Section 5

THE DYNAMICS OF INTERDEPENDENCE: SYNFUELS VERSUS MIDDLE EASTERN OIL

by

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Abstract

The economic and political viability of synfuel programs hinges more upon developments in the Middle East than upon developments in laboratories. The price of Middle East oil sets the level of needed subsidies, while the spectre of cutoffs adds urgency to all alternatives, including synfuels. The relationship is reversible via the "demonstration effect" high-profile, high-cost synfuel projects provide incentive targets to OPEC for further price increases.

The overhang of possible increasing production in the Middle East remains a long-term threat to high-cost alternatives. The areas' oil and gas resources are notably understated, primarily because little or no exploration occurred in major prospective areas after the early 1960's and because no economic outlet whatsoever existed for natural gas until the last few years.

The Middle East oil price is a completely politicised parameter, and prospects for price moderation are inextricably linked to a peaceful resolution of the Arab-Israeli conflict. Volumes of potential Middle East oil are larger than usually forecast, and its price is discretionary. Closing synfuels "feasibility gap" thus hinges upon Middle East politics.

Economics has been all but completely subverted in the pricing and supply of Middle East oil, as access to Middle East oil, too, even absent warfare or an embargo, is increasingly restricted within the compass of bilateral arrangements between producers and consumers. These have proliferated, now involve most important oil-importers, and cover possibly one-half of total Middle Eastern supply. The United States is conspicuously not included, reflecting its political isolation in the Arab world, the European-Japanese-OAPEC initiatives, and, secondarily, new U.S. tax laws which discourage U.S. firms from exploring abroad.

Middle Eastern Oil:

The Weakest Link

Middle Eastern oil today, seven years after the oil embargo of 1973, is still the critical link in the global energy chain. The price of Middle Eastern oil, the security of its supply, and the political terms for access to it, are crucial to all states today -- even energy self-sufficient states such as the U.K. are nonetheless vitally concerned by virtue of their customers' and suppliers' own intimate dependence upon Middle Eastern oil. It is ironical that Middle Eastern oil is even more critically important for the synthetic fuels industries themselves -- i.e. for the ultimate viability of the alternate energy sources with which coal-rich states like the United States hope to emancipate themselves from future dependence on imported oil.

In this essay I shall explore the political-economic environment which will affect the supply and pricing of Middle Eastern oil over the next decade, emphasizing especially those aspects which directly affect the viability of synthetic fuels but equally stressing the critical sensitivity of all energy consumers to the security and costs of Middle Eastern oil.

The future of the synfuels industry is intimately dependent upon developments in the Middle East, rather than developments in laboratories or in pilot plants; the vagaries of Colonel Qaddhafi, or resolutions in the Israeli Knesset, or confessional conflicts between Iraqi Sunni Muslims and their Shi'ite neighbors clearly reinforce our need for synthetic fuels as "secure" alternatives. Similarly, politically-induced increases in the price of oil improve the financial incentives or, more realistically, at least decrease the financial disincentives for synthetic fuels.

More precisely, the price of Middle Eastern oil defines the subsidy which is required, directly or covertly, for the first generation of synthetic fuel plants. The most recent oil price increases have given the final economic imprimatur to nuclear power, which now costs half as much as oil-fired generation, but other major options -- shale oil or coal-derived gas and liquids -- still do require subsidies, in spite of today's hitherto unimagined high oil prices.

The political security of the synfuel projects hinges importantly upon the relation of future oil prices to general inflationary trends -- the "feasibility gap". The exposure of high-cost, high-profile synfuel plants to public attack and the risk in financing such plants will be directly proportional to whatever cost-differentials cannot be concealed through "creative accounting". One need only cite Congressional opposition in the 1960's and early 1970's to controls on oil imports, when Senators Proxmire and Kennedy successfully defended the American consumers' rights to "cheap" foreign oil, rejecting higher prices linked to any security interest. Overt price praemia for domestic energy sources are still politically vulnerable, and thus, oil price increases in the Middle East, however painful to the consumer, do usefully lubricate the construction of expensive alternative fuel facilities.

