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Declining U.S. Credibility and Rising Oil Prices

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The recent rise in world oil prices orchestrated by a reinvigorated Organization of Petroleum Exporting Countries (OPEC) has caught oil consumers off guard. Many were surprised that OPEC, which had floundered since the 1986 collapse of oil prices, had regained its production discipline and ability to push up world oil prices.

Even more surprising was the close cooperation between OPEC's traditional archrivals, Saudi Arabia and Iran. Relations between these countries, OPEC's two largest oil producers, had been hostile since Iran's 1979 revolution, but a growing détente between Saudi Arabia and Iran has been crucial in restoring OPEC's effectiveness. A major Saudi motivation for a rapprochement with Iran has been the declining credibility of the Clinton Administration's policies in the Persian Gulf. The Administration's weak and drifting Iraq policy has encouraged the nervous Saudis to cultivate Iran, both as a counterweight to Iraq and as an insurance policy in case U.S. credibility continues to decline.

Growing Cooperation Between OPEC Rivals. Iran consistently has been an OPEC price "hawk," advocating high oil prices to maximize its short-term oil revenue and provide for its rapidly growing population of 65 million. Saudi Arabia, with only 21 million people and much more oil (260 billion barrels of proven reserves, roughly one-fourth of the world's oil, compared with Iran's 93 billion barrels) has a much longer time frame for maximizing oil revenues. Riyadh historically has been a moderate on oil price issues because it has learned that high oil prices encourage non-OPEC oil producers to expand their production and oil consumers to reduce their dependence on oil and find alternative energy sources. The two OPEC heavyweights, who together control more than 40 percent of OPEC oil production, have clashed repeatedly at OPEC conferences. In November 1997, Riyadh went so far as to threaten to flood the oil market unless Iran agreed to a higher OPEC production quota for Saudi Arabia.

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In addition to its economic reasons for maintaining relatively moderate oil prices, Saudi Arabia had a strong geopolitical rationale for such prices in the 1990s: It faced serious security threats from both Iran and Iraq and sought to constrain their military buildups by minimizing their oil income. Iraq's vengeful dictator Saddam Hussein despised the Saudis for cooperating with the United States in the 1991 Gu[l]f War. The radical Islamic regime in Tehran resen[ted] Riyadh's support for Iraq in the 1980–1988 Iran–Iraq War and its long-standing "special relationship" with the United States. The Ir sought to overthrow the Saudi royal family, attempted to radicalize the Shia minority in Saudi Arabia's oil-rich Eastern Province, and exported terrorism to Saudi Arabia, including the 1996 bombing of the Khobar Towers housing complex, which killed 19 Americans.

Saudi–Iranian relations gradually improved following the 1997 election of reformist Mohammad Khatami as Iran's president. By 1998, Saudi Arabia's fear of Iran was eclipsed by its fear of a resurgent and vengeful Iraq. The collapse of the Clinton Administration's Iraq policy following Saddam's ending of United Nations weapons inspections in November 1998 undoubtedly alarmed the Saudis and strengthened their geopolitical incentives for improving cooperation with Iran. Economic incentives for improving bilateral cooperation also peaked when oil prices fell to $10 per barrel in December 1998 because of a mild winter in the Western Hemisphere and plummeting Asian oil demand due to economic recession.

In early 1999, the Saudis and Iranians held a series of meetings to reach a consensus on oil production issues that was later rubberstamped by other OPEC members at their March 1999 meeting. The Saudis stunned observers by slashing production by 585,000 barrels per day to 7.44 million barrels per day (MBD), far below the 8 MBD "line in the sand" that Riyadh previously had insisted was its production floor. This cutback comprised more than a third of OPEC's 1.7 MBD reduction. Non-OPEC oil exporters Russia, Mexico, Norway, and Oman also agreed to reduce production, creating a 2 MBD shortfall in world oil supplies that drained oil inventories and pushed oil prices up to $34 per barrel by early March 2000. Although the Iranian and Saudi oil ministers issued a joint statement on March 8 promising that OPEC would provide "adequate and timely supplies to balance the market" after its next meeting on March 27, many analysts fear that OPEC production increases will be too little, too late to avoid U.S. gasoline prices as high as $2 per gallon during the peak summer driving season.

The Strategic Petroleum Reserve. To help drive down oil prices, some in Congress have called for the release of oil from the Strategic Petroleum Reserve (SPR). But the SPR, which contains 565 million barrels of crude oil, was designed to protect against a supply crisis, not a price hike. Draining it would leave the U.S. vulnerable in a future oil crisis. The SPR already has shrunk to the equivalent of about 55 days of U.S. oil imports (down from almost 100 days 15 years ago) because U.S. oil imports have risen rapidly and now provide 54 percent of total oil consumption. Rather than seek short-term responses that will provide little relief, Washington should take the long view and seek to increase domestic oil production by opening up promising areas, such as the Arctic National Wildlife Refuge and offshore coastal areas, to exploration and development. Although this may pose some risks to the environment, those risks are dwarfed by the environmental risks posed by the thousands of additional oil tankers that will be needed to deliver foreign oil if domestic oil prodiction is blocked.

The United States also must restore its credibility in the Persian Gulf by demonstrating that it is serious about overthrowing Saddam Hussein, not just containing him. For seven years, the Clinton Administration has failed to provide adequate support for the Iraqi opposition. Passively keeping Saddam "in his box" only strengthens the emerging Saudi–Iranian rapprochement, enhances OPEC solidarity, and allows international pressure to build for lifting economic sanctions against Iraq that could ease oil prices by permitting an expansion of Iraqi oil exports. This would strengthen Saddam Hussein and fuel an Iraqi military buildup that ultimately could provoke another Persian Gulf crisis that would severely threaten U.S. energy security and trigger even higher oil prices.

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