

AN ATTACK ON SADDAM WON'T SEND OIL SKY-HIGH

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After the Republican victories in the recent election, President George W. Bush is sure to pursue his domestic and international agenda aggressively. High on his list of priorities will be a showdown with the Iraqi regime of Saddam Hussein. Many people have been concerned that a war in the Middle East would severely disrupt America's economy and that of other industrial countries by causing a sharp spike in prices and a shortage of oil. But this concern overstates the importance of Middle East producers to the world's economy, and it's mistaken about the effects of a war on oil prices. In fact, with a quick and decisive defeat of Saddam, the price of crude oil is likely to fall sharply.

One reason for this relatively sanguine outlook is the reduced importance of oil to the U.S. economy, compared with 25 years ago. America's spending on oil rose to about 8% of its gross domestic product after the first world oil shock in 1973. But today, oil accounts for only 3 1/2% of GDP thanks to more efficient cars, houses, and equipment, and a shift of production in the American economy toward less energy-intensive methods. The drop in the importance of oil to Europe and Japan has been sharper still. So even a steep spike in oil prices would be much less disruptive to advanced economies than were the major oil price shocks of 1973 and 1979.

Moreover, though the contribution of oil imports to America's domestic consumption has risen from about a third in 1973 to over half during the past 30 years, much of it comes from Mexico, Venezuela, Canada, Norway, Britain, Russia, and a growing share from African producers. Persian Gulf nations provide only about 20% of imported oil, or a little more than 10% of domestic consumption. Imports from other nations would be unaffected by disruption of supplies from the Middle East, though prices would increase.

Predicting what would happen to oil prices should the U.S. and its allies attack Iraq is not an exact science, but the Persian Gulf War provides valuable evidence. Prices more than doubled after Iraq invaded Kuwait in August, 1990. Then they fell sharply from more than \$30 a barrel to about \$20 shortly after Desert Storm began in January, 1991, when it became clear that America's aerial bombardment would quickly defeat Iraq. Oil prices remained at that level for months following the initial attacks despite significant shortfalls in production from Iraq and Kuwait because Saudi Arabia and non-OPEC nations made up the deficit.

Something similar will happen this time. World oil prices probably will rise further as war with Iraq appears to be more certain. However, if the first few days indicate that Saddam will be decisively and quickly defeated, as is highly probable, then oil prices will fall sharply as the "war premium" disappears and uncertainty about world oil production diminishes. Cutbacks in Middle East output would be much smaller than during the Persian Gulf War since Kuwait's facilities would not be destroyed, and Saddam has much less power to damage other facilities than a decade ago. Al Qaeda and other terrorist groups might try to destroy some pipelines and oil-production centers, but they will not

do a lot of damage, partly because these facilities will be guarded closely during and immediately after any war.

After a defeat of Saddam, a friendlier and more democratic Iraqi government is likely to be installed. Oil prices would then fall further than they did after the Desert Storm cease-fire, since that government would be released from the oil-embargo restrictions that were imposed on Iraq under the previous regime. A new government would also look for oil revenue to help rebuild an Iraqi economy that has deteriorated so greatly under Saddam. Since Iraq has the world's second-largest oil reserves, it has considerable potential for greatly increased production.

Some economists and politicians have called for reducing the U.S.'s dependence on imported oil by subsidizing domestic exploration and by greatly increasing the tax on gasoline consumption and other heavy uses of oil. I have argued in an earlier column that increased gasoline taxes are preferable to the minimum gas-mileage standards imposed since the 1980s on fleets of new cars. But an even more effective response to the threat of oil-supply disruption is to quickly build up the Strategic Oil Reserve far beyond its present level, which is equal to about eight weeks' supply of imports. A greatly enhanced reserve, perhaps a 16 weeks' supply, would make it much easier to survive protracted periods of chaos in the Middle East.

Saddam Hussein is a cruel dictator, and I believe he would be extremely dangerous to the world if left unchecked. Other issues are also relevant in determining whether to go to war against his reign. But fear of a sharp and prolonged rise in oil prices should not be one of them, for the most likely scenario is that oil prices will fall significantly and remain low after his regime is toppled.