialize” the costs.

Certainly, this has happened historically. Various companies since World War I have lobbied the British and US governments to give them privileged access to oil in the Middle East. The economic case against such a war is easy. The costs of a war are large and the gains to the particular firms that benefit, while much greater than their pro rata share of the costs, are still tiny compared to the massive overall costs.

**Conclusion**

In 1776, Adam Smith wrote, in *The Wealth of Nations*, “It is not from the benevolence of the butcher, the brewer, or the baker that we expect our dinner but from their regard for their own self-interest.” Similarly, it is not due to the benevolence of the world’s oil suppliers that we get our oil but from their regard for their own interests. Our oil supply is secure, not because our government threatens to use force against those who would make it insecure, but because the world’s oil suppliers want to make money.

**Notes**

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11 These data were accessed from http://inflationdata.com/inflation/Inflation_Rate/Historical_Oil_Prices_Table.asp on 26 February 2007.
13 These data are from www.eia.doe.gov/ipm/supply.html, Table 4.1a.
Part III

Oil and Political Power

Regional Dimensions