

Fueled Again?

GAL LUFT & ANNE KORIN

On February 17, 2006, a rebel group called the Movement for the Emancipation of the Niger Delta (MEND) declared “total war” against oil companies operating in Nigeria’s main oil-producing region. Nigeria is Africa’s leading oil exporter and ranks fifth as an oil supplier to the United States. For oil companies, it is one of the most inhospitable domains on the planet in which to do business. In recent years the country, half of which is controlled by strict Islamic law, has become a cauldron of turmoil where sectarian violence, radicalism and corruption are rampant and on the rise.

That winter week, MEND launched a campaign of pipeline sabotage and kidnapping of oil workers that led to a 20 percent decline in Nigeria’s oil production. Five days later, Iraq, with the world’s second-largest reserve of conventional crude, nearly went offline when the Shi’a Askaria shrine in Samarra was bombed, threatening to drag the country into a bloody civil war. Since Saddam Hussein’s invasion of Kuwait in August 1990, Iraq has been producing far less oil than its potential capacity. Years of sanctions and neglect have brought production to less than three million barrels a day (MBD). The Iraq war has since brought the

country to a new oil production low. A sabotage campaign against the country’s oil installations has reduced Iraqi production to a disappointing average of two MBD. But the Samarra attack could have pushed the country over the edge, stopping crude exports altogether. This was the moment al-Qaeda was waiting for.

Since September 11, terrorist groups have identified oil terrorism as a way to break the economic backbone of the West. Until 2002, the oil market had sufficient elasticity to deal with occasional supply disruptions. Such disruptions could be offset by the spare production capacity owned by some OPEC producers, chiefly Saudi Arabia. This spare capacity has been the oil market’s main source of liquidity. But due to burgeoning demand in developing Asia, coupled with the voracious appetites of traditional consumers in the industrialized world, this liquidity mechanism has eroded from seven MBD in 2002, which constituted 10 percent of the market, to about two MBD today, less than 2.5 percent. As a result, the oil market today resembles a car without shock absorbers: The tiniest bump can send a passenger to the ceiling.

Without liquidity, the only mechanism left to bring the market to equilibrium is rapid and uncontrolled price increases. This reality plays into the hands of jihadists who seek to hurt the Western economy by going after what they call “the provision line and the feeding to the artery of the life of the crusader’s nation.” In

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an October 2004 videotape, Osama bin Laden explained: “We bled Russia for ten years until it went bankrupt and was forced to withdraw [from Afghanistan] in defeat. . . . We are continuing in the same policy to make America bleed profusely to the point of bankruptcy.” And that is why, throughout the world, jihadi terrorists have been attacking oil facilities almost on a daily basis, with significant impact on the oil market.

On a normal day these attacks impose a “fear premium” on the oil market of around \$10–15 per barrel. For the United States, an importer of 12 MBD, this fear premium alone costs roughly \$50 billion a year. But in February the combination of unrest in Nigeria and Iraq and fear over a looming crisis with Iran presented al-Qaeda with a unique opportunity to deliver a crippling blow to the global economy by cutting off a significant amount of oil from the market. That could be done most effectively by an attack on a strategic oil installation in Saudi Arabia. So on February 24 two trucks, driven by suicide bombers and each laden with one ton of explosives, blew up at the outer perimeter of Saudi Arabia’s Abqaiq plant—the world’s largest oil processing facility, through which more than half of Saudi oil passes each and every day.

Luckily, the terrorists failed to cause significant damage to the plant. But had they succeeded in turning the complex into an inferno, they would have denied the world of roughly half of Saudi Arabia’s oil and its remaining spare capacity. That would amount to more oil than all the OPEC members took off the market during the 1973–74 Arab oil embargo. Had such a calamity happened in conjunction with the shutdowns in Nigeria and Iraq, oil prices would have soared to \$150–200 per barrel. If it had happened in the midst of a hurricane season or an extra-cold winter, the outcome would have been even more catastrophic for the United States. Studies and simulations show that a loss of as little as three MBD can cause gasoline prices to double, causing a loss of more than one million jobs in the United States alone, and a significant spike in its current account deficit. If not for three factors—the terrorists’ incompetence, responsible behavior by Iraq’s Shi’a clerics who calmed things down, and the

Nigerian military—February could have ended with a far larger loss.

For the U.S. economy and the world economy at large, the danger of simultaneous multiple failures in the global oil industry could be more economically damaging than an outbreak of a pandemic or a dirty bomb set off in New York City. The supply disruptions of the 1970s cost the U.S. economy between \$2.3 trillion and \$2.5 trillion.¹ According to the National Defense Council Foundation, a disruption of similar proportions today could carry a price tag as high as \$8 trillion—a figure equal to more than 60 percent of U.S. annual GDP, or nearly \$27,000 for every man, woman and child living in America.² This is more money than the United States has spent in all of its wars combined since 1776. That ten of the top-14 oil-exporting countries are politically unstable; that the United States may be facing a long period of increased hurricane activity in the Gulf of Mexico; that, following the Abqaiq attack, al-Qaeda promised “we shall not cease our attacks until our territories are liberated”—all of this implies that it is only a matter of time before the United States finds itself in the midst of a severe oil shock.³ Here is an eminently predictable catastrophe if ever there was one.

The Energy Weapon Is Back

Transportation underlies the modern U.S. economy. Since 97 percent of U.S. transportation energy is petroleum-based, oil is the lifeblood of America’s economy. Without oil, goods and raw materials cannot reach their destinations, service providers cannot arrive at their clients, and children cannot go to school. America is poor in oil relative to its need. It consumes one of every four gallons in the world, but has barely three percent of the world’s prov-

¹Milton Copulos, “America’s Achilles Heel: The Hidden Cost of Imported Oil” (The National Defense Council Foundation, 2003).

²Testimony of Milton Copulos before the Senate Foreign Relations Committee, March 30, 2006.

³*Reuters*, February 26, 2006.