The manifest unreliability of Middle Eastern oil, compounded by the U.S.'s prominent isolation in its unremitting support for the Israelis, adds urgency to the synfuels program, so that access to funds and Congressional compliance in constructing or guising subsidies will depend upon the intensity of political conflict in the Middle East. The Israeli lobby has a clear interest in promoting synthetic fuels in the U.S., irrespective of cost, but that concern recently has been shared more broadly. Such security compulsions were reflected in the Administration's initiatives to expedite the Great Plains coal gasification plant using extra-budgetary subsidization and simultaneously camouflaging the extra costs through rolled-in pricing. Resistance to such hidden costs as equally reflected in court challenges to that gambit by an improbable alliance of industrial and consumer interests.

The process is also reversible, unfortunately, and synfuel programs impact upon the Middle East. The feedback loops in the energy supply system are complex, and synthetic fuels may exercise curiously perverse influences upon oil supply. The "demonstration effect" is the most obvious -- prominently high-cost synthetics or alternatives provoke higher world oil prices; OPEC producers, plus the non-members profiting from OPEC's price policies, look directly at the costs of alternative fuels as the measure of the real value of their own depletable patrimony. Thus, expensive synthetics, such as corn-based alcohol at a price

of $120-plus per barrel of oil equivalent, or coal-based methane at a "modest" $50/BOE, signal to OPEC that their oil is still under-priced. This is the same kind of invidious comparison used by oil-exporting states which look covetously at the high excise taxes on gasoline in Europe -- $60-100 per barrel -- which also signal a market value two or three times higher than even today's OPEC price.

At the same time, alternative energy sources, while tempting higher prices, should also provide over the longer-run a cap for oil prices, although this constraint has yet seriously to be broached. The specter of real competition is still remote, and nuclear power is the only demonstrably economic alternative energy source, yet OPEC thus far need not fear any serious encroachment by nuclear power into its markets for heavy fuel oil, at least over the next decade. At present, therefore, it would require some vaunted but unforeseen technological breakthrough, plus a massively accelerated program of implementation, before synthetic fuels become deterrents to oil price rises, rather than incentives.

The symbiosis, both positive and negative, between Middle Eastern oil and synfuels is apparent, but the mechanics of those interrelationships are both squalidly Byzantine -- literally -- in their intricacy and excruciatingly volatile -- also literally -- in their political uncertainty.

It is possible to extract, however, certain indentifiable threads from the political-economic tangle, and I propose to discuss each of five "discussible imponderables" which will affect the price, availability, or security of Middle Eastern oil:

- Middle Eastern hydrocarbon resource base
- Politics of pricing
- Parameters of production policy
- Preferential access
- "Moral hazard": the perils of U.S. independence

Overlying these issues, of course, is the possibility of war, precipitating another embargo or destruction of oil facilities, as now between Iran and Iraq; but, absent any extreme contingency, the above issues, in the general context of the Arab-Israeli conflict, are the most important.

Energy Endowments in the Middle East

The first consideration is that the spectre of competition from Middle Eastern oil must haunt all alternative sources of energy, rather than vice versa. This applies to conventional sources produced from new, remote or high-cost areas or to unconventional, innovative forms, such as shale oil or geo-pressured methane. Moreover, this spectre is no fleeting poltergeist to be readily exorcised as Saudi fields are depleted.

