

BY ROBERT J. BARRO

WITH FRIENDS LIKE OPEC, WHO NEEDS...



ALL WRONG:
Instead of praising cartel members for raising output, Washington should be criticizing them for holding back in the first place

Robert J. Barro is a professor of economics at Harvard University and a senior fellow of the Hoover Institution (rjbarro@harvard.edu).

Energy Secretary Bill Richardson recently said on TV that "our friends came through for us," referring to recent increases in oil production by Saudi Arabia, Kuwait, the United Arab Emirates, and Mexico. Indeed, oil prices did fall from \$32 per barrel in March to about \$26 at present. But one has to wonder why our "friends" were in a position to raise oil production so quickly. Perhaps they had been holding down production and were, thereby, partly responsible for the runup in oil prices from around \$12 per barrel in early 1999.

This view is confirmed by the table, which shows recent numbers on output and capacity for the main oil producers. The last column shows the percentage of utilized capacity. The main excess capacity is in Saudi Arabia, Kuwait, and the United Arab Emirates—the three countries that Richardson regards as friends.

GOOD GUYS. The U.S. produces roughly the same amount of oil as Saudi Arabia, around 8 million barrels per day. But U.S. consumption, about 19 million barrels a day, makes it the largest net importer of oil. Therefore, the U.S. economy as a whole benefits from lower oil prices. In fact, oil-price hikes up to the early 1980s and perhaps in 1990 were substantial contributors to U.S. recessions.

So the good guys among the oil producers should be the ones who produce as much as possible in relation to their capacity. Thus, within OPEC, the relatively "friendly" countries include Iran, Venezuela, Iraq, Nigeria, and Libya. The bad guys are those that hold down production and keep a lot of spare capacity. Here, the culprits are our supposed friends—Saudi Arabia, Kuwait, and the United Arab Emirates. Mexico became, in 1998, the only non-OPEC nation to maintain spare capacity.

Washington should also realize that friendship had

little to do with the recent increases in oil output. A pure profit motive explains why they increased production. They saw a chance to benefit from the high oil prices.

Richardson also said that oil prices of around \$12 per barrel in early 1999 were too low, peak prices of around \$32 in March, 2000, were too high, and current prices of around \$25 to \$26 are about right. One wonders how he knows all this. Does he also know the just prices of wheat, copper, gold, and shares of Microsoft Corp.? Probably he meant that his friends in the U.S. oil business and the Middle East were unhappy when the price was \$12 and that \$32 did not seem to be sustainable in the current world market. The \$32 price also made a lot of people angry with the Clinton Administration.

There is, of course, a lot to say for letting the market figure out the right price of oil. True, there may be a valid national security argument for maintaining more U.S. domestic oil production than would result at that price, whether it is \$12 or \$32. The best way to ensure adequate domestic supplies would be to reduce the restrictive policies that hinder

exploration and production by, for example, giving less weight to environmental concerns and more to economic and national security considerations in making decisions about increasing oil development in Alaska and offshore.

The worst of all policy choices is to support a world cartel in its attempts to maintain artificially high prices for oil. It is particularly odd when a U.S. government official labels as friends foreign governments that are carrying out acts—collusive behavior to fix prices—that would be regarded as criminal within the U.S. and as violations within the normal framework of global trade. Perhaps, instead of supporting OPEC, we should bring it up on charges with the World Trade Organization.

Oil Production and Capacity

	PRODUCTION*	CAPACITY	CAPACITY USED (%)
MAJOR OPEC			
SAUDI ARABIA	7.8	10.8	72%
IRAN	3.4	3.7	92
VENEZUELA	2.8	3.0	93
IRAQ	2.6	2.8	93
KUWAIT	1.9	2.7	70
UAE	2.1	2.5	84
NIGERIA	2.0	2.2	91
LIBYA	1.4	1.5	93
OTHER LARGEST			
UNITED STATES	8.1	8.1	100
RUSSIA	6.2	6.2	100
MEXICO	3.0	3.3	91
CHINA	3.2	3.2	100
NORWAY	3.1	3.1	100
UNITED KINGDOM	2.9	2.9	100
CANADA	2.6	2.6	100

*MILLIONS OF BARRELS PER DAY
DATA: INTERNATIONAL ENERGY AGENCY