Stop That Wealth Drain

By Amitai Etzioni

Washington is, at best, a two issue town. Nowadays its domestic eye is riveted to the drama of cutting the government’s spending and taxes. On the foreign front, attention focuses on the Middle East. Meanwhile, a golden opportunity to deal with OPEC, an opportunity created by economic slowdown in the U.S. and other Western countries, might well be lost.

WHAT’S THE QUESTION?

In the eight year old what-to-do-about-OPEC debate, competing suggestions are often flung at each other without attention to the problem they are supposed to deal with. For instance, filling our oil reserves will protect us against supply interruptions, but taking millions of barrels out of the market will not curb oil-price increases. On the other hand, conservation might reduce demand for oil, but in the next years will do little to protect us from boycotts. The problem for which there is now an unusual occasion for solution of sorts is the transfer of wealth from the U.S. to oil exporting countries.

The U.S. oil bill for 1980 was $82 billion. The total value of the American corporations listed on the New York Stock Exchange is about $900 billion. At the present oil price, it would take OPEC and company little more than five years to buy up half of these corporations. Of course, the notion of such a purchase is sheerly theoretical. Congress would pass laws to prohibit it if the oil-rich tried a run on Wall Street. The point, though, is that they are doing worse to us; rather than buy stocks of American corporations, they transfer our assets overseas and return us ever less for these assets. Hence, reference to the size of the wealth drain engineered by OPEC is not a call to lock the gates of the New York Stock Exchange to protect American companies from an alien invasion, but to highlight the enormity of the tax imposed by the oil exporters.

Tax is a proper term. The price of imported oil does not reflect production costs, which amount to a fraction of the price charged. Like a tax, the price of most imported oil is set by governments, not the marketplace. And, like a tax, it is used as an instrument to transfer wealth from the people (of oil consuming countries) to a bunch of governments, to be lavished on those they favor.

Various reasons have been advanced as to why Americans need not worry too much about this mountainous transfer of wealth. As these arguments are at the base of our mixture of inaction and misaction, they need to be reviewed before a different approach can be indicated.

Tit-for-Tat Selling. "The more we pay them, the more they buy from us — agricultural products, industrial plants, military hardware. Trade increases. No harm done. What will they do with all these dollars, eat them?" This notion ignores the real exchange rate, the so-called terms of trade, which reflect how many work hours we have to put into paying for each item we buy. As this exchange rate has been changed drastically against us, as reflected in the more rapid increase of oil prices compared to the prices of our exports, "we slave ever longer and harder to pay for what we import, creating a higher standard of living for them, a lower one for us.

Recycling. "Banks can finesse the oil problem by arranging for loans from the oil exporters to us; in this way we can keep paying for the imports." Aside from completely disregarding the wealth drain issue, this narrow financing/banking view of the solution disregards a rather troubling detail: our interest payments on oil exporters' loans will soon exceed what we used to pay for total oil imports. Interest on interest is added to our pyramid of debt to oil exporters. The total outflow of dollars has increased to the point that banks find it difficult to continue to recycle such amounts, although the original alarm was exaggerated. And the financial fix creates a very powerful dependency second only to an oil based one: if the oil exporting countries ever come calling for their loans—or only, say, 25 per cent of them...

Conservation and Development. "If we just get our domestic energy act together, use less imported oil, dig more of our own oil wells, develop alternate energy sources, and conserve more energy in general, our oil bill and dependency will decline and, soon, disappear." Indeed, the high price of oil is a free-market spur to develop and conserve. "What we need worry about is not high prices, but a deliberate, sharp, temporary lowering of imported oil prices, aimed at undermining our conservation and development programs."

The Reagan Administration clearly tilts toward the production side of the cure, the way the Carter Administration was leaning somewhat more toward conservation. Typically, the Reagan Administration decontrolled the price of oil somewhat more rapidly and threw out the regulations requiring lower heating and less cooling in public buildings, and it is quite unsympathetic to the conservationist 55 miles per hour speed limit. George Gilder, a supply-side whiz-kid, a favorite of the new Administration, testified before Congress that he is sure that major breakthroughs in energy production will come within two to three years from one of the many promising R&D drives on the way.

Catch 1: Like all predictions dealing with the future of R&D, no one can say for sure that a miracle breakthrough...
will not occur. But it must be noted that most such breakthroughs require massive changes in equipment, which take years and billions of dollars to accomplish. Thus, even if we found tonight an efficient electric battery to fuel a car, it would require gearing up for mass production and replacing the engines of millions of autos, or installing battery-operated engines in new cars and allowing them gradually to replace gasoline fueled cars. Very few new energy products can simply be pumped into existing systems. A reasonable assumption is that it will take at least eight to 10 years (the lead time of introductions of other R&D items into mass production and consumption) and hundreds of billions of dollars before our energy system is required so as not to be oil based. With most of America’s resources committed to defense, providing for a stagnant standard of living and an already lower amount of social services, the wealth drain takes away resources which otherwise could be used to look for such a massive energy development drive.