One cannot really justify current synfuel programs based upon imminent exhaustion of Middle Eastern oil supplies. The hydrocarbon resources of the Middle East are still seriously and systematically understated, so that scarcity induced by depletion of the geological endowment can itself be no justification for alternatives, nor can depletion-induced higher costs be taken as the basis for current promotion of alternatives. Thus there arises the "Catch-22 Dilemma" which haunted earlier efforts by the International Energy Agency to establish a floor price for oil: what happens to the viability of synfuels projects if increasing supplies of conventional hydrocarbons from the Middle East or from newer areas, such as Mexico or the Canadian Arctic, become available? Will the country which pioneers in developing high-cost alternatives find itself burdened with higher energy costs, supporting a stable of white elephants, while its international competitors, lacking domestic coal resources or otherwise slow to push alternatives, continue to "enjoy" cheaper imported oil? If Middle Eastern oil does not "fade away" like the proverbial "old soldier", if oil is indeed not scarce over the next decades, how can one protect synfuel projects?

The oft-repeated claim that Middle Eastern oil reserves are finite is true but quite uninstructive. The hydrocarbon resources of the Middle East are significantly understated because little exploration has been carried out in

the last 15-20 years; large parts of the region, especially the more prospective areas, were held by concessionnaires who had discovered during the 1940's and 1950's vastly more oil than they could market, so both companies and governments had little incentive to spend current monies to discover oil producible only in the far distant future. Major areas exhibited reserve-to-production ratios well over 50-to-one, so the present value of fresh discoveries was effectively zero.

Symptomatic of the scant exploratory effort is the fact that the density of exploration wells in the Middle East is almost two orders of magnitude less than that in the continental United States, where more than one-half million wells have been drilled. Furthermore, very little exploration has penetrated to the deeper zones, below 10-12,000 feet, for which the a priori geological indications are reportedly most promising, and where the bulk of the area's natural gas resources are anticipated. Indeed, until gas values were dragged positive by the oil price rise after 1973, there had been effectively no exploration for natural gas whatsoever, outside of Algeria. Cursory exploration has already yielded 500-plus trillion cubic feet in Iran, circa three times the U.S. gas reserves and equal to more energy than Iran's remaining oil reserves. A first effort offshore in Qatar last year claimed another 100 trillion cubic feet, and elsewhere active exploration has yet to be seriously resumed.

Politics of Oil Pricing

The price structure of Middle Eastern oil, however, confounds economic theory because neither the large inventory of proven reserves nor the nominal cost of production -- circa 30-60 cents per barrel -- need excercise any moderating influence whatsoever upon the present price or upon future price trends. The price of that oil has become a political parameter, all but quite decoupled from economic considerations. In the words of one senior Arab leader: "We shall talk seriously about the price of oil when the U.S. talks seriously about Jerusalem".

The obtrusive politicisation of oil pricing today preempts any effort to use economic tools or criteria to assess future price trends; rapid rises or sustained plateaus will hinge such imponderables as whether the Israeli

Prime Minister does move his office to Jerusalem or whether the Palestinian leadership appears next year as an observer at the annual meeting of the International Monetary Fund. These factors weigh heavily, since the symbols betoken real political postures, but they cannot successfully be included in the econometric analyses which "proved" U.S. energy independence for 1980 or the academic study which forecast a $1 per barrel price for world oil.

The politicisation began after the 1967 Arab-Israeli war, nurtured in the Arab political reaction to the Arab defeat and catalysed by the ensuing bitterness. The reaction crystalised first in Libya, whose bargaining power was paradoxically consolidated by Israel's obstruction of the Suez Canal. The radicalised Libyans thus enjoyed special power because of the critical significance of their "short-haul" crude oil, the denial of which could not be made up out of the Persian Gulf because insufficient tankers were available to carry the requisite volumes around the Cape of Good Hope.

The new tone was set by the Libyans, flexing their political muscle as a consequence of the Suez closure, who said that higher prices of oil were to be a tax upon the West for its support of "Zionist-imperialist colonialism". Thereafter, the erratic upward movements in prices resulted from complex political compromises among the hard-liners who espoused the Libyan philosophy (spurred, too, of course, by simple greed) and the Saudis. The latter viewed oil prices not as a penalty to be inflicted retrospectively but as a bargaining chip to be used prospectively with the U.S. vis-a-vis Israel. The Saudis did float an offer in 1974 to lower oil prices unilaterally provided that the Nixon Administration would pressure the Israelis to relinquish the conquered territories/ This was rejected, although later, in 1975, the Ford Administration did force Israel to withdraw from the Sinai Peninsula, partly as a quid pro quo for a specified moratorium on further oil price increases.

