All the Oil We Need

By EUGENE GHOLZ and DARYL G. PRESS

WHILE oil prices have declined somewhat of late, the volatility of the market and the political and religious unrest in major oil-producing countries has Americans worrying more than ever about energy security. But they have little to fear — contrary to common understanding, there are robust stockpiles of oil around the globe that could see us through any foreseeable calamities on the world market.

True, trouble for the world’s energy supplies could come from many directions. Hurricanes and other natural disasters could suddenly disrupt oil production or transportation. Iran loudly and regularly proclaims that it can block oil exports from the Persian Gulf. The anti-American rhetoric of President Hugo Chávez of Venezuela raises fears of an export cutoff there. And ongoing civil unrest wreaks havoc with Nigeria’s output.

Even worse, this uncertainty comes in the context of worrisome reports that oil producers have little spare capacity, meaning that they could not quickly ramp up production to compensate for a disruption.

But such fears rest on a misunderstanding. The world actually has enormous spare oil capacity. It has simply moved. In the past, major oil producers like Saudi Arabia controlled it. But for years the world’s major consumers have bought extra oil to fill their emergency petroleum reserves.

Moreover, whereas the world’s reserve supply once sat in relatively inaccessible pools, much of it now sits in easily accessible salt caverns and storage tanks. And consumers control the spigots. During a supply disruption, Americans would no longer have to rely on the good will of foreign governments.

The United States alone has just more than 700 million barrels of crude oil in its Strategic Petroleum Reserve. Government stockpiles in Europe add nearly another 200 million barrels of crude and more than 200 million barrels of refined products. In Asia, American allies hold another 400 million barrels. And China is creating a reserve that should reach more than 100 million barrels by 2010.

Those figures only count the government-controlled stocks. Private inventories fluctuate with market conditions, but American commercial inventories alone include well over a billion barrels. Adding up commercial and government stockpiles, the major consuming countries around the world control more than four billion barrels.

Some policy makers and analysts worry that these emergency stocks are too small. For example, they sometimes compare the American strategic reserve to total American consumption, so the reserves appear dangerously inadequate. The United States consumes about 20 million barrels of oil every day, so the Strategic Petroleum Reserve could only supply the country for 35 days. (Furthermore, the United States could not draw oil out of the reserve at anything approaching a rate of 20 million barrels per day.) This is why President Bush in his 2007 State of the Union address called for doubling the strategic reserve.
But this vulnerability is a mirage. The size of plausible disruptions, not total consumption, determines the adequacy of global reserves. The worst oil disruptions in history deprived global markets of five million to six million barrels per day. Specifically, the collapse of the Iranian oil industry during the revolution in 1978 cut production by nearly five million barrels a day, and the sanctions on Iraq after its conquest of Kuwait in 1990 eliminated 5.3 million barrels of supply. If a future disruption were as bad as history’s worst, American and allied governments’ crude oil stocks alone could replace every lost barrel for eight months.

Current fears about energy security focus on Iran. For example, Tehran could sharply cut its oil exports to drive up global prices. Of course, this would be the economic equivalent of suicide terrorism: oil exports provide more than 80 percent of Iranian government revenues, and a major cutback would wreck Iran’s economy.

It would also be futile because the industrialized world could easily replace Iranian oil. Iran only exports 2.5 million barrels each day. A coordinated release of reserve crude by the United States and its European and Asian allies could replace missing Iranian barrels for a year and a half. Iran is vulnerable; the West is not.

Of course, we are told, Iran might be able to take Saudi, Kuwaiti and Iraqi oil off the market, too, by attacking oil tankers as they pass through the Strait of Hormuz, along Iran’s coast. It’s conceivable, but not likely.

Significantly impeding oil traffic would require a sustained military campaign. Dozens of tankers carry more than 15 million barrels of crude through the strait every day. The water is so deep that the navigable channel for supertankers is 20 miles wide at its narrowest point. There is simply too much traffic across too much space for the waterway to be easily blocked.

Countries have attacked oil infrastructure before, and the results were underwhelming. During the Iran-Iraq war, Baghdad and Tehran struck each other’s oil terminals and tankers repeatedly, but they proved to be very resilient targets. Rugged structures and quick maintenance meant that Iran’s Kharg Island terminal kept pumping despite repeated bombings. Tankers, which dwarf aircraft carriers, have thick hulls designed to prevent oil spills and, when attacked, proved to have few sensitive parts where a “lucky” hit could cause serious damage. They managed to keep the oil flowing through Persian Gulf waters throughout the Iran-Iraq war.

Today, Iran has more advanced anti-ship weapons, and it could surely harass commercial tanker traffic. But it would be hard pressed to sustain an anti-shipping campaign sufficient to reduce oil flows drastically for weeks on end, especially in the face of an intense military response. Even if Iran were able to reduce oil flow though the strait by, say, 30 percent, global reserves could replace losses of that magnitude for more than nine months — plenty of time for the Navy to counter Iranian military operations.

Make no mistake, any major disruption — from a war, a terrorist attack or a natural disaster — would make prices jump until markets realized that the pipes feeding crude into refineries were not going to run dry. But recognizing the great capacity of global reserves to weather disruptions will go a long way to minimizing panic.

Emergency reserves have their limits. They cannot free the industrialized world from the underlying economic fundamentals that drive energy prices. As the global economy grows, demand for energy will rise and oil prices may remain high.

Government-controlled stockpiles should not be used to try to smooth out short-term blips in global supplies, the
normal variations that companies account for with their inventories and financial hedging. Public inventories are a blunt instrument designed to protect the oil market as a whole from major disruptions — national strikes, hurricane damage, wars and attempts at geopolitical blackmail.

Paradoxically, our exaggerated fears over energy security have some benefits — for example, they may reduce the United States’ inclination to attack Iran. But they also have big costs. Politicians could be induced to try costly solutions for problems that don’t exist, like President Bush’s commitment to double the size of the Strategic Petroleum Reserve. Western leaders may also pay too much heed to an oil producer’s saber rattling. And, finally, exaggerated fear may encourage oil-market traders to panic at the first sign of even a small disturbance. When it comes to energy security, let’s not let fear get the best of common sense.

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