IDEAS ON LIBERTY
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Terrorism: The Price of Bad Energy Economics?

Fear of losing access to Saudi oil prompted the U.S. government to intervene in the Persian Gulf a decade ago, to maintain troops in Saudi Arabia ever since, to ignore Riyadh's role in underwriting terrorism even after September 11, and to confront Iraq again. In short, America has been paying a high price for its government's relationship with the rulers of Saudi Arabia.

Why that royal family, which has been spending ten times as much as Iraq on its military, wasn't expected to defend itself was never explained. The problem, presumably, was the lack of internal support for a monarchy both rapacious and useless. Thus enter Washington.

Yet contrary to popular wisdom, the Saudis' trump hand is surprisingly weak. True, with 262 billion barrels in proven reserves, Saudi Arabia has about one-quarter of the world's oil resources and 8.7 times America's supplies. Riyadh is not only the world's leading supplier, but as a low-cost producer can easily augment its daily exports, eight million barrels a day last year.

However, the reserves figure vastly overstates the importance of Middle Eastern oil to the U.S. (and Western) economy. Saudi Arabia accounted for about 10 percent of production last year; it plus Kuwait and the various sheikdoms came to one-quarter; OPEC produced 40 percent of the world's supplies. Were Saudi Arabia to fall, prices would rise substantially only if the conqueror, whether internal or external, held the oil off the market, especially if the other Gulf states also collapsed. The result then would be severe economic pain in the short term, though the Strategic Petroleum Reserve would help moderate prices.

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Such a policy would, however, defeat the very purpose of conquest, even for a fundamentalist regime. After all, the Iranian revolution did not cause that nation to stop exporting oil; in fact, Iranian production increased steadily throughout the 1990s. If a new regime did halt sales, the primary beneficiaries would be other oil producers, who would likely increase exports in response to the higher prices. A targeted boycott against only the United States would be ineffective, since oil is fungible and available around the world. In fact, the embargo of 1973–74 had little impact on production; the global recession of 1975 caused a far more noticeable drop.

A new regime might decide to pump less oil in order to raise prices. Such a strategy would require international cooperation, yet the oil producers have long found it difficult to coordinate price hikes and to limit cheating on agreed-on quotas. Even if effective, restricting sales would have only a limited impact.

A decade ago, when oil was selling for about $20 a barrel, energy economist David R. Henderson, a professor at the Naval Postgraduate School, figured that the worst case of an Iraqi seizure of the Saudi oil fields would be about a 50 percent price increase, costing the U.S. economy about one half of one percent of GDP. Prices are today running close to $30 a barrel, but that includes an uncertainty premium over war with Iraq. Thus, the real price hike today of a Saudi collapse probably would be similar to that of a decade ago. Moreover, it would fall on an economy more than one-quarter larger.

In any case, the economic impact would diminish over time. Countries like Kuwait, Iran, Nigeria, Russia, the United Arab Emirates, and others have the ability to pump significantly more oil. A resolution of Iraq's status would bring substantial new supplies on line; Baghdad pumped 2.2 million barrels a day in 1990, before becoming subject to sanctions after the Gulf War. As economist Susan Lee puts it, should Riyadh turn off the pumps, "the U.S. would find itself plenty of new best friends."

Sharply higher prices would bring forth new energy supplies elsewhere. Total proven world oil reserves were 660 billion barrels in 1980, 1,009 billion in 1990, and 1,046 billion at the end of 2000. Yet in the last decade alone, the world consumed 250 billion barrels of oil. How could this be? A combination of new discoveries and technological advances increased the amount of economically recoverable oil.

Reserves rose even as oil prices dropped. Between 1980 and 1990, proven oil reserves jumped by 62 percent while prices for Middle Eastern petroleum were falling 43 percent. Prices eventually hit a dramatic low in 1998, down another 41 percent, before rising over the next two years.

Plugged Wells

America is dotted with high-cost wells that could be unplugged. The nation's outer continental shelf (OCS) alone is thought to contain more than 30 billion barrels of oil, greater than our current proven reserves; since barely 6 percent of the OCS has been leased, those resources have not been proved. Barely 15,000 acres of the 19.6 million-acre Arctic National Wildlife Reserve could contain a similar amount of oil. Even the modest estimate of five billion barrels of recoverable reserves at current prices would be a significant addition to current supplies. However, we won't know how much is there without drilling, which could be conducted in an environmentally sensitive manner.

Further, some 300 billion barrels of unrecovered oil, ten times our proven reserves and more than known Saudi resources, lie in beds of shale under the United States. They are not counted, however, because they are not currently worth developing. But as prices rise and new techniques are developed, they may become economically recoverable. Moreover, energy companies are looking for new oil deposits around the world, including in the Caspian Basin, Russia, South China Sea, and West Africa. Estimates of as-yet-undiscovered potential recoverable oil range from one trillion to six trillion barrels.

At current consumption rates the Energy Information Administration estimates that we have enough oil for another 230 years and "unconventional" sources, such as shale, that could last 580 years. And even these figures are based on existing prices and technologies. Higher prices would stimulate exploration, as well as production of alternative fuels and conservation, reducing oil consumption.

In short, while an unfriendly Saudi Arabia might hurt America's pocketbook, it would not threaten America's survival. Thus there is no need to go out of our way to protect the Saudi dictatorship, let alone keep the royal family happy. Moreover, the withdrawal of U.S. forces would remove a prime source of potential instability.

Anyway, Riyadh isn't likely to turn hostile. It needs the money from selling oil as much as we need the oil. □

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The Theory of the Corporation

by Norman Barry

Ever a topic of dispute for observers of capitalism, the corporation has been undergoing increased scrutiny in the light of current business scandals. While other forms of capitalist enterprise, such as partnerships and single proprietorships, have avoided some of the wrath of socialist agitators, the limited-liability corporation, public or private, has had to endure the criticism of some market advocates as well as socialists. Of course, now that most sensible collectivists know that real socialism doesn't work, they have had to use a different intellectual methodology to buttress their anti-capitalist predilections. They have chosen *morality*. This has turned out to be quite effective. Moral arguments are pretty much irrefutable, whereas economic ones can be subjected to some kinds of theoretical and empirical tests. Hence the craze for the "social responsibility" of business.

As a matter of fact, the invention of the corporation is the great achievement of Anglo-American capitalism, contributing both to its prosperity and to the freedom it promotes. But it has to be constantly defended. The most obvious advantages of the corporate form are its ability to raise capital for investment and the liquidity that share ownership provides. Free transfer of shares, the main feature of corporate capitalism, produces that flexibility which is the envy of other free enterprise forms.

The major problem is its apparent "privileges"; that is, it is claimed that the corporation can do things that private individuals or business partnerships cannot do, and critics argue that these advantages have to be paid back to society. In other words, the corporation operates under some kind of politically granted license, which has to be earned. Business ethics starts from this assumption. Thus Thomas M. Jones wrote: "the corporation which acts in a socially responsible manner may simply be paying back society for the social costs of doing business, costs for which firms rarely receive an invoice."[1] When he was secretary of labor in the first Clinton administration, Robert Reich repeatedly threatened to withdraw "privileges" from uncooperative firms and promised to reward socially responsible ones with tax and regulatory advantages.

What are these privileges, these gifts of society that grateful corporations must pay for with the sacrifice of shareholder value for the benefit of "society"? First there is entity status; that is, the corporation is allegedly an artificial person, separate from its owners, which can sue and be sued. Then there is limited liability for debt and for torts—stockholders are liable only up to the value of their investments; their private assets are protected. A third "privilege" is permanent life.

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