The past economic success of OPEC is in fact a political phenomenon; through the later 1960's, while oil prices remained an economic parameter, OPEC actually lost ground, and the real price of oil fell secularly. The revolutionary

increase in revenues followed only upon the politicisation of oil pricing. As indicated above, pricing was in a sense symmetrical -- prices rose responding to political pressures, but political compromises also promised to mitigate or even reverse those rises.

Today, the opportunities are reduced; the Saudis no longer suggest price rollbacks in return for a broad peace settlement in the Middle East. At best the "accomodationists" offer moderation, linking future oil price increases to some index tied to global inflation and some marketbasket of currencies. But the political factor is in no sense lost and still, I suggest, overrides purely economic determinants of oil prices. Two such considerations are most important:

1. Climate. Political tensions in the Middle East, even without open conflict, redound to the benefit of the political radicals, who are also the price hawks. The touchstone for moderation is U.S. policy. Thus, for example, the U.S. reluctance to sell Saudi Arabia supplementary equipment for the F-15's, while giving such equipment to the Israelis, translates into pressures for higher oil prices, since the Saudis are less willing to incur regional political costs by resisting, absent clear signals from the U.S. of its willingness to balance its interests.

   Indeed, senior officials even recognize that higher prices reduce the political utility of the oil weapon by shifting demand away from OAPEC oil. Nonetheless, even though many saudi principals intrinsically oppose still higher oil prices -- King Faisal died believing that the price had already moved to an undesirable level -- any such opposition is politically risky because, in the convoluted politics of the Middle East, it is tantamount to support for the United States and thus for Israel.

2. Conflict. Warfare, the ultimate deterioration in political climate, is the limiting case, and we have already seen two clear instances of warfare and revolution triggering otherwise unplanned price increases. In December, 1973 the late Shah of Iran unilaterally decreed a doubling of oil prices, exploiting the shortages and panic purchasing which occurred during the Arab embargo. More recently, after the Shah's exile, the ensuing decline in Iranian exports again precipitated a further round of increases in oil prices as other exporters again took advantage of the tight markets.

> In both instances the oil producers of the Peninsula, Saudi Arabian and the Gulf states, could have increased oil output and easily offset any price rises. None was willing to do so, however, because of the Arab-Israeli conflict and the U.S.' role, and all were quite unresponsive to the argument that high oil prices are a clumsy sanction against the U.S. since they burden the rest of the world quite indiscriminatorily.

The key consideration is that economic incentives play at best a subordinate role in determining the future course of oil prices. The set of oil exporters which need funds -- those which desperately need the revenues, like Ecuador, Venezuela, or Algeria -- are responsive to economic needs, but they also control no surplus production capacity. Conversely, the countries which do not need oil revenues and which are generating large current-account surpluses, can readily emphasize the political trade-offs. It is precisely that second set of "petro-surplus" countries which dominates the price structure, because an aggregate of 3-6 million barrels per day of its production is discretionary and hence is part of the political equation.

Parameters of Production Policy

The level of oil production is itself today a free parameter, no longer related to the exporting countries' financial needs or development programs. Conventional economic theory is again challenged by the new phenomenon of commodity-producers which actually want to reduce output, rather than competing among themselves to increase production. Until the early 1970's such competition, indeed ofttimes quite bitter competition, did characterize the relationships among the Gulf states, Libya, and Venezuela. But the price upheavals between October 1970 and December 1973 created a "backward-bending supply curve", i.e. as prices rose, the desired levels of production fell almost commensurately, since the smaller producing states became sated with oil revenues.

