Energy Insider

The elements of a new oil-supply crisis

by William Engdahl, Energy Editor

One of the obvious dimensions of the march by Ariel Sharon's army into Lebanon is the potential impact on Middle East oil supplies. Although it is not yet clear whether Arab OPEC members, led by a new regime in Saudi Arabia, will invoke the oil weapon against the industrial West, the vulnerability to such a threat is enormous—despite the recent illusion of a glut in world oil supply.

Indeed, the situation led to a charge in Congress that the major oil companies are drawing down inventories in a manner "virtually identical to the 1978-79 situation."

This time, world oil consumption has fallen at unprecedented rates because of the industrial depression induced by the Federal Reserve's imposition after October 1979 of double-digit interest rates and the 1500 percent rise in oil prices since 1973. But the adjacent map demonstrates the obvious: the industrial nations of Europe and Japan are still overwhelmingly dependent on the Persian Gulf for oil.

In 1981, Western Europe imported 5.8 million barrels daily from the Middle East. Japan imported 3 million. The United States imported somewhat more than 1.2 million barrels per day (bpd) from the Middle East.

Over the past several months, and most dramatically since about January of this year, the United States and the rest of the oil-consuming nations have decided to draw on existing inventories. Worldwide, a June 8 Congressional Research Service analysis concludes, "stocks have declined from an estimated 6 billion barrels to levels variously estimated to be between 4.7 and 4.0 billion." They point to the short-term nature of this process and the "likelihood that within the next few months other nations will enter world markets in order to stem their own stock erosion." So world demand should increase just as the Middle East is super-vulnerable again.

Let's look more closely at the U.S. side of this picture. From more than 3 million bpd of Middle East imports in 1978, the United States currently is hovering at a level around 1 million barrels of Arab OPEC imports. In 1981, the United States imported a total of 5.9 million barrels daily from all sources. In the first months of the current year, this plummeted to 4.1 million barrels, a 31 percent drop in the period of a single year.

Depressionary collapse and soaring credit costs have reversed the economics which made it highly profitable in 1979-80 for the major oil companies to build inventories on expectation of rising prices. By this January, according to this analysis by Philip Verleger for Booz-Allen & Hamilton consultants, the cost of holding a barrel of $34 per barrel Saudi crude in inventory soared to a carrying cost of $6.12 annually when interest rates reached 18 percent. From record inventory accumulation in the wake of the Iranian upheaval of 1979, major oil companies began dumping stocks once London engineered the sharp drop in spot market prices last January. The decline in consumption and high cost of holding stocks while prices fell led oil majors to dump an estimated 3.8 to 4.9 million bpd onto world markets; this forced OPEC to sharply cut production in order to restabilize prices.

Now, according to U.S. Energy Information Administration estimates submitted to Congress on June 10, in order to rebuild inventories for next winter's heating oil, the United States will have to increase imports to the tune of at least 1.5 million bpd by this fall. U.S. crude oil stocks, according to official Energy Information Agency figures, were 11 percent below spring of last year. Gasoline stocks are 20 percent lower, while distillate fuel oil stocks are almost 40 percent lower

A recent report by the Congressional Research Service notes that "there are now two shooting wars going on in the Mideast. Should either impair the OPEC countries' ability or willingness to accommodate an increased call on its oil of several million barrels per day, price increases and supply disruptions can be expected."

Of course enemies of OPEC such as Rep. Richard Ottinger are barely able to contain their satisfaction over this prospect. The more sober point is the stupidity of the U.S. foreign policy that puts world energy supplies at risk.