Catch II: In the seven years we have been talking increased production and conservation, we have increased our dependence on imported oil from roughly 13 per cent of our oil needs to 45 per cent in 1979. We did better in 1980 because of our temporarily smaller need due to the recession. Moreover, whatever we gain in reduction of our demand on the world’s oil can be quite readily offset by supply cuts. In recent years the U.S. press has been full of “encouraging” accounts of new American drilling spurred on by the partial deregulation of domestic oil production. Output increased by 500,000 barrels a day from 1977 to 1978. In view of the “aging,” deterioration, and exhaustion of many U.S. wells, this is considered quite a record. However, Saudi Arabia in the past cut production, in one fell swoop, by a million barrels a day. Assume we would really pull our belt tighter and double 1978’s achievements—with their own oil fields deteriorating and their need for additional revenues rather limited—they could cut production by another billion barrels a day before you could say “development.” And if Saudi Arabia—and the other countries which cut outputs, from Kuwait to Libya to Oman—ever tire of this game, there is still the cartel, quite able to keep prices up in all times but a multicountry recession.

AN IMPORT TARIFF

An import tariff was first suggested as early as 1958, by none other than George Shultz, currently an adviser of President Reagan. Over the years since 1958, several formulas have been introduced by numerous economists who favor the tariffs (including Morris Adelman and Robert S. Pindyck of MIT, James Tobin of Yale, and Robert Eisner of Northwestern). The formula which I favor is to match dollar for dollar any future OPEC price increases. The first purpose of the tariff on imported oil (not to be confused with a tax on domestic gasoline) is not to increase domestic prices (in order to spur conservation and production) but to curb the wealth transfer to oil exporting countries. The tariff’s effect on domestic prices depends in part on timing, in part on the reaction of oil exporting countries friendly to the U.S., but in either case the wealth-saving effect will be quite substantial.

At issue is how far one assumes the current oil price to be from what the market will bear. If one assumes an extreme situation, in which the current OPEC price is just at the market, adding on a tax would initially result in little or no price increase, because if OPEC tried to pass the tax on to buyers at the resulting higher price there would be no takers (as Iran found out when it tried to sell its oil at $37.50 when the prevailing price was more or less $32.00). Hence, under this circumstance, oil exporting countries would have to lower their take to make room for the tax.

The oil exporting countries could “retaliate” by cutting production and thus forcing up the price of oil to make up for the U.S. tax take. However, many oil exporting countries would be quite reluctant to do so (e.g., Venezuela and Mexico), because basically they need the revenue for their ambitious development plans and they could not expect to make up with higher prices—on top of the tax—for fewer barrels sold, especially as such price increases would trigger additional tax increases.

Those countries which have a hefty surplus and are most able to cut production, such as Saudi Arabia, the United Arab Emirates, and Kuwait, are those friendly to the U.S. Whatever reasons they have for keeping up production before such a tax is imposed, from concern with the stability of the dollar to international security and arms deals, would not cease after a tax is imposed.

But even assuming some price increases after the imposition of the tax, either due to production cutbacks or due to increased economic activities in the post-recession U.S., West Germany, etc., the oil price would soon find a new point of equilibrium between supply and demand. The only difference would be that this time a significant part of the wealth transported would remain in American hands (and if the other consuming countries followed suit, in Western hands).

Imposing such a tax now is particularly opportune, because the economic slowdown in several key Western nations has created a considerable glut and weakness in the market. This makes it more likely that one could impose a tariff now without facing substantial price increases, than in a period of rising demand for oil.

Objections to the tax are easy to deal with. “The tax would interfere with market forces.” Answer: Unlike practically any other market, the international oil market is dominated by governments. One more “intervention” will barely be noticed.

“The effect of the tax would fall heavily on oil importing regions of the U.S., (e.g., the Northeast), while not being carried by the oil-rich parts.” Answer: Import oil would be mixed with domestic oil to be sold in one national market.

“The tax revenues would be used to finance more government programs.” Answer: Not necessarily. They are not committed to any specific use. One could turn the money gained over to American consumers, or use it to reduce the government deficit, or the national debt, or provide incentives to the private sector for reindustrialization, my preference. The main point is that the tax is imposed not to raise revenues for the government, but to reduce the colossal drain of wealth from the U.S. to oil exporting countries, and to buy time and resources to develop our production and conservation, which cannot be done rapidly and requires hundreds of billions of dollars.

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