For the surplus countries of the Gulf -- Saudi Arabia, Kuwait, and the Emirates -- a production level consistent with global needs for oil implies a rate of depletion of their sole resource which is considerably above their current financial needs, so that, if they produce the requisite volumes, they must if effect transform physical assets under their own soil into paper assets somewhere in the international financial system.

This decision has both economic and political aspects. The surplus countries are singularly reluctant to spend the extra revenues, partly because it means liquidating part of their own future, but more proximately because increased spending at home implies more inflation, given their limited absorptive capacities. In addition, greater expenditure from the oil revenues, even for development projects, inevitably entails increased immigration of overseas labour, because of their small populations and work-forces, which entails over the longer-run both social and political costs.

In theory high production levels could be maintained, while the surplus funds are neutralized and accumulated against future financial needs, if the surplus funds are invested abroad. The accumulation of portfolio assets -- the trading of "black gold for paper gold" -- is now increasingly viewed as unattractive. The economic arguments against "over-production" are that oil in the ground is worth more than money in Western banks. The OAPEC states, like all investors today, have been ravaged by inflation and have additionally suffered from the depreciation of the U.S. dollar in which their income and assets are denominated; the Saudis claim (partly speciously) that inflation alone cost them some $10 billion last year in the value of their investment portfolio, while oil reserves in the ground appreciated by 20 percent or more.

More serious, however, are the looming political disabilities which discourage further build-up of portfolio assets and thus jeopardize world oil production levels. Spurred by legislators such as Senator Stone of Florida or Representative Rosenthal of New York, fearful of the political repercussions of sizable Arab financial investments in the United States, the U.S. government increasingly discourages such investment in the U.S. or in U.S.-owned financial institutions abroad. Since the U.S. market is the largest and most sophisticated financial market in the world -- significantly larger and deeper than the aggregate of other markets -- these measures significantly delimit investment opportunities for petro-surpluses and thus destabilize prospects for needed oil supply over the medium-run.

The most important move was the U.S. sequestration of Iran's assets in November, 1979, which was universally interpreted in the Arab states as a transparently-veiled threat against themselves. Their fears were reinforced when the U.S. government then misrepresented the other oil-producers' position in its own public statements, as well as inaccurately characterizing the nature and imminence of Iran's threatened withdrawal of its deposits from the U.S. The U.S. response, almost more than the act of seizure itself, catalyzed all the worst fears of the other "petro-surplus" countries.

Additional disquieting moves are efforts by the Internal Revenue Service to tax Saudi assets in this country by arguing that the Saudi Arabian Monetary Agency (SAMA) is not a central bank in the juridical sense and thus is not exempt from such taxation, as are central monetary authorities of all other depository countries. A similar effort has been made to tax Kuwaiti official real estate and securities investments in the U.S., based upon still another interpretation of the tax code. More generally, all the surplus states have become increasingly uneasy about the publicity attached to their portfolio investments, especially in the United States, and view with growing concern the disclosure rules and increasing exposure of their portfolio holdings to public discussion.

The disposition of the oil-surpluses is critical to the world energy balance, and transcends the more frequent discussion about the role of the banking system in handling these surpluses; the status of those investments affects future oil supply, not just the lending criteria and country exposures of the international banks. If the exporting countries cannot find safe havens for such surpluses, then there arises the far greater hazard that oil production might be cut back proportionately in the absence of any secure alternative. At the very least, the integrity of the dollar is compromised. There is evidence already that several states, reacting to these constraints and to public strictures, are disinvesting in the U.S. or, at least, are depositing their surpluses elsewhere.

The ramifications of this new development are important:

- Kuwait, for example, cut oil output last spring, in large measure to reduce its exposure to portfolio loss.

- Saudi Arabia suffers increasing criticism internally for its decision to produce oil and hold funds in the U.S., where the technical argument about "security" is a surrogate for opposition to the present Saudi leadership's policy of accommodating the U.S. over the question of Israel.

- Diversion from U.S. markets or U.S. financial institutions exerts downward pressure on the dollar, which is compounded by adverse reactions from money traders who perceive these trends. This weakens the dollar and collaterally adds to pressures for still higher oil prices.

- Offsetting arrangements by other OECD states to accept petrosurpluses on bilateral bases, as recently with Switzerland, Germany, and Japan, potentially reduce U.S. access to crude oil (see below.)

Thus, price alone is no longer sufficient to elicit the levels of oil production which will be needed over the next 10 years or so to fuel any economic recovery in major areas; a political climate will be necessary in which the potential oil exporters will be willing to accept promissory notes in exchange for real oil, a trade today which is ever more hedged by political considerations.

Politics of Access

A still new dimension in world oil markets is the growing emergence of supply restrictions in the form of destination restrictions and "dedicated oil", i.e. volumes which are destined for a specific market or country and which cannot be resold or diverted. This development is intermediate between an embargo, such as that experienced in 1973, and the free market in which the international oil companies sold oil to all bidders. There were some constraints earlier -- the Western states plus the Arab and African exporters enjoined sales to South Africa, and all Arab states forbade oil exports to Israel, but with the exception of those two pariah states, oil flows were economically-responsive flows.

Today, increasing volumes of oil are extracted from the market and are now destination-specific. These reserved volumes parallel the shift from disposition of oil by the major international companies to sales directly by the national oil companies (NOC's) of the exporting states, but this political assignment of export volumes is applied also to exports directly by the private oil companies. Some of the restrictions relating to resale or which limit sales to refiners are purely commercial and are designed to bypass brokers and middlemen. However, more and more of the transactions involve movements of oil within the compass of bilateral agreements -- the so-called "direct deal" oil sales, pioneered most prominently by the Japanese -- or less formally as part of vaguely drawn understandings.

For example, even absent clear protocols, it is now understood that Third-World countries will get preferential access to crude supplies at official prices, and that both exporting NOC's as well as private companies will comply. Thus, when Gulf Oil Corporation invoked force majeure on its sales to Korea after losing entitlements in Kuwait, it was advised by the Kuwait government that full prior contract volumes must be delivered to Korea, and that Gulf's other customers must absorb the full curtailments.

Recently the examples of "flagged destinations" have proliferated, and most of the cases involve explicit or implicit political desiderata. Ireland, a minor figure in oil diplomacy, negotiated an oil supply guarantee with Iraq more or less contemporaneously with its own initiative in building support within the European Economic Community for the Palestinians. The deal may now be moot, given the destruction at Iraq's export facilities, but Israeli sources at the time commented critically, while the Irish countered with charges of Israeli complicity in the murder of several Irish soldiers.

The Irish case has exemplary value because of its timing, but major states, too, are involved in garnering dedicated crude oil for themselves. The Japanese deals originally were linked to specific projects, such as the vast and ill-favored petrochemical project at Bandar Shapur (now Bandar Khomeini)

in Iran, but the most recent deal, bruited in the petroleum trade press, seeming involves a general framework for industrial cooperation with Saudi Arabia. It provides for access both to crude oil and to additional energy supplies embedded in the output of the joint-venture projects such as ammonia oir ethylene plants. Arrangements with the Germans and French, as negotiated with Kuwait and Saudi Arabia, are less explicit, but sidebar discussions over arms sales and joint development of new generations of weapons, independent of the U.S., are involved.

New exploration ventures in the Arab states, especially, reflect the new preferences; any oil discovered by European or Japanese companies which explore in new areas in the Middle East is almost without exception reserved for the national market, as distinct from being available for sale on the world market. At best such volumes might be offered as swaps or exchanges. Non-American firms are distinctly more frequent in the newer areas, reflecting two independent but mutually supportative trends:

- U.S. taxation of overseas oil ventures has become heavier, and the most recently proposed changes, advanced by the Internal Revenue Service, imply full double-taxation for new oil ventures in most areas.

- Conversely, the other OECD states exempt overseas oil ventures from domestic taxation, de facto or de jure, while Japan and Germany in particular offer subsidies for exploration and loan guarantees or interest concessions for oilfield development.

Access to new supplies, as well as existing sources, is being preempted in growing measure by other OECD states, including even smaller states such as Austria or Sweden, while the United States is increasingly under-represented.

These trends are destabilizing in several respects. First, since the oil companies have lost part of their role as arbitrageurs, balancing supply from one area against another, dislocations from any shortfall tend to be both compounded and more concentrated. Second, the United States is conspicuously absent from any such dedications or "flagging" or oil; indeed, it is suspected that there is emerging a form of squeeze play whereby political pressures can

be applied short of a formal embargo -- for example, a "conservation" policy could squeeze supplies to the U.S. while leaving politically favored countries unaffected, a device more subtle than an embargo.

Third, dedicated oil prospectively reduces the possible volumes of oil which might be shared under the International Energy Agency programs in the event of a new supply crisis. It is unlikely that the members would abide by the agreement in any case, especially if the U.S. were to be cut off by virtue of supporting Israel in a new Middle Eastern conflict, but the increasing segregation of oil volumes under the dedication clauses may commensurately reduce the amounts of oil which even theoretically might be shared if the "trigger" is pulled.

Moral Hazard

The final consideration deals with the hypothesis that U.S. moves towards energy self-sufficiency effectively contributing to destabilizing world energy supply. This scenario, discussed in muted tones in the chanceries of the other OECD states and in the Middle East, is predicated on the assumption that the ability or willingness of the United States to play a constructive political role in the Middle East is inversely proportional to U.S. dependence upon Middle Eastern oil. President De Gaulle pithily subsumed this position when he said that the U.S. had befouled the nest in the Middle East but expected the rest of the world to live in it.

The same position was reflected in the complex responses of European and Japanese governments to the original announcement of Project Independence. They first welcomed the prospect of reduced competition for crude oil, seeing thus more left for themselves if the U.S. did successfully curb its imports. The relief quickly turned to apprehension, when analysts concluded further that reduced U.S. oil imports would translate directly into reduced U.S. restraint upon Israel and thus into greater likelihood of further conflict, thereby emperilling that same supply.

The issue of "moral hazard" still festers. Europe and Japan are very much more dependent upon Middle Eastern oil than the U.S., and there persists in the popular press the canard that the U.S. actually precipitated Middle Eastern crises and co-conspired in raising world oil prices specifically in order to undermine the economic strength and international competitive position of the other OECD states.

Perceptions outside of the U.S. of our own roles and positions differ markedly from out our own -- for example, the Camp David accord is generally viewed not as a peace move but instead as a delaying tactic to split the Arab states. What is important in the political context is the belief or the perception, since the belief becomes the father of action, rather than reality. Thus the validity of those perceptions is moot, and it is the consequential decisions which are important.

The Arab states share this concern, albeit from a still different perspective, focusing on our shorter-run efforts to achieve "crisis self-sufficiency". The Saudis quite emphatically view our filling of the Strategic Petroleum Reserve (SPR) as a countervailing challenge to their "oil weapon" -- a perception which ought to be correct. Thus, that action which seems so logical and useful, may itself provoke or accelerate the very crisis for which it was intended as prophylaxis, if, as seems likely, the Saudis and other Gulf states factor that into their political equation.

The issue of "moral hazard" with all of its political repercussions which transcend oil policy itself and reach far into such matters as the structure of NATO, is less imminent, I suspect, in connection with synfuels because any significant contribution of synfuels to U.S. energy supply itself is not imminent. The prospect of being reduced to "swing sources" offends OPEC states, so the related rhetoric in support of synfuels directionally hardens their position but that concern or reaction is probably swamped by more immediate issues. The subject is broached here in order primarily to emphasize the complexity of the interrelationships between Middle East oil politics and our own synfuels policy, interrelationships which we must understand in order that the synthetic fuel policies can evolve rationally and represent a reasoned trade-off between risk and reward.